



Australian Government
Productivity Commission

National Access Regime

Productivity Commission Inquiry Report

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25 October 2013

The Hon Joe Hockey MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's final report into the National Access Regime.

Yours sincerely

Handwritten signature of Patricia Scott in cursive script.

Patricia Scott
Presiding Commissioner

Handwritten signature of Angela MacRae in cursive script.

Angela MacRae
Commissioner

Terms of reference

I, David Bradbury, Assistant Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby refer clause 6 of the Competition Principles Agreement (CPA), Part IIIA of the *Competition and Consumer Act 2010* (CCA) and the operation and terms of the Competition and Infrastructure Reform Agreement (CIRA) to the Productivity Commission (Commission) for inquiry and report within twelve months of receipt of this reference.

Through this inquiry, which is a milestone in the Seamless National Economy National Partnership, the Commission is to assess the role and efficacy of the National Access Regime (the Regime) and propose ways of improving its operation to ensure the efficient operation of and investment in essential infrastructure to promote competition and efficient investment in dependent markets.

Background

The Regime is a regulatory framework that provides an avenue for firms to access certain ‘essential’ infrastructure services owned and operated by others, when commercial negotiations on access are unsuccessful. The Regime is intended to promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets.

The Regime was introduced in 1995 as a key part of the National Competition Policy (NCP), which brought in broad-ranging reforms to enhance productivity and growth in the Australian economy. The regulatory provisions of the Regime are contained in Part IIIA of the CCA and clause 6 of the CPA, which was signed by the Commonwealth and States and Territories in April 1995 to underpin the NCP.

In 2001, the Commission conducted an inquiry into the operation of the Regime. The Commission supported continuation of the Regime and made a number of recommendations to improve its operation — including in relation to clarifying the Regime’s objectives and scope, encouraging efficient infrastructure investment, strengthening incentives for commercial negotiation, and improving the certainty and transparency of regulatory processes. The Australian Government supported most of the Commission’s proposed measures and a number of operational reforms to Part IIIA have since been introduced.

The Council of Australian Governments (COAG) agreed on a new National Reform Agenda in February 2006. As part of that Agenda, COAG signed the CIRA to provide for a simpler and more consistent national system of economic regulation for nationally-significant infrastructure, including for ports, railways and other key infrastructure. The CIRA included some specific reforms to improve the operation of the Regime, building on the Commission's 2001 recommendations. Clause 8.1 of the CIRA provides that once it has operated for five years, the Parties will review its operation and terms.

Scope of the inquiry

In reporting on the Regime and the CIRA, the Commission is to:

1. examine the rationale, role and objectives of the Regime, and Australia's overall framework of access regulation, and comment on:
 - (a) the full range of economic costs and benefits of infrastructure regulation, including contributions to economic growth and productivity;
 - (b) the operation of the Regime relative to other access regimes, including its consistency with those regimes and the effectiveness of the certification process; and
 - (c) the roles of the National Competition Council, the Australian Competition and Consumer Commission and the Australian Competition Tribunal in the administration of the Regime, and the Minister as decision maker, and the relationship between the institutions;
2. assess the performance of the Regime in meeting its rationale and objectives, including:
 - (a) the effectiveness of enhancements made to the Regime and the regulatory reforms agreed under COAG's National Reform Agenda; and
 - (b) how the Regime has been variously applied by decision makers, but not so as to constitute a review or reconsideration of particular decisions;
3. report on whether the implementation of the Regime adequately ensures that its economic efficiency objectives are met, including:
 - (a) whether the criteria for declaration strike an appropriate balance between promoting efficient investment in infrastructure and ensuring its efficient operation and use;
 - (b) whether the criteria for declaration are sufficiently well drafted in the legislation to ensure that its objectives will be met;

-
4. provide advice on ways to improve processes and decisions for facilitating third party access to essential infrastructure, including in relation to:
 - (a) promoting best-practice regulatory principles, such as those pertaining to regulatory certainty, transparency, accountability and effectiveness;
 - (b) measures to improve flexibility and reduce complexity, costs and time for all parties;
 - (c) options to ensure that, as far as possible, efficient investments in infrastructure are achieved; and
 - (d) ‘greenfield’ infrastructure projects and private sector infrastructure provision;
 5. review the effectiveness of the reforms outlined in the CIRA, and the actions and reforms undertaken by governments in giving effect to the CIRA; and
 6. comment on other relevant policy measures, including any non-legislative approaches, which would help ensure effective and responsive delivery of infrastructure services over both the short and long term.

Process

The Commission is to undertake an appropriate public consultation process including holding hearings, inviting public submissions and releasing a draft report.

The Government will consider the Commission’s recommendations, and the Government’s response will be announced as soon as possible after the receipt of the Commission’s final report.

David Bradbury
Assistant Treasurer
[Received 25 October 2012]

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Abbreviations

ACCC	Australian Competition and Consumer Commission
access seeker	a third party (as defined in the CCA, which provides that a third party is a person who wants access to an infrastructure service)
ACTO	Australian Cargo Terminal Operators
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
AGCNCO	Australian Government Competitive Neutrality Complaints Office
AGS	Australian Government Solicitor
APIA	Australian Pipeline Industry Association
ARTC	Australian Rail Track Corporation
BCA	Business Council of Australia
CCA	<i>Competition and Consumer Act 2010</i> (Cwlth) (formerly the <i>Trade Practices Act 1974</i>)
CIRA	Competition and Infrastructure Reform Agreement
COAG	Council of Australian Governments
CPA	Competition Principles Agreement
GDP	Gross Domestic Product
HVCCC	Hunter Valley Coal Chain Coordinator
IPART	Independent Pricing and Regulatory Tribunal (New South Wales)
NCC	National Competition Council
NPA–SNE	National Partnership Agreement to Deliver a Seamless National Economy
QCA	Queensland Competition Authority
QCA Act	<i>Queensland Competition Authority Act 1997</i>
the Regime	the National Access Regime
the Tribunal	the Australian Competition Tribunal

OVERVIEW

Key points

- The National Access Regime should be retained.
 - Access regulation can address an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required for third parties to compete effectively in dependent markets. This is the only economic problem access regulation should address.
 - The scope of the Regime should be confined to ensure its use is limited to the exceptional cases where the benefits arising from increased competition in dependent markets are likely to outweigh the costs of regulated third party access to infrastructure services. Proposed changes to the declaration criteria seek to achieve this outcome.
 - Robust institutional arrangements, including an avenue to limited merits review, should ensure that access regulation is judiciously applied.
- When considering whether to regulate access to infrastructure services in the future, governments should seek to demonstrate that there is a lack of effective competition in the market for the service that is best addressed by access regulation. An assessment of the net benefits should determine whether access regulation is most appropriately applied at the facility or industry level.
 - Facility-based arrangements impose net costs if they are incorrectly applied, and provide incentives for lobbying. Such arrangements should be limited to where there is a clear net benefit from tailoring access regimes for a specific facility.
 - Further industry-specific regimes should apply only where there is sufficient similarity between infrastructure services within the industry and where the industry has features that justify different regulatory treatment from that offered by the generic National Access Regime.
 - Caution should be exercised before mandatory undertakings are implemented in the future. Where mandatory undertakings are used, they should be subject to upfront and ongoing assessment to ensure they are used to target the economic problem. Safeguards for the provider and other existing users of the service should be consistent with those for declared services.
- There is an economic rationale for the Australian Competition and Consumer Commission's (ACCC's) power to direct infrastructure extensions in an access determination but, due to the practical difficulties of directing extensions, it is likely that the benefits of using the power would rarely outweigh the costs.
 - Part IIIA should be amended to confirm that the ACCC's legislative power to direct extensions also encompasses capacity expansions. This will ensure that the safeguards set out in the legislation will also apply to directed expansions.
 - Following a public consultation process, the ACCC should develop guidelines outlining how it would exercise its legislative power to direct extensions such that it would be expected to generate net benefits to the community. The preparation of the guidelines should include an analysis of the workability and adequacy of the provision to direct extensions and its safeguards.
 - The safeguards should not be construed such that a service provider could be required to pay the upfront costs of the directed extension or capacity expansion.

Overview

What has the Commission been asked to do?

Among other things, the Commission has been asked to:

- examine the rationale, role and objectives of the National Access Regime (the Regime), and Australia's overall framework of access regulation
- assess the performance of the Regime in meeting its rationale and objectives. This is to include an assessment of how the Regime has been applied by decision makers, but not so as to constitute a review or reconsideration of particular decisions
- provide advice on ways to improve processes and decisions for facilitating third party access to essential infrastructure
- review the effectiveness of the reforms outlined in the Competition and Infrastructure Reform Agreement (CIRA), and the actions and reforms undertaken by governments in giving effect to the CIRA.

Promoting competition in markets dependent on infrastructure services

In 1992 the Prime Minister commissioned an Independent Committee of Inquiry on National Competition Policy (the Hilmer Committee). The Hilmer Committee proposed the establishment of a new legal regime to facilitate third party access to infrastructure services, thereby enabling competition to emerge in markets that depend on access to those services. While the report focused primarily on access to publicly owned infrastructure assets, the proposed regime was general in nature, with the flexibility to deal with access pricing and related issues irrespective of who owned the infrastructure.

Subsequent to the Hilmer Committee report, the Australian, state and territory governments introduced the National Competition Policy reforms. These wide-ranging reforms included the introduction of the Regime in 1995, the corporatisation and privatisation of some government-owned infrastructure facilities, and the structural separation of vertically integrated services to allow for competition in the contestable components of service delivery. The Commission has previously estimated that productivity and price changes in key infrastructure sectors influenced by the National Competition Policy and related reforms increased

Australia's GDP by 2.5 per cent above what would have occurred without the changes — the Commission did not estimate the gain from only implementing the Regime.

What is the National Access Regime?

The Regime is a regulatory framework through which third parties may seek access to nationally significant infrastructure services. It includes Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA), which sets out the architecture of the Regime, and clause 6 of the Competition Principles Agreement (CPA), which establishes general principles to assess the effectiveness of state and territory access regimes.

The objects clause of Part IIIA establishes the Regime's twin objectives:

- to promote the economically efficient operation of, use of, and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets
- to provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

Part IIIA is a generic access regime, in the sense that the infrastructure services to which it could be applied are not defined in the CCA. A number of other access regimes sit alongside Part IIIA. The Australian Government has access regimes for certain infrastructure services, and state and territory governments have generic, industry-specific and facility-based regimes.

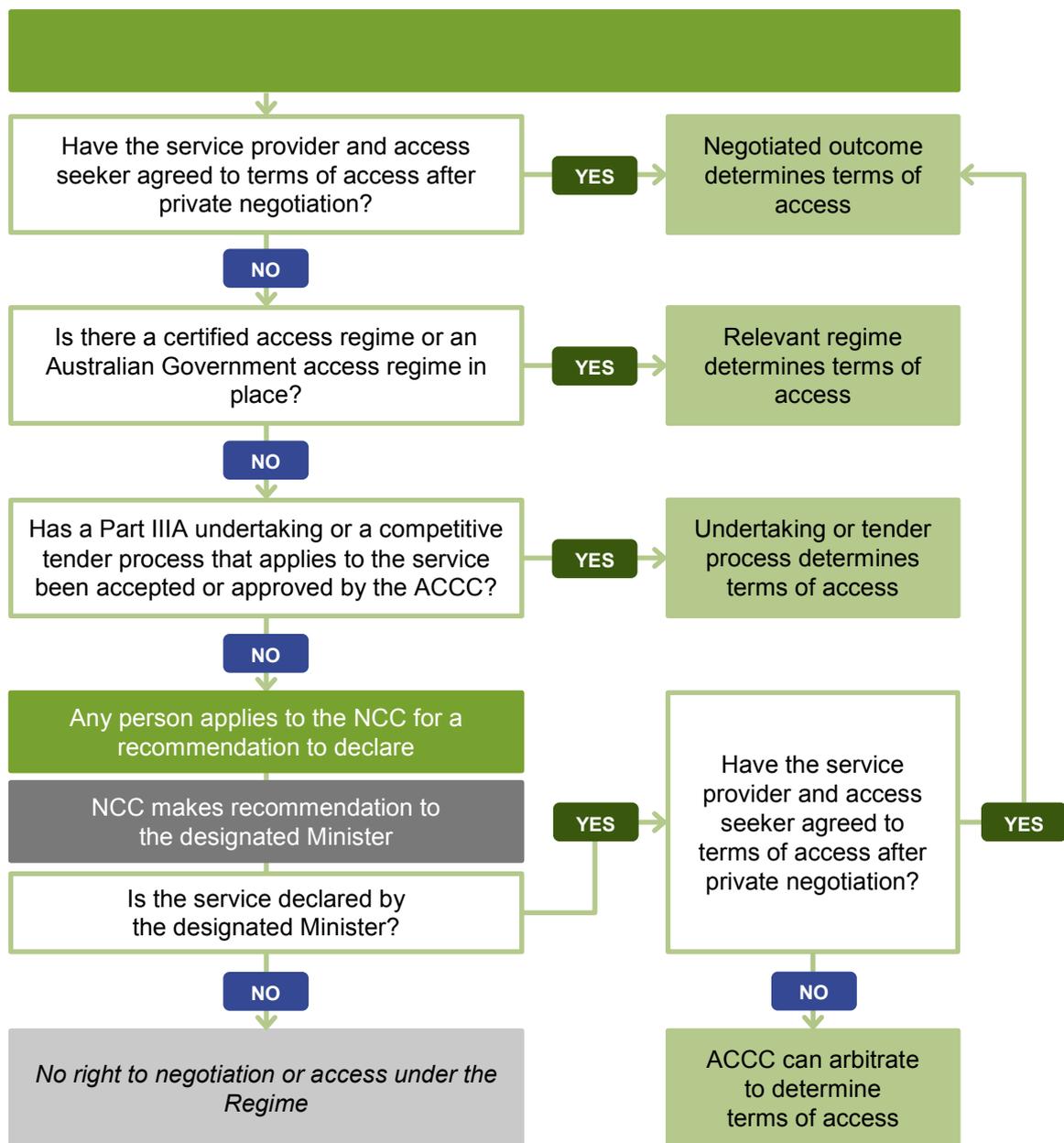
The National Access Regime in practice

In addition to private negotiation, parties can use the Regime to seek access to a service provided by means of an infrastructure facility through one of four pathways (figure 1).

- *Declaration* — a party can request that the National Competition Council (NCC) recommend that the designated Minister declare a particular infrastructure service. Declaration is the first stage of a two-part process where parties can seek the right to negotiate access to an infrastructure service. During the second stage of the process, parties negotiate the terms of access to the service. If a service provider and an access seeker are unable to agree on access terms, the Australian Competition and Consumer Commission (ACCC) can be called on to act as an arbitrator and may determine the terms and conditions of access to the declared service.

- *Certified access regime* — a party can seek access to a service through a state or territory access regime that is certified as effective by the Commonwealth Minister.
- *Undertaking* — a party can seek access to a service under terms and conditions set out in a legally enforceable undertaking that has been accepted by the ACCC.
- *Competitive tender* — a party can access a service provided by a government-owned facility under terms that have been established through a competitive tender process approved by the ACCC.

Figure 1 Pathways to access under the National Access Regime



Up to six institutions currently have a role in regulatory decision making under Part IIIA.

- The NCC provides advice to the designated Minister on whether an infrastructure service should be subject to access regulation or whether a state or territory access regime should be certified.
- The designated Minister makes the decision on whether a service should be subject to access regulation or whether a regime should be certified.
- The ACCC may determine the terms and conditions of access to a declared service if an access dispute proceeds to arbitration, and also decides if an undertaking should be accepted or whether a competitive tender process should be approved.
- Upon application, the Australian Competition Tribunal (the Tribunal) reviews decisions on merits.
- Upon application, the Federal Court and the High Court review decisions on points of law.

What is the economic problem that access regulation should address?

A ‘market failure’ occurs when there is an enduring *lack of effective competition*, due to natural monopoly, in markets for infrastructure services. Large, usually sunk, fixed costs and economies of scale typically associated with natural monopoly can serve as impediments to prospective competitors entering infrastructure service markets. Policy tools other than access regulation are more suited to addressing sources of market power other than natural monopoly.

Where there is an enduring lack of effective competition in markets for infrastructure services, a provider might deny access to, or restrict output and charge monopoly prices for, its infrastructure service. This can reduce economic efficiency where access to the service is required for third parties to compete effectively in dependent (upstream and downstream) markets. As a consequence, transactions that would enhance community wellbeing may not proceed.

Both vertically integrated and vertically separated infrastructure service providers can have an ability and incentive to engage in monopoly pricing of access. Incentives to deny access to some or all access seekers will be heightened where service providers are vertically integrated — that is, where service providers also operate in markets upstream or downstream of the facility. A vertically integrated monopolist may deny access to its infrastructure services to an upstream or downstream competitor if that increases total profits across its operations.

The only economic problem that access regulation should address is an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required for third parties to compete effectively in dependent markets. Access regulation should not be used to avoid the duplication of infrastructure per se, or to address wider social and economic issues such as income distribution or environmental concerns.

When might the benefits of regulated access outweigh the costs?

Access regulation can be used to address an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services — the questions are when, and how, should governments regulate access so that the benefits to the community are likely to outweigh the costs.

There may be benefits from access regulation where infrastructure service providers have enduring market power and an ability and incentive to deny access or restrict output and charge monopoly prices (box 1). Under these circumstances, access regulation can address allocative inefficiencies — a situation where available resources are not used to produce the goods and services that consumers value most. Where a monopoly infrastructure service provider denies access, this can allow them to foreclose a downstream market, restrict output in that market and raise prices above their allocatively efficient levels. Alternatively, an infrastructure service provider might charge monopoly prices for access to their infrastructure, which can lead to allocative inefficiency where output is restricted. Another concern could be that an incumbent infrastructure service provider will attempt to leverage its position to distort outcomes in upstream markets. Addressing allocative inefficiencies associated with denial of access or monopoly pricing can facilitate lower prices for consumers.

Applied appropriately, access regulation can also increase incentives for innovation — a fundamental driver of productivity improvements and economic growth — through the promotion of competition in markets reliant on access to infrastructure services. While there is not a simple linear relationship between competition and innovation, increasing competition has been linked with greater innovation in markets where there is relatively little competition.

Access regulation also imposes costs, in particular where it adversely affects incentives for investment in markets for infrastructure services. There are costs associated with errors in setting access prices. For example, when prices are set too low, this can lead to delayed investment in infrastructure, or the non-provision of

some infrastructure services. Regulated third party access can also impose costs on infrastructure service providers from coordinating multiple users of their facilities.

In the Commission's view, the benefits of access regulation are more likely to outweigh the costs where there is a monopoly provider of infrastructure services. Competition between service providers will generally be preferable to access regulation in markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service).

Box 1 The potential use of market power: an example

Natural gas transmission pipelines may exhibit significant economies of scale in their construction and operation and, in some circumstances, adding compressors can be a lower cost way to increase their capacity than duplicating the pipeline. As such, it can be efficient for a single pipeline to transport gas from a production facility to an industrial or urban centre.

Access regulation may be warranted where the provider of pipeline services has an ability and incentive to charge monopoly prices or deny access to a pipeline in order to generate monopoly rents. This may occur where the provider of pipeline services is not constrained from exercising its market power by:

- the availability of substitute facilities — for example, where there are no other pipelines taking gas from the production facility or delivering gas to the final market
- the availability of substitute goods — for example, where there are no other fuel and energy sources that are suitable substitutes for natural gas
- users with countervailing market power — for example, if users are small and do not have the capacity to build their own pipeline
- the threat of entry — for example, where sunk costs and economies of scale act as an impediment to a competitor building another pipeline.

Conversely, access regulation is unlikely to be warranted where the market power of a provider of a pipeline service is constrained by these factors.

A monopoly position in a market is not sufficient to warrant access regulation

Even where an infrastructure service provider has a monopoly position in a particular market, its market power might be constrained by the existence of substitutes, countervailing market power or the threat of entry. In some circumstances the exercise of market power may simply lead to a transfer of economic rents between parties in the supply chain. (Economic rents are payments in excess of normal profits and hence do not affect the willingness of existing producers to supply.) The exercise of market power might have no effect on output or efficiency outcomes in dependent markets and hence not warrant government intervention. Such a scenario is illustrated in box 2.

Box 2 Access regulation for price takers: a stylised example

The following example is used to illustrate a situation in which access regulation is not warranted. It assumes an iron ore miner owns a vertically integrated rail line used solely to transport ore, which is sold in export markets where Australia is a price taker.

What are the incentives for the incumbent in downstream markets?

The incumbent infrastructure service provider should have an incentive to negotiate access where the benefits to the access seeker (and hence its willingness to pay) outweigh the total costs imposed on the incumbent from allowing access (including coordination costs from having multiple parties use its rail line). As both the service provider and access seeker are price takers, a new entrant does not affect the incumbent service provider's revenues from ore sales, and the incumbent service provider has nothing to gain from excluding other firms from ore markets. On the contrary, it could gain from selling foreseeably unused rail capacity.

In the absence of negotiated access, what might appear to be spare capacity in the incumbent's infrastructure may reflect an efficient margin for operational flexibility or expected growth. In this stylised example, a failure to reach agreement on access terms (where there is no commodity market pricing power to defend) would strongly suggest that if duplication were to occur, this would be more efficient than regulating access.

Where small mines do not justify a new rail line and those mines, if developed, would be at risk of stranding, the incumbent should have an incentive to negotiate terms that cover its costs of providing access. The access seeker should be willing to pay the price where a mineral deposit is sufficiently profitable to warrant displacing output from the incumbent's own mines, or using any spare capacity.

What about upstream markets?

Another concern could be that the incumbent infrastructure service provider will attempt to leverage its position to distort outcomes in upstream markets, for example, to prevent other parties from developing mines that could be served by the rail line or to purchase the new mines at very low prices. However, development of additional mines has the prospect of increasing the profits that the incumbent service provider might earn from its rail line. Where another party can develop a mine more efficiently, this might mean that there are greater profits available to the incumbent by charging for access than if it were to purchase and develop the mine itself.

What if there is an imbalance in bargaining power?

The incumbent infrastructure service provider should have an incentive not to obstruct a more efficient miner from developing a nearby mine, irrespective of the relative size and bargaining power of the two parties. The incumbent should always have the incentive to maximise its returns from the new mine, but stopping the mine or denying access to the incumbent's unused capacity would be against its own interests.

Before investments are made in a new mine, transport to a port would normally be addressed through contracts that provide certainty about terms and conditions of access to rail lines. If new mine investments are sunk in the absence of rail access contracts, the incumbent infrastructure service provider might be able to expropriate economic rents by charging for access. However, this is a transfer of rents between the mine owner and incumbent, rather than behaviour that affects economic efficiency.

Access regulation is unlikely to increase efficiency where the infrastructure service provider has no ability to affect prices in downstream markets — for example, where prices are determined in world commodity markets. The infrastructure service provider would have a strong incentive (through the sharing of its fixed costs) to provide access to any capacity that will be unused for the foreseeable future, provided the access price recovers the full costs of use by the third party. Intervention to require access where these conditions apply risks lowering efficiency and, in the long term, adversely affecting incentives to invest in markets for infrastructure services.

Despite incentives to provide access to foreseeably unused capacity, there may be other reasons why an infrastructure service provider might deny access to another market participant in a real world market situation: the desire for unfettered control over all parts of the production process, distortions in input markets, errors in commercial judgment, a monopoly business culture that does not give effective consideration to new information or innovation, or even poor relationships between market participants. However, these reasons do not relate to the economic problem that access regulation should address, and thus taken alone they are not sufficient to justify using the Regime.

Should the National Access Regime be retained?

Based on a qualitative assessment of the available data, the Commission has determined that the Regime is likely to generate net benefits to the community. The Commission considers that the Regime should be retained, and its scope confined to ensure its use is limited to the exceptional cases where the benefits arising from increased competition in dependent markets are likely to outweigh the costs of regulated third party access. Renewed emphasis should be given to ensuring that the Regime better targets the economic problem to reduce the risk of imposing unnecessary costs on the community and deterring investment in markets for infrastructure services for little gain.

The Commission's approach to assessing the costs and benefits of the Regime

The Commission's approach to assessing whether the Regime is likely to generate net benefits to the community was to assess the costs and benefits of the Regime relative to the alternative scenario or 'counterfactual' of not having the Regime. In the absence of the Regime, governments would still be able to regulate access to infrastructure services through other regulatory frameworks including, for example, industry-specific and facility-based access regimes.

In its assessment, the Commission has taken into account a range of potential benefits. These are:

- improvements to economic efficiency where the Regime reduces monopoly pricing, increases competition in dependent markets, or results in more efficient investment
- benefits from greater consistency in access regulation across the economy
- administrative and compliance cost savings and more effective and efficient infrastructure regulation if the Regime supplants other less effective policy responses, or if its role as an overarching access regime improves other access regimes.

The potential benefits were considered against the costs associated with the Regime.

- Access regulation may result in economic distortions including adverse effects on investment in markets for infrastructure services.
- Administrative and compliance costs can be substantial. For example, BHP Billiton noted that the overall costs of the applications for third party access to rail services in the Pilbara region of Western Australia were ‘in the order of hundreds of millions of dollars’ (box 3).
- Where access regulation is applied, there might be production costs incurred by the infrastructure service provider from coordinating multiple users of its facility.
- Some participants in consultations with the Commission suggested that the Regime has been used for strategic reasons, which may also impose costs on the parties involved.

Part IIIA plays a backstop role for infrastructure services that are not covered by other access arrangements. The threat of access regulation may prompt service providers and access seekers to negotiate private settlements based on what they expect would be imposed through arbitration. However, whether this provides a more efficient outcome will in part depend on whether the underlying regulatory framework is flawed.

Box 3 The long haul: rail access disputes in the Pilbara

Between 2004 and 2008, Fortescue Metals Group and its subsidiary, The Pilbara Infrastructure, lodged declaration applications with the NCC seeking access to infrastructure services provided by four rail lines in the Pilbara region of Western Australia: the Goldsworthy and Mt Newman lines owned by BHP Billiton and its partners, and the Hamersley and Robe lines owned by Rio Tinto and its partners. The NCC recommended that all four lines be declared. In 2006, the Mt Newman line was deemed not declared, as the Minister did not publish a decision within the required timeframe. In 2008, the Minister accepted the NCC's advice and declared the Goldsworthy, Hamersley and Robe lines.

The current status of each of the lines is as follows.

- *The Mt Newman line is not declared.* On review, the Tribunal affirmed the Minister's deemed decision to not declare the service. There were no further reviews. Fortescue subsequently built a rail line that is roughly adjacent to a significant proportion of the Mt Newman line.
- *The Goldsworthy line is declared.* On review, the Tribunal affirmed the Minister's decision to declare the service. There were no further reviews. BHP Billiton has advised the Commission that no third party access has occurred on the Goldsworthy line (nor has any third party entered negotiations with BHP Billiton over access) as a result of declaration.
- *The Hamersley line is not declared.* Setting aside the Minister's decision, the Tribunal found that the line should not be declared. The Full Court of the Federal Court upheld the Tribunal's decision on appeal. The High Court determined in September 2012 that there had 'been no review by the Tribunal of the kind for which the Act provided', and — after establishing the proper construction of the disputed criteria and their application — set aside the orders of the Federal Court and remitted the matter to the Tribunal for reconsideration. In February 2013, the Tribunal concluded its reconsideration, and again determined that the Hamersley line should not be declared.
- *The Robe line is not declared.* The Tribunal affirmed the Minister's decision to declare the line. However, the Full Court of the Federal Court overturned the Tribunal's decision on appeal. As with the Hamersley line, the High Court found that there had been no review by the Tribunal of the kind for which the Act provided and remitted the matter to the Tribunal for reconsideration. The Tribunal subsequently determined that the Robe line should not be declared.

Ideally, an economy-wide quantitative cost–benefit analysis would be undertaken to determine whether the Regime is meeting its economic efficiency objective and generating net benefits to the community. However, it is evident that quantifying the economic effect of the Regime is not practical for several reasons.

- While the number of cases proceeding through to declaration is small (suggesting that data gathering should be easy), the fundamental problem is the inability to observe the counterfactual. In the absence of the Regime, would governments have implemented more efficient or less efficient access regimes, or none at all?
- The effect of the threat of access regulation on incentives for service providers and access seekers to reach negotiated outcomes cannot be measured.
- It is not possible to robustly assess the costs and benefits to the economy of investment decisions that have been affected by the Regime.
- The effects of the Regime cannot be isolated from other factors affecting infrastructure investment, productivity and economic growth.
- Quantifying the effect of the Regime would require comprehensive data on the economy-wide efficiency effects of the Regime (including the certification and undertaking pathways).

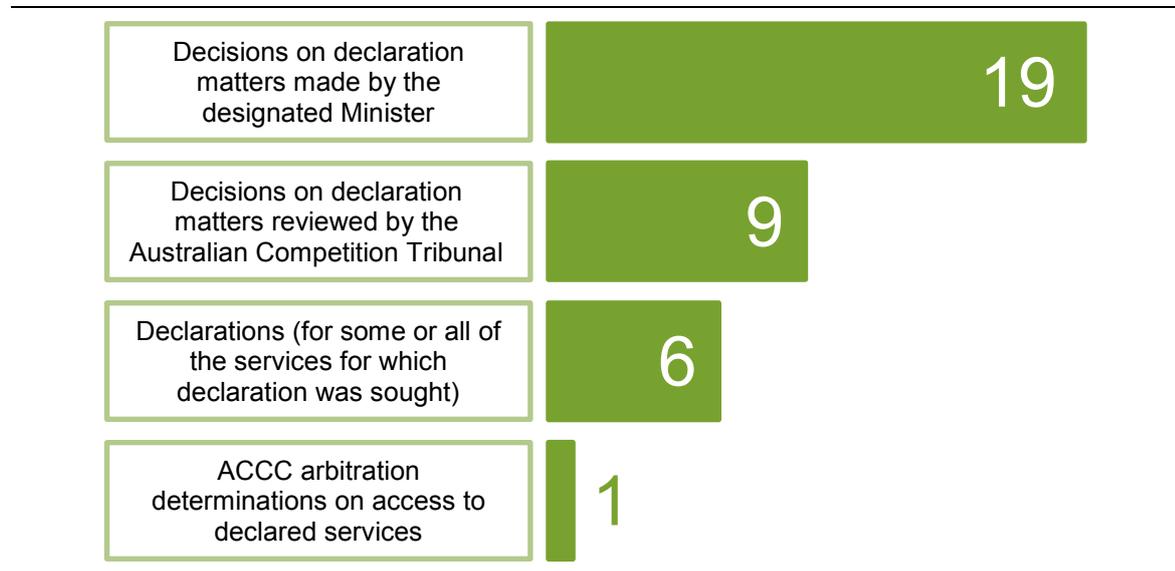
While some submissions suggested that arriving at a cost–benefit estimate would be feasible, none have attempted it or referred to studies that have.

The Commission has data on the costs of the NCC and state regulators, the administrative and compliance costs of developing and implementing some undertakings, and a rough estimate of the administrative and compliance costs of the Pilbara rail case. The ACCC presented data indicating that there have been recent periods of strong investment in several industries subject to access regulation, but it also rightly cautioned against assuming a causal relationship between investment and access regulation.

What other evidence is there that the Regime should be retained?

The Hilmer Committee intended for the Regime to be applied sparingly. This has been borne out in practice — in the nearly 20 years since the Regime was introduced, six declaration decisions have been in favour of the applicant (figure 2). The Commission has been advised that some access seekers made applications for declaration and later withdrew their applications because access was made available by other regulatory means, such as undertakings and industry-specific access regimes.

Figure 2 Declaration matters under Part IIIA
November 1995 – September 2013



Although declaration has been rare, this does not mean that the Regime has been unsuccessful. It could be the case that parties are resolving access disputes without recourse to Part IIIA, or that Part IIIA is an effective threat that encourages parties to reach private settlement.

Many inquiry participants (both infrastructure service providers and access seekers) were supportive of the Regime (box 4), and very few participants considered that it should be revoked. Some participants supported the Regime’s overarching framework, as it acts as a common reference point or benchmark for other access regimes. The negotiate–arbitrate framework was considered a strength by inquiry participants as it gives primacy to private negotiations to avoid the need for the ACCC to set access terms and conditions.

Inquiry participants expressed concern about what would replace the Regime if it were revoked. In the absence of the Regime, governments may adopt ad hoc approaches to access regulation that result in less efficient outcomes than under the Regime. Access arrangements at the facility level, for example, can impose net costs on the community if they are incorrectly applied, and provide incentives for lobbying. Efficiency outcomes could also be worse if governments adopt more heavy-handed regulatory approaches that risk regulatory overreach.

Box 4 Many participants supported the National Access Regime

Although participants proposed a number of reforms to the National Access Regime, many — including infrastructure service providers and access seekers — were supportive of the Regime.

If the National Access Regime were removed and not replaced with an alternative regime then many activities currently undertaken, including above rail activities, would become problematic at best. (Asciano, sub. 15, p. 13)

The National Access Regime and industry-specific and jurisdictional regimes have addressed [the essential facilities] problem effectively in key industries and for particular facilities. (Jemena, sub. 6, p. 2)

Peabody fully supports the existing regulatory framework for third party rail access arrangements at both the Commonwealth and State/Territory level. However, [there are] specific and practical areas of concern that should be addressed ... (Peabody Energy, sub. 30, p. 3)

The National Access Regime directly provides a stable, common framework for much of the infrastructure that underpins Australia's economy. (Australian Pipeline Industry Association, sub. 14, p. 2)

It is probably not time to remove the National Access Regime given the purposes it currently fulfils; however, it should continue to be used sparingly. (Business Council of Australia, sub. 36, p. 6)

Aurizon broadly supports the Commission's final conclusion, namely, that Part IIIA and declaration itself should be retained for the present time. (Aurizon, sub. DR72, p. 8)

Reforming the Regime will have transitional costs

The returns third parties can earn by successfully using access regulation to enable them to compete more effectively in a dependent market could be significant. Conversely, if infrastructure service providers can successfully avoid access regulation they would avoid the risk of regulatory errors curtailing their returns, and they would be able to protect monopoly rents where access regulation would have promoted competition in dependent markets. Where the stakes are high, access seekers and infrastructure service providers will have a commercial interest in testing the legal boundaries of the Regime to reach their preferred outcome, however tightly the legislation is drafted.

The reforms proposed by the Commission seek to clarify the intent of the Regime, with particular focus on the criteria for declaration, as these determine when access regulation will and will not apply. The Commission's reforms, if implemented, would reduce avoidable administrative costs of access cases by improving certainty for access seekers and infrastructure service providers, and reduce the likelihood of unsubstantiated and speculative declaration applications, reviews and appeals.

The Commission is mindful that its proposed reforms to the Regime will have transitional costs, particularly given that any legislative amendments will be tested by affected parties, and it will take time for case law to be established. The proposed reforms may also have implications for state and territory regimes where the language of the legislation mirrors that of Part IIIA. The Commission's proposed reforms to the Regime are confined to where it considers the greatest gains can be made.

Targeting the scope of the Regime at the economic problem

There are five declaration criteria that must be satisfied for the NCC to recommend, and the designated Minister to decide, that a service be declared (box 5). Each criterion should serve a specific purpose, such that the criteria as a whole target the Regime at the economic problem discussed above. The Commission has recommended changes to four of the declaration criteria — it has not proposed amending the national significance test, criterion (c).

Box 5 Declaration criteria

Subsection 44G(2) of the CCA states that:

The [National Competition] Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

- (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility; or
 - (ii) the importance of the facility to constitutional trade or commerce; or
 - (iii) the importance of the facility to the national economy;
- (d) [repealed]
- (e) that access to the service is not already the subject of [an access regime that has been certified as effective unless there have been substantial modifications to the regime or the relevant principles since the regime was certified];
- (f) that access (or increased access) to the service would not be contrary to the public interest.

Subsection 44H(4) of the CCA specifies that the designated Minister cannot declare a service unless he or she is satisfied of the same matters.

The current competition test can overstate the benefits of regulated access

The competition test, criterion (a), seeks to ensure that an infrastructure service will only be declared where access to the service would materially promote competition in a dependent market. Prior to 2006, the NCC and decision makers applied criterion (a) as requiring that *declaration* would promote competition in a dependent market. The approach adopted was to compare the status quo against the future state of competition in a dependent market with declaration of the infrastructure service.

The Federal Court's 2006 decision in *Sydney Airport Corporation Limited v Australian Competition Tribunal* (the Virgin Blue case — in which Virgin Blue was seeking better terms and conditions of access to services provided by the Sydney Airport Corporation) applied a new interpretation of criterion (a). The decision lowered the hurdle for declaration by requiring a comparison of the state of competition without *access* (even though access was already provided to Virgin Blue) and the state of competition with access.

The Federal Court's interpretation of criterion (a) in the Virgin Blue case means the potential effect of access regulation on competition is overstated to the extent that any existing access arrangements promote competition in a dependent market. It has been argued that, using the Federal Court's test, access to almost all natural monopoly infrastructure would satisfy criterion (a) — the criterion may be satisfied even where the market power of a service provider is constrained due to the countervailing market power of users, or where the provider has an incentive to provide access.

The more recent Pilbara rail case may have re-raised the hurdle for satisfying criterion (a) as the Tribunal considered it should assume 'access' refers to access on reasonable terms and conditions. The Federal and High Courts did not comment directly on this aspect of criterion (a) in the Pilbara rail case, but the Federal Court did accept the Tribunal's approach of assuming that 'access' in the *public interest test* (criterion (f)) is access on reasonable terms and conditions.

A test that better captures the effect of declaration on competition

The competition test should be amended so that it is only satisfied where access to an infrastructure service on reasonable terms and conditions through *declaration* (rather than access per se) would promote a material increase in competition in a dependent market. This amendment would confirm the NCC's current interpretation of the criterion by requiring a comparison of the state of competition under the status quo against the state of competition where access is granted on reasonable terms and conditions. This competition test would not be satisfied where there is

already effective competition in dependent markets. It would also not be satisfied where access is already granted to all third parties on reasonable terms and conditions, as declaration would not be expected to alter the terms and conditions of access.

Targeting criterion (b) at the economic problem

The appropriate interpretation of the uneconomical to develop another facility test, criterion (b), is controversial. In its ruling in the Pilbara rail case, the High Court outlined three ways in which criterion (b) has been applied by decision makers in the past: a net social benefit test, a natural monopoly test, and a private profitability test (box 6). The Federal and High Courts ruled in the Pilbara rail case that criterion (b) should be applied as a private profitability test.

Box 6 The three tests previously used to apply criterion (b)

Net social benefit test: It would be uneconomical to develop another facility if, for a likely range of reasonably foreseeable demand for the service provided by the facility, it would be more efficient, in terms of costs and benefits to the community as a whole, for one facility to provide the service rather than more than one.

Natural monopoly test: It would be uneconomical to develop another facility if the facility in question could provide society's reasonably foreseeable demand for the service at a lower total cost than if it were to be met by two or more facilities.

Private profitability test: It would be uneconomical to develop another facility if there is not anyone (including the incumbent operator of the facility to which access is sought) for whom it would be profitable to develop another facility.

All three tests have shortcomings in targeting the economic problem

The Commission considers that criterion (b) should be used by decision makers to identify facilities that give rise to an enduring lack of effective competition in markets for infrastructure services — a purpose that none of the tests previously used to apply criterion (b) are well suited to perform.

- The *net social benefit test* would not identify facilities that give rise to an enduring lack of effective competition. The purpose of the net social benefit test is to identify facilities where there would be net benefits to the community from avoiding duplication of infrastructure. Where they are important to a decision about whether declaration should apply, the consideration of the wider costs and benefits of a single facility (or more than one facility) providing the service should be considered as part of the public interest test (discussed below).

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- The *natural monopoly test* could be satisfied even where the facility would not give rise to an enduring lack of effective competition. By only considering the demand for the facility’s own service — rather than total demand in the market in which the service is supplied — the natural monopoly test could be satisfied for any location-specific facility with its output defined sufficiently narrowly, with enough spare (or expandable) capacity to accommodate a third party.
 - The *private profitability test* might fail in some instances to identify facilities that give rise to an enduring lack of effective competition. The NCC and the ACCC argued it would be very difficult to be satisfied that a facility is unprofitable to duplicate because the issues and analysis associated with whether a facility is unprofitable to duplicate — such as estimating future prices and hurdle rates of return — are likely to be subject to much dispute. Sufficient uncertainty over the question of whether a facility is unprofitable to duplicate could prevent declaration in cases where declaration is warranted. If the NCC and the Minister incorrectly conclude that a facility *is* profitable to duplicate this would guarantee that the relevant service is not declared since failing one criterion is sufficient to avoid declaration. There is also a risk that some facilities that are profitable to duplicate (and thus would not meet the private profitability test) would be associated with the economic problem given that duplication of an infrastructure facility may not result in *effective* competition.

The Commission’s preferred approach to criterion (b)

Due to the shortcomings associated with the tests previously used to apply criterion (b), criterion (b) should be applied in a different manner than in the past. The Commission’s preferred approach to criterion (b) accounts for both the total demand in the market in which the infrastructure service is supplied, and the production costs incurred by infrastructure service providers from coordinating multiple users of infrastructure.

Criterion (b) should be satisfied where total foreseeable market demand for the infrastructure service over the declaration period could be met at least cost by the facility.

In infrastructure markets, an enduring lack of effective competition will usually occur where the incumbent facility can meet total market demand for the infrastructure service at least cost. If a facility can meet total market demand at least cost it would likely hold a strong position in the market for the infrastructure service, given it could draw on its lower costs to deter competitors that threaten its market position. A test that accounts for total foreseeable market demand (including demand for any substitute services provided by facilities serving that market) would

direct criterion (b) toward identifying the most likely source of an enduring lack of effective competition in infrastructure service markets.

The costs that are relevant to determining whether a facility can meet total foreseeable market demand at least cost are the production costs that would be incurred in meeting foreseeable demand. This assessment of costs should include an estimate of any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility. A number of participants suggested that coordination costs can be estimated at the declaration stage. The production costs of coordinating infrastructure use with third parties can be significant, particularly in highly integrated supply chains and, in some cases, these coordination costs will outweigh the benefits of access.

The definition of ‘anyone’ under a private profitability test

In the Pilbara rail case, the High Court determined that the term ‘anyone’ under the private profitability test can include the incumbent operator of the facility to which access is sought. If criterion (b) continues to be applied as a private profitability test, the Commission considers that the term ‘anyone’ should not include the incumbent infrastructure service provider. This is because an incumbent service provider would avoid access regulation if it successfully argued that it could profitably duplicate its own facilities (although it would not be required to do so). All else equal, having the incumbent duplicate, or say it will duplicate, its facility would do little to nothing to promote competition. The definition of anyone would not be an issue if criterion (b) were amended as recommended by the Commission, given the Commission’s preferred approach is focused on the costs of meeting demand using the facility under application rather than the profitability of a project.

The public interest test: raising the hurdle

The public interest test, criterion (f), allows the NCC and decision makers to consider the overall effect of access, taking into account any factors that may have a bearing on whether an infrastructure service should be declared. The public interest test can only be used to deny a declaration application — it cannot be used to get an application ‘over the line’ if other declaration criteria are not satisfied.

Given the costs associated with access regulation, it is appropriate that a service can only be declared where the decision maker is satisfied that declaration is likely to generate overall gains to the community. To support this, criterion (f) would be better drafted as an affirmative test that requires the public interest to be *promoted* (as opposed to access being ‘not contrary to’ the public interest). This approach is

consistent with the focus of the National Competition Policy reforms and the guiding principle that competition will promote community welfare by increasing national income through encouraging improvements in efficiency.

There is precedent for affirmative public interest tests in other legislation, such as the *Telecommunications Act 1997* (Cwlth) and the *Fair Work Act 2009* (Cwlth).

The public interest test should also be amended to require the NCC and decision makers to *have regard to* relevant factors not expressly covered by the other criteria. Such a requirement would not exhaustively define the scope of the public interest test. Assessments under criterion (f) should specifically include any effects on investment (positive and negative) in markets for infrastructure services and dependent markets, and the administrative and compliance costs that would arise due to declaration. This change would also require criterion (f) to be framed as a test that assesses factors that affect the public interest with and without declaration — comparable to the access–declaration distinction associated with criterion (a) discussed above.

Certification: linking Part IIIA and state and territory access regimes

The purpose of certification is to improve the consistency and quality of state and territory access regimes, to promote regulatory certainty (as certifying a regime as effective makes it clear to infrastructure service providers and access seekers which regulatory regime will apply), and reduce the scope for regulatory duplication.

Has certification led to a consistent approach to access regulation?

Clause 6 of the CPA contains a range of principles used by the NCC and the Commonwealth Minister to assess whether a state or territory access regime should be certified as effective. The principles refer to features of access regimes such as scope, the negotiation and dispute resolution frameworks, and the terms of access.

There is evidence to suggest that the application of the clause 6 principles has led to broad consistency across certified state and territory access regimes in key areas. For example, all certified access regimes allow for negotiation between the service provider and the access seeker, provide for the regulator or an independent panel to act as an arbitrator in the event of a dispute, and set access prices using similar principles. This is not to say that all access regimes are, or should be, uniform. Industries and jurisdictions have different characteristics, and the principles are deliberately flexible in order to take these characteristics into account. For example,

rail access regimes differ across jurisdictions even though the majority of these regimes are certified.

Improving regulatory certainty and reducing the costs associated with certification

As part of the declaration process, criterion (e) tests whether an infrastructure service is subject to an access regime that has been certified as effective. Amending Part IIIA so that criterion (e) becomes a separate threshold clause stating that an infrastructure service cannot be declared if it is subject to a certified access regime would avoid the administrative costs incurred by infrastructure service providers, access seekers and the NCC of assessing a declaration application against all declaration criteria, even if a certified regime is in place. Only when this threshold is passed would consideration be given to the declaration criteria.

A formal mechanism for the Commonwealth Minister to revoke certification if there have been substantial modifications to the access regime or the CPA such that the regime would no longer meet the clause 6 principles would improve regulatory certainty for infrastructure service providers and access seekers.

Do the inconsistencies between the CPA and Part IIIA matter?

The clause 6 principles in the CPA provide a framework for state and territory access regimes through certification or by acting as a template for access regulation. If the Commission's proposed amendments to the declaration criteria are not reflected in the CPA, state and territory access regimes may not be appropriately targeted at the economic problem that access regulation should address. The Commission acknowledges that there will be some costs associated with amending the clause 6 principles. However, if the Commission's proposed amendments to the declaration criteria are implemented, the Council of Australian Governments (COAG) should consider aligning the principles in clause 6(3) (relating to the coverage of an access regime) with the relevant declaration criteria in Part IIIA.

The CPA does not include some of the safeguards contained in the CCA that place restrictions on access determinations where an infrastructure service provider is required to extend its facility (discussed below). Therefore, these safeguards are not required to be included in state or territory access regimes for the regime to be certified. If the Commission's proposal that the ACCC develop and publish guidelines on its power to direct facility extensions is adopted (also discussed below), then following publication of the guidelines, COAG should consider including the safeguards already in the CCA in the CPA.

There may also be benefits from streamlining the clause 6 principles to reduce the administrative burden on governments attempting to ensure that their regimes meet the principles. COAG should therefore also consider streamlining the clause 6 principles, although this is likely to have fewer benefits, and therefore is less of a priority, than aligning the clause 6 principles with the declaration criteria.

Is there a need for electricity and gas access regimes to be certified?

A number of inquiry participants suggested that the certification of electricity and gas access regimes is needed to improve the consistency of these regimes with Part IIIA, and to increase regulatory certainty for market participants by removing the possibility that an infrastructure service could be declared. On the other hand, participants noted that the certification of these regimes would offer little benefit over the current regulatory arrangements, and impose upfront and ongoing costs. These costs include the potential for duplication of regulatory processes, and the potential need, under the current certification provisions, for the regimes to be recertified each time there is a change to the rules in electricity and gas regimes to ensure that the protection offered by certification remains.

On balance, the costs of certifying the electricity and gas regimes may outweigh the benefits. Therefore, the Commission considers that COAG should release the state and territory governments from the existing requirement to submit their electricity and gas regimes for certification (although the state and territory governments would be free to seek certification of their regimes if they considered that there would be net benefits from doing so).

Undertakings

All undertakings under Part IIIA that have been accepted by the ACCC were the result of other government legislation (for example, for a wheat terminal operator to export bulk wheat), lease agreements (as is the case for the Hunter Valley rail network) or an intergovernmental agreement (the interstate rail network operated by the Australian Rail Track Corporation).

Some inquiry participants considered that Part IIIA undertakings have proven effective at providing access to infrastructure services. For example, the ACCC stated that undertakings had promoted economic efficiency and aligned incentives for efficient operation and investment in supply chains, in particular in relation to arrangements for wheat port terminals and the Australian Rail Track Corporation's rail networks. However, CBH Group considered that mandatory undertakings were unnecessary for bulk handlers in the wheat sector, and that access would have

occurred without the undertakings. In addition, CBH Group stated that its required undertaking had resulted in administrative and compliance costs of between \$2.3 million and \$2.7 million over the period 2009 to 2012.

Participants also noted that mandating an undertaking may result in some of the safeguards included in the declaration pathway under the Regime being bypassed.

- Merits review of ACCC decisions may not be an option for service providers if a deadline for having an undertaking in place is imposed. CBH Group indicated that it would have applied for merits review of ACCC decisions on whether to accept the wheat undertakings had there not been the risk of ramifications if it exercised its review rights.
- When deciding whether to accept an undertaking, the ACCC is not required to have regard to the safeguards in section 44W of the CCA — which include that the ACCC may not prevent an existing user of the service from obtaining a sufficient amount of the service to meet their reasonably anticipated requirements (although these safeguards are included in the dispute resolution processes in all current Part IIIA undertakings).

In addition, the ACCC is not required to assess whether a service should be covered by access regulation in its assessment of undertakings, either upfront or on an ongoing basis. (The ACCC is required to have regard to the objects clause in Part IIIA when considering whether to accept an undertaking.)

Caution should be exercised before mandatory undertakings are implemented in the future. Where mandatory undertakings are used, the relevant government should request that the NCC assess the service against the declaration criteria before the undertaking is implemented and at appropriate intervals after the undertaking is in place, to ensure that the undertaking is used to target the economic problem that the Regime should address. Opportunities for merits review of ACCC decisions should be preserved, and the safeguards for the provider and other existing users of the infrastructure service should be consistent with those for declared services. These principles should not be departed from lightly, and any departures should not be maintained as an ongoing feature of an access arrangement.

The regulatory power to direct extensions

The ACCC may make a determination in an access dispute that requires an infrastructure service provider to extend the facility or permit interconnection to the facility by a third party. Safeguard provisions in the CCA limit the ACCC's power by preventing a determination that requires the service provider to bear any of the

costs of a directed extension or interconnection, or results in the third party becoming the owner of any part of the facility (s. 44W).

The economic rationale for the ACCC's power to direct extensions is to prevent service providers undermining the objective of the Regime by deliberately delaying infrastructure investment, or constructing facilities with suboptimal capacity, to limit competition and extract monopoly rents. The ACCC has never exercised its power to direct an extension under Part IIIA (nor has it been called on to do so).

Although the provisions to direct extensions in Part IIIA have not been tested, the Queensland Competition Authority is currently assessing a standard user funding agreement under the Queensland rail access regime, which contains similar provisions for regulator-directed extensions to those in the CCA. The experience in Queensland therefore provides insight into how the provisions in the CCA might function if called on.

A decision by the ACCC to direct an extension would require complex operational, commercial and legal considerations. Many participants in this inquiry have expressed serious concerns about when, and how, the ACCC would exercise the power to direct an extension, the practicality of exercising the extension power, the workability of the safeguard provisions in Part IIIA and the potential to adversely affect service providers' investment incentives. The Commission shares these concerns and is firmly of the view that private negotiation is preferable to extensions directed by the regulator.

Due to the practical difficulties of directing extensions, information asymmetry and the complexity of user funding arrangements, including difficulties in setting appropriate access charges, it is likely that the benefits of using the power would rarely outweigh the costs.

However, the power is necessary for the proper operation of the Regime and the ACCC should develop guidelines on how the power to direct extensions would be used such that it is expected to generate net benefits to the community. The guidelines should be developed using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation so the provision to direct an extension is exposed to close scrutiny.

Protecting the legitimate business interests of infrastructure service providers

Of particular concern to the Commission and inquiry participants is the applicability and workability of the safeguards set out in Part IIIA, and whether they will adequately protect the legitimate business interests of service providers. The

provider's legitimate business interests are likely to be broader than the capital cost of extensions, and include adverse effects on the service provider's operations arising from the directed extension. The preparation of the guidelines by the ACCC discussed above should include an analysis of the workability and adequacy of the provision to direct extensions and its safeguards.

The safeguard provisions in section 44W of the CCA are expressed as referring only to extensions of a facility, but the Tribunal and others have interpreted 'extend' to include both geographic extensions of a facility and expansions of a facility's capacity. The Commission has received advice from the Australian Government Solicitor (AGS) that the issue of whether extensions include expansions of a facility's capacity has not been considered judicially and that the decision of the Tribunal is not strictly binding on the ACCC or future determinations by the Tribunal. Part IIIA should be amended to confirm that the ACCC's power to direct extensions also encompasses capacity expansions to ensure that the safeguards set out in section 44W also apply to directed expansions.

At public hearings, the ACCC indicated that it would not 'rule out' the service provider being required to pay upfront for directed extensions with the costs recouped over time through, for example, a take or pay contract. Advice from the AGS is that the safeguard in Part IIIA that provides that the ACCC must not make a determination that would have the effect of requiring the provider to bear some or all of the costs of directed extensions should be construed as *not* permitting a determination along these lines. The Commission considers that the safeguard, as interpreted by the AGS, is appropriate — a service provider should not be required to pay any of the upfront costs of the directed extension.

Is there a need for additional industry-specific regimes?

Industry-specific access regimes appear to have worked well. However, before any additional industry-specific regimes are introduced, governments should seek to demonstrate that there is a policy problem that is best addressed by access regulation and, that there is sufficient similarity between infrastructure services within the industry to make an industry-specific approach the most appropriate. Governments should also seek to demonstrate that there are features of the industry that justify different regulatory treatment for third party access to infrastructure services from that offered by the generic National Access Regime.

Inquiry participants raised concerns about the effectiveness of the generic regime in some industry settings and called for additional or nationally consistent industry-specific access regulation, in particular for rail and airport services, and

heavy vehicle access to some road infrastructure. In the Commission’s view, there is insufficient evidence to suggest that the introduction of additional industry-specific regimes would generate substantial net benefits at this time.

- Differences in rail access regulation between jurisdictions may increase compliance costs for rail operators if they deal with multiple access regimes and economic regulators. However, there is limited evidence on the costs associated with the current approach to rail access regulation and there would likely be considerable time and effort involved in the development of a national approach, particularly given COAG’s current national reform agenda.
- The Commission previously concluded that while some airports have considerable market power arising from barriers to entry and limited substitutes, this market power is somewhat constrained by commercial opportunities and pressures. Further, as airports are vertically separated, they are unlikely to have an incentive to deny access to their major customers — the airlines. In its 2011 inquiry into airport regulation, the Commission supported a further period of price monitoring for aeronautical and car parking services at some major airports. The Commission also recommended that an airport-specific arbitration regime, activated by deemed declaration of airport services under Part IIIA, should not be introduced as it could undermine light-handed regulation and be a far more intrusive form of regulation. The Commission remains of this view.
- The Commission was not presented with any evidence to conclude that road asset owners deny access to heavy vehicle operators with the intention or effect of limiting competition in a dependent market. Restrictions as to which roads can be accessed by heavy vehicles are generally based on technical, safety or engineering reasons. These are not issues that the Regime is designed to, or should, address. Further, issues relating to heavy vehicle access and investment in road infrastructure are being considered under the COAG Heavy Vehicle Charging and Investment Reform project.

A balancing act: sound, timely and transparent decisions

It is necessary to have robust institutional arrangements, and there are sound reasons for retaining each of the steps in the decision-making process. However, unduly long decision-making processes add to legal and administrative costs, and have an adverse effect on investment incentives. While the time taken to resolve some Part IIIA matters has been lengthy — the Pilbara rail case is the standout example of a declaration matter that became mired in a complex legal dispute that took many years to resolve (box 3) — such prolonged cases are not typical of Part IIIA matters.

The capacity and operations of the NCC

The NCC and some other participants in this inquiry raised concerns about the future operations of the NCC, its appropriate structure, and how to strengthen the NCC's capacity when its workload is so uneven. It is important that the NCC has the capability to undertake its difficult tasks in a rigorous way that ensures it has credibility with its stakeholders. While the Commission has not made a recommendation in this area, it draws this issue to the attention of the Australian Government.

Limited merits review is appropriate

Many inquiry participants expressed views on the appropriateness of merits review arrangements in Part IIIA decision-making processes. Some, including the NCC, considered merits review to be a second level of inquiry that is unnecessary, opening the decision-making process to increased uncertainty and delay. By contrast, many other participants were strongly supportive of merits review because:

- merits review may be the only way to correct decisions that were made on the basis of incorrect facts, given judicial review will rarely allow factual errors in decisions to be corrected
- restricting the availability of review to matters of law risks significant errors in the exercise of regulatory discretion being left unaddressed
- decisions on access are complex and technical, and significant judgment is required on when and how to intervene. The possibility of regulatory error is therefore quite high. Given the 'at large' nature of the Regime and its application to infrastructure of national significance, allowing merits review to correct errors is important, and contributes to investor confidence.

Merits review is also likely to be more confined and more timely than in the past.

- In 2010, Part IIIA was amended to require the Tribunal to make review decisions within 180 days (subject to clock-stopping provisions). The amendments also included changes to restrict the Tribunal to only consider information taken into account by the original decision maker, along with additional information that the Tribunal considers reasonable and appropriate.
- In its 2012 decision on the Pilbara rail case, the High Court ruled that the Tribunal had erred in conducting broad additional investigations. Though this decision was based on the legislation as it was prior to the 2010 amendments to Part IIIA, it is likely to limit the Tribunal's scope to obtain new information and conduct a fresh assessment during future merits reviews.

The combined effects of the High Court’s 2012 decision and the 2010 amendments to Part IIIA have not been tested and cannot be known for certain. Nevertheless, it is the Commission’s view (after receiving advice to this effect from the AGS) that the Tribunal’s powers are now more confined than those previously exercised, and that the Tribunal processes may not be as long as they have been in the past. The Commission considers that the direction of the changes — toward a more confined review power and a more timely review process — is the correct one, and that removing provision for merits review from Part IIIA would be premature.

Deemed ministerial decisions reduce opportunities for review

If the designated Minister does not publish a decision on an access matter within the 60-day time limit, then a deemed decision applies. For declaration decisions, the designated Minister is deemed not to have declared the service. There is no requirement that the designated Minister provide reasons for the deemed decision. Where the NCC recommended declaration and there is no record of the Minister’s consideration of the declaration application, there is no decision upon which an action for judicial review could practically be based.

The Commission is of the view that when the designated Minister does not publish a declaration decision within the statutory time limit, the decision should be deemed to follow the NCC’s recommendation. This proposed change would:

- ensure written reasons are provided for all declaration decisions (in the form of the NCC’s recommendation or the designated Minister’s statement of reasons)
- in cases where the designated Minister does not wish to follow an NCC recommendation to declare, impose a requirement on the Minister to make an active decision not to declare the service and to provide reasons for that decision.

The Competition and Infrastructure Reform Agreement

The CIRA was agreed at the February 2006 meeting of COAG. The agreement sets out commitments for simpler and consistent regulation of infrastructure across jurisdictions. It also outlines specific requirements for jurisdictions to consider the use of a competitive tender for the supply of infrastructure services, and governance and reporting arrangements for competitive neutrality where government businesses are in competition with the private sector.

On the basis of the evidence of the effectiveness of the CIRA provided by inquiry participants, and through its own investigations, the Commission has recommended that governments should regularly review competitive neutrality arrangements for

government business enterprises engaged in competition with the private sector to ensure they reflect contemporary practice.

Implementation and further review of the National Access Regime

The Commission is mindful that changes to the Regime, if implemented, will impose transitional costs, particularly as new case law is developed, and this will contribute to regulatory uncertainty. Changes to the Regime may also have implications for infrastructure services that are currently declared, or state or territory access regimes that are currently certified. Recognising these potential disruptions — and the costs they could impose on all affected parties — the Commission has sought to confine proposed changes to the Regime to where it considers the greatest gains can be made (table 1).

The long-term efficiency consequences and effectiveness of the Regime as a whole require ongoing assessment. A further independent review of the Regime should be undertaken no more than 10 years after the Australian Government has formally responded to the recommendations of this inquiry.

Table 1 A summary of the Commission’s recommendations

<i>Recommendation</i>	<i>Purpose</i>
Declaration criteria (recommendations 8.1, 8.2, 8.3, 8.4)	
<ul style="list-style-type: none"> Amend the <i>competition test</i> (criterion (a) in Part IIIA) so that the test is a comparison of competition with and without access on reasonable terms and conditions through declaration. 	To confine declaration to where it is most likely to promote a material increase in competition compared with the status quo.
<ul style="list-style-type: none"> Amend the <i>uneconomical to develop another facility test</i> (criterion (b) in Part IIIA) so that the test is satisfied where total market demand could be met at least cost by the facility. <ul style="list-style-type: none"> Total market demand should include the demand for the service under application as well as the demand for any substitute services provided by facilities serving that market. The assessment of costs under criterion (b) should include an estimate of any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility. 	To better target the economic problem, and better account for the costs of providing the infrastructure service under shared use.
<ul style="list-style-type: none"> If criterion (b) continues to be applied as a private profitability test, it should be amended such that the definition of ‘anyone’ excludes the incumbent service provider. 	To allow for the possibility of declaration in cases where only the incumbent would find it profitable to duplicate the facility.
<ul style="list-style-type: none"> Amend the <i>public interest test</i> (criterion (f) in Part IIIA) so that declaration promotes the public interest. In assessing the public interest, decision makers should have regard to effects on investment and administrative and compliance costs. 	To limit declaration to cases where declaration is likely to generate overall gains to the community.
Certification and undertakings (recommendations 8.5, 8.6, 8.7, 8.8)	
<ul style="list-style-type: none"> Remove declaration criterion (e) from Part IIIA and introduce: <ul style="list-style-type: none"> a threshold clause stating that a service cannot be declared if it is subject to a certified access regime a revocation mechanism that allows certification of a regime to be revoked if substantial modifications have been made to the regime or the principles in clause 6 of the Competition Principles Agreement (CPA). 	To improve investment and regulatory certainty, and reduce administrative costs.
<ul style="list-style-type: none"> COAG should consider aligning the principles in clause 6 of the CPA with Part IIIA, and streamline the principles where appropriate. 	To strengthen the Regime’s framework role, and reduce administrative costs.
<ul style="list-style-type: none"> Release state and territory governments from the requirements to submit their energy regimes for certification. 	To reduce unnecessary costs associated with certification.
<ul style="list-style-type: none"> If mandatory undertakings are used, the NCC should assess the relevant service against the declaration criteria before, and at appropriate intervals after, the mandatory undertaking is in place. 	To ensure that future mandatory undertakings are used to target the economic problem.
Extensions (recommendations 8.9, 8.10)	
<ul style="list-style-type: none"> The ACCC should publish guidelines on how its power to direct extensions would be exercised in practice. 	To outline how the power would be used such that it is expected to generate net benefits.
<ul style="list-style-type: none"> Amend Part IIIA to confirm that the ACCC’s power to direct extensions also encompasses capacity expansions. 	To ensure the safeguards in Part IIIA apply to directed expansions.
Deemed ministerial decisions (recommendation 9.1)	
<ul style="list-style-type: none"> Deemed ministerial decisions on applications for declaration should follow the NCC’s recommendation. 	To improve transparency and provide a statement of reasons that can be used in judicial review.
Broader policy context (recommendations 10.1, 10.2)	
<ul style="list-style-type: none"> Australian, state and territory governments should review their competitive neutrality policies to ensure they are relevant and reflect contemporary practice. 	To promote more effective and accountable competitive neutrality outcomes.
<ul style="list-style-type: none"> Undertake a further independent review of the Regime no more than ten years after the Government’s response to this inquiry. 	To assess the efficiency and effectiveness of the Regime.

Recommendations

RECOMMENDATION 8.1

The Australian Government should amend paragraphs 44G(2)(a) and 44H(4)(a) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (a) becomes a comparison of competition with and without access on reasonable terms and conditions through declaration.

RECOMMENDATION 8.2

The Australian Government should amend paragraphs 44G(2)(b) and 44H(4)(b) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (b) is satisfied where total foreseeable market demand over the declaration period could be met at least cost by the facility. Total market demand should include the demand for the service under application as well as the demand for any substitute services provided by facilities serving that market. The assessment of costs under criterion (b) should include an estimate of any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility.

RECOMMENDATION 8.3

If criterion (b) continues to be applied as a private profitability test, the Australian Government should amend the definition of ‘anyone’ in paragraphs 44G(2)(b) and 44H(4)(b) of the Competition and Consumer Act 2010 (Cwlth) to exclude the incumbent service provider.

RECOMMENDATION 8.4

The Australian Government should amend paragraphs 44G(2)(f) and 44H(4)(f) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (f) becomes a test of whether access on reasonable terms and conditions through declaration promotes the public interest. As part of their assessment of the public interest, the National Competition Council and designated Minister should be required to have regard to the effect of declaration on investment in markets for infrastructure services and dependent markets, and administrative and compliance costs.

RECOMMENDATION 8.5

The Australian Government should amend Part IIIA of the Competition and Consumer Act 2010 (Cwlth) to:

- *remove paragraphs 44G(2)(e) and 44H(4)(e)*
- *introduce a threshold clause stating that a service cannot be declared if it is subject to a certified access regime*
- *include provision for the Commonwealth Minister to revoke the certification of an access regime, following a recommendation from the National Competition Council (NCC), if there have been substantial modifications to the certified regime or the principles in clause 6 of the Competition Principles Agreement (CPA), such that the regime no longer meets the principles in clause 6 of the CPA*
- *enable infrastructure service providers covered by the certified regime, access seekers, or the relevant state or territory government to apply to the NCC to make a recommendation to the Commonwealth Minister for the revocation of certification. The NCC should also be able to initiate the revocation of certification (consistent with the current arrangements for revocation of declaration and ineligibility decisions).*

The protection from declaration offered by certification should apply until the expiration of the certification, unless the certification is revoked by the Commonwealth Minister. Consequential amendments may be necessary to ensure that the designated Minister is able to revoke the declaration of a service if that service becomes the subject of a certified access regime.

RECOMMENDATION 8.6

If the Commission's recommendations to amend the declaration criteria are implemented, the Council of Australian Governments (COAG) should consider amending the Competition Principles Agreement (CPA) to align the principles in clause 6(3) with the relevant declaration criteria in Part IIIA of the Competition and Consumer Act 2010 (Cwlth) (CCA). COAG should also consider streamlining the clause 6 principles in the CPA, in consultation with the National Competition Council, where appropriate.

If the Commission's recommendation that the Australian Competition and Consumer Commission develop and publish guidelines on its power to direct facility extensions is adopted, then following publication of the guidelines COAG should consider including the safeguards in section 44W of the CCA in the CPA.

RECOMMENDATION 8.7

The Council of Australian Governments should release the state and territory governments from the requirements in the Competition and Infrastructure Reform Agreement and the Australian Energy Market Agreement to submit their electricity and gas regimes for certification. States and territories would be free to seek certification of their regimes if they considered that there would be net benefits from doing so.

RECOMMENDATION 8.8

Where an infrastructure service provider is required by a government to have an access undertaking in place in the future, the relevant government should request that the National Competition Council assess the service against the declaration criteria before the mandatory undertaking is implemented and at appropriate intervals after the mandatory undertaking is in place.

RECOMMENDATION 8.9

As soon as practicable, the Australian Competition and Consumer Commission (ACCC) should develop and publish guidelines on how its power to direct facility extensions would be exercised in practice such that it is expected to generate net benefits to the community. The guidelines should be developed by the ACCC using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation.

RECOMMENDATION 8.10

The Australian Government should amend the Competition and Consumer Act 2010 (Cwlth) (CCA) to confirm the prevailing interpretation by the Australian Competition Tribunal that the terms ‘extend’, ‘extensions’ and ‘extending’ in sections 44V, 44W and 44X include expansions of a facility’s capacity. The intent of this amendment is that when making an access determination, the Australian Competition and Consumer Commission can require a service provider to expand the capacity of its facility (in addition to being able to require a geographical extension) and that the safeguards in sections 44W and 44X apply to directed capacity expansions.

In framing the amendments, consideration should be given to the use of the terms ‘extend’, ‘extensions’ and ‘extending’ in other provisions of the CCA, to ensure that the amendments do not give rise to any unintended consequences.

RECOMMENDATION 9.1

The Australian Government should amend subsection 44H(9) of the Competition and Consumer Act 2010 (Cwlth) such that if the designated Minister does not publish a decision on a declaration recommendation within the 60 day time limit, this is deemed to be acceptance of the National Competition Council's recommendation.

RECOMMENDATION 10.1

The Australian, state and territory governments should regularly review their competitive neutrality policies to ensure that they remain relevant and reflect contemporary practice. Specific matters that should be considered include:

- *clearer guidelines on the application of competitive neutrality during the start-up stages of newly established government business enterprises that are or will be engaged in significant business activities*
- *whether processes for handling competitive neutrality complaints are identifiable, independent and accessible*
- *how governments respond to the findings of competitive neutrality complaint investigations.*

To strengthen accountability for competitive neutrality outcomes, the Heads of Treasuries should set a target for producing their annual competitive neutrality matrix report within six months of the end of each financial year.

RECOMMENDATION 10.2

The Council of Australian Governments should commission a further independent review of the National Access Regime no more than ten years after the Australian Government has formally responded to the recommendations of this inquiry.

1 Introduction

The National Access Regime (the Regime) provides an avenue for businesses to seek third party access to services provided by nationally significant infrastructure facilities. The Regime sits alongside industry-specific access regimes (including Commonwealth, state and territory regimes, such as those for telecommunications and electricity), and facility-based access arrangements (some of which fall outside the Regime).

The Regime was introduced by the Australian, state and territory governments in 1995 as part of the National Competition Policy reforms — a broad suite of reforms to increase competition across the economy — following government consideration of the report by the Independent Committee of Inquiry on National Competition Policy (Hilmer Committee 1993). The Regime reflects many, but not all, of the key recommendations of the Hilmer Committee — there are some significant departures. Both the Hilmer Committee and the final form of the Regime placed considerable emphasis on ensuring that the Regime was used in ‘a limited category of cases’ (Hilmer Committee 1993, p. xxxii). The Committee favoured private agreement between access seekers and infrastructure service providers on access terms and conditions, supported by binding arbitration by a regulator in the event that parties could not reach agreement. This approach forms the framework for the Regime.

The Commission reviewed the Regime in 2001 (PC 2001a). The Commission recommended that the Regime should not be abandoned:

Given the in principle case for some curbs on the exercise of monopoly power in the provision of essential infrastructure services, the limited experience in Australia with access regimes, and ongoing structural change in a number of infrastructure sectors, abandoning access regulation at this stage would be inappropriate. (PC 2001a, p. 94)

The Commission made a number of recommendations to improve the Regime. Many of these recommendations were supported by the Australian Government and implemented — although the final form of some amendments did not go as far as the Commission’s recommendations (chapter 2).

In 2006, the Australian, state and territory governments agreed to the Competition and Infrastructure Reform Agreement (CIRA). The agreement sets out commitments for simpler and consistent regulation of infrastructure across

jurisdictions. This inquiry fulfils a commitment under the CIRA to review its operation and terms.

1.1 The scope of the inquiry

The terms of reference for this inquiry (reproduced at the front of this report) require the Commission to examine both the Regime and the CIRA.

- The Regime includes Part IIIA of the *Competition and Consumer Act 2010* (Cwlth), which sets out the architecture of the Regime, and clause 6 of the Competition Principles Agreement, which establishes general principles to assess the effectiveness of state and territory access regimes.
- The CIRA includes agreed reforms to the Regime, and also commitments in the areas of rail, ports, competitive tender, and competitive neutrality.

In assessing the Regime and the CIRA, the terms of reference require the Commission to consider:

- the rationale, role and objectives of the Regime and Australia's overall framework of access regulation
- the performance of the Regime in meeting its rationale and objectives
- whether the implementation of the Regime adequately ensures that its economic efficiency objectives are met
- ways to improve processes and decisions for facilitating third party access to essential infrastructure
- the effectiveness of the reforms outlined in the CIRA, and actions taken by governments in giving effect to the CIRA
- any other policy measures, including non-legislative approaches, which would help ensure the effective and responsive delivery of infrastructure services over both the short and long term.

Importantly, while the Commission has examined cases under Part IIIA in its consideration of the effectiveness of the Regime, it has been asked not to review or reconsider particular decisions.

The terms of reference request that the Commission comment on the operation of the Regime relative to other access regimes, including its consistency with those regimes and the effectiveness of the certification process for state and territory access regimes. In doing so, the Commission has considered a range of state and territory access regimes, such as those in place for electricity and gas. However, the Commission has

not conducted a thorough case-by-case review of these regimes in this inquiry. While some participants made comparisons to the access arrangements for telecommunications, it should be noted that, because of its special characteristics and history, the telecommunications sector has its own access regime that reflects these unique features.

1.2 The importance of infrastructure

Infrastructure services are delivered through electricity, gas and water systems; telecommunications, rail and road networks; and port and airport terminals. The value of these services represent a significant portion of the Australian economy (around 11 per cent of GDP in 2010-11 (BITRE 2012)). The OECD has noted that these systems ‘play a vital role in economic and social development’ (2008, p. 1), and also, in a later report, that:

The benefits to activity of efficient spending in [infrastructure] sectors go well beyond their contribution to capital accumulation. Good infrastructure facilitates trade, bolsters market integration and competition, fosters the dissemination of ideas and innovations and enhances access to resources and public services. (OECD 2010a, p. 91)

A number of inquiry participants noted the importance of infrastructure services to their business or the economy more generally (box 1.1).

The importance of infrastructure is highlighted by its impact on business performance. The cost and quality of infrastructure services is an important driver of a business’s competitiveness and productivity. For example, improvements in transport infrastructure can lower distribution costs, increase access to overseas markets, and improve access to inputs (Prud’Homme 2001), and improvements in telecommunications services can facilitate innovation for businesses and the diffusion of technology (Banks 2012b). On the other hand, poor delivery of infrastructure services can stifle business productivity — for example, Topp et al. (2008) noted that congestion in transport chains for the iron ore and coal mining industries may have been a contributor to a decline in the productivity of the mining sector.

Due to market failures (chapter 3) infrastructure may be subject to regulation, and it is important that this regulation is appropriate to encourage the efficient production of goods and services. For example, if prices for infrastructure services are set too high, this can discourage entry into downstream markets reliant on these services. However, if prices are set too low this can encourage entry into downstream markets by inefficient businesses and reduce incentives for investment in infrastructure services (discussed further in chapter 3).

Box 1.1 Participants' views on the importance of infrastructure

A number of inquiry participants noted the importance of infrastructure services and the regulation of infrastructure to the Australian economy.

Investment in infrastructure, by governments and the private sector, is vital if Australia is going to meet the needs of our growing population. Infrastructure is also key to ensuring that Australian business can continue to compete in international markets ... Access to infrastructure is also vital for attracting investment in Australia by ensuring that new businesses are able to effectively compete with already established businesses in key industries. (Business SA, sub. 5, p. 1)

The competitiveness of the Australian resources sector is in turn heavily dependent on an efficient and cost competitive export supply chain and delivery of timely and coordinated (across the chain) export infrastructure ... The importance of getting the regulatory setting on infrastructure access right in order for Australia to maintain or grow its share of global demand for coal cannot be understated. (Xstrata Coal (now Glencore), sub. 19, pp. 6–7)

Ongoing investment in new economic infrastructure — broadly defined as transport, water, energy and communications infrastructure — will provide the critical services that will underpin the competitiveness of our domestic and export industries and improve living standards for Australians in our fast-growing cities and regions. A further argument in support of regular investment in infrastructure where it is done efficiently is that it can lift productivity by embedding the latest technologies and innovations from around the world to improve safety and service performance. (Business Council of Australia, sub. 36, p. 4)

The fortunes of the Australian minerals industry and infrastructure development are inextricably linked. Mismatches in, or inadequate provision of, infrastructure mean that Australia misses out on maximising the export potential of its resources base either through product not being shipped or, ultimately, mines not developed. (Minerals Council of Australia, sub. 26, p. 7)

The National Competition Policy reforms (which included the introduction of the Regime) were in part aimed at increasing the productivity of Australia's infrastructure stock by promoting competition, and providing incentives to innovate and pass on cost savings to users (PC 2005). These reforms were estimated to have resulted in significant improvements in infrastructure productivity and Australia's GDP. The Commission previously estimated that productivity and price changes in key infrastructure sectors influenced by the National Competition Policy and related reforms increased Australia's GDP by 2.5 per cent above what would have occurred without the changes — the Commission did not estimate the gain from only implementing the Regime (PC 2005).

There may be scope for further productivity gains to be achieved. For example, based on Commission estimates of the benefits to the economy of the National Reform Agenda (PC 2007), the Business Council of Australia estimated that broad reforms to key infrastructure sectors could boost GDP by a further 2 per cent (BCA 2007). The OECD (2010a) has also noted that further regulatory reform in Australia's infrastructure sector is needed.

1.3 The Commission's approach

This inquiry will examine one aspect of infrastructure regulation — the regulatory framework surrounding third party access to infrastructure services — and whether any improvements could be made to this framework that would enhance the wellbeing of the community.

This report analyses the objectives for access regulation, the effectiveness of the Regime in meeting its objectives and the potential reform options. In doing so, the Commission has drawn on general principles for assessing policy reforms (box 1.2).

Box 1.2 Principles of policy assessment

Objectives

- Policy should serve clearly identified problems, goals and objectives.
- The objectives of policy should be specified in a broad way, to allow consideration of all available options.

Costs and benefits of reform

- The benefits of policy should outweigh the costs to the community as a whole.
- All effects of policy should be considered. This includes the 'flow-on' costs to the broader economy, and distributional and environmental costs.
- A range of options to meet the policy objective should be considered, including the option of doing nothing.
- Policy should be clear, simple, consistent with other policy, and compatible with competition, trade and investment-facilitating principles at domestic and international levels.

Implementation and review

- Regulatory institutions should be accountable, and decisions transparent.
- Appropriate guidance should be provided to regulators and regulated entities to ensure the intent of the policy is clear.
- Policy should be subject to review, to ensure its ongoing effectiveness.
- Unnecessary or ineffective regulation should be revised or removed.

Sources: Australian Government (2010); COAG (2007a); OECD (2005).

Consistent with the *Productivity Commission Act 1998* (Cwlth), the Commission considers that the overall objective of regulation should be to enhance the wellbeing of the community as a whole. This includes the wellbeing of infrastructure service providers, access seekers, consumers, businesses, and the broader community.

Rationales and objectives for policy reform

Chapter 3 considers the rationale, role and objectives for the Regime and Australia's access regulation framework. In considering whether there is an economic problem that requires an access regime, the Commission has examined whether there is a 'market failure' in the provision of infrastructure services. A market failure exists where a market, left to its own devices, does not lead to the most efficient allocation of resources across society. There are several different types of market failure that may warrant government intervention. The existence of a market failure implies the potential for government intervention to lead to an improvement in community wellbeing. However, the presence of a market failure does not always justify government intervention — intervention has costs that may exceed the benefits.

Policy alternatives

In assessing the Regime, the Commission has considered policy measures that could meet the policy objective. These include:

- retaining the status quo — keeping the Regime in its present form
- reforming the Regime — keeping the Regime, but making changes to the framework in order to lower the costs of the Regime, and/or increase the benefits
- removing the Regime, and relying on alternatives such as general competition law, new regulatory structures, price surveillance or monitoring, or ad hoc measures, including at the facility level.

Chapter 3 considers the potential policy alternatives to the current access regulation framework, and whether these could feasibly meet the objectives of access regulation at a lower cost than the Regime, having regard to costs such as transitional costs and investor uncertainty.

The costs and benefits of the Regime

Ideally, an economy-wide quantitative cost–benefit analysis would be undertaken to determine whether the Regime is generating net benefits to the community. However, for a number of reasons, this is not practical. Therefore, the Commission has adopted a largely qualitative approach, supplemented with quantitative evidence where available (chapter 7). In doing so, the Commission has considered:

- the effect of the Regime on the efficient operation of infrastructure
- the influence of the Regime on state and territory access regimes

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- administrative and compliance costs (both for governments and businesses)
 - broader economic costs — for example, the effect of the Regime on investment incentives
 - regulatory failure — regulators do not have perfect information, and as a consequence may make incorrect decisions (PC 2011c).

Chapters 4 and 5 examine the operation of the declaration pathway to third party access to infrastructure services. This includes an assessment of the role and performance of the declaration criteria at targeting the economic problem access regulation should address.

Chapter 6 examines the operation of the certification and undertaking pathways to access, and assesses whether these pathways could be improved. Chapter 7 considers the costs and benefits of the Regime, and assesses the performance of the Regime in meeting its rationale and objectives.

Reform options

Chapter 8 outlines the reforms that the Commission considers would better enable the Regime to target the economic problem that access regulation should address, and lower the costs and/or increase the benefits associated with the Regime. This chapter also considers the operation of the Regime alongside other access regimes, such as industry-specific and facility-based access regimes and whether further measures are needed to facilitate efficient investment in infrastructure.

Institutional arrangements

Chapter 9 examines the roles of the key institutions in the Regime, and considers whether the institutional arrangements supporting the Regime could be enhanced to improve the timeliness and quality of decisions. In doing so, the Commission has considered best practice principles for policy administration, including that: regulatory decisions should be transparent, non-discriminatory, and not unduly delay business decisions; review and appeals procedures should be efficient; and regulatory institutions should be accountable and transparent (OECD 2005).

The broader policy context

The CIRA includes reforms beyond those directly relating to the Regime, including in the areas of rail and ports regulation, and competitive neutrality. Chapter 10

examines the outcomes of the CIRA reforms, and considers whether the Agreement should be retained. Additionally, chapter 10 considers the regulatory framework for private sector investment in, and use of, infrastructure services.

1.4 The inquiry process

The Commission received the terms of reference for this inquiry on 25 October 2012, and released an issues paper for the inquiry in November 2012. In preparing the draft report, the Commission consulted widely, including discussions with lawyers, economists, academics, infrastructure service providers, regulators and access seekers. Two roundtables were held in February in Melbourne and Sydney to discuss economic and legal issues relating to the Regime. The Commission received 47 submissions prior to the release of the draft report.

Following the release of the draft report, the Commission engaged in further consultations, and held public hearings in Perth, Sydney and Melbourne. The Commission received 29 submissions following the draft report. Full details of the consultation process are contained in appendix A.

The final report was provided to the Australian Government on 25 October 2013. The Australian Government determined the release date of the final report.

The Commission thanks everyone who participated in the inquiry process.

2 What is the National Access Regime?

Key points

- The National Access Regime is a regulatory framework through which third parties may seek access to infrastructure services owned and operated by others.
 - The Regime aims to promote the economically efficient operation of, use of, and investment in infrastructure, thereby promoting competition in upstream and downstream markets.
 - The Regime gives primacy to negotiations between infrastructure service providers and access seekers, with the threat of regulated access providing an incentive for the parties to reach private agreement.
- The Regime is set out in Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) and clause 6 of the Competition Principles Agreement. The four pathways to access under Part IIIA are:
 - *declaration* — a party can request that the National Competition Council recommend that the designated Minister declare a particular infrastructure service. Declaration is the first stage of a two-part process through which parties can seek the right to negotiate access to an infrastructure service. During the second stage, parties negotiate price and other terms of access to the service. The ACCC can be called on to act as an arbitrator and may determine terms and conditions of access
 - *certified access regimes* — a party can seek access through a state or territory access regime that is certified as effective by the Commonwealth Minister
 - *undertakings* — a party can seek access under the terms and conditions set out in a legally enforceable undertaking that has been accepted by the ACCC
 - *competitive tender* — a party can seek access to a government-owned service under terms established through an ACCC approved competitive tender process.
- The Productivity Commission last reviewed the Regime in 2001, at a time when few applications for access to infrastructure services had been considered. The Commission concluded that it would be inappropriate to abandon access regulation at that stage and made recommendations to improve the operation of the Regime, including clarifying its objective.
 - Concerns raised since the last review include the interpretation of the declaration criteria, the timeliness of decision-making and the review processes.
- Since the Regime was introduced, there have been relatively few applications for declaration. Only a handful of services have been declared, and there has been one arbitrated outcome.
- While some state and territory access regimes have been certified, others — including all gas and most electricity access regimes — remain uncertified.

2.1 Introduction

The National Access Regime (the Regime) is a regulatory framework through which third parties may seek access to nationally significant infrastructure services that are owned and operated by others. The Regime is set out in Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) (formerly the *Trade Practices Act 1974*) and clause 6 of the Competition Principles Agreement (CPA).

The objects clause of Part IIIA (s. 44AA) establishes the Regime's twin objectives:

- to promote the economically efficient operation of, use of, and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets
- to provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

Part IIIA is a generic access regime, in the sense that the infrastructure services to which it could be applied are not defined in the legislation. A number of other access regimes sit alongside Part IIIA, with Part IIIA playing a backstop role. The Australian Government has access regimes for certain infrastructure services, and state and territory governments have generic, facility-based and industry-specific regimes, including regimes covering electricity, gas, and some ports, urban water and rail infrastructure services.

State and territory access regimes are linked to Part IIIA through the process of certification. The CPA contains principles against which the Commonwealth Minister assesses state and territory access regimes, on application from a state or territory minister, and decides whether those regimes should be certified as effective. Other regulatory options, such as anticompetitive conduct legislation and commercial agreements, including leasing arrangements, are also available for dealing with access concerns (chapter 3). The Regime has to be seen in the context of these other options.

History of the National Access Regime

Governments have at various times responded to market failure in infrastructure service markets through public ownership of infrastructure facilities, such as telecommunications, rail and electricity networks. It was often the case that in areas where competition was feasible, legislative restrictions created statutory monopolies.

In 1992, following agreement by the Australian, state and territory governments on the need for a national competition policy, the Prime Minister commissioned an Independent Committee of Inquiry on National Competition Policy, known as the Hilmer Committee. The Hilmer Committee was particularly concerned that the owner of a vertically integrated essential facility may have the potential and incentive to reduce competition in upstream or downstream markets by denying access to its services to competitors.

The Hilmer Committee noted the existence of legislation that dealt with access issues on an industry-specific basis, such as the *Telecommunications Act 1991* (Cwlth) and the *Petroleum Pipelines Act 1969* (WA). However, the Committee was not convinced that access regimes should be legislated and administered on an industry or state basis and considered that there would be merit in adopting a general regime. The Committee was of the view that ‘different approaches or pricing principles adopted in different States have the potential to impede the development of efficient national markets for electricity, gas, rail and other key industries’ (1993, p. 249).

Consequently, the Hilmer Committee proposed the establishment of a new national legal regime under which businesses would ‘be given a right of access to essential facilities when the provision of such a right meets certain public interest criteria’ (1993, p. 239). However, the Committee was ‘conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another’ (1993, p. 248). The Committee favoured private agreement on access terms and conditions supported by binding arbitration by a regulator in the event that parties could not reach agreement. The Committee also proposed that access rights be created by a process of ministerial declaration on the recommendation of an independent and expert body — the National Competition Council (NCC).

At the time that the Hilmer Committee report was delivered, the provision of major infrastructure services was typically the domain of public providers. The Committee found that ‘whilst the majority of “essential facilities” have traditionally been owned by governments, there are many examples of privately owned facilities of similar nature. The general rules proposed are intended to cover essential facilities, irrespective of ownership, where certain public interest and other criteria are met’ (1993, p. 250).

The Hilmer Committee recognised the efficiency benefits that privatisation could offer, but cautioned that ‘privatisation without appropriate restructuring may entrench the anti-competitive structure of the former public monopolies, making structural reform even more important’ (1993, p. 215). Since then, the ownership of

many major infrastructure facilities has changed. Some publicly owned facilities have been sold or leased on a long-term basis, and a number of governments have indicated further privatisations will occur.

Implementing the National Access Regime

Subsequent to the Hilmer Committee report, the Australian, state and territory governments introduced the National Competition Policy reforms. These wide-ranging reforms included the corporatisation and privatisation of some government-owned infrastructure facilities, the structural separation of vertically integrated services to allow for competition in the contestable components of service delivery, and the creation of the National Access Regime. The Regime was established in 1995 through the inclusion of Part IIIA in the then *Trade Practices Act 1974* (Cwlth). The current Regime reflects many of the recommendations of the Hilmer Committee, although there are some significant departures (box 2.1). The Regime provides arrangements for access decisions to be reviewed and is underpinned by a negotiate–arbitrate framework. This framework gives primacy to private negotiation, with the threat of regulated access providing an incentive for infrastructure service providers and access seekers to reach private agreement.

Box 2.1 Some departures from the Hilmer Committee’s recommendations

A number of features of the National Access Regime differ to the recommendations of the Hilmer Committee.

- *A requirement for a positive recommendation from the NCC to precede declaration.* In proposing the creation of a right to access a facility, the Hilmer Committee recommended that ‘the Minister may only make such a declaration if [doing so is] recommended by the National Competition Council and only on terms and conditions recommended by that body or on such other terms and conditions as agreed by the owner of the facility’ (1993, p. 266). Under Part IIIA, the designated Minister may declare an infrastructure service despite receiving a recommendation from the NCC not to declare that service.
- *Merits review.* The Hilmer Committee did not envisage a role for merits review of access decisions, noting that arbitration determinations ‘would be binding and appeals would be limited to matters of law’ (1993, p. 256). Both merits review and judicial review are available for decisions made under Part IIIA.
- *Industry-specific access regimes.* The Hilmer Committee proposed a generic national approach to access regulation and was not convinced that access regimes need to be legislated on an industry-specific basis. There are industry-specific access regimes in place at the Commonwealth, state and territory levels.

Sources: Competition and Consumer Act 2010 (Cwlth); Hilmer Committee (1993).

2001 Productivity Commission review

The Productivity Commission reviewed the Regime in 2001 and has undertaken a number of other inquiries that considered third party access to infrastructure services, including for gas, telecommunications, airport services, wheat export marketing arrangements and rail (PC 2001c, 2004, 2006b, 2010, 2011b). At the time of the Commission's 2001 review of the Regime, few applications for access to infrastructure services had been considered. The Commission concluded that 'abandoning access regulation at this stage would be inappropriate' (PC 2001a, p. 94). This was based on a view that there were cases where providers of infrastructure services would have both the monopoly power and incentive to restrict access and/or raise access prices unreasonably, and that Australia's limited experience with access regulation meant it was too early to assess the Regime's effectiveness.

Consequently, the Commission supported the continuation of the Regime and made a number of proposals to improve the Regime's operation. The Australian Government supported many of the Commission's recommendations, although the final form of some amendments differed from those recommended in the Commission's report (box 2.2).

Box 2.2 Implementation of key recommendations from the Productivity Commission's 2001 review of the National Access Regime

The Commission recommended a number of changes to the operation of the Regime in its 2001 review.

- *The objects of the Regime.* The Commission found that the operation of Part IIIA could be clarified by inserting an objects clause into the legislation. An objects clause was proposed to promote economically efficient use of, and investment in, essential infrastructure services, and to provide a framework and guiding principles to discourage unwarranted divergence in industry-specific access regimes. The Australian Government enacted an amended version of the objects clause in 2006, which included the promotion of effective competition as an objective of the Regime but did not use the term 'essential infrastructure services'.
- *Declaration criteria.* To minimise the prospect of access regulation being imposed in cases where the benefits would be marginal, the Commission recommended that declaration criterion (a), relating to whether access would promote competition, be revised to require access to promote a 'substantial increase' in competition. The Government agreed in principle, but used the phrase 'material increase', because it considered that the term 'substantial' may exclude situations where a small supplier is prevented from gaining access to nationally significant infrastructure.

(Continued next page)

Box 2.2 (continued)

- *Pricing principles.* To support the negotiation and arbitration process, the Commission proposed a set of pricing principles for the ACCC to draw on in its determinations on access disputes. The Government inserted pricing principles into Part IIIA, but some of the specific principles were varied or omitted.
- *Certification.* The Commission recommended that the immunity from Part IIIA afforded to separate Commonwealth access regimes be removed so that, as with state and territory access regimes, Commonwealth access regimes should only be considered effective if they are certified. The Government indicated that it considered this proposal was unnecessary.
- *Ineligibility rulings.* The Commission recommended that the proponent of a proposed investment in an infrastructure facility be able to seek a binding ruling that would apply in perpetuity on whether the services provided by the facility would meet the declaration criteria (see box 2.4 below). Ineligibility rulings were introduced into legislation in 2010. However, the rulings do not apply in perpetuity. Instead, the period for which they are in force is determined by the designated Minister following advice from the NCC, and must be a period of at least 20 years.
- *Time limits.* Recognising concerns about the timeliness of proceedings under Part IIIA, the Commission recommended that time targets should apply.
 - From 2006, the NCC and decision makers were required to endeavour to make a recommendation or decision within non-binding target time periods (ranging from 60 days for ministerial decisions to 6 months for NCC recommendations and ACCC decisions). If they were unable to meet the time target, they were required to publish a notification of an extension.
 - In 2010, amendments were introduced requiring the NCC to make recommendations and decision makers to publish decisions within an expected period (although with provision for the clock to be stopped in certain circumstances). If the NCC or Australian Competition Tribunal are unable to make a recommendation or publish a decision within the period, they may extend it by writing to the designated Minister specifying when they will do so and explaining the reasons for the delay, and by publishing a notification of an extension. If the designated Minister or the ACCC does not publish a decision within their time limits then a deemed decision applies.
- *Deemed decisions.* The Commission recommended that in the event that the designated Minister fails to make a decision on a declaration or certification application within the prescribed time, the Minister should be deemed to have accepted the NCC's recommendation. The CCA was amended in 2010 so that this is now the case for certification applications. However, the deeming provision for declaration decisions remains unchanged — if the designated Minister does not publish a decision within 60 days, the Minister is deemed to have not declared the service and to have published that decision not to declare the service.

Sources: Australian Government (2004); Costello (2006); Emerson (2009a); PC (2001a).

2.2 The National Access Regime in practice

Pathways to access

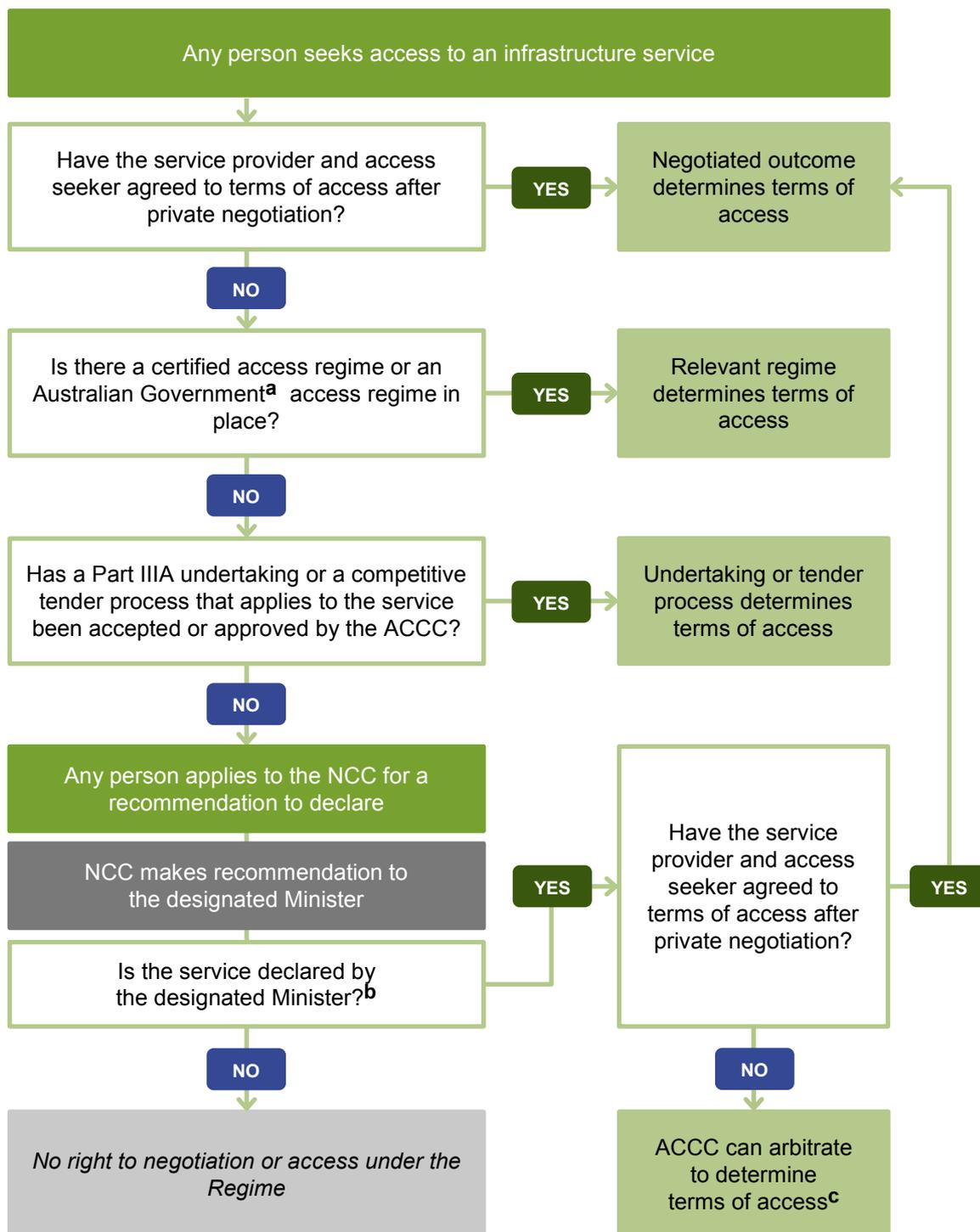
In addition to private negotiation, parties can use the Regime to seek access to a service provided by means of an infrastructure facility through one of four pathways (figure 2.1).

- *Declaration* — a party can request that the NCC recommend that the designated Minister declare a particular infrastructure service. The designated Minister is the Commonwealth Minister, unless the facility is owned by the state or territory government, in which case the designated Minister is the responsible Minister of that state or territory. Declaration is the first stage of a two-part process through which parties can seek the right to negotiate access to an infrastructure service. During the second stage of the process, parties negotiate access to the service. If the service provider and an access seeker are unable to agree on access terms, the Australian Competition and Consumer Commission (ACCC) can be called on to arbitrate and may determine the terms and conditions of access.
- *Certified access regimes* — a party can seek access to a service through a state or territory access regime that is certified as effective by the Commonwealth Minister.
- *Undertakings* — a party can seek access to a service under terms and conditions set out in a legally enforceable undertaking that has been accepted by the ACCC.
- *Competitive tender* — a party can access a service provided by a government-owned facility under terms that have been established through a competitive tender process approved by the ACCC.

There has been limited use of these pathways.

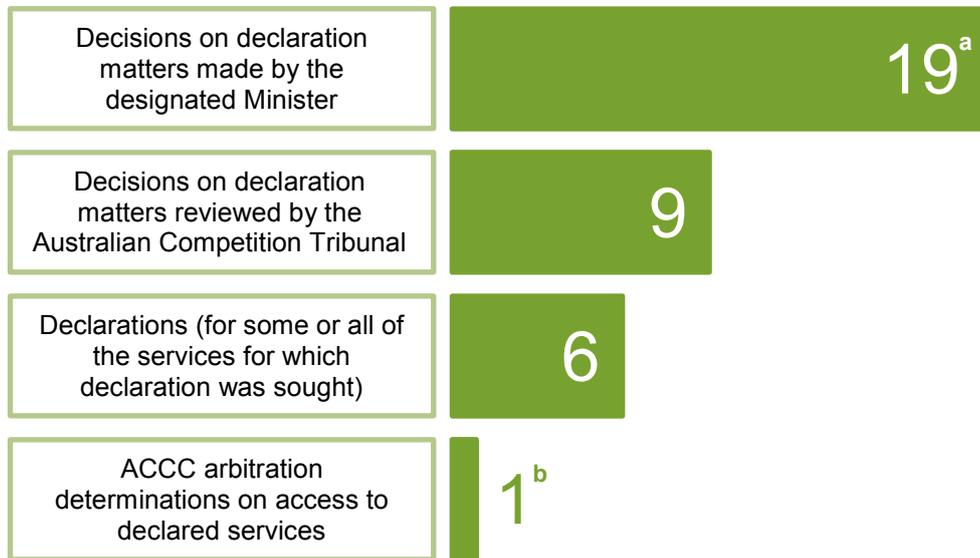
- Since the Regime was introduced, six declaration decisions have been in favour of the applicant (figure 2.2). Of these, three declaration decisions have now expired and one has been revoked.
- The access undertakings that have been accepted by the ACCC were required by legislation (for example, bulk wheat exporters) or government agreement (for example, the Hunter Valley rail network).
- In total, nineteen state and territory access regimes have been certified since the Regime was introduced. Some state and territory regimes remain uncertified, including most electricity regimes and all gas regimes.
- There have been no applications for ACCC approval of a competitive tender process since the competitive tender provisions took effect in 2010.

Figure 2.1 Pathways to access under the National Access Regime



^a Such as the telecommunications access regime provided under Part XIC of the *Competition and Consumer Act 2010* (Cwlth). ^b On application, the merits of the designated Minister’s decision can be reviewed by the Australian Competition Tribunal. Courts can review the decision to ensure that the designated Minister used the correct legal reasoning or followed the correct legal procedure on application by an affected party. ^c The ACCC’s determination does not have to require the service provider to provide access to the service.

Figure 2.2 **Declaration matters under Part IIIA^a**
November 1995 – September 2013



^a This excludes applications that were withdrawn before a declaration decision was made. Some decisions concern applications for declaration of more than one related service. For example, one decision was made in response to the application by Services Sydney for declaration of six services provided by Sydney Water. ^b There have been two applications for arbitration of access disputes, of which one was withdrawn before the ACCC made a determination.

Sources: ACCC (sub. 16, 2013a); NCC (sub. 1, 2004a, 2004b, 2012).

There are a number of similarities between these pathways, including in relation to timeframes, the publication of recommendations and decisions, and review arrangements (box 2.3).

Box 2.3 Elements of the decision-making process

Timeframes for decision making. A 180-day time limit (the expected period) applies to decisions and recommendations by the NCC, the ACCC and the Tribunal (with the exception of competitive tender processes (see below) where the ACCC has 90 days to publish a decision). The designated Minister has a 60-day time limit to publish a decision. The expected period for the ACCC, NCC and Tribunal may be extended by clock stoppers and/or extensions of time (chapter 4). Deemed decisions apply (see below) if the Minister or ACCC do not publish certain decisions within the expected period.

Public submissions. The NCC or ACCC may request public submissions from interested parties to inform their consideration of access matters. If they do so, they are required to have regard to any submissions received.

Deemed decisions. If the designated Minister does not publish a decision on an application within the time limit, then a deemed decision applies. For certification decisions, the Minister is taken to have accepted the NCC's recommendation, while for declaration decisions, the Minister is taken not to have accepted the application (box 2.2). For revocation of declaration, the Minister is deemed to have revoked the decision. For ineligibility decisions, the Minister is taken to have accepted the NCC's recommendation (ineligibility decisions are discussed later in this chapter).

If the ACCC does not publish a decision within the expected period, it is taken to have approved a competitive tender process (in which case the service cannot be declared for a period of 20 years), and taken not to have accepted an access undertaking or access code.

Publication of decisions. With the exception of deemed ministerial decisions, reasons must be published for all recommendations or decisions.

Revocation. Some decisions can be revoked — the NCC can recommend to the designated Minister that declaration and ineligibility decisions be revoked, and the ACCC can revoke competitive tender decisions. Certification decisions cannot be revoked (however, if there is an application for declaration of a service covered by a certified regime and there have been substantial modifications to that regime or to the certification principles, the regime may no longer provide protection from declaration (chapter 6)). Final determination decisions, made by the ACCC following arbitration, cannot be revoked but can be varied if both parties agree. Undertakings and access codes continue until their expiry date unless they are withdrawn or varied by the provider with the ACCC's consent.

Review. Decisions by the designated Minister and the ACCC may, on application by an affected party, be reconsidered by the Tribunal. Parties may be ordered to pay all or part of the costs of such a review. The Federal Court can review decisions on points of law, and subsequent appeals can be made to the High Court.

Source: Competition and Consumer Act 2010 (Cwlth).

What infrastructure services does the Regime cover?

Each pathway provides for a party to seek access to the services provided by means of an infrastructure facility. A service includes the use of an infrastructure facility, such as a road or a railway line, handling or transporting things such as goods or people, or a communications service or similar service, but does not include the supply of goods, the use of intellectual property or the use of a production process, except to the extent that the process is an integral but subsidiary part of the service (s. 44B).

The types of infrastructure and access arrangements that are covered by the Regime are outlined in table 2.1. Other infrastructure services that have been, but are no longer, covered by the Regime include commercial shipping channels and airside facilities at several airports.

Table 2.1 Infrastructure services that are covered by the Regime

<i>Infrastructure services</i>	<i>Access pathway</i>	<i>Jurisdiction responsible for access pathway</i>
Water and sewerage	Certified regime	New South Wales
Electricity transmission and distribution networks	Certified regime	Western Australia and the Northern Territory
Rail	Certified regime	Queensland, South Australia, Western Australia ^a and the Northern Territory
	Undertaking	Commonwealth ^b
	Declaration	Commonwealth ^c
Port terminals	Certified regime	South Australia and Queensland ^d
	Undertaking ^e	Commonwealth

^a The Western Australian rail access regime excludes the BHP Billiton and Rio Tinto rail lines in the Pilbara and the rail lines east of Kalgoorlie, however the rail line operated by The Pilbara Infrastructure is subject to the Western Australian rail access regime. ^b The parts of the interstate rail network and the Hunter Valley rail network that are operated by the Australian Rail Track Corporation are subject to undertakings under Part IIIA. ^c The Goldsworthy rail line and the Tasmanian rail network are declared under Part IIIA. ^d The Dalrymple Bay Coal Terminal is subject to an access regime under the *Queensland Competition Authority Act 1997*. ^e Four port terminal operators have undertakings to cover their wheat handling operations.

Sources: ACCC (2008, 2011b, 2013b); Government of New South Wales (2003); Government of Western Australia (2010); NCC (2004b, 2012a; pers. comm., 20 November 2012).

Declaration of a service

The declaration of a service does not provide access seekers with a right to use the declared service — it provides access seekers with a right to negotiate terms and conditions of access. If a service is declared, any person — not just the original applicant for declaration — has a right to negotiate terms and conditions for access to the service, and a right to seek arbitration in the event of a dispute.

The designated Minister or any other person may submit a written application to the NCC asking the NCC to make a recommendation to the Minister that a service be declared. In making a recommendation or decision, the NCC and the designated Minister must have regard to the objects of Part IIIA and be satisfied of each of five declaration criteria (box 2.4).

Box 2.4 Declaration criteria

Subsection 44G(2) of the CCA states that:

The [National Competition] Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

- (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility; or
 - (ii) the importance of the facility to constitutional trade or commerce; or
 - (iii) the importance of the facility to the national economy;
- (d) [repealed]
- (e) that access to the service is not already the subject of [an access regime that has been certified as effective unless there have been substantial modifications to the regime or the relevant principles since the regime was certified];
- (f) that access (or increased access) to the service would not be contrary to the public interest.

Subsection 44H(4) of the CCA specifies that the designated Minister cannot declare a service unless he or she is satisfied of the same matters.

Use of the declaration pathway

Many of the applications for declaration have related to access to rail services (table 2.2). Four of these related to rail services located in the Pilbara region of Western Australia. Declaration decisions for these services have been subject to merits and judicial reviews that have taken a long period of time (box 2.5). At present, the Goldsworthy rail track in the Pilbara region and the Tasmanian rail tracks are the only declared services. The highest number of declarations that have been in place at any one time is three.

Table 2.2 Decisions made about declaration matters

<i>Year of application</i>	<i>Applicant</i>	<i>Infrastructure services^a</i>	<i>Outcome</i>
1996	Australian Union of Students	Austudy payroll deduction	Not declared
1996	Australian Cargo Terminal Operators	Various services at Sydney Airport	Some services declared until 2005
1996	Australian Cargo Terminal Operators	Various services at Melbourne Airport	Some services declared until 1998 ^b
1996	Carpentaria Transport	Various rail track services in Qld	Not declared
1997	Specialized Container Transport	Various rail track services in NSW	Not declared
1997	NSW Minerals Council	Various rail track services in NSW	Not declared
1997	Specialized Container Transport	Various rail track services in WA	Not declared
2001	Freight Australia	Various rail track services in Vic	Not declared
2001	Aulron Energy	Various rail track services in SA	Not declared
2002	Virgin Blue Airlines	Airside services at Sydney Airport	Declared until 2010
2004	Services Sydney	Sewage transmission and interconnection services in Sydney	Declared, revoked in 2009 ^c
2004	Fortescue Metals Group	Part of Goldsworthy and Mt Newman rail track services	Not declared
2004	Lakes R Us	Water storage and transport services in NSW	Not declared
2007	Tasmanian Department of Infrastructure, Energy and Resources – Rail Unit	Tasmanian rail track services	Declared until 2017
2007	Pilbara Infrastructure	Goldsworthy rail track services	Declared until 2028
2007	Pilbara Infrastructure	Hamersley rail track services	Not declared
2008	Pilbara Infrastructure	Robe rail track services	Not declared
2010	North Queensland Bio-Energy Corporation	Herbert River district cane tram network	Not declared
2011	Board of Airline Representatives of Australia	Jet fuel pipeline and hydrant facility services at Sydney Airport	Not declared

^a Some applications include more than one related service. Rail track services refers to a range of services that vary depending on the application, including, for example: rail tracks, signalling, bridges or passing loops. ^b Certain freight handling services were declared, and then subject to the *Airports Act 1996* (Cwlth) until it was repealed in 2003. ^c On 21 December 2005, the Tribunal, on review of the Minister's deemed decision not to declare the services, declared the sewage transmission and interconnection services provided by Sydney Water. In October 2009, the declaration was revoked following certification of the NSW water access regime.

Sources: NCC (2004b, 2004c, 2012c).

Box 2.5 **The long haul: rail access disputes in the Pilbara**

Between 2004 and 2008, Fortescue Metals Group and its subsidiary, The Pilbara Infrastructure, lodged declaration applications with the NCC seeking access to infrastructure services provided by four rail lines in the Pilbara region of Western Australia: the Goldsworthy and Mt Newman lines owned by BHP Billiton and its partners, and the Hamersley and Robe lines owned by Rio Tinto and its partners. The NCC recommended that all four lines be declared. In 2006, the Mt Newman line was deemed not to be declared, as the Minister did not publish a decision within the required timeframe. In 2008, the Minister accepted the NCC's advice and declared the Goldsworthy, Hamersley and Robe lines.

The current status of each of the lines is as follows.

- *The Mt Newman line is not declared.* On review, the Tribunal affirmed the Minister's deemed decision to not declare the service. There were no further reviews. Fortescue subsequently built a rail line that is roughly adjacent to a significant proportion of the Mt Newman line.
- *The Goldsworthy line is declared.* On review, the Tribunal affirmed the Minister's decision to declare the service. There were no further reviews. BHP Billiton has advised the Commission that no third party access has occurred on the Goldsworthy line (nor has any third party entered negotiations with BHP Billiton over access) as a result of declaration (pers. comm., 11 September 2013).
- *The Hamersley line is not declared.* Setting aside the Minister's decision, the Tribunal found that the line should not be declared. The Full Court of the Federal Court upheld the Tribunal's decision on appeal. The High Court determined in September 2012 that there had 'been no review by the Tribunal of the kind for which the Act provided' (para. 120), and — after establishing the proper construction of the disputed criteria and their application — set aside the orders of the Federal Court and remitted the matter to the Tribunal for reconsideration. In February 2013, the Tribunal concluded its reconsideration, and again determined that the Hamersley line should not be declared.
- *The Robe line is not declared.* The Tribunal affirmed the Minister's decision to declare the line. However, the Full Court of the Federal Court overturned the Tribunal's decision on appeal. As with the Hamersley line, the High Court found that there had been no review by the Tribunal of the kind for which the Act provided and remitted the matter to the Tribunal for reconsideration. The Tribunal subsequently determined that the Robe line should not be declared.

Source: *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36.

Ineligibility for declaration

Under Part IIIA, a person with a material interest in a service to be provided by a proposed infrastructure facility can request that the service be ineligible for declaration for a period of at least 20 years. The NCC and Minister can only

recommend or decide that a service is ineligible for declaration if they are satisfied that the services would not meet the declaration criteria in box 2.4. There have been no ineligibility decisions made, or requested, to date.

Certification

Where an infrastructure service is covered by a state or territory access regime that has been certified as effective, the certified regime provides the pathway by which parties can seek access to the service. The responsible Minister of a state or territory government may apply to have an access regime governing an eligible service certified. State and territory governments have established access regimes for a range of infrastructure services. Certification is not available for Australian Government access regimes.

Certification of an access regime provides the link between Part IIIA and state and territory access regimes. The purpose of certification is to improve the consistency and quality of access regimes, to promote regulatory certainty and to reduce the scope for regulatory duplication (chapter 6). Under declaration criterion (e), a service covered by an access regime that has been certified as effective cannot be declared unless there have been substantial modifications to either the access regime or the relevant principles set out in the CPA since the certification decision was published. Services covered by uncertified access regimes established by state or territory governments may be declared under Part IIIA.

In making a recommendation or decision on whether a state or territory access regime should be certified, the NCC and Commonwealth Minister must:

- have regard to the objects of Part IIIA of the CCA
- assess whether it is an effective access regime by applying the principles contained in clause 6 of the CPA (box 2.6).

Use of the certification process

All state and territory governments have agreed to have their access regimes certified through the Australian Energy Market Agreement (for electricity and gas regimes), and the Competition and Infrastructure Reform Agreement (for other regimes). A number of state and territory access regimes remain uncertified, including all gas access regimes, electricity access regimes (except those in Western Australia and the Northern Territory) and the New South Wales and Victorian rail access regimes. Table 2.3 shows the current status of certification of state and territory access regimes, and box 2.7 provides an example of a certified regime.

Box 2.6 Guiding principles for certification

Clause 6 of the CPA outlines a number of principles for the certification of an access regime. These principles have the status of guidelines in the CCA (s. 44DA), and state that an effective access regime should, among other things:

- be limited to services that are provided by means of significant infrastructure facilities
- contain an objects clause that promotes the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets
- encourage negotiation between parties in the first instance, but where such agreement cannot be reached, governments should establish a right for persons to negotiate access to a service provided by means of a facility
- be consistent where more than one state or territory access regime applies to a service
- have an appropriate dispute resolution framework. The dispute resolution body should consider a range of factors in determining the terms and conditions of access (such as the owner's legitimate business interests and the benefits to the public from having competitive markets).

In 2007, principles relating to appropriate objects clauses, pricing principles and merits review were added to the CPA. However, the Tarcoola–Darwin rail regime and the electricity and gas access regimes developed in accordance with the Australian Energy Market Agreement are exempt from these additions.

Sources: Australian Energy Market Agreement; Competition Principles Agreement.

Table 2.3 Certification status of state and territory access regimes

<i>Jurisdiction</i>	<i>Electricity</i>	<i>Gas</i>	<i>Rail</i>	<i>Ports</i>	<i>Water</i>
NSW	x	x	x	—	✓
Vic	x	x	x	—	—
Qld	x	x	✓	✓ ^a	—
SA	x	x	✓ ^b	✓	—
WA	✓	x	✓	—	—
Tas	x	x	— ^c	—	—
NT	✓	x	✓ ^b	—	—
ACT	x	x	—	—	—

✓ regime certified. x regime uncertified. — no access regime. ^a A certified access regime applies to the Dalrymple Bay Coal Terminal. ^b A certified access regime applies to the Tarcoola–Darwin rail line and the South Australian rail network. ^c Tasmanian rail track services are declared until 2017.

Sources: NCC (2012a; pers. comm., 20 November 2012).

Box 2.7 Example of the certification of a state access regime

New South Wales was the first state to introduce a water access regime. Its regime is specified under Part 3 of the *Water Industry Competition Act 2006* (NSW). Under this Act, any party may apply to the Independent Pricing and Regulatory Tribunal (IPART) to recommend to the relevant NSW Minister that a water or sewerage infrastructure service be covered. Coverage provides an access seeker with the right to negotiate with the service provider. In the event of a dispute, IPART provides arbitration and there is no merits review. There is also provision for a service provider to submit a voluntary access undertaking to IPART for approval.

New South Wales' application for certification of its water access regime was accepted by the Commonwealth Minister in 2009 for a period of 10 years (NCC 2013a). Following certification of the regime, the 2004 declaration of Sydney Water's sewage transmission and interconnection services was revoked.

The Queensland Government has its own generic access regime, set out under the *Queensland Competition Authority Act 1997* (the QCA Act), which is 'broadly modelled on the National Access Regime' and has access criteria that are 'broadly similar to the declaration criteria set out under the National Access Regime' (Queensland Treasury and Trade, sub. 42, p. 4). Undertakings have been accepted under the QCA Act for the Dalrymple Bay Coal Terminal and for the Queensland rail network. Both of these access regimes have been certified as effective under Part IIIA.

Undertakings and access codes

A person who provides or expects to be the provider of an infrastructure service can apply to have the ACCC accept an access undertaking (s. 44ZZA). The access undertaking sets out the terms and conditions of access to the service. Once accepted by the ACCC, the provider is required to abide by the terms and conditions of the undertaking.

An infrastructure service that is covered by an undertaking cannot be declared. However, the ACCC may accept an access undertaking for a service that has been declared or for a service that the designated Minister has decided is ineligible to be declared. The ACCC cannot accept an undertaking for infrastructure services that are covered by access regimes that have been certified as effective.

A prescribed industry body may also submit an access code that details the rules for access to a service for acceptance by the ACCC (s. 44ZZAA). The Australian Energy Market Commission is currently the only operating organisation prescribed as an industry body. Acceptance of an access code does not provide protection from declaration. It provides a framework for undertakings to be submitted by infrastructure service providers in the relevant industry.

The CCA provides examples of items that might be included in an ACCC-accepted undertaking or access code, such as the procedures for determining terms and conditions of access to the service (s. 44ZZA). There is a provision in the CCA for an access undertaking to contain one or more fixed principles — terms that must be carried over into later undertakings (s. 44ZZAAB). These could include an obligation on the provider not to hinder access to the service, or continuation of certain terms and conditions of access to an infrastructure service.

In deciding whether to accept an undertaking or access code, the ACCC is to have regard to a range of matters, including:

- the objects of Part IIIA
- the pricing principles in Part IIIA (see below)
- the legitimate business interests of the infrastructure service provider
- the public interest, including the public interest in having competition in markets (whether or not in Australia)
- the interests of persons who might want access to the service
- any other matters that the ACCC thinks are relevant (s. 44ZZA).

Use of access undertakings and access codes

All the undertakings that have been accepted by the ACCC under Part IIIA were the result of other government legislation (for example, for a wheat terminal operator to export bulk wheat), lease agreements (as is the case for the Hunter Valley rail network) or an intergovernmental agreement (the interstate rail network operated by the Australian Rail Track Corporation). An example of access undertakings from wheat export terminal service providers is given in box 2.8.

Box 2.8 Access undertakings from wheat export terminal service providers

Under the *Wheat Export Marketing Act 2008* (Cwlth), vertically integrated port terminal operators that export wheat are currently required to pass an access test, which includes having an access undertaking accepted by the ACCC — unless an effective access regime is in force.

The ACCC accepted undertakings from GrainCorp Operations, Australian Bulk Alliance (now Emerald Logistics Services), Co-operative Bulk Handling (CBH Group) and Viterra Operations in 2011. These undertakings are due to expire in September 2014. The undertakings oblige port operators:

- not to discriminate or hinder access in the provision of port terminal services
- to negotiate in good faith with eligible wheat exporters for access to port terminal services
- to comply with continuous disclosure rules (ACCC 2013e).

The undertakings also include provision for wheat exporters to seek mediation or binding arbitration on terms of access in the event of a dispute.

The 2010 Productivity Commission report on wheat export marketing arrangements recommended maintaining the existing access test requirement for grain port terminal operators in the short term as a transitional measure. The Commission recommended that from 1 October 2014 access disputes be dealt with under Part IIIA of the CCA (PC 2010).

An amendment to the *Wheat Export Marketing Act* was passed in November 2012, which allows the Minister to approve an industry code of conduct provided that it meets a range of criteria relating to access arrangements for port terminal services. If a code is implemented by 30 September 2014, the access test will be abolished and if not, the access test requirements will continue (Ludwig 2012). A code has not yet been implemented.

Competitive tender

As noted above, a party can access a service proved by a government-owned facility under terms that have been established through a competitive tender process approved by the ACCC. The ACCC may approve a competitive tender process for the construction and operation of a facility that is to be owned by a Commonwealth, state or territory government if it is satisfied that the tender process will result in terms and conditions of access to the service that are reasonable, and the tender process meets the requirements prescribed in the *Competition and Consumer Regulations 2010*. Services that are subject to a competitive tender process that was approved by the ACCC cannot be declared for a period specified by the ACCC (s. 44PA).

Industry-specific regimes

The Australian, state and territory governments have established a range of industry-specific access regimes (box 2.9).

Box 2.9 Industry-specific regimes

Telecommunications: The telecommunications access regime is set out in Part XIC of the CCA. The ACCC may declare a service on its own initiative or in response to a request for access after holding a public inquiry. For all services that are declared, the ACCC must make an access determination setting out the default terms and conditions of access including prices. Alternatively, a service provider of a non-declared service may submit a voluntary undertaking to the ACCC. There is no provision for merits review of decisions made under the telecommunications access regime.

Postal services: The *Australian Postal Corporation Act 1989* (Cwlth) exempts postal services from Part IIIA and establishes specific access arrangements for Australia Post's bulk postal services. The ACCC has the power to inquire into disputes about the terms and conditions of access to Australia Post's bulk mail services, including price, and makes a recommendation to the Minister on appropriate terms and conditions. Application may be made to the Administrative Appeals Tribunal for review of the Minister's decision.

Payments systems: The *Payment Systems (Regulation) Act 1998* (Cwlth) permits the Reserve Bank of Australia to impose an access regime on a designated payment system where it considers it appropriate, having regard to a number of public interest criteria. Access regimes have been established for automatic teller machines, the electronic funds transfer at point of sale (EFTPOS) system and a number of credit and debit card systems. The regimes are intended to promote competition and typically apply rules about rights of access and fees. In the event of a dispute, the Governor of the Reserve Bank (or their appointee) provides arbitration. There is no provision for merits review of decisions relating to designated payment systems.

Rail: Queensland, South Australia and Western Australia have certified rail access regimes for their intrastate rail track, and New South Wales and Victoria have uncertified regimes. While Tasmania does not have a state rail access regime, its rail network is declared under Part IIIA. The Tasmanian Government sought declaration to provide third-party rail operators with the right to negotiate access to the rail line and to allow the ACCC to arbitrate access disputes (DIER 2007). South Australia and the Northern Territory have established a joint access regime for the Tarcoola–Darwin rail track operated by Genesee and Wyoming Australia. Access to the interstate rail track and the Hunter Valley Coal Network is governed by undertakings under Part IIIA. In general, rail access regimes rely on a negotiate–arbitrate approach, in most cases conditioned by floor and ceiling prices approved by the state regulator. State rail regimes do not provide for merits review.

(Continued next page)

Box 2.9 (continued)

Water: New South Wales has introduced an industry-specific access regime for water and sewerage infrastructure services (box 2.8).

Ports: There is an access regime in South Australia that covers access to services at six ports. Service providers must negotiate with access seekers for ports that are subject to the access regime and provide access on fair commercial terms. In the event of an access dispute, the Essential Services Commission of South Australia may appoint an arbitrator.

There is also a facility-based access arrangement for the Dalrymple Bay Coal Terminal (DBCT) in Queensland. It consists of an undertaking under Queensland's generic third party access regime (the QCA Act). The undertaking sets out the terms and conditions for access to the DBCT including prices, a framework for negotiating access and arbitration by a jointly agreed expert or the Queensland Competition Authority.

Electricity: Access to electricity networks in the National Electricity Market is governed by the National Electricity Law and Rules implemented by statute in participating jurisdictions — all states and territories except for Western Australia and the Northern Territory. The regime is 'open access' and operates under the principle that all participants should have the opportunity to access services provided by the networks forming part of the national grid. The Australian Energy Regulator (AER) determines whether, and what form of, access regulation applies to electricity services. Providers may be subject to price and/or revenue regulation by the AER, or a requirement to negotiate with access seekers in good faith and provide cost-based offers.

In the event of a dispute, the AER provides arbitration. Decisions of the AER are subject to merits review by the Australian Competition Tribunal, although these arrangements were reviewed in 2012 and changes have been proposed (SCER 2013).

Western Australia and the Northern Territory — which are not currently connected to the National Electricity Market — have separate access regimes that have been certified under Part IIIA.

Gas: The National Gas Law and Rules are implemented by statute in each jurisdiction and govern access to natural gas pipelines across Australia. Under the gas regime, anyone can apply to the NCC to request that it recommend to the relevant Minister that a pipeline be covered under the regime. The NCC determines the form of regulation to apply to covered pipelines.

- For pipelines covered by 'full regulation', an access arrangement must be submitted to the regulator for approval setting out the terms and conditions of access to the service including a reference tariff (the regulator is the AER everywhere except Western Australia, where it is the state's Economic Regulation Authority).
- For pipelines covered by 'light regulation', certain information about the pipeline must be published and a negotiate–arbitrate framework applies.

In the event of a dispute, the AER (or the Western Australian Energy Disputes Arbitrator) provides arbitration. Decisions of the regulator, arbitrator, Minister and NCC are subject to merits review by the Australian Competition Tribunal.

Some industry-specific regimes have been certified as effective (discussed above and in chapter 6). The Australian Government has access regimes for telecommunications, postal services and financial payments systems. These regimes are established by legislation that sits outside Part IIIA of the CCA.

Industry-specific regimes can differ in a number of ways, including the objectives of the legislation, the role of merits review, and the roles of decision makers and regulators. For example, limited merits review is available under the national electricity and gas laws, however, no merits review is available for decisions under the telecommunications access regime. Also, the national electricity and gas laws have a stated efficiency objective, as well as an objective to provide services ‘for the long-term interests of consumers’. In comparison, the NSW water access regime has an efficiency objective but does not mention the long-term interests of consumers.

The negotiate–arbitrate framework

Following the declaration of a service (or the equivalent process for certified state or territory regimes), parties may negotiate the terms and conditions of access to the infrastructure service. This process is based on a negotiate–arbitrate framework, which gives primacy to private negotiation between a service provider and an access seeker, subject to the threat of arbitration by the ACCC.

If the service provider and access seeker are unable to agree on one or more aspects of access to a declared service, either the provider or access seeker can notify the ACCC of an access dispute, in which case the ACCC can arbitrate and make a determination on access. The determination does not have to require the infrastructure provider to make access to the service available. The negotiate–arbitrate framework is discussed further in chapter 4.

Use of arbitration

There have been two instances in which arbitration proceedings under Part IIIA have been initiated.

- In November 2006, Services Sydney notified the ACCC of an access dispute, having been unable to negotiate access to declared sewage transportation and interconnection services operated by Sydney Water. The ACCC’s final determination set pricing terms using a retail price minus avoidable costs methodology (ACCC 2007).

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- In January 2007, Virgin Blue notified the ACCC of an access dispute with Sydney Airport Corporation. Negotiations continued following the commencement of arbitration. In May 2007, Virgin Blue withdrew its notification of an access dispute noting that the parties had come to a private agreement (Virgin Blue 2007).

Pricing principles and determinations by the ACCC

When making a determination as part of arbitration proceedings, and in making decisions on undertakings or access codes, the ACCC is required to consider the pricing principles set out in the CCA. The NCC and the designated Minister are required to consider the same pricing principles (set out in the CPA) when making certification recommendations and decisions.

The pricing principles relating to the price of access to infrastructure services are:

- (a) that regulated access prices should:
 - (i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
 - (ii) include a return on investment commensurate with the regulatory and commercial risks involved; and
- (b) that the access price structures should:
 - (i) allow multi-part pricing and price discrimination when it aids efficiency; and
 - (ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and
- (c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity. (s. 44ZZCA)

2.3 Part IV of the CCA

Part IIIA operates in conjunction with other parts of the CCA. In particular, section 46 in Part IV (restrictive trade practices) deals with anticompetitive behaviour on the part of corporations with substantial market power. Section 46 is broader in scope than Part IIIA and applies to services that do not meet the declaration criteria and to services that are not within the Part IIIA definition of a service. (As noted, this Part IIIA definition specifically excludes the supply of goods and the use of a production process.)

Importantly, section 44ZZNA of the CCA states that Part IIIA does not affect the operation of Part IV (or Part VII, which deals with authorisations, notifications and clearances in respect of restrictive trade practices). Consequently, both parts may operate at the same time and remedies under both are possible.

In order to prove a breach of section 46, it must be established that the conduct of a corporation with a substantial degree of market power has taken advantage of that market power for the proscribed purpose of:

- eliminating or substantially damaging a competitor in that market, or in any other market
- preventing the entry of a person into that market or into any other market, or
- deterring or preventing a person from engaging in competitive conduct in that market, or any other market.

Although there have been various cases involving breaches of section 46, there has been limited experience in applying section 46 to disputes over third party access to infrastructure services. One relevant case involved electricity transmission in the Northern Territory (box 2.10).

Box 2.10 NT Power v Power and Water Authority

In 2004, Northern Territory Power Generation (NT Power) sought access to existing electricity transmission infrastructure owned by the Power and Water Authority (PAWA) — a body corporate subject to directions by the Northern Territory Minister for Essential Services. PAWA generated and purchased electricity and then on-sold it in retail markets.

NT Power successfully sued PAWA, and wholly owned subsidiary Gasgo, under section 46 of the CCA for refusing to allow NT Power to access PAWA's transmission and distribution infrastructure to sell electricity. The High Court held that 'PAWA's denial of access to its infrastructure to NT Power, for no reason of want of capacity or technical difficulty or safety, but simply in order to protect its revenue position in relation to electricity sales, was conduct designed to secure PAWA's position as part of its carrying on of a business' and that this contravened section 46 (para. 72).

The High Court found that PAWA had market power in the markets concerned with transmission and distribution and in the supply and sale of electricity. Much of this power was derived from PAWA's ownership of infrastructure, which created substantial barriers to entry. The High Court also found that 'PAWA's decision to refuse access to infrastructure had the purpose of excluding NT Power from the market, and that purpose could not have been achieved by its refusal of access to infrastructure had it not been for PAWA's market power' (para. 150).

Source: NT Power Generation Pty Ltd v Power and Water Authority [2004] HCA 48.

There is divergence in views on whether section 46 could be used as a stand-alone mechanism to address concerns about access to infrastructure services. Some of these views were outlined in the Commission's previous review of the Regime (PC 2001a). At that time, the Commission concluded that there were doubts about the efficacy of section 46 and noted the Hilmer Committee's concerns about the applicability of section 46 to infrastructure access issues. Further consideration of whether anticompetitive conduct provisions could be used as stand-alone mechanisms to address infrastructure access issues is contained in chapter 3.

3 Why do we need access regulation?

Key points

- Access regulation can address an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required for third parties to compete effectively in dependent markets. This is the only economic problem access regulation should address.
 - Infrastructure typically involves substantial investment and there can be impediments to entry, so there may be only one provider in a market.
 - Where an infrastructure service provider is not constrained from using its market power, denial of access or monopoly pricing can lead to allocative inefficiencies that impose costs on the community. Access regulation can address these allocative inefficiencies, and facilitate lower prices for consumers.
- The benefits of access regulation are more likely to outweigh the costs where there is a monopoly provider of infrastructure services.
 - Competition between service providers will generally be preferable to access regulation in markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service).
 - However, a monopoly position in a market is not sufficient to warrant access regulation. There is unlikely to be a sustained problem if there are close substitutes, or the monopoly power is not enduring.
- Access regulation should cover vertically integrated and vertically separated service providers, as both can affect competition in dependent markets where they have the ability and incentive to engage in monopoly pricing of access.
- Related issues raised by participants that are important but do not constitute part of the problem that access regulation should address include increasing commodity exports and environmental effects from duplicating infrastructure. Access regulation should also not be used to avoid the duplication of infrastructure per se.
- Government intervention can be costly — in particular where it adversely affects investment incentives — and is only warranted when it generates net benefits to the community. Access regulation should be applied sparingly.
 - There are costs associated with errors in regulating access prices, for example when prices are set too low as this could lead to delayed investment or the non-provision of some infrastructure services.
 - Mandating third party access imposes costs on infrastructure service providers, including from coordinating multiple users of their facilities.

3.1 The economic problem

As set out in chapter 1, government intervention can improve community wellbeing where there is a market failure (box 3.1). In the context of appropriately applying access regulation, the economic problem must relate to a failure in markets for infrastructure services.

There was widespread agreement from participants that the market failure the National Access Regime (the Regime) should address is a *lack of effective competition* that arises due to natural monopoly in infrastructure services. (Effective competition requires that firms should be subject to a reasonable degree of competitive constraint from actual or potential competitors, or from customers, as opposed to a theoretical — and unattainable — ideal of perfect competition.) Where access is required for third parties to compete effectively in dependent markets, a lack of effective competition can impose costs on the community where this allows service providers to restrict output and maintain prices above allocatively efficient levels (the components of economic efficiency are defined in box 3.4).

Box 3.1 Sources of market failure

Externalities arise when the actions of an individual or firm create a benefit or a cost for others who are not a party to the transaction and these effects are not reflected in market prices.

Public goods arise where consumption of a good is non-rivalrous (consumption by one party does not affect the amount available to others) and non-excludable (people cannot be prevented from consuming the good). Producers and consumers cannot capture the full benefits of provision and payments for provision cannot be enforced. Consequently, public goods are likely to be under-provided by the private sector.

Inadequate information about a transaction can occur where there are institutional or cost barriers preventing parties obtaining relevant information about the characteristics of a transaction (most notably risks) and/or each other. In such cases, market participants may adopt simplified decision rules based on a reduced set of information.

Information asymmetry arises where one party knows more about key aspects of a transaction than the other. One possible consequence is ‘adverse selection’ — a bias toward entering into lower quality or higher risk transactions. Another potential problem is ‘moral hazard’, which occurs when a party exploits an information advantage and this affects the probability or magnitude of a payment from another party.

Lack of effective competition may arise in the presence of market characteristics such as natural monopoly or when the market has a small number of firms that are able to restrict output and maintain prices above efficient levels. A small number of participants in the market alone is not evidence of the exercise of market power. The threat of new entrants may discourage the use of market power, as may any countervailing power held by customers.

Sources: PC (2012a); *Application by Chime Communications Pty Ltd (No 2)* [2009] ACompT 2.

Several inquiry participants cited the Hilmer Committee's description of the economic problem, while others presented their own views on where access regulation should apply (box 3.2). The Commission's approach in this chapter is to consider the circumstances under which there might be an enduring lack of effective competition and to identify the potential efficiency consequences.

Box 3.2 Views on where access regulation should apply

Some facilities that exhibit these [natural monopoly] characteristics occupy strategic positions in an industry, and are thus 'essential facilities' in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets ... Where the owner of the 'essential facility' is vertically-integrated with potentially competitive activities in upstream or downstream markets ... the potential to charge monopoly prices may be combined with an incentive to inhibit competitors' access to the facility. (Hilmer Committee 1993, pp. 240–1)

The National Access Regime should seek to improve efficiency by facilitating competition in markets where access to significant natural monopoly infrastructure is required. (Asciano, sub. 15, p. 18)

Third party access regulation is likely to be appropriate in industries with natural monopoly characteristics where an infrastructure facility forms a bottleneck for firms operating in upstream or downstream markets ... Economic regulation of natural monopolies aims to achieve the productive efficiency benefits of a single infrastructure operator while preventing the allocative and dynamic efficiency losses that would result from the monopolist's use of its market position ... access regulation is intended to promote competition in markets that need access to bottleneck infrastructure. (ACCC, sub. 16, p. 5)

Some services are provided by facilities that have natural monopoly characteristics, where developing alternative facilities would be wasteful, and for which access is essential for competition in dependent markets. (NCC, sub. 9, p. 12)

Regulatory intervention into private property rights, if imposed at all, should only be imposed where there is a significant failure in an identifiable (not hypothetical or imaginary) market. Where market forces can resolve issues of access, regulatory intervention is not appropriate. ... Regulation should be imposed only where there is clear market failure, not because of an unjustified assumption that markets will fail because of irrational behaviour. (Rio Tinto Iron Ore, sub. 8, pp. 3, 9)

Causes of a lack of effective competition

Natural monopoly was the source of a lack of effective competition most commonly cited by participants. The existence of a natural monopoly is determined by the relationship between output and average cost (box 3.3). Large, usually sunk, fixed costs and economies of scale typically associated with natural monopoly can serve as impediments to prospective competitors entering infrastructure service markets (Schmalensee 1987).

Box 3.3 What is a natural monopoly?

A natural monopoly is a market that can be served at a lower cost by having one producer rather than two or more (Gans, Hanks and Williams 2001). (Technically, a test for natural monopoly requires global — that is, across all possible output quantities — subadditivity of costs (Baumol 1977).) There was some debate in the Australian Competition Tribunal's 2010 decision on the Pilbara rail case¹ as to whether 'lower cost' should give regard only to production costs incurred by the firm (consistent with definitions by Joskow (2007) and Panzar (1989)) or also to broader social costs accruing outside the firm (Baumol 1977; Sharkey 1982). The Tribunal found that, on balance, economists have typically tested for natural monopoly by only taking into account production costs and excluding broader social costs.

The definition of a natural monopoly is closely linked to the shape of the average cost curve and to the quantity of output. Natural monopolies typically involve significant fixed costs and relatively small marginal costs, so that average cost declines with output. Declining average cost (economies of scale) can mean one provider can meet total market demand at a lower average cost than when more than one provider is in the market. However, a market can be a natural monopoly even in the presence of increasing average costs, as costs might still be higher when the market is split between two providers. Where a firm produces more than one type of good or service, economies of scope can also be important.

As a facility becomes congested and approaches capacity constraints, this can lead to rapid increases in the incremental cost of producing another unit. At still higher levels of output, congestion costs for a single provider can increase to the point where it becomes more efficient to have two or more providers and a natural monopoly might evolve into a competitive market — for example, as a single bridge across a river becomes more congested, satisfying demand might require two or more bridges (Gans, King and Mankiw 2001). There are also reported cases where natural monopoly characteristics are consistent with two infrastructure service providers (electricity distributors) operating in the same market (chapter 5).

There are several other possible sources of a lack of effective competition (associated with market power) including government legislation, patents and copyrights, network externalities and exclusive control over a strategic site or key resources (Frank and Bernanke 2009). Strategic behaviour — such as creating barriers to entry or predatory behaviour — can also be used to stifle competition.

Access regulation is not the most efficient means to address market power due to government legislation, patents and copyrights or strategic behaviour — in all of these cases there are more direct means to address the problem. Network externalities may strengthen the case for access regulation but do not, of

¹ *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2.

themselves, represent a primary rationale for access regulation. As set out by the Australian Competition and Consumer Commission (ACCC):

... denial of access for interconnection [to maintain market power associated with network externalities] seems more likely to occur on a sustained basis where a network has enduring market power (either from natural monopoly characteristics or from substantial first mover advantages gained from a previous natural, or government-imposed monopoly position). (sub. 16, p. 87)

Monopoly power due to a unique strategic site could reflect the constraints of the natural landscape. For example, there might be only one suitable site for a bridge or a port facility (Waud and Hocking 1992). Reflecting this possibility, Xstrata Coal (now Glencore) suggested that third party access to single-user integrated facilities should only be required where ‘there is absolutely no practical alternative’ (sub. 19, p. 4). Under these circumstances, market power comes from the lack of other suitable sites, rather than the shape of the underlying average cost curve (as is more typically the case for natural monopoly). Unique strategic sites could still be natural monopolies, however, as it might be more costly (even prohibitively costly) to develop another facility. Where unique strategic sites lead to a natural monopoly, access regulation could be appropriate.

It is only in circumstances where market power is expected to be enduring — that is, persisting over an extended period of time — that government action might be warranted.

Constraints on the use of monopoly power

Even where an infrastructure service provider has a monopoly position, there might be constraints on its capacity to restrict output and maintain prices above efficient levels. As noted by the Minerals Council of Australia (sub. DR74), market failure alone is not sufficient to justify government intervention. Key constraints on the use of monopoly power include:

- *substitutes* — for example, where the owner of a rail line holds a monopoly along that line, the existence of a road that can provide an equivalent or similar service would act as a constraint on the capacity of the rail owner to use its market power. The Australian Rail Track Corporation (ARTC) argues that ‘competitive forces in the markets from which it [the ARTC] derives a significant portion of its revenue on the interstate rail network do not permit it to conduct its business with market power’ (sub. 20, p. 8). Alternatively, there might be other substitute final goods or services that do not require use of the infrastructure facility. For example, substitute fuel and energy sources can replace natural gas in many applications, constraining the exercise of market power by gas transmission pipeline owners (King and Maddock 1996; PC 2004)

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- *countervailing power* — where a limited number of access seekers are able to set their own bargaining power against that of the monopolist. For example, countervailing power can act as an effective constraint on the market power of airports that rely on a small number of airlines to provide the majority of their business, such as Adelaide airport (PC 2011b)
 - *the threat of entry* — under the theory of ‘contestable markets’, where new firms face no disadvantage relative to existing firms, there are no sunk costs and entry can occur more quickly than the incumbent is able to change its prices, a monopolist will operate as if it was in a competitive market (Baumol 1982). However, sunk costs and economies of scale associated with natural monopoly can act as an impediment to prospective competitors entering markets for infrastructure services.

In sum: under what circumstances might access regulation be warranted?

A market failure occurs when there is an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services. In these circumstances, access regulation might be warranted where the infrastructure service provider’s market power is not constrained by the existence of substitutes, countervailing power or the threat of entry. Policy tools other than access regulation are more suited to addressing sources of market power other than natural monopoly.

What effect does a lack of effective competition have on efficiency?

An enduring lack of effective competition in markets for infrastructure services can affect each of the three components of economic efficiency (box 3.4). The Commission’s focus on efficiency reflects the potential for efficiency improvements to increase the wellbeing of the community by improving the use of scarce resources — an activity is economically efficient if there is no other use of the resources that would yield a higher net benefit to the community. Tradeoffs between economic efficiency and other objectives are considered in section 3.3.

Box 3.4 **Components of economic efficiency**

The general concept of overall economic efficiency encompasses allocative, productive and dynamic efficiency.

Allocative efficiency requires that available resources be used to produce the goods and services that consumers value most. For any given good or service, allocative efficiency is achieved where price (marginal benefit) is equal to marginal cost (including social costs that accrue outside the firm). If third party access to infrastructure services increases competition in upstream or downstream markets, prices and output in those markets should tend toward their allocatively efficient levels. For natural monopoly markets where a firm is operating under declining average cost, pricing at marginal cost is likely to be unsustainable or would require government subsidies, as discussed in the text.

Productive efficiency requires that goods and services be produced at the lowest possible cost. In some cases the measure of cost will need to be defined to include broader social costs. For a natural monopoly market, it will be less costly for one firm to serve demand than two or more firms.

Dynamic efficiency requires the optimal allocation of resources over time as technology, the availability of inputs and consumer preferences change. Investments — including those directed at innovation, research and development to create improved products and more cost-effective ways of producing goods and services — should be made when their total expected benefits exceed their full economic costs. In an infrastructure context, investments in infrastructure facilities (including investments to upgrade, maintain and expand current infrastructure) as well as in new downstream and upstream facilities are relevant.

Sources: PC (2008c, 2011a, 2013d).

Effects on allocative efficiency

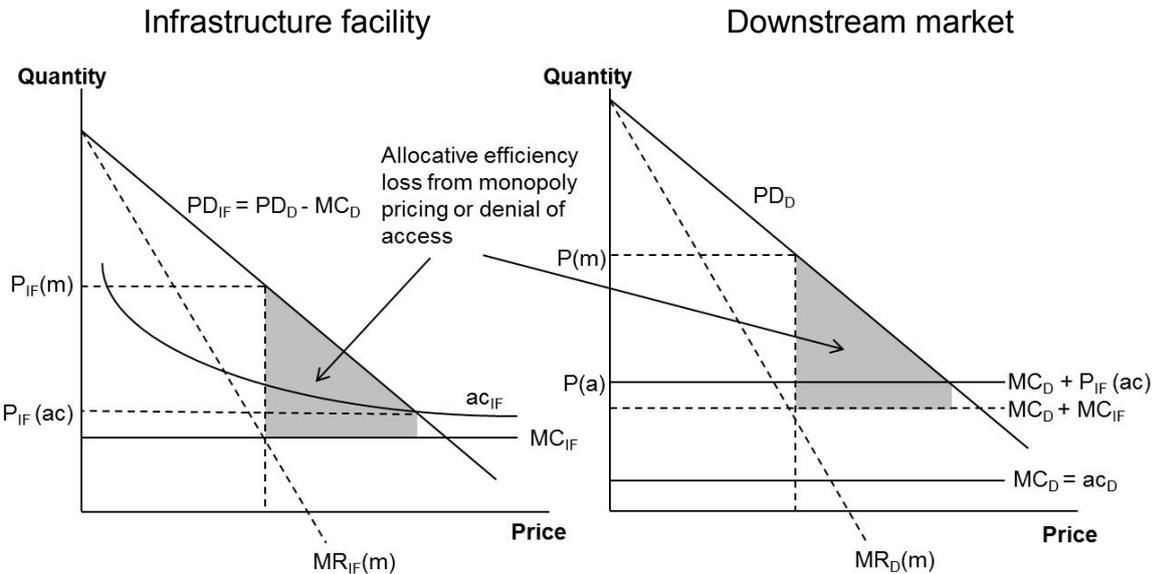
The allocative efficiency costs of a lack of effective competition can be compared with a benchmark where the service provider charges a price equal to its average cost of supply. Large sunk costs and relatively small marginal costs of supply mean that an infrastructure service provider can be operating at a point where its average cost declines with increasing output. In these circumstances, the lowest price the service provider could sustain in the longer term is average cost, where it just breaks even. This provides a reasonable conceptual benchmark for evaluating the effects of monopoly provision of infrastructure services on allocative efficiency.

Using an average cost benchmark leaves some allocative efficiency gains on the table relative to a perfectly competitive market, where price is equal to the marginal cost of supply (Hirshleifer and Glazer 1992). However, a service provider operating under declining average cost and pricing at marginal cost would not cover its costs,

because its average cost would be higher than its marginal cost. In the longer term, this would be unsustainable or would require government subsidies, which would itself entail efficiency losses associated with raising government revenue through taxation (Joskow 2007).

The static analysis in figure 3.1 shows that a monopoly infrastructure service provider can reduce allocative efficiency through either denial of access or monopoly pricing. Relative to a benchmark of average cost pricing, allocative efficiency costs are imposed whether the monopolist chooses to charge a monopoly price for access ($P_{IF}(m)$) or to deny access and foreclose the downstream market, using its monopoly power in that market to charge a price of $P(m)$.

Figure 3.1 Static analysis of access denial and monopoly pricing^a
Implications for allocative efficiency



MC_{IF} , MC_D = marginal cost for infrastructure facility and downstream producers respectively
 $MR_{IF}(m)$, $MR_D(m)$ = marginal revenue for infrastructure facility and a monopolist in the downstream market
 $P_{IF}(m)$, $P(m)$ = monopolist price for infrastructure facility and downstream market (vertically integrated supplier)
 ac_{IF} , ac_D = average cost for infrastructure facility and downstream producer
 $P_{IF}(ac)$, $P(a)$ = regulated price for access at average cost and competitive price in downstream market where access price is set to average cost for infrastructure facility
 PD_{IF} , PD_D = inverse demand function for infrastructure services and downstream market

^a Pricing strategies are based on the monopolist maximising its profits by equating marginal cost with marginal revenue, under assumptions that: any market(s) upstream are competitive or supplied by the infrastructure service provider; a fixed quantity of services from the infrastructure facility must be used for each unit of output in the downstream market (allowing demand for access to be derived as by Viscusi, Harrington and Vernon (2005)); there is a single service provider at the infrastructure facility level but potential for multiple firms to compete in the downstream market; and there are constant marginal costs of production in both markets, with significant fixed costs in the infrastructure facility and no fixed costs in downstream production.

The key result of reduced allocative efficiency under denial of access or monopoly pricing also holds where a monopolist has an upward sloping average cost curve, for example where the facility is approaching capacity constraints. As a facility reaches capacity, the marginal cost of supplying additional services is likely to increase. This can lead to marginal costs that exceed average costs, and average costs that increase with output over the relevant production range. As a consequence, an infrastructure service provider is likely to have a greater incentive to deny access or charge monopoly prices and reduce output, in order to reduce its average costs. Although the average cost benchmark is likely to be higher for a facility with little surplus capacity, reduced allocative efficiency can still be expected because the service provider will still have an incentive to set prices in excess of its marginal cost of supply.

Under either denial of access or monopoly pricing there are forgone transactions where willingness to pay in the downstream market exceeds the incremental costs of additional supply across the whole production chain. This results in costs to the community from an inefficient allocation of resources associated with ‘monopoly rents’. Monopoly rents are payments to those with a stake in the monopoly business (beyond that required for an investment to proceed) funded by higher prices for consumers that lead to inefficient under-consumption of infrastructure services (PC 2010, 2013a). By reducing output, monopoly pricing of access has the potential to affect competition in downstream markets. However, there can still be allocative efficiency costs from monopoly pricing even where this has no effect on competition in a downstream market, because less of the infrastructure service is produced.

Real world settings are more complex and there is a need to consider the potential dynamic effects of monopoly provision of infrastructure services (discussed later in this chapter) or returns above average cost that might be required by the service provider to justify risky investments. There might also be potential for the infrastructure service provider to use two-part pricing and/or price discrimination to set more efficient prices, but still extract rents equal to or greater than those under denial of access or monopoly pricing. (Two-part pricing is a combination of a fixed charge and a quantity-based charge, which offers greater pricing flexibility than a single quantity-based charge.) In practice, however, information limitations and administrative costs can limit the degree of price discrimination that is possible.

Effects on productive efficiency

Monopoly providers of infrastructure services will, in general, have an incentive to minimise their costs in order to maximise profits. In some circumstances, however, a monopolist might not seek to minimise costs due to a lack of competitive pressures,

resulting in ‘x-inefficiency’ (Leibenstein 1966; PC 2011a). Access to infrastructure services can potentially address x-inefficiency in dependent markets by increasing competition in those markets and allowing for more ready comparison of performance across different firms (Allan Fels, sub. 40). However, there is less scope for regulated access to address any x-inefficiencies in the provision of infrastructure services themselves, as access would not generate any increase in competition in that market. In fact, where access regulation also involves regulated access prices, some forms of price regulation — in particular, cost-based pricing — can introduce productive inefficiencies (Averch and Johnson 1962).

Of more relevance to productive efficiency, a potential competitor might be prompted to build another facility where the incumbent leverages its monopoly power to deny access or charge monopoly prices for access. The ACCC (sub. 16) and the National Competition Council (NCC, sub. 9) both highlighted the risk of ‘wasteful duplication’ of natural monopoly infrastructure where access regulation is not applied. Wasteful duplication is taken to refer to productive inefficiency that arises from duplication where it would be less costly — including social costs that are incurred outside the firms involved — to satisfy demand with one facility than with two or more. A regularly cited example is the construction of parallel hybrid-fibre cable networks by Telstra and Optus in the 1990s (King 2011).

However, the efficiency consequences from duplication are not likely to be as severe as those from denial of access or monopoly pricing. Where duplication leads to the creation of an effective substitute service, this provides a market-driven solution to monopoly power through facilities-based competition and addresses the allocative inefficiency problems outlined above. Under these circumstances, the arguments set out above against regulation under an existing duopoly or oligopoly market structure will hold. There can be additional gains where the entrant is more efficient than the incumbent (for example, due to technological advances after the initial facility was built) or where productivity is improved through innovation fostered by the competitive process and the replacement of inefficient firms by more efficient firms (‘creative destruction’ (Schumpeter 1942)).

In addition, under some circumstances the incentives of market participants can prevent natural monopoly facilities from being duplicated anyway (box 3.5).

Productive inefficiencies can and do occur regularly — even in competitive markets — and are not a sufficient rationale for government intervention. As Hazlett has pointed out, ‘competition inevitably involves duplication costs’ (1986, p. 1352). For example, two hardware shops in close proximity to one another will both incur costs in fitting out the stores as well as advertising and marketing efforts (that is, there will be some duplication of effort). Infrastructure typically involves substantial

investment, but the magnitude of costs involved in duplication is not a compelling rationale for government intervention as it is not a market failure.

While, all else equal, the community will be better off with higher productive efficiency, the Commission considers that discouraging duplication of natural monopoly infrastructure is not, of itself, a rationale for regulated third party access to infrastructure services.

Box 3.5 Natural monopolies and contestable markets

As part of the Pilbara rail proceedings, economists Professor Kalt and Professor Willig — on behalf of Rio Tinto Iron Ore — argued that if a market is contestable (that is, if the potential for entrants to enter the market leads to competitive outcomes (Baumol, Panzar and Willig 1988)), the incentives of private parties will prevent natural monopoly facilities from being duplicated. That is, if sharing a facility would be cheaper than building a new facility, the self-interest of the incumbent would lead it to provide access and earn returns from doing so. When it is cheaper to construct an alternative facility the incumbent cannot offer a price to the potential entrant that would entice it to not build a new facility.

Consider a simplified example where the cost of building a new facility is \$150 and the cost to a vertically integrated incumbent of allowing an entrant to use its facility is \$100. If variable costs are the same under duplication and access, this is sufficient to conclude that the facility is a natural monopoly. The incumbent could offer the entrant access for \$149, earning a profit of \$49.

However, the incumbent (if not a price taker) will have lower profits in the dependent market due to the entry of a competitor. Notably, the amount of profit the incumbent expects to lose under duplication might differ from the expected amount under access. If the incumbent's expected losses in the dependent market under access exceed its access revenue, it will not provide access and the facility could be duplicated if it is profitable to do so. If the incumbent's expected losses in the dependent market under duplication are equal to or greater than its expected losses under access, the incumbent would provide access and regulation would not be required to avoid the duplication of a natural monopoly. Professor Kalt argued that in most instances the loss in profits in the dependent market is likely to be greater under duplication than under access.

In its determination, the Tribunal argued that contestability theory does not apply to markets for infrastructure services, because of the sunk costs incurred when investing in infrastructure. The Tribunal concluded that 'the markets with which Part IIIA is concerned are as far removed from being "contestable" as may be' (para. 1065). The Tribunal also suggested that an incumbent might be worse off by providing access given that it otherwise might have only faced a competing facility with limited capacity, and a facility-based competitor would have to endure long lead times on its investment.

Sources: Kalt (2005); Willig (2009).

Effects on dynamic efficiency

The potential to earn monopoly rents through an infrastructure facility might mean that the timing of infrastructure investments is suboptimal from a societal viewpoint. In this regard, the following potential effects are worth noting.

- Where the provision of new infrastructure services is contestable (more than one firm could make the necessary investment) and is expected to earn the investor a future stream of monopoly rents, competition between potential providers could see investment take place as soon as the project is expected to be profitable. This might lead to investment occurring too early from the community's perspective. That is, while investing in an infrastructure project may provide a positive present value of private benefits, investing in the same project in the future may provide greater private and social benefits (TransGrid 2003). This may occur if an investor commits to a project earlier than is efficient in order to ensure that a competitor does not beat them in establishing a monopoly position.
- Conversely, an incumbent infrastructure service provider with enduring market power might have an incentive to delay or limit investments in new service capacity, or in maintaining and upgrading existing services (ACCC, sub. 16), in order to benefit from congestion through higher access prices. Such investments might occur beyond the point in time at which they are socially desirable.
 - Similarly, a monopolist that does not face the threat of competitive entry in a market for infrastructure services may have lower incentives to seek out new ways to improve its product and service quality, and to be innovative in general (Shepherd 1998).

Investment in markets that rely on access to an infrastructure facility could be lower due to any enduring market power held by the incumbent service provider. For instance, if an incumbent infrastructure service provider does not allow third party access, the amount of innovation and the range of services available to end users could be lower than otherwise. Moreover, even if a service provider does provide access to third parties, efficiency enhancing investments in dependent markets could still be delayed, or not made at all. This is because of the risk for third parties that, in the absence of contracts that prevent increases in the price of access, the service provider might raise its access prices to extract some of the value of the investment once an investment that depends on an incumbent facility is sunk (the 'hold-up' problem) (Goldberg 1976).

While these dynamic inefficiencies may arise in the absence of regulation, there can also be potentially substantial negative investment effects from access regulation (section 3.4).

Should access regulation apply to duopolies and oligopolies?

In markets for infrastructure services, problems from a lack of effective competition are most likely to arise where services are provided by monopolists. Where a limited number of alternative service providers provide substitute services (such as under a duopoly or oligopoly market structure), there might still be scope for some competition. That is, service providers might still have some market power, but this power will be muted by the existence of direct competitors that are able to provide the same or a similar service. Under these circumstances, ‘if there are two potential providers of the essential input, then the need for intrusive regulation through declaration is significantly diminished’ (King 2000, p. 71). Accordingly, in recommending the establishment of a regime for access to essential facilities, the Hilmer Committee stressed that ‘an “essential facility” is, by definition, a monopoly’ (1993, p. 239).

In markets where there are few competitors, it will generally be preferable to rely on market outcomes than to apply regulation. As set out by Viscusi, Harrington and Vernon:

That a market has only a few firms is not a sufficient condition for regulation to be welfare-improving, inasmuch as competition may nevertheless be strong because firms are innately competitive or because potential competition forces them to be so. Regulation in such markets is likely to reduce welfare. (2005, p. 563)

Infrastructure facilities typically involve large sunk costs and relatively small marginal costs of supply. These cost structures imply that competition between a limited number of firms that provide substitute services is likely to be stronger than in some other markets that do not involve large sunk costs. Competitors in the provision of infrastructure services will have an incentive to serve as many customers as possible and lower their average costs.

On the other hand, competitors are unlikely to be able to compete successfully where they are unable to provide an effective substitute service. In these circumstances, the infrastructure service provider can still have monopoly power even where there is notionally another competitor, and there might be a role for access regulation. For example, as part of its assessment of Virgin Blue’s application for declaration of services at Sydney Airport, the NCC (2003) concluded that Bankstown Airport could not provide the same service. The Tribunal contrasted the situation at Sydney Airport with the potential for Avalon Airport to compete with Melbourne Airport by offering a similar service. The Tribunal noted

that ‘where an airport, such as Melbourne Airport, is operating in a competitive market, the environment for negotiating terms is enhanced’.²

Ownership structure of the service provider — vertical integration

Incentives to deny access to some or all access seekers will be heightened where infrastructure service providers are vertically integrated — that is, where service providers also operate in markets upstream or downstream of the facility. Under these circumstances, denial of access can be used to protect a monopoly position in an upstream or downstream market, in particular where that allows the service provider to increase total profits across its operations.

Where a service provider is not competing in upstream or downstream markets, it will usually have little incentive to deny access. Rather, it will have a commercial incentive to allow competition in dependent markets to maximise its own profits (Hilmer Committee 1993). APA Group (sub. DR60) and the Australian Airports Association (sub. 3) suggested that there is no need for regulatory intervention where service providers are not vertically integrated. Some inquiry participants have advocated more stringent access regulation for vertically integrated firms than for those that are vertically separated (ARTC, sub. 20; Asciano, sub. 15).

There are sound reasons for the Regime to apply to both vertically integrated and separated service providers. In some cases, vertically separated service providers will still have an ability and incentive to charge monopoly prices for access to their infrastructure. As noted above, monopoly pricing of access can lead to allocative inefficiency, and restrict competition and investment in dependent markets. For example, under the National Gas Law, owners of covered gas pipelines are required not to carry on a related business (producing, purchasing or selling natural or processable gas). In cases where the pipeline owner is not constrained from exercising its market power, vertically separated gas pipeline owners can still have an ability and incentive to charge monopoly prices and restrict output to increase their profits (box 3.6). In other cases, the capacity of gas pipeline owners to charge monopoly prices will be constrained by the existence of substitutes or countervailing market power (Australian Pipeline Industry Association, sub. DR52).

Constraining the Regime to only vertically integrated service providers could also raise significant problems with legal interpretation and incentives for service providers to change structure to avoid coverage (PC 2001b).

² *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5, at para. 392.

Box 3.6 The potential use of market power: an example

Natural gas transmission pipelines may exhibit significant economies of scale in their construction and operation and, in some circumstances, adding compressors can be a lower cost way to increase their capacity than duplicating the pipeline. As such, it can be efficient for a single pipeline to transport gas from a production facility to an industrial or urban centre.

Access regulation may be warranted where the provider of pipeline services has an ability and incentive to charge monopoly prices or deny access to a pipeline in order to generate monopoly rents. This may occur where the provider of pipeline services is not constrained from exercising its market power by:

- the availability of substitute facilities — for example, where there are no other pipelines taking gas from the production facility or delivering gas to the final market
- the availability of substitute goods — for example, where there are no other fuel and energy sources that are suitable substitutes for natural gas
- users with countervailing market power — for example, if users are small and do not have the capacity to build their own pipeline
- the threat of entry — for example, where sunk costs and economies of scale act as an impediment to a competitor building another pipeline.

Conversely, access regulation is unlikely to be warranted where the market power of a provider of a pipeline service is constrained by these factors.

By contrast, the Minerals Council of Australia and Xstrata Coal suggested that there should be a *higher* threshold for regulating vertically integrated service providers that are privately owned or funded.

The application of Part IIIA to privately-owned, vertically-integrated facilities needs to be more clearly defined, including via a mechanism to exempt such facilities from the operation of the statute. (Minerals Council of Australia, sub. 26, p. 6)

An existing privately funded integrated (ie single owner – single user) infrastructure chain should not (or an element of it should not) be subjected to declaration unless: it is impractical for a third party potential user to duplicate all or the relevant part of the chain; or the economic benefit of granting access outweighs the economic detriment. (Xstrata Coal, sub. 19, p. 12)

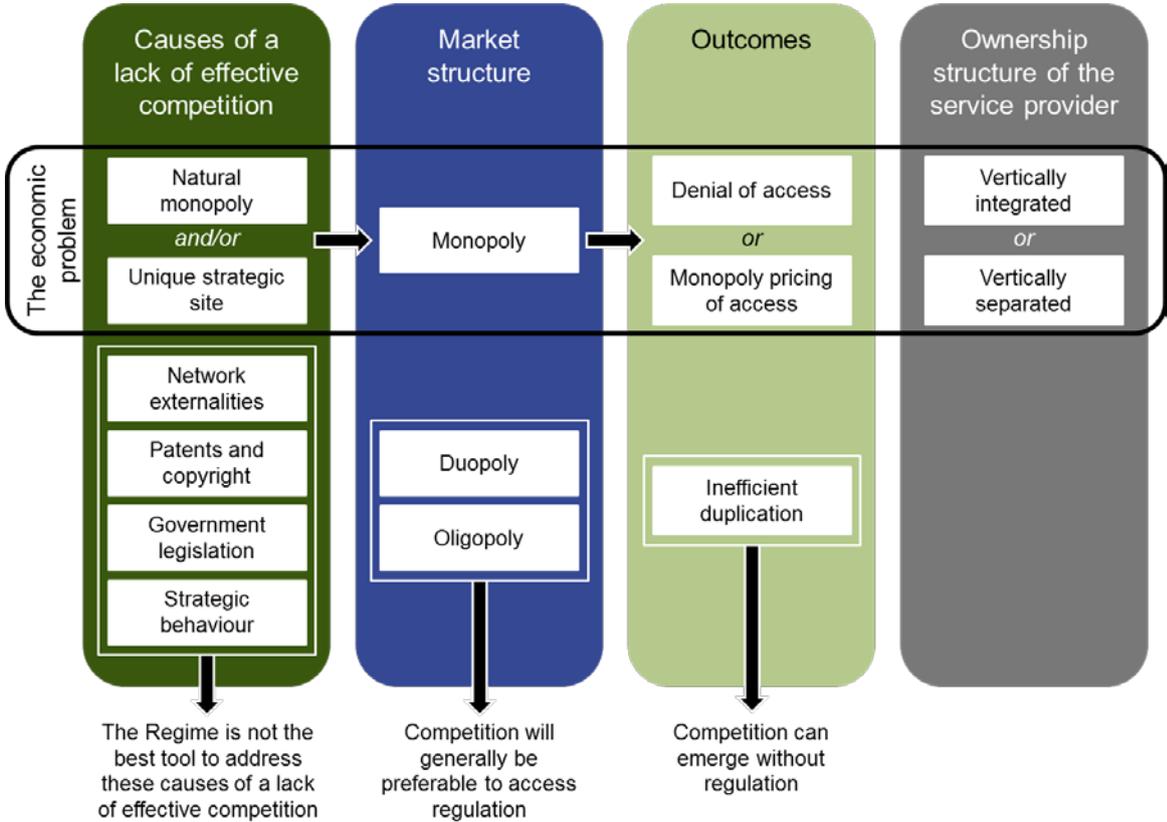
The Commission considers that it would be inappropriate to exclude an infrastructure facility from access regulation solely because it has been privately funded (or is privately owned) and is vertically integrated. For example, an electricity distribution network that is vertically integrated into the retail market might have an incentive to raise prices or deny access to increase returns, irrespective of whether or not it has been privately funded. The Regime's backstop role across a broad range of industries means that it needs to remain generic enough to cover a range of different circumstances.

Assessment of the economic problem

In sum, the Regime should only address market failure from an enduring lack of effective competition where there is monopoly provision of infrastructure services due to natural monopoly. Competition between service providers will generally be preferable to access regulation in markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service).

A lack of effective competition is likely to constitute an economic problem where access is required for third parties to compete effectively in dependent markets, and an infrastructure service provider denies access altogether or (for both vertically integrated and separated service providers) restricts output in order to charge monopoly prices (figure 3.2). As a consequence, transactions that would enhance community wellbeing may not proceed. The Commission considers that the purpose of access regulation is to facilitate improvements in allocative efficiency, rather than to improve productive efficiency through avoiding wasteful duplication.

Figure 3.2 Where the Regime should apply



Some related issues that are not part of the economic problem

Inquiry participants highlighted some issues related to accessing infrastructure services that, in the Commission's view, are not problems that the Regime should address. These are, however, important matters in their own right and in some instances may require separate policy attention.

Addressing external effects of duplicating infrastructure

A specific concern about duplication of infrastructure raised by participants relates to aesthetic and environmental effects from construction of multiple and overlapping infrastructure. For example, there have been proposals to build multiple rail lines to transport coal from the Galilee Basin in Queensland (box 3.7).

Box 3.7 Galilee Basin rail

The Galilee Basin in central Queensland is the location of a number of coal projects currently under development. Exploration for coal seam gas and shale gas has also been conducted in the area. Prior to 2012, there were at least six rail projects proposed to service the Galilee Basin and the nearby Bowen Basin, mostly travelling to the port of Abbot Point. The Queensland Deputy Premier described the rail projects as:

... a twisted mess of lines on a map, a lot of money wasted and no real progress towards an acceptable outcome for the proponents, for the local communities, for landholders or for the environment. (Seeney 2012a, p. 555)

In 2012, the Queensland Government stated that it would be looking to reduce the number of rail corridors servicing the Galilee Basin to two — one running east–west connecting with Aurizon's existing network, and another running north–south to the port at Abbot Point. The Deputy Premier indicated that the Government would be 'very unlikely to exercise [its] powers of compulsory land acquisition to establish railways outside these defined corridors' (Seeney 2012a, p. 555). The Government has indicated that the new lines will have open access and that there will be an opportunity for providers to develop their own lines within the defined corridors (Seeney 2012c).

Following the Queensland Government announcement, two companies that had proposed rail along the east–west corridor, QR National (now Aurizon) and Adani, agreed to jointly evaluate an integrated rail project (Seeney 2012b). Along the north-south corridor, GVK Hancock has signed a non-binding agreement with Aurizon to jointly develop and manage Galilee Basin rail and port infrastructure, under which Aurizon would exclusively provide rail haulage from GVK Hancock's mines to port (Aurizon and GVK Hancock 2013). GVK Hancock has also signed a memorandum of understanding with QCoal, which anticipates that QCoal's product will be transported using the infrastructure being developed by GVK Hancock (GVK Hancock 2012).

While these concerns might partly relate to the higher cost of building multiple infrastructure facilities and the implications for productive efficiency, there is an additional issue here with external effects of duplication that are incurred outside the firms involved. In this case, the economic problem is not so much a lack of effective competition, as it is an externality problem (box 3.1).

Although aesthetic and environmental effects from building infrastructure can be an important issue, these effects are better addressed more directly through appropriate planning, zoning and development assessment than through access regulation. The approvals process for major projects is being assessed by the Commission in a concurrent inquiry (PC 2013b).

Planning, zoning and development assessments are not well suited to managing the operation of infrastructure once constructed, or to promoting competition. As noted by the Australian Pipeline Industry Association:

Using other regulatory measures to achieve access can be problematic. Use of planning processes or leasing arrangements would undoubtedly be a ‘force fit’ application of regulatory measures designed for another purpose. (sub. 14, p. 5)

Where planning, zoning and development assessments create an enduring lack of effective competition in markets for infrastructure services, there might be benefits from facility-based access arrangements. This might occur where governments limit development of competing facilities through the planning process or through other government legislation. In these instances, arrangements for access to infrastructure services can be established through facility-based approaches that are a requirement of project or development approvals, a condition of privatisation or a specific provision in legislation or government agreements. However, there remains a need to ensure that facility-based access regulation is the most efficient means to address any competition issues that arise in dependent markets as a result of government planning and approval processes (chapter 8).

Commodity exports

Some participants argued in consultations that access regulation should be used to increase commodity exports and export income, thereby increasing royalties and tax revenues. The Minerals Council of Australia argued against revocation of access regulation of multi-user infrastructure services on the basis that this would allow monopoly pricing that would ‘lead to inefficient allocation of resources and reduction of national export income’ (sub. 26, p. 6).

Where Australian exporters have no ability to affect world prices, private incentives to maximise profits will generally be aligned with the efficient use of export infrastructure (box 3.8). As noted by the Exports and Infrastructure Taskforce, ‘Australia’s export chains are strongly exposed to world market disciplines, and hence have strong incentives to be, and remain, efficient’ (2005, p. 39). Operators of commodity export facilities have an incentive to operate efficiently because they do not have any capacity to affect downstream prices where Australian suppliers are price takers in bulk commodity export markets. While Australia is a major exporter of commodities such as iron ore, black coal, wheat and wool, the international prices for these commodities are determined in world markets (Hughes et al. 2011; Kay, Blewett and Huston 2012). As noted in a Reserve Bank of Australia research paper, ‘a common, and reasonable, assumption is that a small economy such as Australia takes world prices, and so its terms of trade, as given’ (Gillitzer and Kearns 2005, p. 4). Thus, fluctuations in Australian exports would be unlikely to affect world prices in the medium to long term.³

Due to its inability to affect prices in commodity markets in the medium to long term, the operator of a commodity export facility will have little or no incentive to withhold supply from global commodity markets. There will be a deadweight loss if the operator of a rail line used to transport ore for export charges a standard price per unit of throughput (the shaded triangle EFI in figure 3.3, which is associated with a transfer of rents to the rail operator equal to the shaded rectangle BCGH). However, this deadweight loss represents gains available to the parties through negotiation and/or use of two-part pricing. As a result, operators of commodity export facilities will, in general, have an incentive to try to negotiate access on satisfactory terms where the benefits (accruing to the access seeker) outweigh the total costs imposed on the operator. Consequently, leaving access to commodity export facilities to market forces is unlikely to have negative effects on royalties or tax revenues.

³ For some commodities, large fluctuations in the level of Australian exports (such as through natural disasters) could lead to significant short-term price movements. For example, participants have raised the potential for large producers in Australia to affect global iron ore prices in the short term by delaying expansions. However, such fluctuations would be unlikely to have a significant effect on global prices in the longer term. This is because other commodity exporters may respond to higher prices by increasing their own supply, or major importers may turn to domestic production. Both of these responses would offset any effect on prices from a change in the volume of Australian exports.

Box 3.8 Access regulation for price takers: a stylised example

The following example is used to illustrate a situation in which access regulation is not warranted. It assumes an iron ore miner owns a vertically integrated rail line used solely to transport ore, which is sold in export markets where Australia is a price taker.

What are the incentives for the incumbent in downstream markets?

The incumbent infrastructure service provider should have an incentive to negotiate access where the benefits to the access seeker (and hence its willingness to pay) outweigh the total costs imposed on the incumbent from allowing access (including coordination costs from having multiple parties use its rail line). As both the service provider and access seeker are price takers, a new entrant does not affect the incumbent service provider's revenues from ore sales, and the incumbent service provider has nothing to gain from excluding other firms from ore markets. On the contrary, it could gain from selling foreseeably unused rail capacity.

In the absence of negotiated access, what might appear to be spare capacity in the incumbent's infrastructure may reflect an efficient margin for operational flexibility or expected growth. In this stylised example, a failure to reach agreement on access terms (where there is no commodity market pricing power to defend) would strongly suggest that if duplication were to occur, this would be more efficient than regulating access.

Where small mines do not justify a new rail line and those mines, if developed, would be at risk of stranding, the incumbent should have an incentive to negotiate terms that cover its costs of providing access. The access seeker should be willing to pay the price where a mineral deposit is sufficiently profitable to warrant displacing output from the incumbent's own mines, or using any spare capacity.

What about upstream markets?

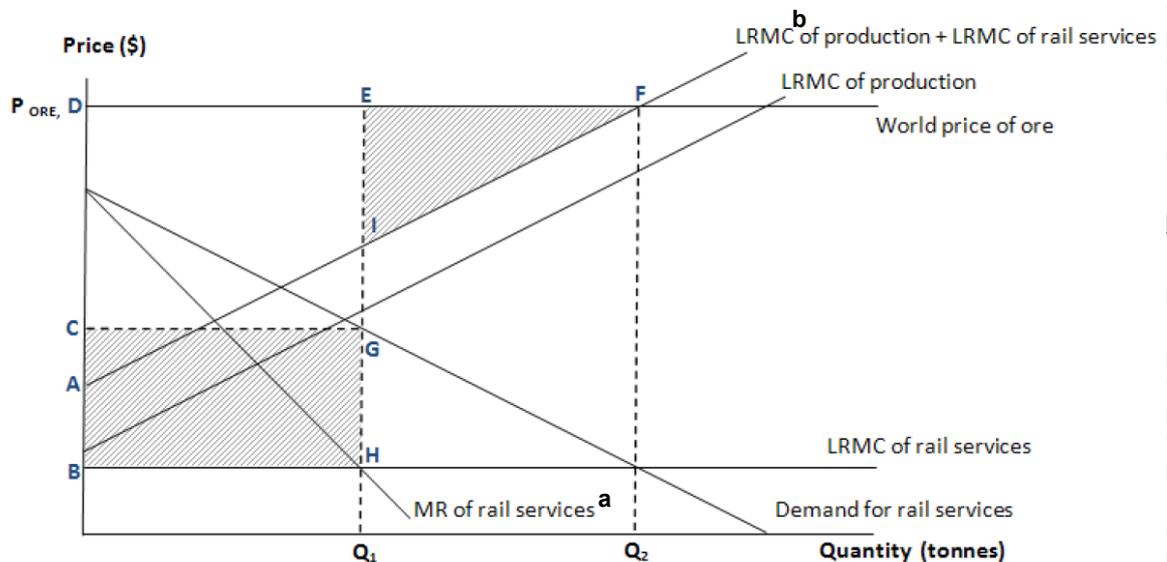
Another concern could be that the incumbent infrastructure service provider will attempt to leverage its position to distort outcomes in upstream markets, for example, to prevent other parties from developing mines that could be served by the rail line or to purchase the new mines at very low prices. However, development of additional mines has the prospect of increasing the profits that the incumbent service provider might earn from its rail line. Where another party can develop a mine more efficiently, this might mean that there are greater profits available to the incumbent by charging for access than if it were to purchase and develop the mine itself.

What if there is an imbalance in bargaining power?

The incumbent infrastructure service provider should have an incentive not to obstruct a more efficient miner from developing a nearby mine, irrespective of the relative size and bargaining power of the two parties. The incumbent should always have the incentive to maximise its returns from the new mine, but stopping the mine or denying access to the incumbent's unused capacity would be against its own interests.

Before investments are made in a new mine, transport to a port would normally be addressed through contracts that provide certainty about terms and conditions of access to rail lines. If new mine investments are sunk in the absence of rail access contracts, the incumbent infrastructure service provider might be able to expropriate economic rents by charging for access. However, this is a transfer of rents between the mine owner and incumbent, rather than behaviour that affects economic efficiency.

Figure 3.3 Static analysis of rail services used for exports



^a MR: Marginal revenue. ^b LRMCM: Long-run marginal cost.

Source: ACCC (sub. 16).

In these circumstances, the exercise of market power may lead to a transfer of economic rents between parties in the supply chain, without any allocative efficiency effects in dependent markets. Economic rents are payments in excess of normal profits and hence do not affect the willingness of existing producers to supply: a producer that has established a position in a market will supply any units where its returns cover its opportunity costs of supply, and will supply these units irrespective of whether or not there are additional returns from economic rents. Gilbert + Tobin and Glencore expressed concerns with failing to regulate where there are economic rents.

Monopoly pricing, or rent shifting, is likely to have a material effect on the returns of the downstream users of the infrastructure. Reducing the returns of users in the supply chain will lead to less investment, less entry and less expansion over time. (Gilbert + Tobin, sub. DR70, p. 7)

If the Commission accepts that regulation is intended to address the market failure that arises from the lack of effective competition so as to avoid circumstances where transactions that would enhance community wellbeing may not otherwise proceed, it is difficult to understand how economic rent seeking can be supported or dismissed. (Glencore, sub. DR64, p. 4)

In this context, it is important to distinguish between monopoly rents and economic rents more generally. The existence of economic rents does not, of itself, justify government intervention. Economic rents do not affect supply decisions of existing suppliers and thus will only have an effect on efficiency where there are monopoly

rents (as set out above, monopoly rents arise where higher prices for consumers lead to inefficient under-consumption of infrastructure services).

An example where an infrastructure service provider will have an incentive to set prices above allocatively efficient levels and earn monopoly rents is access to electricity networks. In electricity markets, restricting supply and increasing prices will lead to inefficient under-consumption, as consumer demand responds to higher prices. Consequently, an enduring lack of effective competition in the supply of electricity network infrastructure services is likely to lead to allocative inefficiency and costs to the community (as depicted in figure 3.1). As discussed in box 3.8, this can be contrasted with the situation facing operators of commodity export facilities, which have an incentive for efficient use of their facilities where they cannot affect prices in commodity markets.

Access regulation as a means to address economic hold-up

Some commodity export facilities could be subject to economic hold-up — where a service provider raises its access prices to extract some of the value of an investment that depends on access to an incumbent facility. The ACCC has argued that this will have ‘negative implications for allocative and dynamic efficiency, productivity and export earnings’ (sub. 16, p. 77) and that, in the context of mining, ‘if the entire rent ... is taken from a prospector, then you’re going to be inhibiting investment in those prospecting activities upstream in the future’ (trans., p. 98).

However, where there is economic hold-up between a service provider and access seekers, there is potential for the problem to be addressed through non-regulatory solutions (PC 2013a). Long-term contracts between service providers and access seekers can be negotiated prior to the latter making substantial investments, thereby facilitating investment in dependent markets. Alternatively, if there are potentially substantial gains from access that cannot be achieved through negotiations between different parties, the service provider might be willing to buy out the access seeker — bringing to market previously untapped economies of scale and scope.

For example, following an unsuccessful application in August 1998 by Robe River Iron Associates to gain access to Rio Tinto Iron Ore’s Hamersley rail track, Rio Tinto became a majority joint venture participant in Robe River Iron Associates. Robe River and Hamersley rail lines are now operated as a single integrated network by Rio Tinto Iron Ore’s rail division (Rio Tinto Iron Ore 2013). Similarly, BC Iron obtained access to Fortescue’s rail line in the Pilbara region of Western Australia through a joint venture (Brockman Mining Australia, sub. DR67), preventing stranding of BC Iron’s deposit. Alternatively, an access seeker might see benefits from being vertically integrated and build its own facility.

Incentives of service providers to allow access to commodity export facilities

Where it is a price taker in world markets, an infrastructure service provider that reduces throughput will be cutting its own revenue relative to that available through negotiating with users. Instead, where natural monopoly infrastructure is operating under economies of scale, the service provider will have an incentive to increase throughput by providing third party access, thereby sharing its fixed costs and reducing its average costs. As such, the service provider will have a strong incentive to provide access to any capacity that will be unused for the foreseeable future, provided the access price recovers the full costs of use by the third party.

The Commission, in its inquiry into wheat export marketing arrangements, noted the benefits to bulk wheat terminal operators from maximising throughput at port terminals, because the global wheat market is highly competitive and many terminals have spare capacity (PC 2010). Aurizon made a similar point with regard to access to its rail lines.

Aurizon have a strong commercial incentive to increase utilisation of sunk assets through negotiating commercial access arrangements to maximise throughput. To put it very bluntly, we make more money with greater output, greater throughput, so we want to facilitate greater throughput. (trans., p. 146)

Intervention to require access where the infrastructure service provider has no ability to affect prices in downstream markets risks lowering efficiency and, in the long term, adversely affecting incentives to invest in markets for infrastructure services. Access regulation would need to lead to more efficient outcomes than would be achieved through negotiation between the parties, which seems unlikely when neither party has an incentive to see profitable projects left undeveloped and the regulator would be operating with less information than the commercial parties.

Despite incentives to provide access to foreseeably unused capacity, there may be other reasons why an infrastructure service provider might deny access to another market participant in a real world market situation: the desire for unfettered control over all parts of the production process, distortions in input markets, errors in commercial judgment, a monopoly business culture that does not give effective consideration to new information or innovation, or even poor relationships between market participants. However, these reasons do not relate to the economic problem that access regulation should address, and thus taken alone they are not sufficient to justify using the Regime.

There might also be distributional consequences from the division of profit between providers of export infrastructure and customers. The appropriateness of using access regulation to address distributional concerns is considered in section 3.3.

3.2 What policy tools could address the economic problem?

In many instances, private negotiations over access will lead to efficient outcomes and obviate the need for government intervention (as acknowledged in paragraph 2.2 of the Competition and Infrastructure Reform Agreement). In other instances, access regulation is only one of several policy instruments available to address an enduring lack of effective competition in markets for infrastructure services.

Access regulation

As discussed above, there may be benefits from access regulation where infrastructure service providers have enduring market power and an ability and incentive to deny access or restrict output and charge monopoly prices. Under these circumstances, access regulation can address allocative inefficiencies from monopoly pricing or denial of access and facilitate lower prices for consumers. Access regulation can also have implications for innovation and its diffusion across the economy (box 3.9).

Some form of price regulation (or threat of price regulation) is an important component of access regulation. Specification of minimum service quality standards may also be required (ACCC, sub. 16). Otherwise, the service provider could stifle competition and extract rents by charging a monopoly price for access, or by cutting costs through service degradation.

There are a number of different ways in which access regulation can be implemented. For example, access regimes might be legislated on an industry-specific or economy-wide basis, or via legislation or government agreements applicable to specific facilities (chapter 8).

Another way in which access regulation can be implemented is via a competitive tender process. Where terms and conditions of access can be included in a long-term contract, a competitive tender for the construction and operation of an infrastructure facility can be used to set access conditions. The terms and conditions of access need to be a key condition of selecting a preferred tenderer so that, once chosen as the sole provider of a service, the provider is unable to use its monopoly position to refuse access or charge monopoly prices. Under circumstances where the challenges of designing a competitive tender process that sets out terms and conditions of access can be overcome, this can be an effective way to establish access conditions (chapter 8).

The potential costs associated with access regulation are described in section 3.4.

Box 3.9 Access regulation and innovation

Innovation and its diffusion are fundamental to productivity and economic growth. There are multiple ways in which access regulation can affect innovation.

Competition can be important in providing an incentive for firms to innovate. While there is not a simple linear relationship between competition and innovation, empirical support is mounting for the hypothesis that in markets where there is relatively little competition, increasing competition is correlated with greater innovation (OECD 2010b).

Where access promotes competition in dependent markets, this has potential to deliver long-term benefits through the competitive stimulus for innovation and cost reduction (Areeda, Kaplow and Edlin 2005). For instance, the Commission has previously highlighted the explosion of product offerings in the telecommunications market as an example where new entrants to a market have stimulated innovation (PC 2001a).

On the other hand, where access regulation discourages effective facilities-based competition, innovation might be stifled in the delivery of the regulated service itself (Hazlett 1986; Owen 1985). Similarly, access regulation might diminish incentives to innovate in facility design (PC 2004).

Timely provision of efficient economic infrastructure investment also plays a key role in supporting innovation activity (PC 2008a). The effects of access regulation on incentives to invest in infrastructure facilities, discussed below, will therefore have important implications for innovation.

The overall effects of access regulation on the rate of innovation will depend on how regulation is applied. For example, access prices that are set too low have the potential to impede innovation due to reduced profit incentives (Hilmer Committee 1993). Aurizon has argued that provisions in the ARTC's undertaking that regulate the size of carriages used in the Hunter Valley network stifle innovation, by preventing any product differentiation in the above rail market (sub. DR72).

Anticompetitive conduct legislation

As described in chapter 2, Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) (which sets out the architecture of the Regime) operates in conjunction with section 46 of the CCA, which deals with anticompetitive behaviour by corporations with substantial market power.

Section 46 has been used to address some of the issues that arise as a consequence of a lack of effective competition in infrastructure services. Pengilley (2007) has argued that the NT Power case (described in box 2.10) makes it clear that section 46 applies to denial of access and that jurisprudence regarding section 46 has developed through the Melway, Boral and Rural Press cases between 2001 and 2003.

However, there are limitations to the capacity of section 46 alone to adequately address all instances of monopoly power in infrastructure facilities. In particular, access would only be available where an access seeker was able to prove that it had been denied access, or access on reasonable terms, because of a proscribed purpose. Some behaviour associated with monopoly power and identified as a problem in the first half of this chapter — in particular, monopoly pricing — would not constitute any of the proscribed purposes in section 46 (as set out in chapter 2). Also, even where a breach can be established, courts could have difficulty in determining appropriate terms and conditions of access (especially pricing).

The ACCC (sub. 16) and the NCC (sub. 9) highlighted the issues with using section 46 to address access to infrastructure. Gilbert + Tobin (sub. 45) suggested that there may be cases involving existing infrastructure that would be better served through amendments to section 46, such as giving courts a power to direct that pricing be arbitrated by the ACCC. This would address the courts' difficulty in determining appropriate terms and conditions of access, but not the challenges in establishing that denial of access was for a proscribed purpose.

As the ACCC and NCC submissions indicate, the NT Power and other section 46 cases do not invalidate the Hilmer Committee's (1993) and Productivity Commission's (2001a) concerns about more general applicability of section 46 to markets for infrastructure services. The Commission remains of the view that the application of section 46 has a limited capacity to resolve access disputes. Nor would it be appropriate to amend section 46 to better address issues of access to infrastructure, as this would risk creating uncertainty and deterring efficient competitive behaviour across a much broader range of corporations and economic transactions.

Structural separation

Structural separation can address the heightened incentives for a vertically integrated service provider to deny access. Structural separation of government-owned businesses was the preferred approach put forward by the Hilmer Committee to address monopoly provision of infrastructure services and was a key focus of the National Competition Policy reform package. For example, a key reform underpinning the creation of the National Electricity Market was the separation of potentially contestable generation and retail activities from the ownership of network infrastructure.

Structural separation can offer benefits through promoting competition in contestable elements of the production chain and targeting regulation to monopoly

infrastructure assets. Through introducing competition, structural separation can stimulate innovation and efficiency in competitive markets and help to eliminate cross subsidisation (OECD 2006). It has been argued that structural separation of Telstra would have led to a more competitive telecommunications industry in Australia (Sims 2013b). Similarly, if structural separation of QR National's (now Aurizon) rail track and rail haulage operations had occurred, this might have made the ensuing regulatory task simpler (Parmenter 2013).

However, structural separation can also trigger a number of costs. These include losses in economies of scope, coordination costs associated with incomplete contracts (section 3.3), and one-off adjustment costs from separation. Investment incentives might also be negatively affected by separation (OECD 2012; PC 2006b). The potential investment effects of separation need to be set against any incentives for vertically integrated service providers to delay investment to create scarcity.

Accounting separation or 'ring fencing' is a weaker form of separation that requires vertically integrated service providers to maintain separate accounts for their regulated (infrastructure facility) and unregulated arms. This is designed to reduce the incentives and opportunities to deny access and/or shift costs to the regulated part of the business (PC 2010).

Structural or accounting separation — where justified by a comparison of costs and benefits — may be a complement to, rather than a complete substitute for, access regulation. Structural separation cannot address all cases where monopoly provision of infrastructure services will be a problem. In particular, structural separation will not address allocative efficiency issues associated with monopoly pricing of access, as a structurally separated infrastructure service provider will still have an incentive to maximise its profits by reducing access in order to raise access prices above the allocatively efficient level.

Public ownership

Governments have traditionally played a significant role in the construction, ownership and operation of key infrastructure assets. Public ownership can occur through construction and service provision by a government-owned corporation (such as construction of the enlarged Cotter Dam in the Australian Capital Territory by ACTEW Corporation and construction of new rail track assets in the Hunter Valley by the ARTC), or nationalisation of assets that were held privately.

Public ownership does not of itself solve problems of monopoly pricing and denial of access. While in the past many government-owned infrastructure assets ran at a

loss in order to meet social as well as economic goals, managers of some publicly owned infrastructure may still face incentives to maximise profit by raising prices and restricting output. Public ownership therefore does not obviate the need for access regulation where an infrastructure service provider is likely to have a sustained monopoly position.

Price regulation

In the absence of a requirement to provide access, regulation of pricing alone is only likely to increase incentives to deny access if monopoly rents could be earned through a related entity (Brennan 2008). That is, although regulation of access prices would prevent the service provider from earning monopoly rents in the market for the infrastructure service, it would have an incentive to deny access so that the monopoly rents could be seized by a related or vertically integrated entity upstream or downstream (Hilmer Committee 1993, p. 241).

However, where there are some constraints on market power, price surveillance can be less intrusive than access regulation, yet discourage monopoly pricing by providing a threat of government intervention or sanctions. For example, the Commission has found that price and quality monitoring of airports is ‘fundamental to providing the information base necessary to establish whether there is a prima facie case of misuse of market power’ (PC 2011b, p. 214) and has previously recommended that the Regime leave open ‘the option of using price monitoring and other light handed approaches for regulating major infrastructure provision’ (PC 2006a, p. XXIX). Michael Cunningham (sub.18) suggested that price surveillance might also be relevant following revocation of an access declaration.

Another alternative to access regulation is price regulation of final product prices (Ergas 2009b; Allan Fels, sub. 40). However, such an approach would reduce the scope for market-based prices to emerge in contestable parts of the production chain upstream and downstream from monopoly infrastructure — for example in electricity generation and retail.

The Commission’s assessment

Guidelines for best practice regulation stipulate that each feasible option to address a policy problem should be assessed based on the costs and benefits of intervention (Australian Government 2010). The preferred option should be the best of all options available, including the ‘do nothing’ option — the overall benefits need to outweigh costs to justify government intervention (chapter 7).

Many of the policy options considered above have limited capacity to address the problem of an enduring lack of effective competition in markets for infrastructure services. Anticompetitive conduct legislation, public ownership and price regulation of final product prices are unlikely to be efficient means for addressing this problem. Prices surveillance and structural separation can be used instead of access regulation in specific circumstances, but are not suitable replacements in all instances.

3.3 The Regime’s economic efficiency objective

The preceding discussion suggests that access regulation may be needed to address an enduring lack of effective competition in markets for infrastructure services. An appropriate objective for the Regime is important to provide the greatest likelihood that the benefits of intervention will outweigh the costs.

The objects clause for Part IIIA — inserted into the legislation in 2006 — establishes the promotion of economic efficiency for the purposes of improving competition, and a consistent approach to access regulation across industries, as twin objectives for the Regime (chapter 2). Objects clauses are also included in most other Australian access regimes. While some regimes have adopted a similar objects clause to Part IIIA, others differ in various ways.

The Commission considers that the focus on economic efficiency in the Part IIIA objects clause is appropriate. There was widespread agreement on this matter from participants, with a number arguing, either explicitly or implicitly, that the promotion of economic efficiency should remain the primary focus of the Regime (ACCC, sub. 16; APA Group, subs. 35 and DR60; Asciano, sub. 15; Australian Pipeline Industry Association, sub. 14; Business Council of Australia, sub. 36; Brisbane Airport Corporation, sub. 27; GDF SUEZ Australian Energy, sub. 13; Jemena, sub. 6; Peabody Energy, sub. 30; Queensland Treasury and Trade, sub. 42; Xstrata Coal, sub. 19).

Other rationales, such as the redistribution of income, are sometimes advanced for regulating monopoly infrastructure. For example, Glencore argued that: ‘Fundamentally there’s an equity issue here. Why should one party be able to extract profit from another simply because that other party has no other choice?’ (trans., p. 128).

The Commission considers that supplementing the economic efficiency objective with other aims, such as income redistribution, would not be appropriate. A number of participants shared this view (ACCC, sub. 16; APA Group, sub. 35; Asciano,

sub. 15; Australian Pipeline Industry Association, sub. 14; Jemena, sub. 6). In particular, the regulatory uncertainty that may arise from altering the objects clause would be unlikely to provide much corresponding benefit. Besides, a sole focus on improving economic efficiency would not necessarily preclude the achievement of distributional goals (ACCC, sub. 16; Banks 2012a).

3.4 Potential economic effects of access regulation

As set out above, where there is an enduring lack of effective competition associated with an infrastructure service, there may be grounds for governments to intervene to address the economic problem. However, government intervention can be costly, and is only warranted when it produces net benefits to the community. In this context, an understanding of the full economic effect of regulation is important.

Effects on investment

Access regulation can have both positive and negative effects on incentives to invest in infrastructure facilities and in dependent markets. As noted in section 3.1, access regulation could potentially address some of the adverse effects on investment that arise from a lack of effective competition by encouraging better-timed investments in infrastructure services, and facilitating third party investments in dependent markets. The ACCC observed that many of the potential negative effects on investment from mandating third party access are difficult to avoid, and can apply to both infrastructure service providers and access seekers.

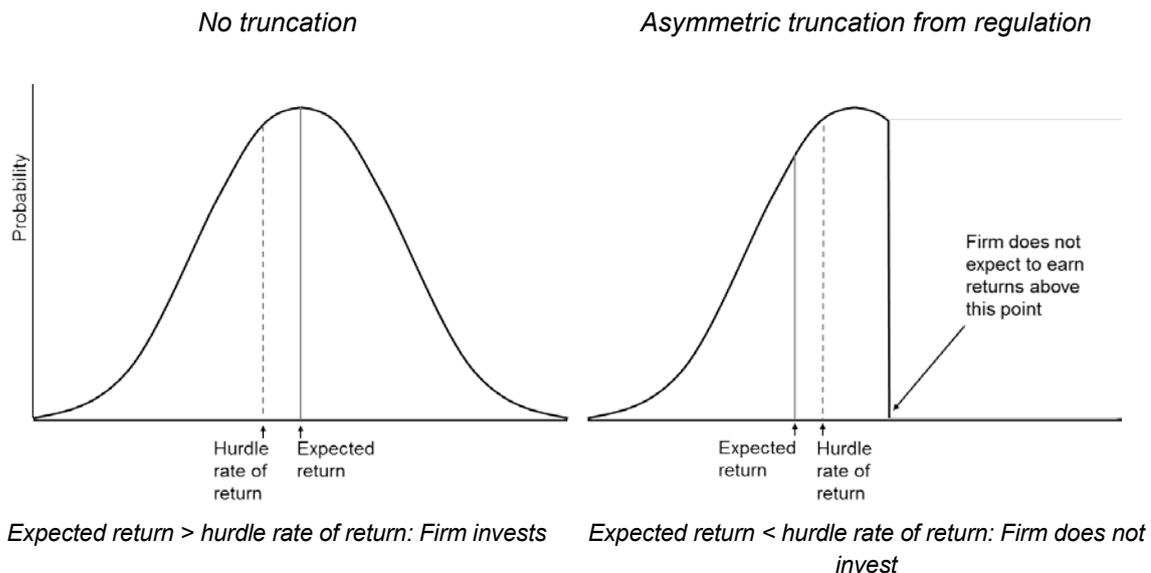
Due to information constraints and limitations on the regulator's ability to foresee all potential consequences of regulatory decisions, it is not possible to design access regulation that avoids creating any distortions to infrastructure investment incentives. In regulating infrastructure access, some balancing will be needed of the impacts of regulatory measures on the efficiency of investment, both by the infrastructure operator and by access seekers, and on the efficiency benefits from facilitating competition in downstream markets by regulating access to the essential input. (sub. 16, p. 47)

Infrastructure service providers

One channel through which investment incentives of infrastructure service providers can be compromised is where regulation is expected to expropriate above-normal returns but not compensate for below-normal returns ('asymmetric truncation') (APA Group, sub. 35; Brisbane Airport Corporation, sub. 27; Hausman 2008; Gilbert + Tobin, sub. DR70; Train 1991). This asymmetry arises due to the likelihood that third parties will only seek access when demand for the

service is high, leaving the infrastructure service provider to bear all of the downside risk associated with its investment (Allan Fels, sub. 40). If the future curtailment of high profits means that a potential investor's expected return is driven lower than the required hurdle rate of return, regulation will inhibit investment (figure 3.4).

Figure 3.4 **Asymmetric truncation^a**



^a Asymmetric truncation arises where the access seeker is subsidised by the infrastructure provider (Hausman 2008). It occurs as depicted above where high economic profits (profits beyond the hurdle rate, which represents the opportunity cost of inputs) are constrained to zero under regulation (PC 2004) and are thus excluded from firms' investment decisions. A dampening of the returns to the right of the distribution (without necessarily constraining economic profits to zero) would also reduce the expected return to the investment and could thus jeopardise investment decisions.

The effect of asymmetric truncation could apply to investments in new infrastructure, as well as investments in upgrading and maintaining current infrastructure (Pindyck 2007).

Any 'regulatory risk' associated with access regulation could also impede efficient investment in infrastructure facilities (Aurizon, sub. DR72; Australian Pipeline Industry Association, subs. 14 and DR52; BHP Billiton, subs. 29 and DR65; Brisbane Airport Corporation, sub. 27; Business Council of Australia, sub. DR69; Allan Fels, sub. 40; Gilbert + Tobin, sub. DR70; Rio Tinto Iron Ore, sub. DR55). As stated by Egert: 'uncertainty about the regulator's actions poses a non-negligible threat to investment in network industries' (2009, p. 9). In particular, uncertainty regarding future access obligations could compound the inherent risk associated with making infrastructure investments. Hence, access regulation could have the further effect of increasing investors' required hurdle rate of return.

In some cases, the above effects may encourage incumbent service providers to underinvest in the capacity of their facilities in order to avoid regulation (APA Group, subs. 35 and DR60; Australian Pipeline Industry Association, sub. 14; ARTC, sub. 20; BHP Billiton, sub. DR65; Allan Fels, sub. 40; Jemena, sub. 6).

In a similar vein, Monkhouse (2007) suggested that while it makes sense for BHP Billiton to invest in latent capacity to provide itself with an option on the upside to its demand forecasts (given long lead times of 3–5 years for capital investments in transporting iron ore), a regulator is likely to class this as ‘spare capacity’ and could mandate access at just the time the business would wish to use it themselves. This would constitute a transfer to the third party of a ‘real option’ over the future use of the infrastructure, and so imposes a cost on the infrastructure service provider. Monkhouse argues this is a significant disincentive to investment.

Access seekers

Access regulation could distort the incentives of third parties to invest in infrastructure facilities of their own. RBB Economics (sub. 31) noted that duplication of natural monopoly infrastructure can be worthwhile to achieve the dynamic benefits that arise from facilities-based competition. In this regard, there are two main costs if access regulation discourages third parties from investing in alternative infrastructure.

- It is less likely that inefficient service providers will be replaced by more efficient service providers through the process of creative destruction. Even the threat of duplication can improve performance in natural monopoly industries (Owen 1985). Consumers benefit when rival facilities compete to become one of the few or only market suppliers (Hazlett 1986).
- Access could ‘lock in’ the infrastructure technology used by the incumbent facility, given there would be reduced incentives for potential entrants to find a more innovative way of providing the service (Briglauer 2013; Michael Cunningham, sub. 18; Hazlett 1986).

Innovation and creative destruction are regarded as important determinants of a nation’s productivity (Banks 2012a). As noted by Allan Fels:

... even the prospect of obtaining access to the monopolist’s facility decreases the access seeker’s incentive to invest in developing its own competing facility, thus perpetuating the monopolist’s control over the facility and reducing the prospect of future competition ... the risk is that even the possibility of seeking access will deter investment and innovation, potentially curtailing socially beneficial head-to-head competition over the longer term. (sub. 40, p. 28)

Allan Fels (sub. 40) went on to argue that where a regulator sets the access price below the economic cost of supplying the service, there could be overinvestment in dependent markets.

Table 3.1 summarises the potential positive and negative effects of access regulation on investment.

Table 3.1 Potential investment effects from mandating access

<i>Agent</i>	<i>Positive effects on efficiency</i>	<i>Negative effects on efficiency</i>
Infrastructure service provider	<ul style="list-style-type: none"> • Reduced incidence of premature investment to capture monopoly rents where more than one firm could potentially build a facility • Less incentive to delay investment to benefit from congestion where a monopoly position has been established 	<ul style="list-style-type: none"> • Diminished incentives to invest in new facilities • Reduced incentives to invest in maintaining, upgrading and extending facilities • Underinvestment to avoid access regulation
Access seekers	<ul style="list-style-type: none"> • Increased investment in a dependent market facilitated by access on reasonable terms and conditions • Diminished incentives to duplicate natural monopoly infrastructure can improve productive efficiency 	<ul style="list-style-type: none"> • Diminished incentives to invest in new facilities can decrease dynamic efficiency in the market for infrastructure services • Overinvestment in dependent markets where access seekers do not face full economic costs

Sources: Biggar (2011); Allan Fels (sub. 40); PC (2004).

Access pricing and regulatory error

Regulated access prices will be either prescribed by the regulator, or negotiation between parties will converge to prices roughly similar to what they would expect the regulator to set (chapter 4). Thus, once the decision to intervene in the market is made, the task of the regulator is to either set, or signal its preference for, access prices that maximise the net benefits from access regulation.

Given that regulators are unable to set optimal access prices (prices that would maximise overall economic efficiency) with precision, there is scope for regulatory error in the setting of access terms and conditions. As Allan Fels acknowledged, ‘setting the appropriate price requires much detailed, difficult to obtain information about industry cost and demand conditions, making some degree of regulatory error inevitable’ (sub. 40, p. 46). Several participants highlighted examples of, or the scope for, errors in the setting of access terms and conditions (APA Group, sub. DR60; Aurizon, sub. DR72; BHP Billiton, sub. DR65; Business Council of Australia, sub. DR69).

Regulatory error can involve prices that are set either too high or too low relative to the optimal level. If the regulator sets prices above the level required for investment to proceed, infrastructure services will be under-consumed relative to their efficient level. Prices that are set too low can lead to delayed investment, or the non-provision of some infrastructure services (PC 2010).

The Commission considers that the consequences for efficiency from setting access prices too low are, all else equal, likely to be worse than setting access prices too high. This is because deterring infrastructure investment (from setting access prices too low) is likely to be more costly than allowing service providers to retain some monopoly rent (from setting access prices too high) (PC 2008b). The Commission noted in its recent review of electricity regulation that regulators should err on the side of allowing higher returns to regulated businesses to allow for this asymmetry (PC 2013a).

There are some arguments that suggest regulators have a tendency to set access prices too low (Hausman 2008; NECG 2001). Given the greater efficiency consequences of setting access prices too low, this bias would increase the expected costs associated with regulatory error.

Coordination costs

Participants highlighted various costs that could be imposed on infrastructure service providers from having to coordinate multiple users of their infrastructure. These costs can arise from an inability to internalise into a contract all potential contingencies and cannot be avoided simply through setting appropriate access prices (Allan Fels, sub. 40; Michael Smart, trans., p. 83).

- *Additional maintenance costs* (ACCC, sub. 16; BHP Billiton, sub. 29; Allan Fels, sub. 40; Rio Tinto Iron Ore, sub. DR55). If additional maintenance costs are easily observable, the incumbent could charge an appropriate fee to recover them. However, if the incumbent cannot easily monitor the manner in which the third party uses its facility, it may be impossible or prohibitively expensive to internalise such costs in a contract. Where this is the case, the third party has less incentive to minimise the costs it imposes on the incumbent through its use of the infrastructure. There are also costs associated with ensuring that an infrastructure facility is compatible with a third party's operations (Gómez-Ibáñez 2010).
- *Reduced operational efficiency and flexibility* (BHP Billiton, sub. 29; Allan Fels, sub. 40; Institute of Public Affairs, sub. 23; Rio Tinto Iron Ore, subs. 8 and DR55). Providing third party access could interfere with an incumbent's

efficient operation of its infrastructure facility. Notably, there could be scheduling costs from increased use of the infrastructure, as well as an associated loss of flexibility in the management of the facility owing to the contractual rights held by a third party. The ACCC provided examples of reduced operational efficiency and flexibility associated with rail infrastructure.

Coordination problems may also arise between different users of the infrastructure: for example, in a rail network with multiple train operators, coordination problems may emerge in relation to the scheduling of train paths. (sub. 16, p. 81)

- *Problems with coordinating investments* that are aimed at improving the operation, or expanding the capacity, of an infrastructure facility (BHP Billiton, sub. 29; Institute of Public Affairs, sub. 23; Rio Tinto Iron Ore, subs. 8 and DR55). In this regard, investments or innovations that are unexploited, delayed, mistimed or otherwise sub-optimal may be relevant.

There are some arguments that suggest the above costs could be substantial. For example, some inquiry participants related the above costs to the transactions costs literature (Coase 1937; Williamson 1989), which suggests that firms will vertically integrate to avoid the costs from contracting with third parties (Allan Fels, sub. 40; Institute of Public Affairs, sub. 23; Michael Smart, subs. 10 and DR56). Also, Gómez-Ibáñez (2010) argued that coordination costs can outweigh the benefits from increased competition achieved through access regulation (box 3.10).

The Commission considers that in some instances an estimate of coordination costs could be pivotal in an assessment of overall costs and benefits from access regulation. The scope for recognising these costs in the criteria for determining whether specific infrastructure facilities should be subject to access regulation is discussed in chapter 5.

Other costs of access regulation

The ACCC (sub. 16) pointed out that a number of administrative and compliance costs from regulation are unavoidable. These include the costs incurred by regulators and businesses when dealing with declaration applications, arbitration proceedings and reviews of regulatory decisions. The costs associated with government intervention in markets, such as compensatory payments, as well as the costs from firms engaging in strategic behaviour, including through lobbying, are also relevant. These costs, as well as the others highlighted above, are explored in further detail in chapter 7.

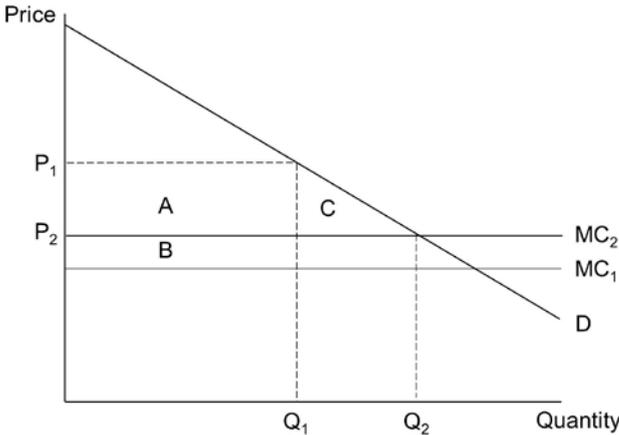
In sum, the costs of intervention highlight the importance of carefully designing access regimes to limit declaration to instances where regulation is likely to

generate net benefits to the community. Access regulation should be applied sparingly, reflecting the Hilmer Committee’s view that notions of private property and freedom of contract should not be disturbed lightly (Hilmer Committee 1993). The following two chapters examine the appropriateness of the Regime’s process and criteria for determining whether specific infrastructure facilities should be subject to access regulation.

Box 3.10 The competition–coordination tradeoff

Gómez-Ibáñez (2010) used a simple model of a market that is dependent on a network infrastructure facility to illustrate the tradeoff between increased coordination costs from sharing a facility and improved competition in a dependent market (between a vertically integrated service provider and third parties given access to the facility). The model abstracts from dynamic effects, and uses a number of assumptions to focus on this tradeoff. Demand in the dependent market is represented in the diagram below as the number of units of traffic over the network (for example, rail shipments) at a given price.

Without third party access the service provider can use its market power to charge consumers in the dependent market a price of P_1 per unit of traffic over the network, which exceeds its marginal cost of supply (MC_1). Producer surplus is equal to areas A and B, less any fixed costs. Under third party access, competition should see the service provider and third parties charge prices that are closer to their marginal cost (including regulated charges that third parties pay the service provider for access). However, the marginal cost of supply increases from MC_1 to MC_2 due to the costs associated with coordinating shared use of the facility.



(Continued next page)

Box 3.10 (continued)

The benefits from lower prices through competition can be outweighed by coordination costs. Assuming that marginal costs in the dependent market are the same for the incumbent and third parties given access to the facility, the new price charged to consumers will approach P_2 . Even if competition drives prices all the way down from P_1 to where $P_2 = MC_2$ (in practice, efficiency benefits from competition would be smaller, as the service provider would need to recover its fixed costs and there would be effects on incentives for infrastructure investment), Gómez-Ibáñez concluded that only a small increase in coordination costs can offset these competitive benefits.

Third party access increases consumer surplus by areas A (consumers pay less for the units of traffic that they would have purchased anyway) and C (they purchase more units at the lower price). Producer surplus decreases by area A (prices fall on traffic units that would have been purchased anyway) and area B (costs increase, associated with coordination of shared use).

Whether third party access increases social surplus depends on whether area C is larger than area B. Relevant to this is the size of the shift in the marginal cost curve and the slope of the demand curve, which will vary across industries. Economic rents in area A are transferred from the service provider to consumers.

Source: Gómez-Ibáñez (2010).

4 The declaration, negotiation and arbitration process

Key points

- Obtaining access to an infrastructure service via the declaration pathway under Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) consists of two parts.
 - *The decision to declare* an infrastructure service establishes an obligation on the provider of the service to negotiate access terms for the service with any party.
 - *The negotiate–arbitrate framework* allows for terms and conditions of access to be negotiated or, if agreement cannot be reached, for terms to be set through arbitration by the Australian Competition and Consumer Commission (ACCC).
- The two-part process should be retained in Part IIIA.
 - Negotiation between the parties is the preferred option for setting access terms, and arbitration adds impetus for the parties to reach agreement.
 - Alternative models, such as upfront regulator-determined access terms, will be more effective in some industry-specific regimes, but are not suitable for the National Access Regime given its generic nature.
- Even where a dispute proceeds to arbitration, it might not result in access to a service under regulated prices and other terms. Among other outcomes:
 - the party that initiated arbitration may withdraw notification of the dispute
 - the access seeker might not enter an access arrangement on the arbitrated terms
 - the ACCC may decide not to compel a service provider to provide access to a declared service.
- The economic rationale for an ACCC power to direct extensions (including capacity expansions) is to prevent service providers deliberately delaying infrastructure investment, or constructing facilities with suboptimal capacity, in order to limit competition and extract monopoly rents.
 - Private negotiation is preferable to regulated extensions. Due to the practical difficulties of directing extensions, it is likely that the benefits of using the extension power would rarely outweigh the costs.
 - It is important that the ACCC’s legislative power to direct extensions also encompasses capacity expansions so that the safeguards set out in the legislation will also apply to directed expansions.
 - The safeguards should not be construed such that a service provider could be required to pay the upfront costs of the directed extension or capacity expansion.

Declaration under Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) provides a pathway for access seekers to obtain access to infrastructure services provided by facilities that are owned by another business. Declaration is the first stage in a two-part process — it involves an assessment of whether to impose an obligation on the provider of an infrastructure service to negotiate with any party seeking access to that service (figure 4.1).

In the second stage of the process, the National Access Regime (the Regime) emphasises negotiation between businesses as the preferred basis for setting access terms. However, where a service provider and an access seeker are unable to agree on access terms, either party can notify the Australian Competition and Consumer Commission (ACCC) of an access dispute, and request a binding determination on the parties through arbitration. Negotiate–arbitrate frameworks of this kind also apply in other access regimes, with features tailored to specific industry requirements and different agencies presiding over arbitration (for example, state and territory economic regulators).

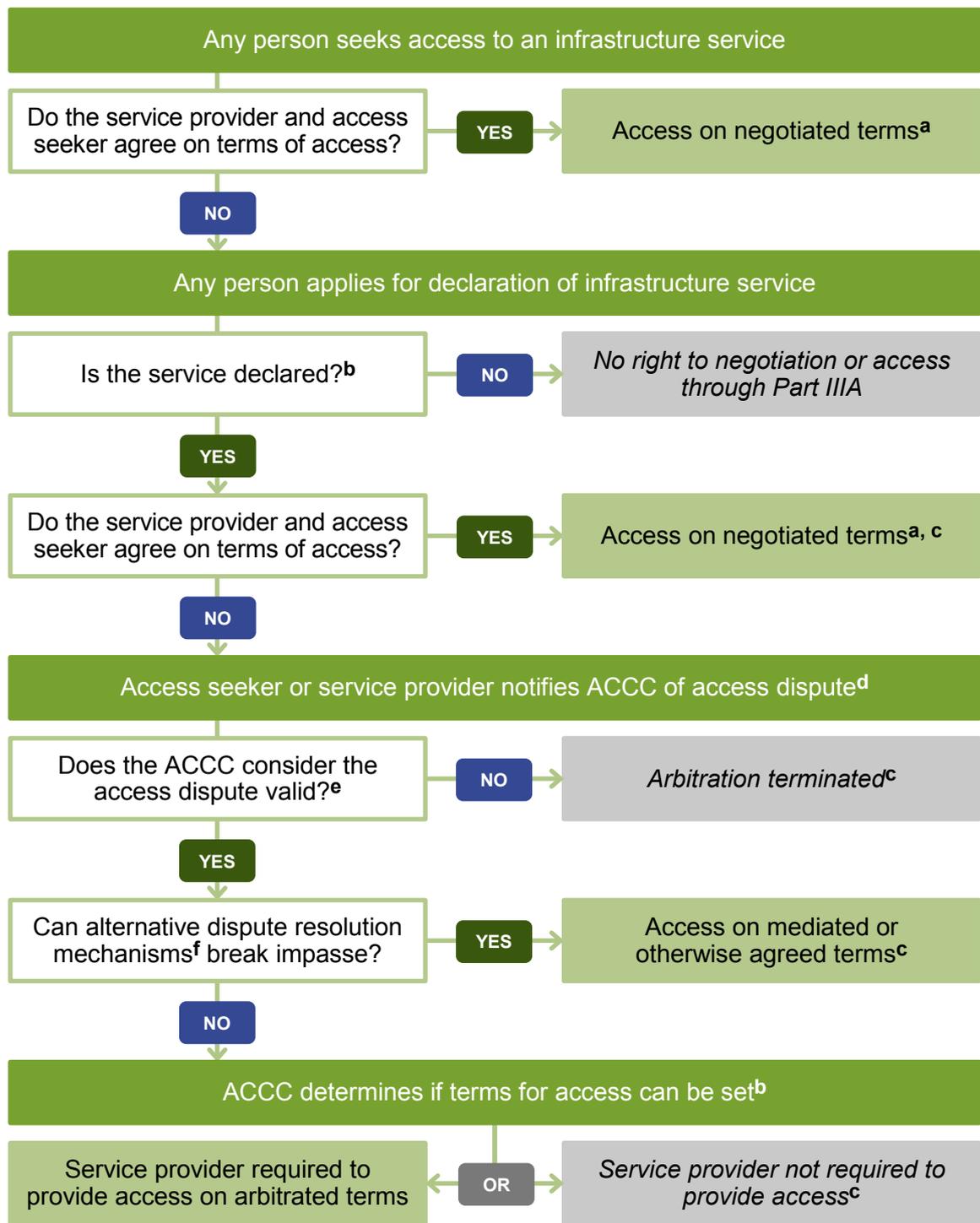
This chapter and the next focus on the declaration pathway. This chapter considers the broad process of declaration, including the negotiate–arbitrate framework under which pricing and other terms for third party access can be set. Chapter 5 examines the conditions and criteria that must be satisfied for an infrastructure service to be declared.

4.1 The decision to declare

As figure 4.2 illustrates, the declaration process comprises multiple steps, associated with different decision makers.

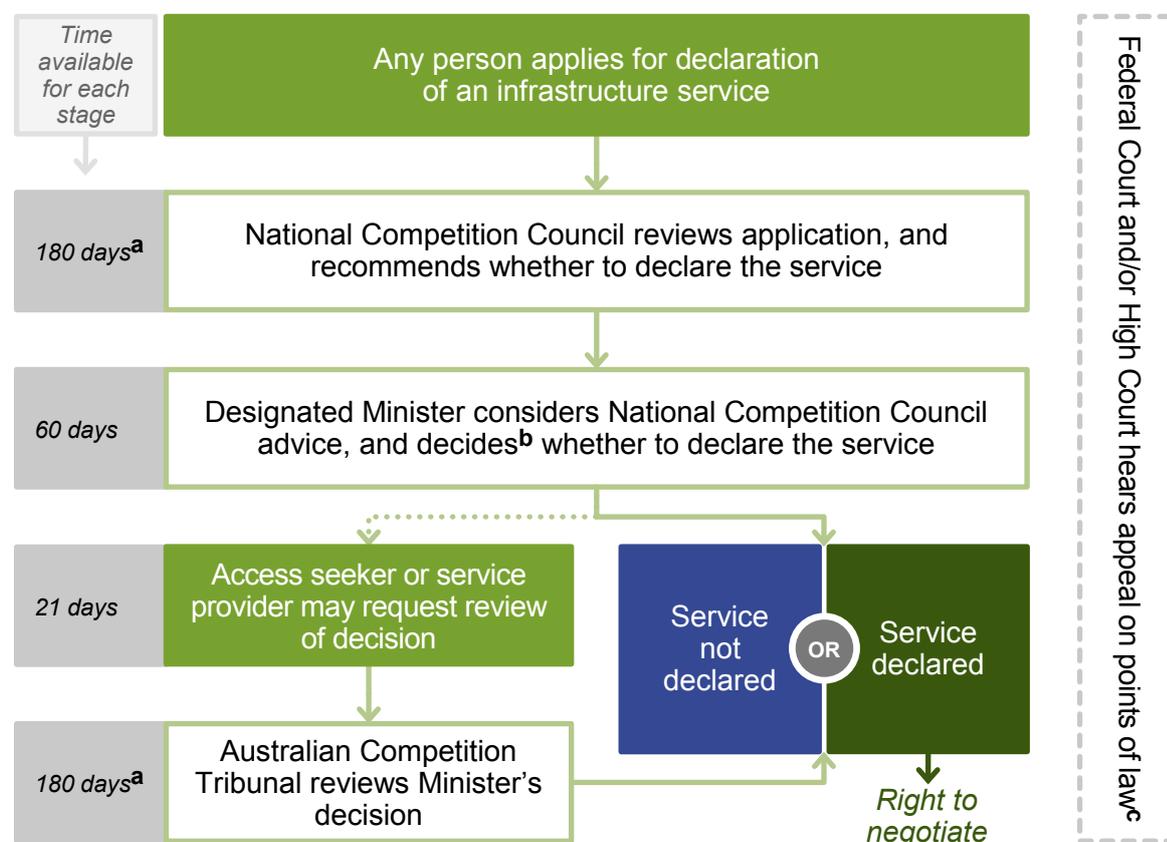
- The National Competition Council (NCC) provides a recommendation to the designated Minister on whether a service should be declared.
- The designated Minister decides whether to declare a service. For infrastructure where the service provider is a state or territory government (or a government-controlled company), the relevant jurisdiction’s premier or chief minister is the designated Minister. In all other cases, the designated Minister is a Commonwealth Treasury portfolio minister or parliamentary secretary (s. 44D).
- The declaration applicant or the affected service provider can request that the Australian Competition Tribunal (the Tribunal) reconsider the designated Minister’s decision (s. 44K). Additionally, appeals on points of law can be heard by the Federal Court (and subsequently the High Court) if leave for appeal is granted.

Figure 4.1 Declaration, negotiation and arbitration under Part IIIA



^a Or parties may agree that a workable access arrangement is not possible, and proceed no further with negotiations. ^b Decisions on whether to declare a service or set arbitrated access terms may be referred to merits or judicial review. ^c Even if access does not proceed (or does not proceed on arbitrated terms), declaration remains in effect until its expiration or revocation. ^d Notification of an access dispute can be withdrawn at any time (before the ACCC makes a final determination) by the party that gave notice of the dispute, and in other limited circumstances. ^e Subject to the conditions set out in section 44Y of the CCA, which allows the ACCC to terminate arbitration if (among other reasons) the dispute is vexatious or trivial. ^f Such as mediation or conciliation. Parties may also agree to refer the matter to a technical expert or a private arbitrator.

Figure 4.2 Declaring access to an infrastructure service under Part IIIA



^a Time limits for NCC and Tribunal decisions may be extended (box 4.1). ^b If the designated Minister does not publish a decision within 60 days of receiving a recommendation from the NCC, the infrastructure service is deemed to have not been declared. ^c Appeals on points of law can be heard by the Federal Court and/or High Court, where an appeal is made and leave is granted for the appeal. Such reviews can be sought for any decisions made during the declaration process. The Federal Court and/or High Court will not necessarily rule on whether the service is declared, but instead clarify a point of law before referring the matter back to the relevant stage of the process.

Recommendation to declare

Under section 44F of the CCA, the designated Minister or ‘any other person’ is entitled to make a written application to the NCC, asking it to recommend that a service be declared. The NCC has 180 days to make a recommendation to the designated Minister as to whether a service should be declared. As box 4.1 outlines, this period may be extended with notice.

If the NCC finds that a service should be declared, it must also recommend an expiry date for the declaration — in effect, nominating an appropriate time period for the declaration to apply. The NCC has recommended declaration periods of up to 50 years (as with Sydney Water’s sewerage services), but has generally endorsed shorter periods (for example, 10 years for parts of the Tasmanian rail freight network, and 5 years for cargo-related infrastructure services at Sydney Airport).

The CCA empowers the NCC to request information and accept submissions when considering a declaration application (ss. 44FA and 44GB). The CCA also requires the NCC to publicly release its recommendation, although not until the designated Minister has decided whether to declare the service (s. 44GC). The NCC commonly releases a draft recommendation for comment as part of a public consultation process, but there is no statutory requirement for it to do so.

Box 4.1 Clock stoppers and extensions of time

While Part IIIA imposes time limits on the NCC and decision makers, the limits applying to the NCC, ACCC and Tribunal can be suspended through the use of ‘clock stoppers’. The clock may be stopped when:

- the relevant parties (which can include the service provider and access seeker, if one exists) agree in writing to ‘stop the clock’
- the NCC, ACCC or Tribunal formally request more information relating to a matter
- the ACCC is arbitrating an access dispute and an applicable undertaking is lodged
- the ACCC is arbitrating an access dispute and the decision to declare the disputed service is referred to the Tribunal for review.

The ACCC and Tribunal are able stop the clock for as long as they consider justified, while the NCC may stop the clock for a maximum of 60 days (s. 44GA).

There is also provision for the NCC to extend the period available to it to produce a recommendation, and for the Tribunal to extend the timeframe in which it will make a decision. The time allowed can be extended when:

- the NCC is considering whether a service should be declared, and is unable to make a recommendation within the specified timeframe
- the Tribunal is reviewing any decision, and is unable to conclude its review within the specified timeframe.

To obtain an extension of time, the NCC or Tribunal must give notice in writing to the designated Minister, explaining why it was unable to reach a decision within the time allowed and specifying a new deadline. The NCC or Tribunal must also inform the applicant and other affected parties, and publish a notice about the extension in a national newspaper. There is no limit on the number or duration of extensions that can be enacted.

If the NCC or the Tribunal do not produce a recommendation or decision within the specified timeframe, and provide no notice of an extension, the validity of the recommendation or decision (once made) is not affected. No recommendations or decisions have exceeded the current time limits introduced in 2010 — the NCC has produced only one recommendation, while no new matters have been referred to the Tribunal for review.

Clock stoppers and extensions of time are not available to the designated Minister. If the Minister does not publish a decision within the specified period, a deemed decision applies (chapter 9).

The designated Minister's decision

Once the designated Minister has received the NCC's recommendation in response to a declaration application, he or she is required to publish a decision within 60 days (ss. 44H and 44HA). Where a decision is not published within the specified time limit, the designated Minister is taken to have not declared the service (a 'deemed decision', discussed further in chapter 9).

The designated Minister must provide reasons as part of any published decision, although there are no requirements as to the level of detail that must be provided. If the designated Minister decides to declare the service, he or she must also specify an expiry date for the declaration.

In making a declaration decision, the designated Minister is not bound to accept the NCC's advice, and may also invite submissions and consider any other relevant matters. The factors which the NCC and the designated Minister must assess — including the declaration criteria — are discussed in chapter 5.

Reviewing declaration decisions

Where the designated Minister decides to not declare a service, the original applicant for the declaration can apply for the merits of the decision to be reviewed by the Tribunal. Similarly, where the designated Minister decides to declare the service, the provider of that service may request a review (s. 44K). There is also opportunity for judicial review of declaration matters by the Federal Court and/or High Court (chapter 9). The relevant court may grant leave to hear appeals on legal reasoning and procedure regarding declaration and arbitration decisions (figure 4.2).

In conducting merits reviews of declaration decisions, the Tribunal has the same powers as the designated Minister (s. 44K(5)). It reconsiders the matter based on the information that was taken into account by the designated Minister, and can also request further information that it considers reasonable and appropriate (chapter 9).

The Tribunal may affirm or set aside the original decision. If it affirms a decision to declare, it may vary the terms of the decision — for example, changing the expiry date of any declaration set by the designated Minister. The Tribunal has 180 days to make a decision, although that deadline may be extended (box 4.1).

4.2 The negotiate–arbitrate framework

The declaration of an infrastructure service establishes a right for an access seeker to negotiate with the provider of the service on the price and terms of access. This right extends to any access seeker, not just the declaration applicant. Negotiated outcomes resolving the terms and conditions of access are preferable to regulated outcomes because the parties to a dispute will know more about their claims and the costs and benefits of gaining or providing access than a regulator could. Negotiation can thus limit the potential for regulatory error.

The CCA does not establish a formal process for the conduct of negotiations between infrastructure service providers and access seekers. The NCC has stated that ‘it is expected that an access seeker will seek to negotiate the terms and conditions of access directly with the service provider’ (NCC 2011b, p. 10).

A right to negotiate the terms and conditions of access does not guarantee that an agreement will be reached between the parties. Consequently, some form of impetus or threat may be required to provide incentives for parties to negotiate reasonable pricing and other conditions. This comes from the prospect of arbitration, which any party to a dispute regarding a declared service can request at any time.

Framework for resolving access disputes under Part IIIA

If any party to a negotiation is dissatisfied with its progress, that party may notify the ACCC in writing of an access dispute, thereby invoking the arbitration provisions of Part IIIA (s. 44S). The CCA sets out matters that the ACCC must take into account when making a determination (box 4.2), although there are no specific requirements for how these matters must be assessed. There is also no fixed structure for arbitration proceedings under Part IIIA, but the ACCC can hold hearings and take submissions from the parties and relevant experts. Where multiple access disputes share matters in common, the ACCC is permitted to conduct joint arbitration hearings (s. 44ZNA).

Before making a determination, the ACCC is required to issue a draft determination to the parties, and may make an interim access determination that applies in advance of a final determination. When it makes a final determination, the ACCC must give the parties its reasons for making the determination (s. 44V). Arbitration is conducted in private unless the parties to a dispute agree otherwise. Nevertheless, the ACCC is required to publicly release a written report on its final determination (s. 44ZNB) (but not for draft or interim determinations). Once notified of an access dispute, the ACCC has 180 days to issue a final determination (subject to the conditions discussed in box 4.1).

Box 4.2 Matters to be taken into account when making a determination

Under section 44X of the CCA, the ACCC is required to consider the following matters in making a final determination in a dispute about access to a declared service:

- (aa) the objects of [Part IIIA];
- (a) the legitimate business interests of the provider, and the provider's investment in the facility;
- (b) the public interest, including the public interest in having competition in markets (whether or not in Australia);
- (c) the interests of all persons who have rights to use the service;
- (d) the direct costs of providing access to the service;
- (e) the value to the provider of extensions whose cost is borne by someone else;
- (ea) the value to the provider of interconnections to the facility whose cost is borne by someone else;
- (f) the operational and technical requirements necessary for the safe and reliable operation of the facility;
- (g) the economically efficient operation of the facility;
- (h) the pricing principles specified in section 44ZZCA.

The ACCC may also take into account any other matters that it thinks are relevant.

There are various circumstances under which notification of an access dispute will not result in access occurring on terms determined by the ACCC — or at all (table 4.1). Of the two cases of arbitration initiated under Part IIIA, neither resulted in an access arrangement adopting regulated terms (box 4.3).

Box 4.3 Arbitration under Part IIIA in practice

The ACCC has been notified of an access dispute under Part IIIA on two occasions.

- In November 2006, Services Sydney requested arbitration after it failed to secure what it considered reasonable terms for access to Sydney Water's declared sewage transmission and interconnection services. The ACCC made a final determination in June 2007. Services Sydney lodged an application with the Tribunal for review of the ACCC's determination, but it subsequently withdrew the application and opted not to proceed with its business plans. Consequently, no access occurred on the ACCC's regulated terms. (Declaration of Sydney Water's services was revoked in October 2009, following certification of a water industry access regime in New South Wales.)
- In January 2007, Virgin Blue notified the ACCC that it was unable to reach agreement with Sydney Airport Corporation on access terms for airside services. Negotiations continued after the commencement of arbitration, and the parties reached an agreement in May 2007. Consequently, arbitration proceedings were terminated without the ACCC finalising a determination. (Declaration of Sydney Airport's airside services expired in December 2010.)

Table 4.1 Reasons why arbitration may not result in regulated access

<i>Reason</i>	<i>Explanation</i>
Withdrawal of access dispute by notifying party	The notifying party may withdraw notification of an access dispute at any point prior to the time the ACCC produces a final determination (s. 44T). This may be to pursue options for alternative dispute resolution, or to enact an agreement negotiated between the parties — as occurred between Sydney Airport Corporation and Virgin Blue in 2007 (box 4.3). Additionally, where the service provider is the notifying party, the access seeker may withdraw notification after a draft determination has been issued (but still before the ACCC makes its final determination). This means an access seeker can terminate arbitration if it is unwilling to accept the proposed access terms it might be legally required to enter into were a final determination produced (Gear 1995).
Regulated terms rejected by access seeker	The ACCC may require the access seeker to ‘accept, and pay for, access to the service’ (s. 44V(2)(b)). However, where it does not impose this condition, the access seeker is not bound to enter an access arrangement with the service provider on the arbitrated terms and conditions — as in the sole completed case of arbitration under Part IIIA (box 4.3).
Termination of arbitration by ACCC	The ACCC has the power to terminate arbitration proceedings where (among other circumstances) it judges that an access dispute is vexatious or trivial, or it considers that the party that initiated arbitration has not engaged in good faith negotiations (s. 44Y). It must terminate arbitration if the declaration of the relevant service is varied or set aside by the Tribunal (s. 44YA). Where the ACCC is arbitrating an access dispute and an undertaking in relation to the relevant infrastructure service is lodged, the ACCC has the option of deferring arbitration while it considers the undertaking. If the ACCC accepts the undertaking, it must terminate the arbitration when the undertaking comes into operation, but only to the extent of the matters relating to access to the service that are dealt with in the undertaking (s. 44ZZCB).
Access not mandated by ACCC	In producing a determination, the ACCC is not required to compel a service provider to grant access to a particular access seeker (s. 44V). This may occur where the ACCC considers that there are no feasible terms on which access to the service, as required by the access seeker, could be imposed.
Decision not reached within time limit	If the ACCC does not produce a determination within the set 180-day period (excluding any periods for which the clock was stopped), it is taken to have not imposed any new obligations or altered any existing obligations between the parties (s. 44XA(6)). That is, a deemed final determination is one that retains the status quo.

As long as a declaration remains in effect, arbitration remains a live option for a service provider and any party seeking access to the declared infrastructure service. Hence, for a given case between a service provider and a particular access seeker, if no access terms are agreed or determined, it remains possible that a future access request could emerge in relation to the same declared service.

Final determinations made by the ACCC may be the subject of merits review by the Tribunal, which can be requested by any party to the final determination. For the purposes of merits review, the Tribunal has the same powers as the ACCC, and performs a ‘re-arbitration’ of the matter (s. 44ZP(3)). As with its reviews of declaration decisions, the Tribunal should produce a determination within 180 days

of a party submitting a written application for review. In addition, section 44ZR provides that the Tribunal's review of the determination can be appealed to the Federal Court on a question of law. Leave may be granted for subsequent appeals to the High Court.

The threat of arbitration influences negotiations under Part IIIA

Under the Regime, arbitration is available for instances where at least one of the parties to an access dispute considers that negotiations have reached an impasse. Nevertheless, the *prospect* of arbitration being triggered will in turn affect the outcome of negotiations between service providers and access seekers, regardless of whether arbitration is used. Economic literature examines the ways in which arbitration can influence privately negotiated outcomes in other contexts, such as the labour market (box 4.4). The same principles are likely to apply to arrangements for accessing declared infrastructure services.

Gans and Williams found that 'in order to influence investment incentives, firms must form expectations as to the regulated price that will be applied' in the event of arbitration (1998, p. 159). This meant that 'the principles that the ACCC and the Tribunal eventually adopt for pricing arbitrations under Part IIIA will constrain the range of pricing outcomes within which the parties can bargain for access' (Gans and Williams 1997, p. 20).

A party will only initiate arbitration in circumstances where it considers that a regulatory determination would deliver a better outcome than that available to it through negotiation. BHP Billiton suggested that:

... [an access seeker that] expects that arbitrated access terms would be more favourable than negotiated terms will have every incentive to ensure that contractual terms are resolved by arbitration rather than negotiation. (sub. 29, p. 31)

The corollary to this is that if the opposing party to the dispute expects that arbitration would produce a worse outcome for it than the likely negotiated outcome, it will have an incentive to moderate its negotiating position to avoid a regulatory determination. Consequently, the parties will negotiate a private settlement that resembles what they expect would be imposed through arbitration. The ACCC (sub. 16) and Virgin Australia (sub. 39) pointed to the access dispute between Sydney Airport Corporation and Virgin Blue (box 4.3) as evidence of how arbitration can motivate shifts in negotiating positions. However, as noted in box 4.4, whether such shifts provide for more efficient outcomes will in part depend on whether the underlying regulatory approach is flawed.

Box 4.4 **The threat of arbitration: lessons from the labour market**

The negotiate–arbitrate framework is not unique to access regulation under Part IIIA, with much of the literature examining its application in industrial relations. In that context, employees (and their representatives) and employers negotiate pay and conditions; where talks break down, they may progress to arbitration. As with access seekers and service providers, the expectation is that the parties will generally regard it as in their interests to privately negotiate an agreement rather than have a determination imposed.

- Farber and Katz observed that ‘the presence of any arbitration procedure determines the environment within which the parties negotiate, and consequently, directly affects the terms of negotiated agreements’ (1979, p. 62). As such:
 - where there is uncertainty about what the arbitrator would decide, risk-averse parties (for whom uncertainty imposes costs) are able to negotiate around a range of potential settlements, bounded by the avoided costs of arbitration
 - the more certain the parties are about what the arbitrator will decide, the more closely any negotiated outcome will resemble the expected arbitration outcome.
- Bloom (1981) added that factors such as uncertainty, timeliness and legal costs help to establish a ‘contract zone’, in which parties can privately negotiate a deal that delivers an outcome for each side that is at least equal to what they expect the arbitrator would determine. Hence, even if the parties were certain about the outcome of any arbitration, they would still have an incentive to reach a private settlement (as long as undertaking negotiation is less costly than the arbitration process).
- Bruce (1982) considered that negotiation might be driven more by a tactical need for each party to obtain information from their counterparty rather than any expectation of reaching an agreement. In so doing, the parties can reduce uncertainty about what an eventual arbitrated outcome would look like, in turn influencing the form of any negotiated outcome.
- The above examinations of arbitration assume a single issue is in dispute (for example, price). However, disputes often involve multiple issues simultaneously, representing a bundle of terms and conditions that can be traded off. In this light, Contini (1966) argued that there could exist multiple combinations of outcomes that will satisfy both sides to a dispute. Bruce (1982) noted that, as the parties will have greater knowledge collectively than an external arbitrator, this set of mutually advantageous outcomes (relative to the arbitrated decision) will provide further impetus for negotiation.

While negotiated settlements are likely to converge on what an arbitrator would determine, Bruce (1981) also pointed out that this does not guarantee that the efficient outcome (at least in terms of the parties’ combined interests) is reached. If the arbitrator’s basis for decision making is flawed, private settlements will be subject to the same flaws. The efficient outcome may not be attainable, as bargaining will be skewed towards whichever party is the beneficiary of the arbitrator’s approach.

4.3 Should the negotiate–arbitrate framework be retained?

Evaluating the success of the negotiate–arbitrate framework is not straightforward, with the evidence open to different interpretations. A significant problem is assessing the unknowable counterfactual: how would negotiations progress were there no threat of arbitration? It is clear that service providers can have incentives to delay negotiations and frustrate access seekers. As one example, King used the hypothetical case of a gas retailer who owns the distribution network.

While access negotiations are stalled, the owner of the reticulation network can continue to reap monopoly profits from gas sales. Successful access negotiations will lead to retail gas competition. At best, the facility owner will continue to achieve monopoly profits through sales of reticulation access but, more likely, the profits that flow to the facility owner will fall. Agreement is not in the facility owner’s interest. (1997, p. 12)

Access seekers might also use the declaration process to engage in strategic behaviour. For example, some participants in consultations with the Commission suggested that access seekers may have an incentive to use the declaration process as a signalling mechanism to attract new capital from investors (although it has not been possible for the Commission to test this proposition).

Further complicating matters is that there might be little scope for the parties to reach agreement. As Ergas cautioned, service providers and access seekers can have ‘sharply divergent interests, differing views of the world, and (given the scope for gaming associated with ongoing regulatory intervention) limited ability to make credible long-term commitments to one another’ (2009a, p. 35). In some cases, negotiations between a service provider and an access seeker should be unsuccessful — that is, the efficient outcome from a social perspective would be no provision of third party access to an access seeker in a particular case (chapter 3). Consequently, the failure of negotiations to reach agreement is not necessarily an indicator of the performance of the overall process.

Past changes to the negotiate–arbitrate framework

Amendments to Part IIIA in 2006 and 2010 sought to improve the effectiveness of the negotiate–arbitrate framework. Two of the problems targeted related to access arrangements for multiple access seekers and the timeliness of decision-making processes involving the NCC, ACCC, designated Minister, Tribunal and the Federal and High courts.

Dealing with multiple access seekers

Bilateral negotiation between a service provider and multiple individual access seekers can result in duplicative processes. In turn, this might impose a significant administrative and compliance burden if multiple access disputes were to separately require arbitration. To reduce the costs and burden of responding to multiple access seekers, the Commission recommended in 2001 that:

- the ACCC be permitted to undertake joint arbitration hearings (involving multiple parties drawing on the same or similar infrastructure service)
- service providers be permitted to lodge undertakings for services previously declared for access (providing an alternative to arbitration).

While these recommendations were adopted in amendments to Part IIIA in 2006, the provisions have not yet been used. Consequently, it is not possible to determine whether the changes fully address concerns relating to multi-party access arrangements.

Timeliness of decision making

In many cases, a decision by the designated Minister is contested by the party disadvantaged by that decision (table 4.2). Amendments to Part IIIA in 2006 and 2010 imposed new time limits on the declaration and arbitration processes (sections 4.1 and 4.2). In addition, the 2010 amendments (and subsequent court judgments) have clarified the scope of merits reviews conducted by the Tribunal (chapter 9). Despite these changes, several participants expressed concerns about the length of time taken to conclude proceedings (for example, Anglo American Metallurgical Coal, sub. 44; Bob Baxt, sub. DR53; BHP Billiton, sub. 29; Brockman Mining Australia, sub. DR67; Business Council of Australia, sub. DR69; Gilbert + Tobin, sub. 45; Law Council of Australia, sub. 32; Dominic L’Huillier, sub. 7; Peabody Energy, sub. 30; Qantas, sub. 28; and Virgin Australia, sub. 39).

Given the relatively recent introduction of the 2010 time limits, and the small number of declaration applications that have been considered since then, the effect of these changes cannot be gauged with precision. However, as discussed in chapter 9, the direction of the changes — towards a more timely process and more confined reviews — is clear.

Table 4.2 Time taken to conclude declaration matters under Part IIIA

Shaded rows indicate applications that resulted in declaration for all or some of the services for which declaration was sought

Application ^a lodged	Applicant	Months taken (approximate)				Last decision published ^c
		by NCC	by Minister	by reviews ^b	in total ^c	
Apr 1996	Australian Union of Students	2	2	12	15	Jul 1997
Nov 1996	Aust. Cargo Terminal Operators (Syd)	6	2	32	40	Mar 2000
Nov 1996	Aust. Cargo Terminal Operators (Mel)	6	2	..	8	Jun 1997
Dec 1996	Carpentaria Transport	5	2	na	7	Aug 1997
Feb 1997	Specialized Container Transport (NSW)	4	2 ^d	na	7	Aug 1997
Apr 1997	NSW Minerals Council	5	2 ^d	na	7	Nov 1997
Jul 1997	Specialized Container Transport (WA)	4	2	na	6	Jan 1998
May 2001	Freight Australia	7	2	na	9	Feb 2002
Sep 2001	Aulron Energy	10	2	6	18	Mar 2003
Oct 2002	Virgin Blue Airlines	14	2	33	49	Oct 2006 ^e
Mar 2004	Services Sydney	9	2 ^d	11	22	Dec 2005
Jun 2004	Fortescue Metals Group	22	2 ^d	49 ^f	74	Jun 2010
Oct 2004	Lakes R Us	13	2	na	15	Jan 2006
2006 amendments introduce 'target' time limits^f						
May 2007	Tasmanian DIER — Rail Unit	4	2	..	5	Oct 2007
Nov 2007	Pilbara Infrastructure (Goldsworthy line)	10	2	20	32	Jun 2010
Nov 2007	Pilbara Infrastructure (Hamersley line)	10	2	52	64	Feb 2013
Jan 2008	Pilbara Infrastructure (Robe line)	7	2	52	62	Feb 2013
Mar 2010	North Queensland Bio-Energy	4	2 ^{d,g}	..	6	Sep 2010
2010 amendments introduce 'binding' time limits^g						
Sep 2011	Board of Airline Reps of Australia	6	2	..	8	May 2012

na Not available: application for merits review withdrawn before Tribunal decision reached. .. Not applicable.

^a Excludes applications that were withdrawn prior to a declaration decision. ^b Merits reviews by the Tribunal, and appeals on legal reasoning or procedure heard by the Federal and High Courts, where a decision was reached. Includes time taken for applications to be lodged. ^c Totals and dates exclude any time taken by review applications that were subsequently withdrawn. Totals may not match sum of individual columns due to rounding. ^d Deemed decision by the designated Minister. ^e Sydney Airport Corporation sought leave to appeal the Federal Court's decision in the High Court. Leave was refused in March 2007, although the declaration remained in effect while the application was considered. ^f Amendments to Part IIIA in August 2006 applied various 'target' (non-binding) time limits to any recommendations and decisions subsequently made. The NCC had a four month target to make a declaration recommendation to the designated Minister, while the Tribunal had a four month target to review a decision. A 60-day limit on the designated Minister's declaration decisions remained. All deadlines (including for the designated Minister) could be extended without limit. ^g Time limits introduced in July 2010 applied to any recommendations and decisions subsequently made. These changes, which remain in effect, are outlined in section 4.1.

Sources: NCC (2012c); Senate (2010, citing Treasury answer to questions on notice, 5 February 2010).

Replacing or supplementing the negotiate–arbitrate framework

An assessment of the negotiate–arbitrate framework must also consider the viability of other mechanisms for resolving access disputes. Some participants proposed alternatives to, or measures that would supplement, the current negotiation and arbitration provisions of the Regime.

Upfront regulatory arrangements

Some participants did not regard the negotiate–arbitrate framework as effective at ensuring access to infrastructure services is provided on reasonable terms, instead proposing a more active role for regulators upfront. Glencore, for example, argued that:

... where there is only one supplier of services and users have no real or practical bypass, there cannot by definition ever be a commercial negotiation ... Accordingly, while there should always be scope for parties to negotiate as a first right, there must be a credible, robust and timely alternative available to access seekers. Glencore, therefore contends that pre-determined minimum terms and pricing must be developed by regulators where a facility is the subject of declaration. (sub. DR64, pp. 11–2)

Similarly, although its comments focused on the gas access regime rather than Part IIIA, the Energy Users Association of Australia (sub. DR51) proposed that all pipelines be subject to regulated terms (including set reference tariffs) by default, with pipeline owners or users able to subsequently seek revocation of coverage.

Some access regimes draw on direct regulatory intervention in setting access terms. Under the telecommunications access regime (box 4.5), the ACCC sets access prices, with parties able to negotiate different arrangements if they choose. For some electricity and distribution services, the Australian Energy Regulator sets fixed prices and conditions. As a precondition for exporting wheat in bulk, port terminal operators are required to submit undertakings for acceptance by the ACCC (chapter 6). The ACCC (2009b) found that regulatory decision making can provide timely resolution of access disputes, reduce uncertainty and strengthen competition compared to negotiation and arbitration. However, negotiated outcomes between the parties would be preferable. The ACCC itself stated that:

... one of the advantages of the negotiate–arbitrate framework is that the threat of regulatory intervention can support the primacy of commercial negotiations and avoid the need for the regulator to set regulated access terms and conditions. (sub. 16, p. 6)

Given the general nature of Part IIIA, there would be practical difficulties in setting regulated access terms and conditions on an ex ante basis for all the infrastructure services that the Regime could potentially cover. In some cases, the setting of such

terms could itself become a protracted process — the regulator’s knowledge of the industry’s operations and the conduct of the service provider and access seekers would influence both the timeliness and quality of the regulatory outcomes. The Commission therefore does not see sufficient benefit from imposing upfront regulatory arrangements to justify the cost of abandoning the established processes of negotiation and arbitration.

Box 4.5 Telecommunications access arrangements

Until 2011, telecommunications services were subject to a negotiate–arbitrate framework under Part XIC of the CCA. However, in evidence to a Senate inquiry, access seekers complained that incumbents (chiefly, Telstra) held sufficient market power to stymie the negotiation process, raise costs for prospective competitors, and effectively limit competition. The Australian Government took the view that ‘determining terms and conditions of access ... has proven to be time-consuming and litigious’ (Conroy 2010b, p. 47), and argued that arbitration was employed under Part XIC to prolong access disputes. Once the ACCC had produced its final determination, Telstra would request a review by the Tribunal in ‘almost all’ cases (Conroy 2010b, p. 48). Exhausting these legal avenues could mean that arbitration added years to already long-running access disputes. For its part, Telstra argued that the access regime was discouraging its competitors from efficiently investing in new infrastructure (Telstra 2009).

Upfront access arrangements adopted as the alternative

Under the 2010 amendments to Part XIC, the negotiate–arbitrate framework for telecommunications access was replaced with upfront access arrangements.

- An access undertaking can be submitted by the provider of a non-declared service. The undertaking — which must be approved by the ACCC before it takes effect — sets out the terms that a service provider is willing to offer access seekers.
- A third party can apply for a service to be declared, or the ACCC can commence declaration proceedings itself. If, after a public inquiry, the ACCC declares a service, it must produce an access determination that imposes default terms of access for declared services. In the absence of any negotiated agreement between the service provider and an access seeker, the conditions contained within the access determination will apply.

Differential regulation — light and full coverage

Under the national gas access regime, the NCC is required not only to consider if a pipeline should be regulated, but also how it should be regulated. For pipelines subject to ‘full’ coverage, service providers are required to submit access arrangements to the Australian Energy Regulator (comparable to a mandatory undertaking under Part IIIA). Pipelines that are subject to ‘light’ coverage, by contrast, operate under a standard negotiate–arbitrate framework. Similar powers are

available under Queensland’s generic access regime, whereby the Queensland Competition Authority (QCA) can require the provider of a declared infrastructure service to submit an undertaking.

The NCC (sub. 9) proposed that a light–full regulatory model could be extended to declaration decisions under Part IIIA. Light (negotiate–arbitrate) regulation would remain the default position. Full regulation might involve mandatory undertakings, whereby service providers set out the terms under which they are prepared to provide access, with these terms to be approved by the ACCC. The NCC suggested that full regulation could be applied where there are likely to be many access seekers, negotiation of access arrangements is expected to be particularly complex, or capacity constraints are likely to lead to insufficient service availability for access seekers (in the absence of facility expansion or extension). Aurizon (sub. DR72) considered that decisions about light or full regulation could also be made *ex ante* through a declaration process for greenfield infrastructure (a matter discussed in chapter 8).

The Commission considers that the costs of introducing a light–full regulatory model into Part IIIA would outweigh the benefits. With specific reference to the NCC’s suggested instances of where full regulation would be beneficial:

- there is already scope to deal with multiple access seekers through the use of undertakings voluntarily lodged by a service provider, and for joint arbitration hearings where an access dispute involves multiple access seekers
- complexity is a feature of many forms of commercial negotiation, but this does not by itself justify regulatory intervention. Furthermore, there is no guarantee that a regulator’s judgment in complex arrangements will be any better than what the parties could negotiate between themselves
- capacity constraints can be addressed through contractual arrangements between a service provider and access seekers or, in the event of an access dispute being notified, by the ACCC — which has the power to direct the extension of an infrastructure facility (discussed in section 4.4). There does not appear to be a compelling basis for circumventing these processes in favour of an *ex ante* decision during the declaration stage.

The full regulation option departs from the primacy of commercial negotiation on which the Regime is predicated. By design, full regulation results in any opportunity for negotiation between the parties being supplanted by regulatory intervention — with all the disadvantages that entails. Given the options (including arbitration and voluntary undertakings) already available to the parties to address impasses or otherwise streamline negotiations, the Commission does not regard a more heavy-handed approach of the kind proposed as warranted.

Mandatory information disclosure

In its 2001 inquiry into the Regime, the Commission recommended mandatory information disclosure requirements to facilitate negotiations for access to declared services. While the Australian Government chose not to adopt the Commission's information disclosure recommendation, some participants in this inquiry returned to the idea.

- Bob Baxt (subs. 33 and DR53) proposed that access seekers should be obliged to propose the terms on which they are seeking access when making a declaration application, rather than waiting until the negotiation or arbitration stages.
- Asciano (subs. 15 and DR62) called for providers of declared infrastructure services to be required to supply detailed cost information to access seekers to facilitate 'even handed' negotiation of access pricing and terms.

Additionally, Brockman Mining Australia (sub. DR67) argued that service providers should be required to routinely publish details of available capacity and queuing processes being used for capacity-constrained infrastructure — although its comments were focused on the Railways (Access) Code 2000 (WA), rather than the negotiate–arbitrate framework under the National Access Regime.

One of the Commission's concerns in 2001 was that poor information disclosure would limit opportunities for productive private negotiations, with access seekers (or service providers) unable to obtain sufficient detail to make (or respond to) an access request. Although participant commentary in that inquiry raised concerns about information disclosure, there was little direct evidence of problems eventuating. Certainly, no access seeker or service provider had initiated arbitration to circumvent obstructions experienced during negotiation. In summary, the Commission was pre-emptively responding to a potential impediment to effective negotiation, at what was an early stage of the Regime's operation. More than a decade later, there are no compelling signs that poor information disclosure presents a systemic weakness in the negotiate–arbitrate framework.

One issue raised by participants to this inquiry is that poor information disclosure can needlessly prolong processes for agreeing on access terms. Bob Baxt considered that, if service providers and access seekers could agree on the broad parameters of what access terms would be acceptable before any declaration application was lodged, 'there is little doubt that quick negotiations [could] be pursued in order to finalise the terms of final access' (sub. DR53, p. 3). Asciano stated that the advantageous negotiating position held by service providers due to information imbalances 'often results in costly and protracted access negotiations' (sub. DR62, p. 5).

As noted in section 4.2, the CCA does not include any specific requirements for how negotiations must be conducted. However, at the time an access dispute is notified, the ACCC will consider whether the notifying party has engaged in good faith negotiations. Where the party has not, the ACCC can terminate arbitration proceedings. The Commission expects that a willingness to share information would factor into any assessment of whether ‘good faith’ has been demonstrated. While no such ‘good faith’ obligations apply to the responding party in an access dispute, section 44ZG(1) enables the ACCC to give directions to any party during arbitration, and section 44ZJ provides for penalties where (without reasonable excuse) a party called as a witness refuses or fails to answer a question or produce a document as required. This provides a targeted threat for individual cases, and should therefore encourage the exchange of relevant information during negotiations. By contrast, any information disclosure requirements that might be imposed at the negotiation stage would necessarily be high level given the generic nature of the Regime — it is not clear that these could provide much new impetus for negotiated outcomes. Consequently, the Commission considers that the benefits of mandatory information disclosure are unlikely to exceed their costs.

Ad hoc responses

The Board of Airline Representatives of Australia (sub. 2) suggested that the declaration pathway could only resolve disputes pertaining to access terms and competition in a narrow range of circumstances. It recommended that the Australian Government establish a standing ‘infrastructure forum’ to consider complaints regarding infrastructure use not addressed by Part IIIA, and propose remedies for lawmakers or regulators to implement. The Board of Airline Representatives of Australia (sub. DR49) stressed that their proposed infrastructure forum would only deal with situations where the National Access Regime did not apply.

However, the Commission notes that the only way to test whether the National Access Regime should apply to a particular service (where it is not covered by any other recognised access arrangement) is for a party to lodge a declaration application. Access seekers could therefore use an infrastructure forum as an alternative pathway for obtaining regulated access outcomes. Ad hoc mechanisms may work against the primacy of negotiation between access seekers and service providers, by providing avenues for the parties to lobby for favourable regulatory measures. This would also open the door to policy inconsistency, producing considerable uncertainty for service providers and access seekers.

An alternative, narrower option proposed by Michael Cunningham (sub. 18) would be to create a ‘circuit-breaker’ mechanism for intractable access disputes, whereby

the arbitrator in a particular access dispute could trigger an independent review into whether a negotiate–arbitrate framework should be retained for that service. Although a review mechanism of this kind would likely require a higher threshold to be met than if any party could directly initiate it, such a mechanism may still be ‘gamed’ by parties during the course of arbitration. The circuit breaker may also add considerable additional costs to an access dispute, further lengthening the time taken to reach a determination. Consequently, the Commission does not see a strong case for incorporating either of these ad hoc mechanisms within the Regime.

The negotiate–arbitrate framework should be retained

As highlighted, there has been only one arbitrated determination under Part IIIA. This could mean the threat of arbitration is providing an incentive for providers to grant access where it is feasible and mutually agreeable terms are reached. Alternatively, the time, cost and uncertainty associated with navigating the declaration process could be deterring potential access seekers from using Part IIIA as a pathway to access infrastructure services, resulting in plans to enter upstream and downstream markets being abandoned altogether.

While there is little empirical evidence to conclusively prove which of these explanations is correct, the Commission considers that primacy should be given to negotiation, subject to an effective threat of arbitration. Arguably, the considerable resources devoted over several years by parties to the Pilbara rail case may emphasise that the threat is indeed considered a credible one. Moreover, although there are some concerns about the operation of the negotiate–arbitrate framework, there is no basis for concluding that alternative measures would lead to better outcomes. The Commission regards the negotiate–arbitrate framework as providing a sound basis for resolving access disputes under Part IIIA.

That is not to suggest that negotiation and arbitration will be appropriate in every context. The particular experiences of service providers, access seekers and regulators in some sectors — for example, telecommunications — have given rise to alternative approaches to access dispute resolution. Measures such as upfront regulatory arrangements can be more effective than the generic access regime at resolving access disputes in the specific circumstances of individual industries. As Dominic L’Huillier commented:

In practice a mixture of the ex-ante and ex-post approaches is common — the challenge is striking the appropriate balance between the ex-ante (prescriptive) and ex-post (generic) regimes. (sub. 7, p. 22)

It is appropriate that industry-specific regimes remain open to alternative approaches, where there is a strong basis for deviating from a negotiate–arbitrate framework.

4.4 Directions to extend and expand facilities

Under section 44V of the CCA, the ACCC may make a determination in an access dispute that requires an infrastructure service provider to extend the facility or permit interconnection to the facility by a third party. A similar provision is included in the principles used for assessing the effectiveness of state and territory access regimes in the Competition Principles Agreement (clause 6(4)(j)).

The ACCC's power to direct extensions is potentially very strong. Many participants in this inquiry have expressed serious concerns about when, and how, the ACCC would exercise the power to direct an extension, the practicality of exercising the extension power, the workability of the safeguard provisions in Part IIIA and the potential to adversely affect service providers' investment incentives.

Rationale for a power to direct extensions

The economic rationale for the ACCC's power to direct extensions is to prevent service providers undermining the objective of the Regime by deliberately delaying infrastructure investment, or constructing facilities with suboptimal capacity, to limit competition and extract monopoly rents.

Although Part IIIA is expressed as referring only to an ACCC power to direct a provider to 'extend' the facility, the Tribunal and others have interpreted 'extend' to include both geographic extensions of a facility and expansions of a facility's capacity. The Commission has received advice from the Australian Government Solicitor (AGS) which supports the Tribunal's interpretation (pers. comm., 21 August 2013). However, the AGS has noted that this issue has not been considered judicially and that the decision of the Tribunal is not strictly binding on the ACCC or future determinations by the Tribunal.

The ACCC has never exercised its extension power under Part IIIA, nor has it been called on to do so (ACCC, sub. 16). However, a number of participants in this inquiry have highlighted that whereas access issues in the past two decades often related to the use of spare capacity, some key infrastructure assets are now operating at full capacity and users will increasingly be seeking providers to extend or expand existing infrastructure facilities. The QCA stated that:

Growth in the economy has meant the excess capacity previously associated with many infrastructure facilities is now being utilised and there are significant demands for increased investment to further expand capacity and improve reliability. (sub. 38, p. 9)

In its Pilbara rail decision¹, the Tribunal found that expansion would be necessary for three of the four rail lines in question to satisfy third party demand for the service. In addition, parties seeking access to the Central Queensland coal rail network have accused the service provider of withholding agreement to expand capacity to secure favourable terms (box 4.6).

Box 4.6 Goonyella to Abbot Point Expansion

The Goonyella to Abbot Point Expansion (GAPE) is a \$1.1 billion rail infrastructure project completed in June 2012. The expansion project more than doubled the volume of coal that can be hauled from mines in Queensland's Bowen Basin to the port at Abbot Point. The extension and expansion works were undertaken by Aurizon (the operator of the existing rail track infrastructure in the Bowen Basin — then called QR Network) and underwritten by agreements with coal companies (Aurizon 2012a, 2013).

Some coal producers and the Queensland Resources Council have claimed that Aurizon refused to undertake the GAPE project unless access seekers agreed to pay additional fees to ensure the company earned a rate of return above the regulated rate (Anglo American Metallurgical Coal 2010; Queensland Resources Council 2010). BHP Billiton Mitsubishi Alliance stated:

The absence of any defined regulatory protections for new [Central Queensland rail] expansions in the 2008 Access Undertaking meant producers had no option but to accept [QR Network's] terms if they wanted to grow their coal business in Queensland. (2012, p. 3)

In 2010, the QCA made amendments to Aurizon Network's regulatory arrangements (an access undertaking) to address coal network expansion issues. Aurizon is now required to gain the regulator's approval to earn above regulated returns from funding expansions, and users have the option of funding expansions (QCA 2010b, p. 20). However, the QCA (sub. 38) has questioned the adequacy of the legislation (the *Queensland Competition Authority Act 1997* (Qld) and *Competition and Consumer Act 2010* (Cwlth)) to permit workable user funding of expansions.

Participants' views on the need for an ACCC power to direct extensions

A number of regulators and access seekers supported an ACCC extension power on the basis that it counters incentives for infrastructure service providers to forgo or delay expansion to create scarcity and charge monopoly prices, or to construct a facility with suboptimal capacity to avoid access regulation (ACCC, sub. 43; Anglo American Metallurgical Coal, sub. DR50; Asciano, sub. DR62; Brockman Mining Australia, sub. DR67; Glencore, sub. DR64; NCC, sub. DR48; QCA, sub. DR57).

¹ *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2.

Infrastructure service providers expressed divergent views. BHP Billiton (sub. DR65) argued that directed extensions cannot be practically implemented and the power undermines the investment incentives of service providers (discussed below). BHP Billiton proposed that the power be limited to ‘interconnection of a provider’s facility with an access seeker’s infrastructure, in circumstances where access could not occur without that interconnection’ (sub. DR65, p. 16). In contrast, Aurizon stated that an extension power that included capacity expansions ‘is reasonable, provided the legitimate interests of the access provider are protected’ on the basis that ‘this achieves the regime’s efficiency objectives’ (sub. DR72, p. 22).

Furthermore, Aurizon proposed that ‘the power to direct geographical extensions should depend on the extension satisfying the declaration criteria’ (sub. DR65, p. 22). Aurizon’s proposal raises the question of whether it is possible to legally and practically distinguish between geographic extensions and capacity expansions. APA Group (sub. DR60) and the Australian Pipeline Industry Association (sub. DR52) stated that geographical extensions and capacity expansions are clearly distinguishable in relation to gas transmission pipelines. In contrast, Gilbert + Tobin (trans., p. 71) considered that it was not possible to distinguish between geographic extensions and capacity expansions. The ACCC considered that it might be possible to make a distinction between geographic extensions and capacity expansions in some industries, such as communications and potentially rail, but not in others. The ACCC stated that the Regime is a general access regime and it does not make sense to have ‘an artificial separation that may work with some industries but doesn’t work with others’ (trans., p. 100).

Protecting the legitimate business interests of service providers

A key objective of the National Access Regime is to promote efficient investment in infrastructure. As discussed in chapter 3, regulatory risk associated with access regulation could impede efficient investment in infrastructure facilities. Infrastructure developments typically involve large, sunk and lumpy capital investments and a requirement to extend a facility could pose a significant risk for prospective infrastructure developers. Appropriate safeguards are therefore needed to protect the infrastructure service provider’s legitimate business interests, reduce risk and preserve investment incentives.

To protect service providers, section 44W of the CCA places restrictions on access determinations, including that the ACCC must not make a determination that would:

- result in the third party becoming the owner (or one of the owners) of any part of the facility, or of extensions of the facility, without the consent of the provider (s. 44W(1)(d))

-
- require the provider to bear some or all of the costs of extending the facility or maintaining extensions of the facility (s. 44W(1)(e)).

The provider's legitimate business interests are likely to be broader than the capital cost of extensions, and include adverse effects on the service provider's operations arising from the directed extension. Section 44X outlines a number of matters the ACCC must take into account in making a final determination, including:

- the legitimate business interests of the provider, and the provider's investment in the facility (s. 44X(1)(a))
- the direct costs of providing access to the service (s. 44X(1)(d)).

Participants have told the Commission that if the definition of 'extend' does not include capacity expansions, then the ACCC could still direct a facility expansion but the safeguards in section 44W would not apply. This is because subsection 44V(2) states that the ACCC can make a determination 'dealing with any matter relating to access by the third party to the service' and provides a list of examples which includes directing facility extensions. However, the list of examples is not exhaustive and the ACCC can make determinations related to other matters, potentially including directing capacity expansions.

The Commission requested legal advice from the AGS on the consequences for the application of the safeguards if the term 'extend' were to be held by a court as not including capacity expansions. The advice stated that, in such an instance, the safeguard in paragraph 44W(1)(d) regarding the ownership of an extension would apply to directed capacity expansions only if the expansion capacity could be characterised as 'any part of the facility', and it is not clear that this would necessarily be the case (AGS, pers. comm., 21 August 2013).

Furthermore, the AGS advised that the safeguard in paragraph 44W(1)(e) regarding who bears the costs of an extension would not apply. However, the ACCC might, depending on the circumstances, be able to elect not to make a determination that required the provider to bear the costs of expanding the capacity of the facility.

As discussed above, in the Pilbara rail case the Tribunal considered that the term 'extend' includes capacity expansions. The Tribunal stated that 'it follows from this that the limitations regarding extensions (for example, in s. 44W) will apply' (para. 730). However, the AGS has advised that it has not been decided judicially whether 'extend' includes capacity expansions, and so this is not beyond doubt (pers. comm., 21 August 2013). Confirming in legislation that the term 'extend' also includes capacity expansions would ensure that the safeguards in section 44W apply to directed capacity expansions.

Workability of the safeguards

Participants questioned the workability of the extension safeguards for service providers in the CCA. Although the provisions to direct extensions in Part IIIA have not been tested, the QCA is currently assessing a standard user funding agreement (SUFA) for extensions and expansions to the Central Queensland coal rail network. The operator of the network, Aurizon, is subject to the Queensland rail access regime which contains similar provisions for regulator-directed extensions to those in the CCA. The experience in Queensland therefore provides insight into how the provisions in the CCA might function if called on (box 4.7).

Box 4.7 Funding extensions and expansions in the Central Queensland coal rail network

Aurizon's 2010 access undertaking requires it to comply with a set of investment framework principles as well as submit a standard user funding agreement. The investment principles set out the rights and responsibilities of Aurizon, access seekers and the QCA regarding extensions and expansions to the Central Queensland coal rail network:

- users may opt to fund major extensions and expansions of the rail network, even in circumstances where Aurizon is willing to do so
- funding users will be compensated for their investment by users of the additional capacity who did not contribute funding
- Aurizon will own and operate the rail infrastructure, other than customer-specific branch lines.

In July 2013, Aurizon submitted a revised proposal for a standard user funding agreement to the QCA. The agreement sets out a template for the mechanism by which users of the rail network may contribute to the funding of rail infrastructure. The proposed framework centres on an arrangement in which funding users hold preference units in a trust that then develops the infrastructure and leases it to Aurizon. The QCA has indicated it will assess the proposed agreement and make a decision on whether to approve it in early 2014.

Sources: Aurizon (2012b); QR Network (2010).

The QCA (sub. 38) has indicated that safeguard provisions in the Queensland rail access regime (and in the CCA) may prove problematic to developing and implementing a workable user funding agreement. The QCA stated that project financing principles emphasise security over funds invested and certainty on the repayment of those funds and 'as elementary as these principles may sound, there is significant doubt as to whether they can be implemented effectively in the context

of the National Access Regime’ (sub. 38, p. 16). The QCA cited the following reasons:

- Security over funds invested may require the ownership of the asset being transferred to the funding user in the event of insolvency of the service provider.
- Certainty over the repayment of funds invested may result in the contributed assets being treated (for accounting purposes) as debt of the service provider, which may consequently impose a cost on the provider.

These conditions might respectively violate paragraph 44W(1)(d), which states that a third party cannot become the owner of any part of the facility without the consent of the provider; and paragraph 44W(1)(e), which sets out that the provider cannot be required to bear some or all of the costs of extending the facility or of maintaining extensions. In its submission to the draft report the QCA (sub. DR57) reiterated that the safeguards may result in a determination requiring a service provider to extend its facility being unenforceable.

Are the safeguards adequate and appropriate?

On the basis of their assessment that similar provisions in the Queensland rail access regime have been an impediment to the development of a user funding agreement for extensions to the Central Queensland coal rail network, the QCA and Glencore advocated relaxing the safeguards for infrastructure service providers in section 44W of the CCA.

The QCA advocated the adoption of the relevant provisions contained in the Competition Principles Agreement (CPA) for assessing the effectiveness of state and territory access regimes (clause 6(4)(j)). The CPA extension provisions do not contain equivalent safeguards to section 44W of the CCA, although there is a provision that the legitimate business interests of the service provider be protected (discussed further in chapter 6). According to the QCA, the provisions in the CPA ‘would provide sufficient protection for the interests of all parties’ (sub. DR57, p. 4). However, adopting the CPA provisions would expand the ACCC’s discretion and could increase the scope for regulatory error with consequential adverse effects on investment incentives for service providers.

In its submission to the draft report, Glencore (sub. DR64) identified 20 principles it considered should be included in amendments to the CCA or included in guidelines governing extensions and expansions. In aggregate, adoption of the proposed principles would increase the discretion of the regulator and decrease the protections for service providers.

The ACCC has stated that because the provision has yet to be used, it is ‘difficult with respect to section 44V(2) to state with any certainty whether the current safeguards strike an appropriate balance between the interests of infrastructure service providers and access seekers’ (sub. DR58, p. 5). At public hearings the ACCC stated that it is ‘premature to be saying that we want to ... change [the safeguards] or add to them or detract from them’ (trans., p. 99). The ACCC (trans., p. 99) indicated that it would consider issues relating to the safeguards when developing guidelines on the extension power (as discussed in chapter 8, the Commission has recommended guidelines be developed).

Infrastructure service providers considered that the safeguards in section 44W should be retained (Aurizon, sub. DR72; Rio Tinto Iron Ore, sub. DR55) or strengthened (BHP Billiton, sub. DR65). Aurizon stated that ‘the provisions are ... effective in the sense that they provide an appropriate limit on the regulator’s power in order to protect the investment incentives and business interests of the access provider’ (sub. DR72, p. 25).

Bearing the upfront costs of directed extensions

Rio Tinto Iron Ore argued that the current safeguard prohibiting the ACCC from making a determination requiring the provider to bear some or all of the costs of an extension should be retained, stating that ‘the way costs are dealt with under the current regime is appropriate’ (sub. DR55, p. 14). Rio Tinto Iron Ore emphasised that a company’s board is the appropriate body to determine whether a company undertakes significant capital expenditure.

... allowing the ACCC to require a company to invest in an expansion for the benefit of third parties would require the ACCC to usurp the board’s proper functions, and interpose the ACCC into the management of the infrastructure owner’s business. (sub. DR55, p. 14)

BHP Billiton warned against relaxing the safeguard.

Further issues would arise if the safeguard in s. 44W(1)(e), which prevents the provider from being required to ‘bear some or all of the costs of extending the facility’, was watered down. If that occurred, such that mandated expansions were financed using ‘take or pay’ agreements, and the access seeker became insolvent before the expiry of such an agreement, the provider could be stranded with an asset which it did not want and which the access seeker had not fully funded. (sub. DR65, p. 17)

At public hearings, the ACCC appeared to disagree with the premise of BHP Billiton’s statement: that an infrastructure service provider could not be required to pay for a directed extension upfront. The ACCC (trans., p. 101) indicated that it would not ‘rule out’ the service provider being required to pay upfront for directed

extensions with the costs recouped over time through, for example, a take or pay contract. Willett considered ‘it would be preferable in seeking to achieve the objectives of Part IIIA for the access seeker to have the opportunity to meet all of the costs of the expansion through ongoing access fees’ (2013, p. 8).

The AGS (pers. comm., 21 August 2013) has provided legal advice to the Commission that the safeguard should be construed as *not* permitting a determination requiring the service provider to pay for a directed extension upfront. In advice provided to the Commission, the AGS acknowledged that it was possible to argue that, if the provider’s costs are eventually repaid, it could be said that the provider did not, at least after some period of time, bear any of the costs of extending the facility. However, the AGS saw two problems with such an argument.

- As there is no guarantee of the degree to which the extension would be accessed there would be no guarantee that the costs would ever be returned to the provider. An access determination expressed in such terms still might result in the provider eventually having to pay some of the costs of the extension; accordingly, the result could well be the provider bearing some of the costs of the extension, contrary to paragraph 44W(1)(e).
- Up until the time that the costs of extending the facility have been fully repaid, it could be reasonably said that the provider is in fact bearing some or all of the costs of the extension, contrary to paragraph 44W(1)(e).

Provision for indirect and opportunity costs

The Australian Airports Association (sub. DR61) and BHP Billiton (sub. DR65) expressed concern about how the ACCC would construe the term ‘cost’ in section 44W, which stipulates that the ACCC cannot make a determination that would require the provider to bear some or all of the costs of extensions or interconnections to the facility. BHP Billiton (sub. DR65) stated that it was not clear what the term ‘cost’ in the section meant. It questioned whether the term included costs such as constraints or delays to the provider’s own operations or expansions that resulted from an extension, or other associated opportunity costs such as the diversion of management time away from its business. BHP Billiton recommended that the section be amended ‘to confirm that this prevents the provider from bearing any direct, indirect or opportunity cost concerning the extension/expansion or interconnection’ (sub. DR65, p. 20). Similarly, the Australian Airports Association stated:

At a minimum the term ‘cost’ in section 44W(1) should be amended to expressly include opportunity costs and costs associated with any impairment to the use and operation of the facility and associated land borne by the owner. (sub. DR61, p. 3)

As noted above, the legitimate business interests of providers and the costs of providing access are also dealt with in section 44X, which states that the ACCC must, when making a final determination, take into account the legitimate business interests of the service provider, and the provider's investment in the facility (s. 44X(1)(a)); and the direct costs of providing access (s. 44X(1)(d)). The explanatory notes for the amendment bill inserting Part IIIA into the CCA (then the *Trade Practices Act 1974* (Cwlth)) state that:

The references here to the 'legitimate' business interests of the provider and to the 'direct' costs of providing access are intended to preclude arguments that the provider should be reimbursed by the third party seeking access for consequential costs which the provider may incur as a result of increased competition in an upstream or downstream market. (Gear 1995, p. 34).

These provisions appear to provide sufficient scope for the ACCC to take into account a broad range of other legitimate costs of directed extensions borne by the service provider, including the costs of disruption of the provider's operation and development of the facility. Guidelines developed by the ACCC on the extension power should outline how the legitimate business interests of the service provider will be taken into account, and the types of direct costs to be considered by the ACCC when making a determination directing the extension of a facility. The development of the guidelines should be informed by public consultation (chapter 8).

Ownership of directed extensions

Rio Tinto Iron Ore (sub. DR55) disagreed with the suggestion of some participants (QCA, sub. 16; Glencore, sub. DR64) that the current prohibition on determinations resulting in an access seeker becoming the owner of any part of the facility, be removed. Rio Tinto Iron Ore stated that:

... interposing multi-party ownership into a privately-held facility will create complex management issues, investment disputes and delays, and operational, maintenance and financing risks ... By way of example, even simple matters such as the scheduling of maintenance works on different parts of the infrastructure owned by different parties would necessarily involve consultation, negotiation and coordination, with the potential for delays and increased costs (and possibly safety concerns). (sub. DR55, p. 13)

Challenges associated with a power to direct extensions

An ACCC power to direct facility extensions when making an access determination raises a number of practical issues. These include how information asymmetry between the regulator, infrastructure service provider and access seekers would be

managed, who would fund the extension, and how the design and construction of the extension would be managed.

BHP Billiton expressed concern that any extension power broader than one limited to permitting interconnections ‘will raise complex practical issues which will be incapable of resolution in the absence of agreement between the provider and access seeker, and is likely to be futile in practice’ (sub. DR65, p. 16). The practical issues identified by BHP Billiton include how the extensions will be designed and extension works contracted, how real-time technical construction decisions will be made and how costs and risks will be allocated.

Information asymmetry

There is information asymmetry between regulators, service providers and access seekers. Service providers and access seekers have more information about a regulated facility and the prevailing market conditions than the regulator, and there are also information asymmetries between service providers and access seekers. Regarding information asymmetry and the regulatory power to direct extensions, the ACCC stated:

In the ACCC’s view, the infrastructure operator and access seekers (including potential access seekers) have better information on the risks and returns associated with specific infrastructure extensions than the regulator. (sub. 16, p. 49)

If the regulator makes its decision with less information than the other parties, there will be a risk of error. The ACCC recognised that information asymmetries make private negotiation preferable to regulated extensions.

Where possible therefore, the ACCC considers that the infrastructure operator and access seekers should reach agreement on whether to extend the facility. (sub. 16, p. 49)

User funding of extensions

Stakeholders have noted that, in the absence of an ability to compel a service provider to invest in extensions itself, funding of extensions by users could provide an alternative to accepting unreasonable terms of access. Bordignon and Littlechild identified that a user funding option for extensions in the Australian Rail Track Corporation’s (ARTC) Hunter Valley rail network access undertaking ‘seeks to avoid the possibility of “hold-up” by a monopoly infrastructure owner not investing in new capacity’ (2012, p. 182). At public hearings Anglo American Metallurgical Coal stated that a proposed user funding agreement for the Central Queensland coal rail network ‘will provide a point of leverage for industry to ensure that, in the

absence of a sufficiently robust regulatory environment to ensure that Aurizon does expand, their rate of return is ultimately reasonable’ (trans., p. 44).

For an extension that is proposed to meet the demand of a single access seeker or group of readily identifiable access seekers, user funding may be easily implemented where there is little difficulty attributing the costs between access seekers and charging them accordingly.

Funding issues may be more complex where:

- the service provider does not want to undertake the extension
- there are many users
- the efficient extension or expansion of capacity is not incremental, for example, where the capacity of the extension or expansion will cater for a level of demand that is not expected to be reached for a number of years.

A user funding arrangement has been developed for the Hunter Valley rail network and, as discussed above, a user funding agreement is under development for the Central Queensland coal rail network. The ACCC highlighted the user funding arrangement in the ARTC’s Hunter Valley access undertaking as an example of ‘mechanisms for encouraging the infrastructure operator to extend the capacity of its rail track network when warranted by user demand’ (sub. 16, p. 49) (box 4.8).

Where users propose an infrastructure investment that ARTC is unwilling to fund, the undertaking sets out a ‘user-funding’ process by which users can pay for the project to be undertaken by ARTC (provided certain safety and technical requirements are met). (ACCC, sub. 16, p. 49)

However, the ARTC stated that the provision of upfront capital payments by users complicates ownership and taxation issues.

The provision of initial capital payments by users for extensions to a facility may introduce a range of uncertainties for both parties in relation to ownership of extended facilities, the taxation treatment of the initial capital payments, and taxation treatment of ongoing depreciation of the assets. Such uncertainties may result in the legal and financial framework surrounding such arrangements becoming far more complex than otherwise might be necessary in order to mitigate the risks arising from these uncertainties, posing a constraint to the completion of such arrangements and investments in the network. (sub. 20, pp. 10–1)

Stakeholders have indicated that the tax effectiveness of user funding has been achieved in the proposed SUFA for the Central Queensland coal rail network through the use of a trust arrangement (QCA, sub. 38) (box 4.7). However, Aurizon (sub. DR72) and Glencore (sub. DR64) have stated that taxation issues significantly complicate user funding of infrastructure.

Box 4.8 The user funding option in the Hunter Valley access undertaking

The ARTC's 2011 access undertaking contains provisions for a user funding option where the ARTC advises that it will not fund a project, or will only fund part of a project. The access undertaking requires that if a user (or prospective user) notifies the ARTC that it is willing to fund the project in whole or in part through a capital contribution such that the ARTC's financial position is no worse off, then the ARTC and the user will negotiate in good faith on a user funding agreement under which the ARTC will proceed with the project and the user will provide funding for the project.

Subject to the ARTC's agreement, a user may fund the ARTC's costs of providing additional capacity:

- by providing an amount of initial funding in advance of a project commencing sufficient for the ARTC to commence the project, and providing additional funding for the next stages of the project when agreed milestones are achieved
- by reimbursing the relevant costs as and when they are incurred by the ARTC
- in any other way that the ARTC and the user agree.

In the event of a dispute as to the terms of a user funding agreement, the arbitrator is the ACCC.

Unless it otherwise agrees, the ARTC will manage the construction of the additional capacity under the user funding option. Any additional capacity, once created, will be owned by the ARTC (or the lessor under the lease of the rail track from the NSW Government) and managed by the ARTC.

Source: ARTC (2011).

Designing and constructing extensions

The Law Council of Australia (sub. DR68) and BHP Billiton (sub. DR65) questioned the ability of the ACCC to require a service provider to undertake an extension, indicating it would need to take on a project management role that it was unsuited for. The Law Council stated that:

... the ACCC may find itself having to undertake the complex tasks of designing and overseeing the construction of significant infrastructure projects, where the access provider refuses, beyond compliance with the terms of enforceable orders imposed on it, to do so. (sub. DR68, p. 7)

In response to concerns such as these, the ACCC argued that 'the regulator should never ... step in and try to run the project, design it or whatever else' (trans., p. 102). The ACCC said that its preferred approach is 'to provide effective incentives to prompt the infrastructure operator to extend or expand its facility, including providing the option of user-funded extensions or expansions' (sub. DR58, p. 5).

Another potential issue for access seekers is their ability to control the cost of ACCC-directed extensions undertaken by service providers. Where a service provider is directed to extend its facility it may have an incentive to be uncooperative and the ability to inflate costs (such as by gold plating the infrastructure) and delay construction. The QCA identified cost control as a key issue for user funding of capacity expansions.

Users were concerned that, as they had little control over managing the construction of the expansion, they would have little control over ensuring that the works were undertaken efficiently, but would have to fund whatever cost was incurred. (sub. 38, p. 13)

The Commission's assessment

There is a strong case for the safeguards in section 44W of the CCA. Increased discretion for regulators to determine the conditions of directed extensions, as proposed by the QCA and Glencore, would increase regulatory risk for infrastructure service providers and could have an adverse effect on their investment incentives. Consistent with the advice of the AGS on the meaning of the safeguard in paragraph 44W(1)(e), the Commission considers it is appropriate that a service provider should not be required to pay the upfront costs of a directed extension. It is important that the ACCC's legislative power to direct extensions also encompasses capacity expansions so that the safeguards in section 44W apply to directed expansions.

A decision by the ACCC to direct an extension would require complex operational, commercial and legal considerations. The Commission is firmly of the view that private negotiation is preferable to extensions directed by the regulator.

Due to the practical difficulties of directing extensions, information asymmetry and the complexity of user funding arrangements, including difficulties in setting appropriate access charges, it is likely that the benefits of using the power would rarely outweigh the costs.

However, the power is necessary for the proper operation of the Regime and the ACCC should develop guidelines on how the power to direct extensions would be used such that it is expected to generate net benefits to the community. The guidelines should be developed using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation so the provision to direct an extension is exposed to close scrutiny. The Commission's recommendations on directed extensions are outlined in chapter 8.

4.5 Other arbitration powers and responsibilities

While there was considerable commentary about the ACCC's capacity to direct extensions and/or expansions of facilities, some participants also commented on other aspects of the regulator's decision-making powers when resolving access disputes. These relate to the pricing principles and the infrastructure owner's priority of access to its infrastructure services.

Pricing principles

As outlined in chapter 2, the ACCC must have regard to a set of pricing principles when arbitrating an access dispute (or assessing an access undertaking — chapter 6). The intention of the pricing principles is to give guidance to infrastructure service providers and access seekers on how the ACCC might arbitrate an access dispute (PC 2001a). As the ACCC stated, the principles enable the regulator (or the Tribunal during reviews), to use its discretion.

It is ... appropriate that [the pricing principles] are specified in high-level terms, as this allows for flexibility, when applying the principles, to take into account relevant industry circumstances and changes in those circumstances over time. High-level specification also allows for updating of the methodologies adopted to reflect developments in best practice regulation and in relevant economic and finance theories (where appropriate). (sub. 16, p. 40)

Part IIIA does not require every principle to be individually satisfied in making a decision — a decision maker is required to 'have regard to' the principles (Costello 2006).

There is little evidence on the effectiveness of the pricing principles in the context of arbitration, although there has been greater application of the principles in assessing access undertakings under Part IIIA. The ACCC (sub. 16) considered that the pricing principles served their purpose well. Some inquiry participants regarded the principles as providing necessary safeguards, particularly for infrastructure owners (for example, Asciano, sub. 15; Jemena, sub. 6).

Some participants also flagged what they regarded as weaknesses of the current principles, specifically in relation to how the ACCC should consider incentives for efficient investment in infrastructure. Brisbane Airport Corporation (sub. 27) suggested that the pricing principles should explicitly refer to incentives for efficient investment in infrastructure. APA Group (sub. 35) considered that regulators should be given greater direction on how to avoid setting prices so low that service providers would underinvest in infrastructure. Queensland Treasury and

Trade (sub. 42) suggested that specific pricing principles could be established for greenfield infrastructure facilities, which would seek to promote investment.

The Commission is satisfied that the ACCC has sufficient scope for considering investment incentives in its determinations. The pricing principles require the ACCC to ‘include a return on investment commensurate with the regulatory and commercial risks involved’ (s. 44ZZCA(a)(ii)). Moreover, section 44X — which lists all the matters that the ACCC is required to consider when making an access determination — includes references to the service provider’s investment and the economically efficient operation of the facility. The ACCC stated that it considered that ‘Part IIIA currently allows for sufficient flexibility to take into account the specific circumstances of regulated infrastructure in determining an appropriate rate of return’ (sub. 43, p. 2).

The access requirements of the infrastructure service provider

Part IIIA contains provisions that require the ACCC to consider the interests of the service provider and other existing users of the facility when making an access determination. These include paragraph 44X(1)(a) — which explicitly notes that the business interests of the service provider and its investment in the facility must be taken into account — and paragraph 44W(1)(a), which states that the ACCC must not make a determination that:

[prevents] an existing user obtaining a sufficient amount of the service to be able to meet the user’s reasonably anticipated requirements, measured at the time when the dispute was notified.

BHP Billiton (sub. 29, p. 18) raised two issues with paragraph 44W(1)(a). First, BHP Billiton noted that there is no safeguard if the user’s access requirements differ from their ‘reasonably anticipated requirements’ measured at the time the dispute was notified. BHP Billiton suggested that this means the service provider may not have priority if they discover they need more capacity than was anticipated at the time the dispute was notified. BHP Billiton (sub. DR65) suggested that paragraph 44X(1)(a) be strengthened to require that the business interests of the provider are protected (as opposed to being ‘taken into account’).

BHP Billiton also noted that the service provider could lose priority over time under paragraph 44W(1)(a). For example, BHP Billiton considered that if an existing user of a service or a third party notified the ACCC of a dispute, the service provider’s reasonably anticipated requirements could be given the same priority as the other existing users.

These issues have not arisen for services declared under Part IIIA. However, the Tribunal considered the issue of the service provider losing priority in the Pilbara rail case (para. 128). The Tribunal suggested that the situation where a service provider loses priority against other users could not have been intended. The Tribunal noted that, in practice, there are likely to be discretionary factors for favouring the service provider in determinations. The NCC (sub. 9) agreed with the Tribunal, noting that paragraph 44X(1)(a) requires that the interests of the service provider be taken into account in a final determination. Nonetheless, the NCC suggested that an additional clause could be added to section 44W, that explicitly gives the service provider priority over other users of the infrastructure.

A similar issue has arisen in the access undertakings for bulk wheat exporters. The ACCC did not accept a clause in the undertakings that would have given the service provider priority over other users of the infrastructure, as these clauses appeared to be inconsistent with the objective of the *Wheat Export Marketing Act 2008* (Cwlth), which required ‘fair access to services’. The Productivity Commission stated that the ACCC’s stance was ‘probably appropriate’ because the transition to the new marketing arrangements meant that ‘reasonably anticipated requirements’ had not been established (PC 2010, p. 234). However, the Productivity Commission also noted that it was not its role to pre-empt any potential arbitration under the wheat undertakings. The Productivity Commission stated that, in the long run, the balance between the rights of the service provider and access seekers in the bulk wheat exporter undertakings should be consistent with the rights provided under the determination provisions of Part IIIA — that is, that the reasonably anticipated requirements of all existing users should be protected.

The safeguards in Part IIIA need to strike the right balance between the interests of the service provider, other users of the service and access seekers, and ensure that the objectives of Part IIIA are achieved. According to the NCC (sub. 9, p. 24), paragraph 44W(1)(a) is designed to provide ‘those who have negotiated access to the service with a degree of confidence that their reasonably foreseeable requirements will not be disrupted by later access seekers’. Giving the service provider priority over other existing users may reduce this confidence. In addition, it may strengthen the monopoly position of the service provider if existing users of the service lose access rights to accommodate the provider’s requirements.

The Commission notes the views of the Tribunal and the NCC that there will generally be discretionary factors that provide the service provider with priority where appropriate, including paragraph 44X(1)(a). Given this, on balance, the Commission does not consider that the safeguards for service providers should be amended at this time.

5 Declaration criteria

Key points

- There are five declaration criteria that must be satisfied for a service to be declared. Each criterion should serve a specific purpose, such that the criteria as a whole ensure the Regime targets the economic problem: an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required for third parties to compete effectively in dependent markets.
- To better target the economic problem, the competition test, criterion (a), should test whether declaration of (instead of access to) a service would promote competition.
- The uneconomical to develop another facility test, criterion (b), should be used to identify facilities that give rise to an enduring lack of effective competition in markets for infrastructure services.
 - Criterion (b) should be applied in a different manner than in the past by directing decision makers to test whether a facility can meet total foreseeable market demand for the infrastructure service — including the demand for any substitute services — at least cost.
 - The assessment of costs under criterion (b) should be based on an estimate of production costs that would be incurred in meeting total foreseeable market demand for the infrastructure service, including costs from coordinating multiple users of the infrastructure facility.
- The production process exception as interpreted by the High Court is suitable for Part IIIA as it is a generic access regime. Greater consideration of coordination costs in criterion (b) would assist in preventing declaration from inefficiently breaking up highly integrated supply chains.
- The public interest test, criterion (f), allows a decision maker to consider the overall effect of access, taking into account any factors that may have a bearing on whether an infrastructure service should be declared. A service should only be declared where the decision maker is satisfied that declaration is likely to generate overall gains to the community. Criterion (f) should be amended to:
 - establish that declaration would promote the public interest, rather than be ‘not contrary to the public interest’ (as is currently the case)
 - require a decision maker to have regard to the possible effects on investment, and any administrative and compliance costs that would arise due to declaration
 - assess the effect of the declaration of (instead of access to) a service.

The scope of the National Access Regime (the Regime) is determined by a set of declaration criteria and other tests set out in Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA). Clear criteria and tests outlining which infrastructure services should be subject to declaration are important to ensure the Regime addresses the identified economic problem (discussed in chapter 3) and any unintended consequences are minimised, including regulatory uncertainty for service providers, access seekers and other affected parties.

This chapter outlines the Commission's assessment of the declaration criteria (and other tests) used to determine whether a service provided by an infrastructure facility should be declared under Part IIIA. The Commission's recommendations for reform are outlined in chapter 8.

5.1 Definition of a service

Declaration under Part IIIA gives an access seeker the right to negotiate access to a service provided by means of a facility. The distinction between a facility and a service recognises that a facility can provide more than one service, and some of these services may meet the declaration criteria while others may not. For the purpose of Part IIIA a service is defined to include the use of an infrastructure facility, handling or transporting things, and communications services (s. 44B). A service specifically excludes (except to the extent that it is an integral but subsidiary part of the service) the supply of goods, the use of intellectual property, or a production process.

Production process exception

As the use of a production process is excepted from the definition of a service, production processes are not eligible to be declared under Part IIIA, except to the extent that a production process is an integral but subsidiary part of the service (s. 44B). There have been a number of court rulings on the meaning of a production process since 1998 (box 5.1). In these court cases, rail line operators in the Pilbara region of Western Australia sought to have their rail lines recognised as production processes such that their use could not be declared. The High Court ruled in 2008¹ that the rail lines in question form *part* of their operator's production process but use of the lines would not constitute a use of that production process.

¹ *BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2008] HCA 45.

Box 5.1 Court rulings on the application of the production process exception to Pilbara iron ore rail lines

The interpretation of the production process exception has been considered in four cases relating to applications for declaration of three rail lines in the Pilbara.

Hamersley rail line (1999)

In *Hamersley Iron Pty Ltd v National Competition Council* [1999] FCA 867, the Federal Court ruled that the Hamersley rail line was part of Hamersley Iron's production process. The Court defined a production process as 'a series of operations by which a marketable commodity is created or manufactured' (para. 34) and stated that:

Hamersley's production process in the Pilbara extends, on this view, from its commencement of mining operations at the mines to the completion of the product that it sells, namely, export product. There was no evidence to show that Hamersley produces a marketable commodity at an earlier stage. (para. 34)

Mt Newman and Goldsworthy rail lines (2006, 2007, 2008)

The more recent cases in relation to the Mt Newman and Goldsworthy rail lines have found that the production process exception *did not* apply.

In *BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2006] FCA 1764, the Federal Court disagreed with the findings in the Hamersley decision and ruled that the Mt Newman and Goldsworthy rail lines did not constitute use of a production process. The Court defined a production process as 'the creation or making of a product or the transforming of one thing into another' (para. 152). It stated that:

The rail service involves the use of infrastructure or a facility that enables the transportation of one product ... but the infrastructure facility (the railway line and associated infrastructure) does not transform that product into something different. (para. 153)

On appeal by BHP Billiton to the Full Court of the Federal Court (*BHP Billiton Iron Ore v The National Competition Council* [2007] FCAFC 157), the Court found that use of the Mt Newman and Goldsworthy rail lines was not use of BHP Billiton's production process. It stated that 'a production process might comprise a sequence of steps, that, for example, include ... the collection and haulage of ore ...' (para. 163) but did not accept 'that the phrase "the use of a production process" includes a step in a production process...' (para. 172).

BHP Billiton appealed this decision to the High Court (*BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2008] HCA 45), which found that the rail lines are an integral part of the rail line operator's production process for a marketable commodity (accepting the definition used in the Hamersley case). However, the Court also found that use of the rail lines (part of the production process) by an access seeker did not constitute a use of that production process.

What purpose does the production process exception serve?

There was some agreement among inquiry participants that the production process exception is intended to prevent declaration of services for which the costs of access

would be prohibitively high. Allan Fels stated that the exception ‘could be useful in precluding access to highly integrated services, where the costs of adding a third party are likely to be large’ (sub. 40, p. 47). Rio Tinto Iron Ore considered that:

The exception needs to operate as an effective gate keeper to ensure that regulation does not unduly interfere with an incumbent’s own means of production, given the high inefficiency costs and investment disincentives such interference causes. (sub. DR55, p. 3)

A number of participants argued that the High Court’s decision had undermined the purpose of the exception. Rio Tinto stated that:

The impact of the distinction adopted by the High Court — that services that are used by the facility owner as a production process will not attract the exception unless access to the ‘process’ is sought (as distinct from access to the infrastructure used by the incumbent in its production process) — means that the exception is unlikely ever to apply. (sub. DR55, p. 3)

Allan Fels stated that:

The Court’s decision substantially confines the scope of any possible ‘production process’ exemption: by reducing the exemption to an interpretation that is entirely restricted to the physical transformation of inputs into outputs ... (sub. 40, p. 47)

However, Michael Smart questioned whether the High Court’s decision had implications beyond the particular rail line in question, stating that ‘it is difficult to generalise from that result’ (sub. 10, p. 2). At public hearings he said:

I think if Ford went to Holden and said, ‘We would like to use your assembly line on weekends,’ the production process exemption would be available, and there may be other cases where there is a similarly high degree of transaction cost that would be created by declaration, and there I think the production process exemption could play its intended role. (trans., p. 75)

Should the production process exception be amended?

Participants proposed amendments to the definition of a service to strengthen or clarify the intent of the production process exception.

- Michael Smart regarded the wording of the subsection to be ‘unclear, giving rise to multiple, conflicting judicial interpretations’ (sub. 10, p. 1). He proposed that the legislation state explicitly that the test for a production process ‘requires analysis of transaction or coordination costs’ (sub. DR56, p. 1).
- BHP Billiton proposed that the production process exception be amended to stipulate that the exception includes the use of ‘any material part of a production process’ (sub. 29, p. 16).

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- Rio Tinto Iron Ore proposed a similar amendment to BHP Billiton stating that it was necessary for the definition of a service to exclude the use of a facility that is ‘used as an integral part of a production process by the facility owner or access provider’ (sub. DR73, p. 2). Rio Tinto Iron Ore added that, if there was a concern about precluding access to some facilities for which access would not affect the relevant production process, the exception could be further amended such that it would not apply if ‘it can be demonstrated that use of such facility by any third party would not have any material impact on such production process’ (sub. DR73, p. 2).

For declaration to enhance efficiency the benefits of access must exceed the coordination costs that would be incurred. In this context, the Commission considers that, although the legal distinction between what is and what is not a production process is imperfect, the exception could prevent declaration in obvious cases where coordination costs will exceed any competition benefits (the exception is commonly associated with manufacturing (Institute of Public Affairs, sub. 23)).

Beyond these obvious cases it would be difficult to define a comprehensive exception based on the types of facilities or their characteristics that will exclude only facilities for which access regulation would not have net benefits. At public hearings the executive director of the National Competition Council (NCC) John Feil stated that:

The production process [exception] is as good as we’re going to get on the definition around a production process. I think there is a significant issue, when you look at particular production processes, in extrapolating to all production, trying to define a general issue around some specific issues ... and where we are on the production process I think satisfactorily lands us, without tinkering. (trans., pp. 173–4)

The amendments to the production process exception proposed by BHP Billiton and Rio Tinto have the potential to undermine the role of declaration in the Regime since they could preclude declaration of a wide range of infrastructure services. For example, Western Power in 2001 argued before the Federal Court that an application for declaration of services provided by its electricity transmission and distribution networks should not be considered by the NCC because the network forms an integral part of its electricity production process (Weiter 2002). Regarding this case, the NCC stated that:

The production process that went to the High Court was about the iron ore industry. When the first judgment came out of the Federal Court, we did have an application from an electricity generator to argue that transmission lines were part of the production process. So to use the specific case of one industry to start writing principles that govern all ... opens up significant risks ... (trans., pp. 173–4).

The amendments proposed by BHP Billiton and Rio Tinto could preclude declaration of services provided by facilities which are integral to a production process but for which the coordination costs resulting from access would be low (but material), and outweighed by the benefits of declaration.

Michael Smart's proposal (sub. DR56) that the production process exception explicitly require the assessment of transaction costs would require too complex an assessment for it to serve as an effective initial filter.

The Commission's assessment

The production process exception as interpreted by the High Court is suitable for Part IIIA, as Part IIIA is a generic access regime. Amending the production process exception to suit a particular industry, for example the iron ore export industry, would be likely to result in a provision that is ill-suited to other industries. The Commission considers that in many cases it will be appropriate to assess the potential coordination costs of access on a case-by-case basis. This can be achieved through an assessment against the declaration criteria — the Commission has recommended that greater consideration be given to coordination costs to assist in preventing declaration from inefficiently breaking up highly integrated supply chains (discussed below and in chapter 8).

5.2 Declaration criteria

There are five declaration criteria that must be satisfied for the NCC to recommend, and the designated Minister to decide, that a service be declared (box 5.2). A sixth criterion that 'access to the service can be provided without undue risk to human health or safety' was removed from the CCA in 2010.

The Commission considers that it is appropriate that all five criteria must be satisfied for a service to be declared. However, it is important that the criteria are drafted so that they work together effectively in targeting the economic problem — an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required for third parties to compete effectively in upstream or downstream markets (commonly referred to as dependent markets) (chapter 3). Accordingly, the following sections of this chapter present the Commission's assessment of how the declaration criteria (a), (b), (c) and (f) can best target the economic problem. The mechanics and policy implications of criterion (e) are examined in chapter 6, which discusses the process for certifying state or territory access regimes.

Box 5.2 Declaration criteria

Subsection 44G(2) of the CCA states that:

The [National Competition] Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

- (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility; or
 - (ii) the importance of the facility to constitutional trade or commerce; or
 - (iii) the importance of the facility to the national economy;
- (d) [repealed]
- (e) that access to the service is not already [subject to an access regime that has been certified as effective unless there have been substantial modifications to the regime or the relevant principles since the regime was certified];
- (f) that access (or increased access) to the service would not be contrary to the public interest.

Subsection 44H(4) of the CCA specifies that the designated Minister cannot declare a service unless he or she is satisfied of the same matters.

5.3 Criterion (b) — the uneconomical to develop another facility test

(b) that it would be uneconomical for anyone to develop another facility to provide the service²

In its ruling on the Pilbara rail case, the High Court³ outlined three ways in which criterion (b) has been applied by decision makers in the past.

- *Natural monopoly test*: It would be uneconomical to develop another facility if ‘the facility in question can provide society’s reasonably foreseeable demand for the relevant service at a lower total cost than if it were to be met by providing two or more facilities’ (para. 79). The Australian Competition Tribunal (the Tribunal)

² Part IIIA also requires the NCC (subsection 44F(4)) and the Minister (subsection 44H(2)) to consider whether it would be economical for anyone to develop another facility to provide *part* of the service.

³ *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36.

used this test in the Pilbara rail case.⁴ The approach taken under the natural monopoly test has not involved a test for global subadditivity of costs, which would identify whether a facility is a natural monopoly as defined in the economic literature (chapter 3). Rather, the test has generally been applied by comparing costs that would be incurred under two different scenarios: one where the facility under application alone meets a given level of demand for the service, and another where a second facility is built.

- *Net social benefit test*: It would be uneconomical to develop another facility if ‘for a likely range of reasonably foreseeable demand for the services provided by means of the facility, it would be more efficient, in terms of costs and benefits to the community as a whole, for one facility to provide those services rather than more than one’ (para. 80). This test was applied by the Tribunal in the Sydney Airport⁵ and Services Sydney⁶ cases, and by the NCC in its Pilbara rail recommendations.
- *Private profitability test*: It would be uneconomical to develop another facility if ‘there is not anyone for whom it would be profitable to develop another facility’ (para. 77). The Federal⁷ and High Courts ruled in the Pilbara rail case that criterion (b) should be applied as a private profitability test. The High Court ruled that the definition of ‘anyone’ should include the incumbent operator of the facility to which access is sought. In its Pilbara rail decision, the Tribunal (para. 954) said that a facility would be unprofitable to duplicate if an entrant was unable to earn sufficient revenue to cover the full private costs of an alternative facility and a normal rate of return.

The appropriate interpretation of criterion (b) is controversial. Inquiry participants were divided on the issue of which test should be applied (box 5.3).

⁴ *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2.

⁵ *Sydney International Airport* [2000] ACompT 1.

⁶ *Application by Services Sydney Pty Limited* [2005] ACompT 7.

⁷ *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58.

Box 5.3 **Some participants' views on criterion (b)**

While all three tests used to apply criterion (b) were endorsed by different participants, much of the commentary centred on the relative merits of the natural monopoly and net social benefit tests on the one hand, and the private profitability test on the other.

Arguments in favour of the natural monopoly and net social benefit tests

Participants in favour of a natural monopoly or net social benefit test mainly sought to highlight the weaknesses of the private profitability test in arguing for their preferred test. Anglo American Metallurgical Coal (sub. 44), the NCC (sub. 9) and QCA (sub. 38) (which favoured a natural monopoly test), and the ACCC (sub. 16) and Xstrata Coal (now Glencore — sub. 19) (which favoured a net social benefit test) all argued that a private profitability test can lead to wasteful duplication of natural monopoly infrastructure. Other criticisms of the private profitability test were that it will lead to underinvestment in dependent markets (ACCC), that it will increase applications for revocation of declaration (Anglo American, NCC, QCA and Xstrata Coal) and that it does not take into account whole of economy costs (Treasury, sub. 34).

Some participants highlighted difficulties in determining whether a facility would be unprofitable to duplicate, including the challenges associated with estimating prices, revenue and required rates of return (Law Council of Australia, sub. 32; NCC, subs. 9 and DR48; Queensland Government, subs. 42 and DR71; Michael Smart, sub. DR56). The ACCC (subs. 16 and DR58) noted the volatile nature of measures relevant to whether a facility is unprofitable to duplicate, such as prices, and the associated uncertainty about whether a facility satisfies a private profitability test.

Arguments in favour of the private profitability test

BHP Billiton (subs. 29 and DR65), Michael Cunningham (sub. 18), Allan Fels (sub. 40) and Rio Tinto Iron Ore (subs. 8 and DR55) argued that a benefit of the private profitability test is that it better promotes facilities-based competition in cases where the entry of a competing service provider is feasible. BHP Billiton and Rio Tinto Iron Ore said that the private profitability test is consistent with the objects of Part IIIA, given it only allows for declaration where an incumbent does not face a competitive constraint. BHP Billiton and Rio Tinto Iron Ore also argued that because the private profitability test is not based on a hypothetical case, it would be relatively easy to apply. The Law Council of Australia (sub. 32) did not express a clear preference for either test, but noted that the private profitability test helps to promote the dynamic efficiencies that arise from infrastructure investments.

The Law Council of Australia also suggested that performing a natural monopoly test is difficult because it 'requires knowledge of cost functions for alternative asset configurations that may not actually exist' (sub. 32, pp. 14–5). Allan Fels (sub. 40) said the natural monopoly test can be difficult because of the evolving nature of technology and costs. BHP Billiton (sub. DR65) argued that the natural monopoly test is impractical because it relies on information and analysis that is not understood by infrastructure service providers and access seekers.

How well does each test target the economic problem?

The declaration criteria should work together to target the Regime at the economic problem that access regulation should address — an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required to compete effectively in dependent markets (chapter 3). To this end, criterion (b) should be used by decision makers to *identify facilities* that give rise to an enduring lack of effective competition in markets for infrastructure services.

The net social benefit test

The net social benefit test would not identify facilities that give rise to an enduring lack of effective competition. As noted by the ACCC (sub. 16), the net social benefit test would ideally involve decision makers estimating the productive, allocative and dynamic efficiency effects of developing another facility (as outlined in the Tribunal’s decision in the Duke case,⁸ which involved an application by AGL Energy for the Eastern Gas Pipeline to be covered under the national gas access regime).

These factors, to the extent that they are important to a decision about whether declaration should apply, should be considered as part of the public interest test in criterion (f) (section 5.6). It is not appropriate to estimate these factors in criterion (b), because they do not help decision makers to identify facilities that give rise to an enduring lack of effective competition. Rather, the net social benefit test helps to identify facilities where there would be net benefits to the community from avoiding duplication of infrastructure.

That said, estimating wider costs and benefits is difficult, suggesting the net social benefit test would be particularly difficult to apply in practice. It would also be difficult to apply the net social benefit test in a transparent and objective manner. For example, quantifying the potential costs and benefits that relate to regional development or environmental outcomes would require decision makers to exercise significant judgment. Among the reasons given by the Tribunal for rejecting the net social benefit test in its Pilbara rail decision was that the need to quantify wider costs and benefits would make the test difficult to apply (para. 838).

The natural monopoly test

The Commission considers that the natural monopoly test would be satisfied for facilities that give rise to an enduring lack of effective competition. Large, usually

⁸ *Duke Eastern Gas Pipeline Pty Ltd* [2001] ACompT 2.

sunk, fixed costs and economies of scale typically associated with natural monopoly can serve as impediments to market entry and thus lead to a lack of effective competition (chapter 3). For facilities that do not meet the natural monopoly test there is likely to be competition for the relevant services, or at least the threat of entry, given the incumbent facility cannot meet demand at least cost.⁹

However, the natural monopoly test could also be satisfied even where the facility would not give rise to an enduring lack of effective competition. A service provided by a facility is unlikely to warrant declaration if effective competition for the service either already exists, or is expected to emerge in the absence of access regulation through the entry of a competitor.

A recommendation made by the NCC under the national gas access regime is relevant to cases where competition already exists. In the Duke case, the NCC argued that the Eastern Gas Pipeline satisfied each of the declaration criteria — including the natural monopoly test — and therefore recommended coverage (NCC 2000a). However, this conclusion was reached despite the relevant dependent market being served by multiple pipelines. Allan Fels summarised the consequences of this approach.

[Criterion (b)] now goes toward almost exact replication of the facility, rather than considering the broader context of substitution from competing facilities. It consequently makes it far easier for the test set out in the criterion to be met. After all, it is significantly less likely that it would make economic or commercial sense to exactly replicate a particular piece of infrastructure than to construct an effective but not exact substitute ... (sub. 40, p. 51)

The above example suggests that by only considering the demand for the facility's own service — rather than total demand in the market in which the service is supplied — the natural monopoly test could be satisfied for any location-specific facility with its output defined sufficiently narrowly, with enough spare (or expandable) capacity to accommodate a third party.

In other cases, competition might be expected to emerge for facilities that meet the natural monopoly test. While natural monopolies are sometimes thought to preclude profitable duplication, it has been established in the economic literature that natural monopoly technologies can be profitably duplicated, even if multiple competitors are not always sustainable in such industries (Baumol, Panzar and Willig 1988). In some United States jurisdictions there are examples of duplicated electricity

⁹ In the absence of other sources of market power, there is unlikely to be an enduring lack of effective competition. As noted in chapter 3, where an enduring lack of effective competition arises due to a source other than natural monopoly, policy tools other than access regulation would be more appropriate.

distribution facilities (Kwoka 2006) (although it is far from commonplace and typically one of the providers is government owned) and duplicated cable television networks (Hazlett 1986, 1990).

There are arguments that suggest in some cases a stronger competitive environment would likely ensue if, instead of regulating access, competition emerged through the development of another facility. For example, Kalt (2005) argued that when companies compete through their own facilities they will do so on the basis of variable costs. Also, Willig (2009) claimed that the development of a competing facility can result in more intense competition through the extra capacity made available by duplication, the introduction of new technologies that give an entrant a competitive advantage, and reduced opportunities for rival companies to collude.

Further, the Commission recognises that the natural monopoly test can be difficult to apply in practice, as noted by BHP Billiton, Allan Fels and the Law Council of Australia (box 5.3).

The private profitability test

The private profitability test could identify *some* facilities that give rise to an enduring lack of effective competition. This is because many facilities that are associated with a lack of effective competition would be unprofitable to duplicate (and hence would meet the test). For facilities that are unprofitable to duplicate, any enduring lack of effective competition through denial of access or monopoly pricing would not be addressed through market entry by a competitor. Potential entrants might expect they would capture insufficient market share, or prices would be driven too low after entry, to justify the size and risk of the necessary infrastructure investment.

BHP Billiton (sub. 29) argued that some facilities associated with a lack of effective competition would meet the private profitability test (that is, they are unprofitable to duplicate and hence their services would be declared if all other tests were met), but not the natural monopoly test (that is, they are not natural monopolies and therefore their services would not be declared). The potential implication of this argument is that the private profitability test would promote efficiency in cases where the natural monopoly test would not. However, in cases where a facility meets the private profitability test but not the natural monopoly test, it is unlikely that criterion (a) would be satisfied (box 5.4).

Box 5.4 Facilities that would meet a private profitability test and not a natural monopoly test

Some participants provided examples of infrastructure facilities that would meet a private profitability test, but not a natural monopoly test. The ACCC (sub. 16) used the example of a football stadium. BHP Billiton (sub. 29) provided an example of a rail line that has insufficient capacity to accommodate all third party demand, and therefore cannot meet demand at least cost.¹⁰ BHP Billiton argued that declaration could promote the objects of Part IIIA in this scenario.

It is unlikely that declaring the services provided by such facilities would promote a material increase in competition in a dependent market and thus meet criterion (a).

- The ACCC noted in the context of its stadium example that declaration of such services would be unlikely to significantly improve efficiency, which is consistent with a situation where declaration does not promote a material increase in competition in a dependent market.
- For the BHP Billiton example, where there is insufficient spare capacity, this will limit the scope for access to promote a material increase in competition in a dependent market. In its recommendation on declaration of jet fuel supply infrastructure services at Sydney Airport, the NCC (2012b) concluded that the limited amount of capacity that could be used by third parties on the pipeline under application would likely limit the effect of access regulation on competition.

An enduring lack of effective competition that arises for reasons other than natural monopoly is more appropriately addressed by policy tools other than access regulation (chapter 3).

Importantly, a private profitability test might fail in some instances to identify facilities that give rise to an enduring lack of effective competition. There are at least two reasons why this might occur.

First, there are some practical issues with the private profitability test that may limit its effectiveness. Since the Federal Court's judgment in the Pilbara rail case, the NCC has consistently expressed a strong view that a private profitability test would be unworkable in practice. In particular, the NCC has emphasised that — in instances where another facility that could provide the service has not already been, or is not committed to being, developed — the NCC and the designated Minister would almost always face competing assessments of profitability from access seekers and service providers, and it would be very difficult to be satisfied that a facility is unprofitable to

¹⁰ If a facility (or an expanded facility) cannot physically meet foreseeable demand for a service then it cannot meet demand at least cost and is not a natural monopoly.

duplicate (NCC 2011c).¹¹ The ACCC (sub. DR58), Anglo American Metallurgical Coal (sub. DR50) and the Queensland Government (sub. DR71) made similar arguments. The Queensland Government noted that:

Application of the private profitability test would depend on a number of factors and assumptions, including deciding a sufficient rate of return and reasonably forecasting likely market conditions to determine whether the relevant market can support a duplicated facility. While these factors may be commonly applied in commercial business decisions, this usually involves a well-defined and actual project, as opposed to a more hypothetical case when considering an access proposal. It would be difficult for a regulator (or the deciding Minister) to reconcile potential information disputes on these matters and be satisfied about whether or not a facility is profitable to duplicate. (sub. DR71, p. 2)

Given a decision maker has to be affirmatively satisfied that a facility is uneconomic to duplicate, sufficient uncertainty over the question of whether a facility is unprofitable to duplicate could prevent declaration in cases where declaration is warranted.

Second, there is a risk that some facilities that are profitable to duplicate (and thus would not meet the private profitability test) would give rise to a lack of effective competition. This is because, while it may be profitable for a business to develop another infrastructure facility to provide the service, this may not necessarily result in *effective* competition. The Tribunal argued in its Pilbara rail decision that:

If viewed as a [private profitability] test, as the incumbents would have it, then [criterion (b)] simply tests whether a person could compete in a related market without access. It does not ask whether that person could compete effectively. It is not hard to conceive of circumstances in which a market is less than effectively competitive because third parties, relying on marginally profitable alternative facilities, cannot truly compete with an incumbent using (a much more profitable) facility with natural monopoly characteristics. (para. 818)

A potential implication of this is that an enduring lack of effective competition could persist despite the duplication of an infrastructure facility. In these cases the private profitability test would not identify facilities that give rise to an enduring lack of effective competition. For example, the ACCC highlighted that while competing infrastructure investments have been made in the Australian telecommunications sector, these investments are ‘geographically limited and serve relatively small numbers of customers’ (sub. 16, p. 112). Michael Smart noted that:

... situations exist in which an entrant could find it privately profitable (even in the

¹¹ A further concern with the application of a private profitability test relates to the definition applied to ‘anyone’ when assessing whether it would be uneconomical for anyone to develop another facility to provide the service (chapter 8).

long term) to construct an alternative facility, but that this construction would fail to discipline the incumbent's conduct. (sub. DR56, p. 2)

The Commission's assessment

All of the tests used to apply criterion (b) have shortcomings in their ability to identify facilities that warrant access regulation. As noted above, the net social benefit test would not help decision makers to identify facilities that give rise to an enduring lack of effective competition. There is substantial scope for regulatory error under the natural monopoly and private profitability tests.

There are two types of regulatory error that could apply to declaration decisions. One type of error occurs when a service is declared, but access regulation does not provide net benefits to the community (*false positive*). The converse error occurs when a service is not declared, but access regulation would have provided net benefits to the community (*false negative*). While both errors can occur irrespective of the test used in criterion (b), their likelihood will vary with the test applied.

- There is likely to be a greater risk of false positives under the natural monopoly test than under a private profitability test. This is because some facilities that meet a natural monopoly test could face effective, facilities-based competition in the absence of access regulation.
- There is likely to be a greater risk of false negatives under a private profitability test than under a natural monopoly test, due to either the risk that a decision maker will incorrectly conclude that a facility is profitable to duplicate, or the difficulty in being satisfied that a facility is unprofitable to duplicate.
 - Even where a decision maker is correctly satisfied that a facility is profitable to duplicate, there is still scope for a false negative to occur. This is because the eventual duplication of a facility might not lead to effective competition, meaning that access regulation could have potentially provided greater benefits than the unregulated scenario.

False positives can entail substantial costs by affecting incentives to invest in infrastructure. The effect of false positives would be compounded if regulators set inefficient access prices. However, a facility that satisfies criterion (b) under a natural monopoly test, but would constitute a false positive, would still avoid regulation if it failed one of the other declaration criteria. Criterion (a) and criterion (f) are less likely to be satisfied in cases where effective facilities-based competition is expected to emerge in the absence of access regulation. However, criterion (b) — like each of the other declaration criteria — still has an important role to play in filtering out cases where regulation is not warranted so that the declaration criteria work together to effectively target the economic problem.

The risk of false negatives under a private profitability test is problematic, especially as such errors would not be remedied by the other declaration criteria — a service only has to fail one of the declaration criteria to avoid declaration. Importantly, in cases where a decision maker incorrectly concludes that a facility is profitable to duplicate, the behaviour of an unfettered monopolist would not be conditioned by the threat of entry by rival suppliers, given it is unprofitable to develop another facility.¹²

The Commission’s preferred approach to criterion (b)

Due to the shortcomings associated with the tests considered above, criterion (b) should be applied in a different manner than in the past. That said, the Commission’s preferred approach to criterion (b) is focused on an assessment of the costs of providing the relevant infrastructure service, and is therefore based on the natural monopoly test. As set out below, the Commission’s preferred approach to criterion (b) accounts for both the total demand in the market in which the infrastructure service is supplied, and the production costs incurred by infrastructure service providers from coordinating multiple users of infrastructure.

Assessing the costs of providing the relevant service has practical advantages over a profitability assessment. As noted by the NCC, an assessment of costs under the natural monopoly test is ‘grounded in principles that economists generally understand’, while the issues and analysis associated with whether a facility is unprofitable to duplicate — such as estimating future prices and hurdle rates of return — are likely to be subject to more dispute than those relating to whether a facility is a natural monopoly (trans., p. 156). The Law Council of Australia also suggested that the approach taken in the natural monopoly test places ‘arguably greater discipline upon experts to present economic evidence in an impartial way compared with the private profitability test where the relevant cost information will be private and may only be in the possession of the infrastructure owner’ (sub. 32, p. 15).

Some participants raised concerns with the Commission’s draft report recommendation that criterion (b) should be based on the natural monopoly test, arguing that such a test would not promote facilities-based competition and/or would be more likely to lead to false positives (Aurizon, sub. DR72; BHP Billiton, sub. DR65; Business Council of Australia, sub. DR69; Chamber of Commerce and Industry of WA, sub. DR59; Rio Tinto Iron Ore, sub. DR55).

¹² In an analysis of regulatory errors, Easterbrook (1984) argued that the impact of false negatives is likely to be lower than false positives. However, this was on the basis that an unregulated monopolist (which would result from a false negative) would eventually attract competitive entry through the prices it sets.

The Commission agrees that criterion (b) should — in combination with the other declaration criteria — help to promote *effective* facilities-based competition and reduce the risk of false positives. This is why the Commission’s preferred cost-based approach to criterion (b) differs from the natural monopoly test.

A market-based approach

The Commission’s considers that criterion (b) should direct decision makers to test whether a facility can meet total foreseeable *market* demand for the infrastructure service — including the demand for any substitute services provided by facilities serving that market — at least cost. To do so, the costs from a facility meeting total foreseeable market demand should be compared with the costs from that demand being met by two or more facilities.

Including the demand for substitute services in criterion (b) would better target the Regime at the economic problem. In infrastructure markets, an enduring lack of effective competition will usually occur where the incumbent facility can meet total market demand for the infrastructure service at least cost. If a facility can meet total market demand at least cost it would likely hold a strong position in the market for the infrastructure service, given it could draw on its lower costs to deter competitors that threaten its market position. Allan Fels noted that an incumbent natural monopoly could deter entry if it could credibly threaten a ‘price war’ (sub. 40, p. 53). Accounting for total foreseeable market demand would direct criterion (b) toward identifying the most likely source of an enduring lack of effective competition in infrastructure service markets.

A market-based test in criterion (b) could avoid declaration of services that face effective competition from other facilities — effective duopolies or oligopolies. As discussed in chapter 3, allowing competition between two or more competing infrastructure service providers will generally be preferable to access regulation in markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service). At the same time, the test could still be satisfied for facilities that face ineffective competition — notional duopolies or oligopolies.

It is relevant that the Commission is also recommending that criterion (a) be reframed (section 5.4), and that the hurdle for satisfying criterion (f) be raised (section 5.6). As noted above, criterion (a) and criterion (f) are less likely to be satisfied in cases where effective facilities-based competition is expected to emerge in dependent markets.

Applying a market-based test

A determination of whether a facility could meet total foreseeable market demand for the infrastructure service at least cost can be made through the following steps.

1. Define the market (or markets) in which the infrastructure service under application is supplied (box 5.5).
2. Estimate total foreseeable demand in the market in which the infrastructure service under application is supplied for a given future point in time. In general, this future point in time should be when total market demand is expected to be at its highest level in the recommended declaration period. Where demand is expected to increase over time, total market demand should be estimated for the end of the recommended declaration period.
3. Assess whether the facility could meet total foreseeable market demand for the infrastructure service over the declaration period at least cost.
 - In particular, compare the costs from the facility meeting total foreseeable market demand to the costs that would be incurred in the least costly alternative scenario. The alternative scenario considered will depend on whether there is a substitute service provided by another facility.
 - ... If there is not a substitute service provided by another facility there is only one potential alternative scenario: a duplicate (or partial duplicate) facility is built.
 - ... If there is a substitute service provided by another facility there are, broadly, two potential alternative scenarios: the two substitute facilities share total foreseeable market demand; or a third facility is built to provide part of total foreseeable market demand.

If the facility under application could meet total foreseeable market demand at least cost it would satisfy criterion (b).

The costs that are relevant to determining whether a facility can meet total foreseeable market demand at least cost are the production costs that would be incurred in meeting foreseeable demand. Costs that are related to the application of access regulation should not be included since the test should be used to identify facilities that give rise to an enduring lack of effective competition, rather than to identify the costs of access regulation. The administrative and compliance costs that may be imposed once a service is declared should be considered in criterion (f) (section 5.6).

Box 5.5 Market definition and the SSNIP test

Market definition is regularly undertaken in competition law cases, and has been used in the Part IIIA context for criterion (a) (CRA International 2006; Synergies Economic Consulting 2010a).

The ‘small but significant and non-transitory increase in price’ (SSNIP) test is a conceptual tool for defining markets that is used by competition authorities worldwide (Bishop and Walker 2002). The test works by first defining the potential market as narrowly as possible. For example, assume a decision maker wants to define the market in which a rail line operates. The narrowest potential definition of the market would only include the rail line. Next, the decision maker would ask whether a small but significant and non-transitory increase in the price of rail line services (usually a 5-10 per cent increase in price maintained over a year) would be profitable for the rail line operator. Whether the price change would be profitable depends on the degree of substitution on the demand and supply sides of the market. Demand-side substitution occurs when consumers respond to the price increase by purchasing other services instead (such as road transport). Supply-side substitution occurs when competitors respond to the higher price by switching supply to directly compete with the supplier of the service.

If there is enough substitution on the demand and/or supply sides of the market such that the price increase would be unprofitable, then the market has been defined too narrowly. A broader market would then be defined on the basis of the expected nature of substitutability — for example, if a price increase of rail line services is not expected to be profitable because consumers of those services would substitute to road services, the market would be redefined as rail *and* road transport. The SSNIP test would then be applied to this collection of services. If raising the price of a collection of services would be profitable then the market is defined as including those services.

Regulatory authorities typically recognise that in many instances the required data for performing a SSNIP test will not be available (ACCC 2011d; DoJ and FTC 2010). Hence, the value of the test mainly lies in its role as a conceptual framework within which to view evidence of competition between products or services, rather than as a formal econometric test.

The NCC (sub. DR48) cautioned that care would be needed to ensure that only genuine substitutes are considered for the purposes of estimating total market demand. The Commission agrees, and notes the Law Council of Australia’s comment that the SSNIP test is familiar to courts that deal with competition law cases (sub. 32, p. 17).

Also, any costs incurred in both scenarios (that is, costs that would be incurred both where the facility under application meets total foreseeable market demand and under the least costly alternative scenario) will cancel out and therefore do not need to be estimated. The Tribunal took this approach in its Pilbara rail determination (para. 907), where it noted that it was unnecessary to estimate the capital and operating costs that would be incurred in both scenarios that it considered. The

scenarios considered involved the incumbent's line being shared and a duplicate facility being built.

Meeting total foreseeable market demand would in most cases require the service provider to supply its infrastructure service to third parties. Thus, the assessment of costs should include an estimate of any production costs that would be incurred from the infrastructure being shared by multiple parties. These costs will include any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility.

Costs from coordinating multiple users of an infrastructure facility

The production costs from coordinating multiple users of infrastructure can be significant, particularly in highly integrated supply chains. These costs have underpinned suggestions from participants for an 'efficiency override', whereby the relevant minister would have the power to exempt vertically integrated export-oriented facilities from Part IIIA on national interest grounds (Minerals Council of Australia, sub. 26; Rio Tinto Iron Ore, sub. 8). BHP Billiton (sub. 29) argued that a way to prevent declaration where access regulation is likely to impose significant costs is to test whether the facility would have sufficient capacity to accommodate a third party.

The Commission's view is that a broad exemption for all vertically integrated export-oriented facilities could see some infrastructure services that warrant declaration avoid being declared. While the Commission noted in chapter 3 that access regulation is unlikely to increase efficiency where the infrastructure service provider has no ability to affect prices in downstream markets (such as bulk commodity export markets), this may not always be the case. In this context, it is important to note that some infrastructure facilities may be used for both export and non-export commodities. The Commission is also of the view that the capacity test proposed by BHP Billiton would undermine the operation of the Regime by potentially preventing declaration of services that warrant declaration (if, for example, an extended facility could meet foreseeable market demand at least cost).

The Commission's preferred approach is to account for the costs of coordinating multiple users of infrastructure by including an estimate of coordination costs in criterion (b). This would help to prevent declaration in cases where it would not be economically feasible to accommodate third party access. At the same time, a case-by-case assessment of coordination costs would still allow a service to be declared where this is warranted. A number of participants supported the principle of accounting for coordination costs if a natural monopoly-type test is used for

criterion (b) (ACCC, trans., p. 106; Law Council of Australia, sub. DR68, trans., p. 194; Queensland Government, sub. DR71; Rio Tinto Iron Ore, sub. DR55).

What coordination costs should be accounted for under criterion (b)?

In the draft report the Commission argued that while all coordination costs are relevant to determining whether declaration should apply, only some of these costs are relevant to determining whether a facility can meet total market demand at least cost. The Commission outlined some of the coordination costs that should be accounted for under criterion (b), and said that any coordination costs that are not relevant to the test could be considered by decision makers in criterion (f).

In chapter 3, the Commission outlined costs that could be imposed on infrastructure service providers from having to coordinate multiple users of their infrastructure, including costs associated with additional maintenance, reduced operational efficiency and flexibility, and problems coordinating investments.

In response to the draft report, Rio Tinto Iron Ore (sub. DR73) argued that criterion (b) should account for the coordination costs associated with additional maintenance, reduced operational flexibility and efficiency, impediments to expansions and adoption of new technology, and loss of throughput and productivity.

As noted above, the Commission considers that production costs that would be incurred in meeting foreseeable demand should be accounted for in criterion (b). Based on this principle, coordination costs that arise from sharing infrastructure are relevant to criterion (b) and should be taken into account. These include the costs of:

- *building the physical access or interface to the facility to allow for third party use, as well as any increased maintenance costs.* Additional maintenance costs may be incurred by the infrastructure service provider, for example, if a third party's operations are unsuited to the incumbent's infrastructure and consequently greater maintenance of the infrastructure is required
- *reduced operational flexibility and efficiency.* Multiple users of a facility could reduce the flexibility and efficiency of the facility's operations and require capital investments or operational changes (including changes to scheduling) to be made to maintain the output of the service
- *measures taken to coordinate investments that are necessary for the facility to meet total foreseeable market demand for the infrastructure service at least cost.* Delays to facility expansions or the adoption of new technologies that improve the efficiency of the service may arise as a result of the incumbent having to deal with multiple users. In this context, measures taken to address issues in

coordinating multiple users may be required to ensure the facility can meet total foreseeable market demand. For example, additional administrative and financial costs might be incurred in anticipation of coordination difficulties. Also, where the need to negotiate with multiple users leads to delays in the adoption of new technologies, the costs of producing the service might be higher than otherwise.

It is not possible to envisage every type of cost that may arise from sharing infrastructure. Thus, the above list of coordination costs that are relevant to the test proposed by the Commission is not exhaustive. When considering which costs should be included in criterion (b) the general principle outlined above should always apply: production costs that would be incurred in meeting foreseeable demand. Costs that do not meet this principle — such as costs associated with any adverse effects on incentives to make future investments in infrastructure service markets, and administrative and compliance costs from regulation — should be accounted for in criterion (f) (section 5.6).

Can coordination costs be estimated?

The terms and conditions of access will not be exactly known at the declaration stage and it will therefore not be possible to calculate coordination costs with precision. This was noted by the NCC (sub. DR48), which cautioned that evidence on coordination costs may only become available at the arbitration stage. However, decision makers are already required to make judgments about the future third party use of a facility when estimating foreseeable demand for the service. Reflecting this, a number of participants suggested that coordination costs can be estimated at the declaration stage (Anglo American Metallurgical Coal, trans., p. 47; Asciano, trans., p. 153). On this matter, Asciano said that:

... a view on coordination costs can be reached without reams and reams and years and years of analysis. Obviously the more analysis that you do the more you understand [the] nature of those coordination costs; the more you understand too whether those coordination costs can be mitigated. But to answer your question very simply, yes, we do think it's possible [to arrive at an assessment of coordination costs without having precise estimates]. (trans., p. 153)

The Commission does not consider that the inclusion of these costs would change the role of the ACCC in determining the terms and conditions of access should the matter reach arbitration.

Facilities that are impractical to duplicate

In some instances binding physical or regulatory constraints might prevent a potential competitor from developing a rival infrastructure facility. Glencore (formerly Xstrata

Coal, subs. 19 and DR64) suggested that a threshold criterion should test whether it is impractical to duplicate an infrastructure facility due to social, environmental or physical factors.

The Commission considers that, where such constraints present a true barrier to developing another facility, decision makers are able to take this barrier into account when determining whether a facility satisfies criterion (b). Hence, adding a requirement that decision makers explicitly consider such factors when determining whether a facility satisfies criterion (b) would be unlikely to provide much benefit. Given the scope for legislative change to create regulatory uncertainty, the Commission has only proposed reforms where the greatest gains can be made (chapter 8). As noted by the NCC:

... there is no practical benefit in amending the CCA to explicitly recognise situations where a binding physical or regulatory constraint prevents a potential competitor from developing a rival infrastructure facility. Where such constraints present a genuine barrier then a decision maker can take this into account in determining whether a facility is uneconomic to duplicate ... (sub. DR48, p. 8)

In sum: the Commission's preferred approach to criterion (b)

Criterion (b) should be satisfied where total foreseeable market demand for the infrastructure service over the declaration period could be met at least cost by the facility. That is, criterion (b) should be satisfied where the costs from the facility meeting total foreseeable market demand over the declaration period are lower than the costs that would be incurred under the least costly alternative scenario. Total foreseeable market demand should include the demand for the service under application as well as the demand for any substitute services provided by other facilities serving that market. Cost estimates should include an estimate of any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility.

5.4 Criterion (a) — the competition test

(a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service

Criterion (a) seeks to ensure that an infrastructure service will only be declared where access to the service would materially promote competition in a dependent market. Under Part IIIA, the promotion of competition is a proxy for more efficient outcomes, reflected in lower prices and/or higher output in a dependent market.

The promotion of competition can be measured by a number of legal indicators set out in CCA precedent. In the Queensland Co-Op Milling case,¹³ the Trade Practices Tribunal linked the scope for competition to the following elements of market structure.

- The number and size distribution of independent sellers, especially the degree of market concentration
- The height of barriers to entry, that is the ease with which new firms enter and secure a viable market
- The extent to which the products of the industry are characterised by extreme product differentiation and sales promotion
- The character of ‘vertical relationships’ with customers and with suppliers and the extent of vertical integration
- The nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities. (para. 516)

Which markets are important when assessing competition outcomes?

The starting point for assessing whether a service meets criterion (a) is to identify whether there is a market in which competition might be promoted, and determine if this market is separate from the market for the infrastructure service. The definition of what constitutes a market (discussed in box 5.5) is therefore important in determining whether criterion (a) is satisfied.

Some inquiry participants identified the ability of access seekers to put forward any market as a dependent market as a weakness of the Regime. RBB Economics stated that ‘access seekers are able to put forward multiple markets, some of which may be completely unrelated to the economic problem that the [Regime] is trying to address’ (sub. 31, p. 11). Similarly, Allan Fels stated that ‘this criterion all too readily degenerates into an opportunity for the access seeker to advance a “laundry list” of markets, some purely incidental or of secondary importance’ (sub. 40, p. 50). Various participants argued that there might not be an improvement in economic efficiency where competitive outcomes are not improved in final consumer markets; or where competition is only promoted in a market that is not nationally significant. These suggestions have much merit in principle, but narrowing the focus of criterion (a) to particular markets is fraught with practical difficulties.

¹³ *Re Queensland Co-Op Milling Association Ltd* (1976) 8 ALR 481; ATPR 40–012.

Final consumer markets?

Inquiry participants told the Commission that for access to improve community wellbeing, it is not sufficient for there to be an improvement in competition in any market. Instead, it must result in an improvement in competitive outcomes (greater allocative efficiency through increasing output and putting downward pressure on prices) in a *final consumer market*. Consistent with this, King and Maddock argued that:

If access improves competition and lowers prices at one stage of the production process, for example, but market power further down the production chain means that this competition does not feed through into lower consumer prices, then there is unlikely to be a significant welfare gain. (1999, p. 22)

Assessing impacts on competition in a final consumer market (as a proxy for more efficient outcomes) could underpin a theoretically sound competition test. However, it would be difficult to implement and could create additional layers of complexity in the process of defining dependent markets and assessing the effect of access on competition. First, many goods and services sold in final consumer markets may also serve as inputs in the production of other goods and services. As such, the line between what is a final consumer market and an input market is not always clear. Second, there may be a number of steps in a production chain between the infrastructure service in question and a final consumer market, making robust links between the two difficult to establish. With no clear definition in law to rely on, a ‘final consumer market’ test is likely to be unworkable — a conclusion endorsed by Gilbert + Tobin (sub. DR70).

Nationally significant markets?

Some participants (BHP Billiton, sub. DR65; Allan Fels, sub. 40; Minerals Council of Australia, subs. 26 and DR74) suggested that criterion (a) is deficient in that, under the present wording, it may be satisfied by a material increase in competition in a market that is not nationally significant or substantial. Where this holds, there is a risk that the costs of declaration and arbitration may exceed the benefits from any resulting increase in competition.

The NCC considered that in such a situation ‘criterion (f) is unlikely to be satisfied because the competitive benefits of access are likely to be outweighed by the costs of regulation’ (sub. 9, p. 21). Consistent with this, the Federal Court in the Pilbara rail case indicated that the importance of the dependent market, relative to the costs

of declaration, would likely be considered under the public interest test in criterion (f).

It cannot be the case, for example, that a declaration of access must be made by the Tribunal where only a modest improvement in competition in a minor downstream or upstream market is likely to ensue from access at great cost in the way of disruption to an incumbent's operations ... (para. 111)

Inserting a requirement that criterion (a) may only be satisfied where the market in which competition will be materially promoted is of national significance would complicate assessment of declaration applications against the criterion because there is no objective threshold as to what defines a nationally significant market. Moreover, even significant competition benefits in a small market could still produce overall gains for the community — the key consideration for the public interest test, criterion (f).

Where is the hurdle set on promoting competition?

When Part IIIA was enacted in 1995, criterion (a) was framed such that 'access (or increased access) to the service would *promote* competition in at least one market ...'. In its 2001 review of the Regime, the Commission considered that the decisions of the Tribunal up to that point indicated that criterion (a) could be satisfied by a marginal or trivial increase in competition — and this was an insufficient hurdle against inappropriate declaration. Criterion (a) was amended in 2006 to require that access promote a *material* increase in competition (although the Commission had recommended the term 'substantial increase').

In addition to legislative amendments, judicial decisions have also affected the application of criterion (a).

- Prior to 2006, the NCC and decision makers applied criterion (a) as requiring that declaration would promote competition in a dependent market. The approach adopted was to compare the status quo against the future state of competition in a dependent market with declaration of the infrastructure service.
- In considering the Virgin Blue case,¹⁴ in which Virgin Blue was seeking better terms and conditions of access to services provided by the Sydney Airport Corporation, the Federal Court disagreed with the approach whereby the term 'access' in criterion (a) became synonymous with 'declaration'. The Federal Court stated that:

... all s. 44H(4)(a) requires is a comparison of the future state of competition in the dependent market with a right or ability to use [the] service and the future state of

¹⁴ *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146.

competition in the dependent market without any right or ability or with a restricted right or ability to use the service. (para. 83)

The decision lowered the hurdle for declaration by requiring a comparison of the state of competition without access (even though access was already provided in the Virgin Blue case) and the state of competition with access. This means that the potential effect of access regulation on competition is overstated to the extent that any existing access arrangements promote competition in a dependent market. Allan Fels stated that the court effectively endorsed the position that ‘the test ought to be whether access — of any sort — would improve competition over a situation where access did not exist’ (sub. 40, p. 49). Hence, criterion (a) may be satisfied even where the market power of a service provider is constrained due to the countervailing market power of users, or where the provider has an incentive to provide access.

- In the Pilbara rail case, the Tribunal may have re-raised the hurdle for satisfying criterion (a). Referring to the Federal Court’s decision in the Virgin Blue case, the Tribunal considered that it should ‘assume that access is on reasonable terms and conditions, without speculating about any particular terms that might be imposed by arbitration under Part IIIA’ (para. 1066). Furthermore, it observed that:
 - ‘Access must be “essential” or “necessary” to permit effective competition in a related market for criterion (a) to be satisfied’ (para. 1067).
 - ‘If a dependent market is already effectively competitive, intervention is not called for’, that is, criterion (a) has ‘no application to a market which is effectively competitive’ (para. 1068).
 - If a ‘facility could profitably be duplicated ... [and] access to the natural monopoly facility or the construction of a substitute facility would equally promote an increase in competition ... [then] criterion (a) would not be satisfied’ (para. 1070).

The Federal and High Courts did not comment directly on this aspect of criterion (a) in the Pilbara rail case. However, the Federal Court did accept the Tribunal’s approach of assuming that ‘access’ in the *public interest test* (criterion (f)) is access on reasonable terms and conditions, and the NCC (sub. 9) considered this provided some authority to the Tribunal’s decision. The NCC now assesses criterion (a) as requiring a comparison of the state of competition under the status quo against the state of competition where access is granted on reasonable terms and conditions (NCC, pers. comm., 23 April 2013). Allan Fels (sub. 40) cautioned that there is some uncertainty as to whether this approach is consistent with the Virgin Blue decision.

What is the appropriate competition test?

In its draft report, the Commission concluded that criterion (a) should be expressly focused on the specific effect of *declaration* (rather than *access*) on promoting competition in dependent markets. Under this test, the comparison is of the future state of competition in a dependent market without declaration (the status quo) compared with a situation in which the service is declared. The test should not be satisfied where there is already effective competition in dependent markets because declaration would be unlikely to promote a material increase in competition.

Of those participants who commented on the Commission's proposed configuration of criterion (a), there was general support for concentrating on the competition effects of declaration (Aurizon, sub. DR72; Business Council of Australia, sub. DR69; Law Council of Australia, sub. DR68; NCC, sub. DR48). Some participants (for example, Gilbert + Tobin, sub. DR70) expressed reservations that consideration of the effects of declaration might require decision makers to predict the likely terms of access that might emerge. In the Commission's view, it would not be necessary for decision makers to come to a view on the outcomes of negotiation or arbitration under Part IIIA. Rather, it would be sufficient for decision makers to assume that access may occur on *reasonable* terms and conditions — as the NCC currently does.

Although Rio Tinto Iron Ore supported the Commission's proposed amendment of criterion (a), it suggested that a further clause be added to link the promotion of competition to improvements in economic efficiency.

To ensure criterion (a) is focused upon improvements in economic efficiency, [Rio Tinto Iron Ore] believes it should be amended to read: '*(a) declaration of the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service, and thereby result in an overall material improvement in economic efficiency.*' (emphasis in original, sub. DR55, p. 11)

In its draft report, the Commission discussed recasting criterion (a) as a test of efficiency rather than competition — recognising that competition is an imperfect proxy for efficiency (and, in turn, an imperfect proxy for the gains to the community from access). It concluded that such a test would be unworkable, costly and produce uncertainty for access seekers, service providers and decision makers. Rio Tinto's hybrid proposal may minimise these downsides — inviting decision makers to consider efficiency with reference to competition in dependent markets. However, assessments of efficiency would be analytically complex (potentially requiring consideration of efficiency impacts in multiple dependent markets), difficult to substantiate, and would increase regulatory discretion, potentially resulting in more errors. In short, although a competition test is an imperfect proxy

for efficiency, the practical drawbacks of an efficiency test are likely to exceed the potential benefits of emphasising the overall gains to the community.

The Commission considers that the current competition test should be reframed as a test of whether declaration (not access) would promote competition. A declaration-focused competition test is the most effective way to target the economic problem that the Regime is intended to address. Such an approach is also consistent with the current position of the NCC on the interpretation of the competition test following the Tribunal's 2010 decision in the Pilbara rail case.

What about monopoly pricing?

The Queensland Government considered that:

... while some deference to existing third party access arrangements is appropriate, it is important that declaration should not be prevented where existing access arrangements are provided on inadequate or unreasonable terms and conditions. (sub. DR71, p. 1)

The Commission agrees that where the terms of access are so 'inadequate or unreasonable' they disrupt competition in dependent markets, the consequent efficiency losses represent a problem that access regulation should address. However, competition can be an imprecise proxy for efficiency in some circumstances, particularly with regard to monopoly pricing. This may be the case where monopoly pricing by an infrastructure service provider does not affect the level of competition in dependent markets. For example, in the Virgin Blue case, the NCC considered that even a large increase in airside service charges by Sydney Airport would not reduce demand sufficiently to cause an exit from the market or a contraction in the number of flights offered on Sydney routes such that competition would be adversely affected. It therefore recommended against declaration on the basis that it would not promote competition (NCC 2003).

The Commission considers that it is appropriate that criterion (a) — reframed to consider the effect of declaration rather than access — allows for declaration where the prevailing terms and conditions of access are so poor that they disrupt competition in another market.

Tools other than those available under Part IIIA might be able to address monopoly pricing where it does not affect competition in dependent markets. For example, some industries (including airports) are subject to prices surveillance under Part VIIA of the CCA — declaration could supersede the use of these less intrusive approaches (chapter 3). Monopoly pricing may also be addressed through price regulation under industry specific access regimes (as is the case for electricity networks).

5.5 Criterion (c) — the national significance test

(c) that the facility is of national significance, having regard to:

- (i) the size of the facility; or*
- (ii) the importance of the facility to constitutional trade or commerce; or*
- (iii) the importance of the facility to the national economy*

The NCC has described criterion (c) as ‘a test of materiality, placing less important facilities outside the scope of Part IIIA’ (2005, p. 20). It is a subjective test, with no clear threshold for a facility to be judged as nationally significant. As the High Court noted in its hearing of the Pilbara rail case, criterion (c) ‘direct[s] attention to matters of broad judgment of a generally political kind’ (para. 43).

Questions of national significance have been in focus for some declaration decisions.

- Criterion (c) played a decisive role in an NCC (1997) recommendation not to declare services provided by Queensland Rail, finding that the collection of above and below rail services covered by Carpentaria Transport’s application were not nationally significant. The Queensland Premier (as designated Minister) determined that the rail services as a whole were nationally significant, although declaration was rejected on other grounds (Borbridge 1997).
- The NCC (2010b) considered that the Herbert River tramway network (used for the transport of sugarcane and raw sugar in North Queensland) was not nationally significant. The tramway network was considered small in terms of the number of farms and mills served, and was found to make an immaterial contribution to Australia’s sugar exports. (By deemed decision, the service was not declared.)

There was little participant commentary on criterion (c), although the NCC (subs. 9 and DR48) proposed that ‘the size of the facility’ be removed as a consideration that decision makers should have regard to when assessing national significance. It suggested that size introduced uncertainty into the decision-making process, with no clear criteria governing how size is relevant to national significance. The Queensland Government (sub. DR71) supported retention of criterion (c) as currently configured.

Ultimately, the NCC and the designated Minister are required to use their judgment when considering any matters to which they must have regard. In the Commission’s view, the discretionary nature of the national significance test means that there are unlikely to be significant gains from removing ‘the size of the facility’ as a matter expressly listed in criterion (c).

5.6 Criterion (f) — the public interest test

(f) that access (or increased access) to the service would not be contrary to the public interest

Criterion (f) allows the NCC and decision makers to consider the overall effect of access, taking into account any factors that may have a bearing on whether an infrastructure service should be declared. A decision maker can dismiss a declaration application where it concludes that the community would be worse off if there were access (or increased access) to a particular service, even if all other declaration criteria are satisfied. In contrast to the other declaration criteria, criterion (f) is framed in the negative. The decision maker must be satisfied that access ‘would not be contrary to the public interest’ (rather than finding it ‘would be in the public interest’). Criterion (f) can only be used to deny a declaration application — it cannot be used to get an application ‘over the line’ if other declaration criteria are not satisfied.

What is the appropriate role for a public interest test?

Participant views on the purpose of criterion (f) varied. The Law Council of Australia (sub. 32) found that criterion (f) was seldom a matter on which declaration decisions hinged. However, Allan Fels suggested that the ‘watering down’ of the other declaration criteria had strengthened the importance of criterion (f) as a filter for unjustified applications (sub. 40, p. 54).

Given the costs associated with access regulation, the package of declaration criteria should work together to deny declaration applications that would produce only trivial or ambiguous gains if successful. Some participants considered that criterion (f) supported this goal in a residual capacity, with the other declaration criteria — where satisfied — establishing a prima facie case for declaration. For example, Anglo American Metallurgical Coal argued that:

... if criteria (a) and (b) are satisfied then access is in the public interest unless the access provider can prove that there is some other public interest which overrides this conclusion. (sub. DR50, p. 9)

In expressing a similar view, the NCC (trans., pp. 162–3) considered it unlikely that a marginal declaration application would succeed in reality, because most of the relevant public interest effects of declaration are considered in criteria (a) and (b) — ambiguity would generally lead to at least one of those tests not being satisfied, and the declaration application therefore failing.

The Commission does not share this view. Criterion (f) provides the only opportunity for a decision maker to consider the overall consequences of declaration. The purpose of criterion (f) should be to require that the community as a whole is likely to be better off as a result of declaration.

Assessing the public interest draws on the balance of expected outcomes assessed under the other criteria, but also includes matters that the other criteria do not highlight, including environmental outcomes. Equally, where particular costs or benefits identified in the other criteria do not have a bearing on the public interest effects of declaration, they would not be relevant to criterion (f). For example, the production costs of duplicating a facility (in part or in whole) will be relevant to criterion (b) — the purpose of which should be to identify facilities that are associated with an enduring lack of effective competition (section 5.3) — but may not be relevant to criterion (f). Whether the costs of duplicating a facility should also be considered under criterion (f) would depend (among other things) on whether *declaration* is expected to affect whether a facility is duplicated or not. For example, if an airport is not expected to be duplicated even if its services are not declared then the costs of duplicating the airport should not be accounted for under criterion (f).

The Commission's preferred approach to criterion (f) is consistent with the focus of the National Competition Policy reforms and the guiding principle that competition will promote community welfare by increasing national income through encouraging improvements in efficiency (NCC 1996).

Options for strengthening the public interest test

The Commission has examined options for strengthening the operation of criterion (f), including:

- an explicit cost–benefit assessment of declaring a service
- an affirmative test of the public interest
- requiring a decision maker to have regard to specific matters, such as long-term effects on investment decisions, and administrative and compliance costs
- concentrating on whether declaration, rather than access, is contrary to the public interest.

A cost–benefit test

In its 2010 decision in the Pilbara rail case, the Tribunal applied criterion (f) as an assessment of the overall costs and benefits of third party access to a service. Several participants supported using a cost–benefit test as one of the hurdles that a declaration application must pass. The Law Council of Australia considered it:

... critical that [declaration] decisions reflect an appropriate and transparent weighing of the costs and benefits associated with declaration in a clearly defined and evidence based manner. (sub. 32, p. 4)

BHP Billiton (sub. 29) supported the inclusion of a cost–benefit test in the declaration criteria, but as an additional test to the current criterion (f). Michael Cunningham (sub. 18) suggested that the existing broad public interest test could either be replaced or supplemented by an onus on the applicant to demonstrate that the benefits of declaration would exceed the costs. Gilbert + Tobin argued that cost–benefit assessments were important in allowing assumptions to be scrutinised and tested, and limiting scope for the ‘politicisation’ of declaration decisions (sub. DR70, p. 8).

In principle, there is a compelling case for declaration decisions to be based on an overall assessment of the costs and benefits of regulatory intervention. In practice, explicit cost–benefit assessments are unlikely to provide a sound basis for declaration decisions. As the Tribunal acknowledged in its initial consideration of the Pilbara rail case, ‘many of the alleged costs and benefits of access are esoteric or qualitative in nature [while others] depend upon the occurrence of future events which are necessarily uncertain’ (para. 1169). Consequently, the Tribunal considered that criterion (f) did ‘not require a precise quantifiable cost–benefit analysis’, but could instead provide ‘some order of magnitude value’ to the costs and benefits of access (para. 1305). Such order-of-magnitude approaches may be regarded as reasonable in cases where the net impacts of access are unambiguous. However, at least some decisions would require contentious judgment calls.

The Commission is unconvinced that a cost–benefit assessment would enhance certainty for service providers and access seekers. A cost–benefit assessment may be interpreted as casting criterion (f) in the same ‘technical’ light as criteria (a) and (b) — and therefore, consistent with the High Court’s Pilbara rail decision, more open to review. Given the contestable nature of many of the costs and benefits that must be considered, a high level of judgment will always be required in public interest assessments. Attempting to process such judgments through a formalised cost–benefit framework would, perversely, increase unpredictability in the application of Part IIIA — in turn increasing the administrative costs of the declaration process and weakening investment incentives.

An affirmative test

In its draft report, the Commission recommended that criterion (f) be reconfigured as an affirmative test, requiring that decision makers be satisfied that access would be in the public interest.

Michael Cunningham (sub. 18) suggested that the negative, ‘not contrary to’, framing of the public interest test establishes a low threshold for satisfaction of criterion (f). The Minerals Council of Australia (subs. 26 and DR74) recommended an affirmative public interest test. Aurizon endorsed an affirmative test as one way to ‘provide greater clarity and certainty about the application of the “public interest” test’ (sub. DR72, p. 13).

Some inquiry participants expressed doubts about the merit of adopting an affirmative public interest test. The ACCC (trans., p. 89) noted that, while well intended, small wording changes could have unintended consequences — lengthy debates in court over the intent of legislative phrasing would create barriers to a simpler process.

BHP Billiton (sub. DR65) was unconvinced that an affirmative test would prevent declaration in all inappropriate cases. It cited the time and resources available to the NCC and the designated Minister, along with the limited scope for the Tribunal to review a decision that hinged on criterion (f), as impediments to good decision making. The role of the Tribunal in reviewing declaration decisions is discussed further in chapter 9.

Other participants raised concerns about the practical operation of a public interest test. The NCC argued that proving the positive satisfaction of the public interest required a much broader scope for criterion (f) than its current negative construction. The NCC stated that:

... you would have to make inquiries into a whole range of areas to be positively satisfied that it is in the public interest, and not necessarily the residual issues that may have been raised by parties regarding other matters ... In the positive test you have to consider all matters. In the negative test you consider other matters. (trans., p. 162)

The NCC considered that an affirmative test would result in service providers submitting ‘truckloads of reasons why [declaration would be] negative’ (trans., p. 164). Similarly, the Queensland Government cautioned that an affirmative public interest test might set ‘too high a threshold’ for declaration, since the likely benefits of access may be harder to identify than the expected costs (sub. DR71, p. 3).

The Commission is of the view that the current construction of the public interest test sets a hurdle for declaring an infrastructure service that is too low to ensure that

access regulation is only applied where it is likely to generate net benefits to the community. In keeping with the broader principle that government intervention should promote community welfare, a service should only be declared where the decision maker is satisfied that access would be in the public interest test.

An affirmative public interest test could be achieved by changing the language from ‘not contrary to the public interest’ to a test of what would ‘promote the public interest’. A similar expression, ‘in the public interest’, is used in sections of the CCA (for example, in relation to prices surveillance under Part VIIA) and other legislation (for example, the *Telecommunications Act 1997* (Cwlth) and the *Fair Work Act 2009* (Cwlth)).

A ‘having regard to’ clause

There are factors that will often be relevant in assessing an application that are not expressly covered by the other criteria. These include:

- effects on investment, including the possibility of deterred, delayed or otherwise insufficient investment in infrastructure services
- administrative and compliance costs that are incurred in the event of a decision to declare a service (but not those associated with a declaration application, which parties will face irrespective of the eventual outcome).

These are factors that the NCC advises it may give consideration to when assessing a declaration application, depending on the evidence presented to it (NCC 2013b). Such factors are important to assess the efficiency implications of declaration. Without any specific requirement for them to be considered, they could conceivably be overlooked in some cases where they are relevant.

One option to ensure that decision makers consider effects on investment (positive and negative) and administrative and compliance costs is to introduce a ‘having regard to’ clause into criterion (f). A similar approach was advocated by the Law Council of Australia (sub. 32), which supplemented its suggested configuration of criterion (f) as a cost–benefit assessment by specifying broad matters that a decision maker should have regard to. Queensland Treasury and Trade also considered that criterion (f) could include ‘greater guidance on the matters that the decision maker should have regard to’ (sub. 42, p. 7). Aurizon (sub. DR72) noted that a ‘having regard to’ clause offered a rules-based approach to improve application of the criterion.

In responding to the Commission’s draft report, the NCC (sub. DR48) opposed the introduction of a ‘having regard to’ clause. Its concerns included:

- applicants seeking to address all the listed factors in criterion (f) regardless of whether they are relevant or not
- the perception that factors explicitly listed in criterion (f) would be weighted as more important than any other matters that might be relevant to the public interest
- the potential for inappropriate expansion of the clause, as a ‘reasonably confined list could become a “grab bag” of issues’ during the legislative process (sub. DR48, p. 15).

However, a ‘having regard to’ clause would not prescribe how the matters included should be assessed, or the weighting given to any particular factor over another. Rather, the NCC and decision makers would be asked to consider the listed matters in their assessment, and to exercise their judgment accordingly. The Commission also notes that ‘having regard to’ clauses are already used in Part IIIA, including in criterion (c) (section 5.5).

Beyond the investment effects and administrative and compliance costs identified above, some participants offered additional matters for inclusion in a ‘having regard to’ clause.

- The Law Council of Australia (sub. 32) and Queensland Government (sub. DR71) favoured explicitly requiring consideration of the benefits that declaration might bring — particularly the competition benefits determined in criterion (a) (section 5.4).
- Aurizon (sub. DR72) argued that coordination costs should be specifically considered in criterion (f). (As noted in section 5.3, the Commission considers that some types of coordination costs should be assessed as part of criterion (b) — production costs that would be incurred by the infrastructure service provider in meeting foreseeable demand in the absence of access regulation. Any other costs that would result from shared use of a facility would be more appropriately tested under criterion (f).)
- Rio Tinto Iron Ore (sub. DR73) suggested that criterion (f) should emphasise consideration of any environmental, social and national security consequences associated with declaration.

A ‘having regard to’ clause would be non-exhaustive — omission from the list of matters cited in the criterion does not imply that a particular factor will never be relevant to judgments about the public interest and should be discounted or dismissed. However, the Commission considers that a ‘having regard to’ clause

should emphasise matters that will generally be important to all declaration decisions, and should focus on the economic problem that the Regime should address. On balance, it does not consider that any of the aforementioned options warrant inclusion in the ‘having regard to’ clause.

Declaration, not access

The current framing of criterion (f) does not allow for an assessment of whether *declaration* is contrary to the public interest. As discussed in section 5.4 in relation to criterion (a), courts have interpreted (and subsequently decision makers have applied) a distinction in terminology between ‘access’ and ‘declaration’. The Virgin Blue case established that use of the term ‘access’ requires that the counterfactual to be tested is ‘no access’ — even in cases where access has already been privately negotiated. Consequently, where third parties already have access to the service, the assessed net gains to the community from declaration could be overstated.

As discussed in section 5.4, the NCC (2013b) considers that the current reference to access refers to access on reasonable terms and conditions. This interpretation, if upheld, would lessen the apparent distinction between ‘access’ and ‘declaration’, since reasonable terms and conditions would be the expected outcome of declaration. However, it would still not provide the opportunity to consider effects on investment and the administrative and compliance costs that are triggered by declaration. For a designated Minister to be able to express concerns about the public interest aspects of declaration, greater certainty and clarity could be achieved by redrafting criterion (f) to focus explicitly on the public interest implications of ‘access on reasonable terms and conditions through declaration’ rather than ‘access (or increased access)’ to the service.

Raising the hurdle

Criterion (f) should be a rigorous test, which only enables the declaration of infrastructure services where the decision maker is satisfied that declaration is likely to generate overall gains to the community. To this end, the Commission considers that three changes to criterion (f) are warranted.

- Criterion (f) should be an affirmative test that requires the public interest to be promoted, rather than (as is currently the case) access being ‘not contrary to the public interest’.
- A ‘having regard to’ clause should be inserted, which would require consideration of the effect of declaration on investment in infrastructure services and dependent markets, and the administrative and compliance costs that are

incurred once a service is declared. The ‘having regard to’ clause should not be an exhaustive list of what constitutes the public interest.

- The effect on the public interest of declaring a service should be assessed, rather than (as is currently the case) the effect of access (or increased access) to the service.

The Commission’s recommendations for amending the declaration criteria are set out in chapter 8.

6 Certification and undertakings

Key points

- The purpose of certification of a state or territory access regime is to improve the consistency and quality of access regimes, to promote regulatory certainty, and reduce the scope for regulatory duplication.
 - There is evidence to suggest that application of the principles in clause 6 of the Competition Principles Agreement (CPA) has led to broad consistency across state and territory access regimes in key areas.
 - The principles for certification are flexible, and allow state and territory governments to tailor access regimes to suit their jurisdictions and industries.
- While certification appears to have been effective, there is some scope to increase the net benefits associated with certification.
 - A service subject to a certified regime can be declared if there have been substantial modifications to the certified regime or the certification principles. This undermines the regulatory certainty provided by certification.
 - On receiving a declaration application, the National Competition Council may be required to assess the infrastructure service against all declaration criteria, even when the presence of a certified regime means that a service will not be declared (if there have been no substantial modifications to the certified regime or the clause 6 principles). This imposes unnecessary administrative costs.
 - There are differences between the clause 6 principles and the provisions in Part IIIA. Without reform to the CPA to remove these differences, state and territory access regimes may not be appropriately targeted at the economic problem that access regulation should address, and may not include appropriate safeguards for service providers.
 - The costs involved in requiring the states and territories to certify their electricity and gas access regimes may outweigh the benefits.
- All undertakings that have been accepted by the ACCC have been submitted due to legislative requirements or government agreements.
- Caution should be exercised before mandatory undertakings are implemented in the future. If they are used, there are some principles to be considered that should not be departed from lightly.
 - They should be subject to upfront and ongoing assessment to ensure that they are used to address a lack of competition in markets for infrastructure services.
 - They should include safeguards for service providers and existing users of the service that are consistent with those for declared services.
 - Opportunities for merits review of ACCC decisions should be preserved.

Certified state or territory access regimes and access undertakings accepted by the Australian Competition and Consumer Commission (ACCC) provide two pathways to access under Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA). This chapter discusses the purpose and use of certified access regimes and access undertakings, and the process for approving certification and undertaking applications. The chapter highlights potential issues, and chapter 8 contains recommendations to improve the certification and undertakings processes.

6.1 Certification

The Competition Principles Agreement (CPA) was agreed by the Australian, state and territory governments in 1995 and was amended in 2007 to include further principles. The CPA recognises that the National Access Regime (the Regime) is not intended to cover an infrastructure service covered by a state or territory access regime that conforms to agreed principles set out in the CPA.

All states and territories have electricity and gas access regimes, most have rail access regimes, and some have regimes for ports and urban water. These access regimes cover both government-owned and privately owned services. In Queensland, a generic access regime broadly modelled on Part IIIA applies (the *Queensland Competition Authority Act 1997*), under which sit undertakings for the rail network in Queensland and the Dalrymple Bay Coal Terminal.

Under paragraphs 44G(2)(e) and 44H(4)(e) of the CCA (referred to as criterion (e)), a service cannot be declared if access to the service is the subject of a state or territory access regime that has been certified as effective, unless there have been substantial modifications to the regime or the relevant principles in the CPA since the regime was certified. State and territory governments can apply to the National Competition Council (NCC) for a recommendation to the Commonwealth Minister to have their access regimes certified as effective (chapter 2). Under section 44N, in making a decision on whether an access regime is effective, the Commonwealth Minister must apply the principles in clause 6 of the CPA (clause 6 principles) (table 6.1), and have regard to the objects clause of Part IIIA of the CCA. Note that certification does not cover privately negotiated access regimes, or Australian Government access regimes.

Following amendments to Part IIIA in 2010, only regimes that have been certified are a relevant consideration for criterion (e) (prior to these amendments a regime was considered effective if it met the clause 6 principles, even if it was not certified). Uncertified regimes provide no protection from declaration under criterion (e). However, they may still be a relevant consideration for other criteria,

such as the public interest test — for example, the designated Minister could decide that it is not in the public interest to declare an infrastructure service when access is already being provided under an uncertified state or territory regime (Emerson 2009a).

What is the purpose of certification?

Encouraging a consistent approach to access regulation

The objects clause of Part IIIA establishes the provision of ‘a framework and guiding principles to encourage a consistent approach to access regulation in each industry’ as an objective of the Regime (s. 44AA). Certification encourages consistency across state or territory access regimes by having the NCC and the designated Minister assess the regimes against the clause 6 principles.

A consistent approach to access regulation may offer a number of benefits. First, consistency within an industry may reduce administrative and compliance costs for infrastructure service providers and access seekers that operate under multiple regulatory frameworks. Second, consistent regulation may allow regulators, access seekers and service providers to learn from the decisions of regulators in other jurisdictions and industries, and thus lower the administrative and compliance costs of the regulation.

However, implementing a consistent approach to regulation will have costs. Consistent regulation may limit the flexibility of jurisdictions to take into account the characteristics of their industries, and if there are sound reasons for differences in regulation, implementing a consistent approach to regulation is likely to generate net costs (Ergas 2012). For example, mining companies that operate rail tracks in the Pilbara region of Western Australia have suggested that their lines are unsuited to the rail track access regime that applies to most of Western Australia’s rail network, and would be better suited to haulage regulation due to the integrated nature of the Pilbara lines (BHP Billiton Iron Ore 2005; Roy Hill Infrastructure 2010). Further, different wheat export facilities have varying degrees of market power, and thus differing degrees of regulation may be warranted (PC 2010). In addition, there are likely to be costs associated with negotiating and maintaining consistency, and therefore the benefits of a consistent approach must be material to warrant proceeding (PC 2009).

Table 6.1 The clause 6 principles

<i>Clause</i>	<i>Principle</i>
6(2)	The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the state or territory party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless: a the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the state or territory b substantial difficulties arise from the facility being situated in more than one jurisdiction.
6(3)	The regime should apply to services provided by means of significant infrastructure facilities where: i it would not be economically feasible to duplicate the facility ii access to the service is necessary to permit effective competition in a downstream or upstream market iii the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.
6(4)(a)	Wherever possible, third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.
6(4)(b)	Where such an agreement cannot be reached, governments should establish a right for persons to negotiate access to a service provided by means of a facility.
6(4)(c)	Any right to negotiate access should provide for an enforcement process.
6(4)(d)	Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.
6(4)(e)	The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.
6(4)(f)	Access to a service for persons seeking access need not be on exactly the same terms and conditions.
6(4)(g)	Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.
6(4)(h)	The decisions of the dispute resolution body should bind the parties; however, rights of appeal under the existing legislative provisions should be preserved.
6(4)(i)	In deciding terms and conditions for access, the dispute resolution body should take into account: i the owner's legitimate business interest and investment in the facility ii the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets iii the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake iv the interests of all persons holding contracts for use of the facility v firm and binding contractual obligations of the owner or other persons (or both) already using the facility vi the operational and technical requirements necessary for the safe and reliable operation of the facility vii the economically efficient operation of the facility viii the benefit to the public from having competitive markets.

(Continued next page)

Table 6.1 (continued)

<i>Clause</i>	<i>Principle</i>
6(4)(j)	The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to: <ul style="list-style-type: none"> i such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility ii the owner's legitimate business interests in the facility being protected iii the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.
6(4)(k)	If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.
6(4)(l)	The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.
6(4)(m)	The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.
6(4)(n)	Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.
6(4)(o)	The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.
6(4)(p)	Where more than one state or territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other cooperative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.
6(5)(a) ^a	The regime should include objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.
6(5)(b) ^a	Regulated access prices should be set so as to: <ul style="list-style-type: none"> i generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services and include a return on investment commensurate with the regulatory and commercial risks involved ii allow multi-part pricing and price discrimination when it aids efficiency iii not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher iv provide incentives to reduce costs or otherwise improve productivity.
6(5)(c) ^a	Where merits review of decisions is provided, the review will be limited to the information submitted to the original decision maker except that the review body: <ul style="list-style-type: none"> i may request new information where it considers that it would be assisted by the introduction of such information ii may allow new information where it considers that it could not have reasonably been made available to the original decision maker iii should have regard to the policies and guidelines of the original decision maker (if any) that are relevant to the decision under review.

^a Does not apply to the Tarcoola–Darwin rail regime, or the electricity and gas access regimes established under the Australian Energy Market Agreement.

Source: Competition Principles Agreement.

The clause 6 principles are deliberately flexible to accommodate differences in characteristics between jurisdictions — they provide an overarching framework for access regimes. This provides state and territory governments with a degree of flexibility to design access regulation in a way that best suits their jurisdictions and industries.

Providing a minimum quality standard

The clause 6 principles provide a framework for state and territory access regimes through certification or by acting as a template for access regulation, and are intended to reflect the principles underlying the Regime, such as the negotiate–arbitrate model. To the extent that these principles are best practice, they may improve the quality of access regulation — either by improving its ability to meet economic efficiency objectives, or by lowering the administrative and compliance costs associated with regulation.

Promoting regulatory certainty and limiting regulatory duplication

Certification and criterion (e) limit the scope for an infrastructure service to be declared when it is already subject to an access regime that has been certified as effective. The Hilmer Committee stated that:

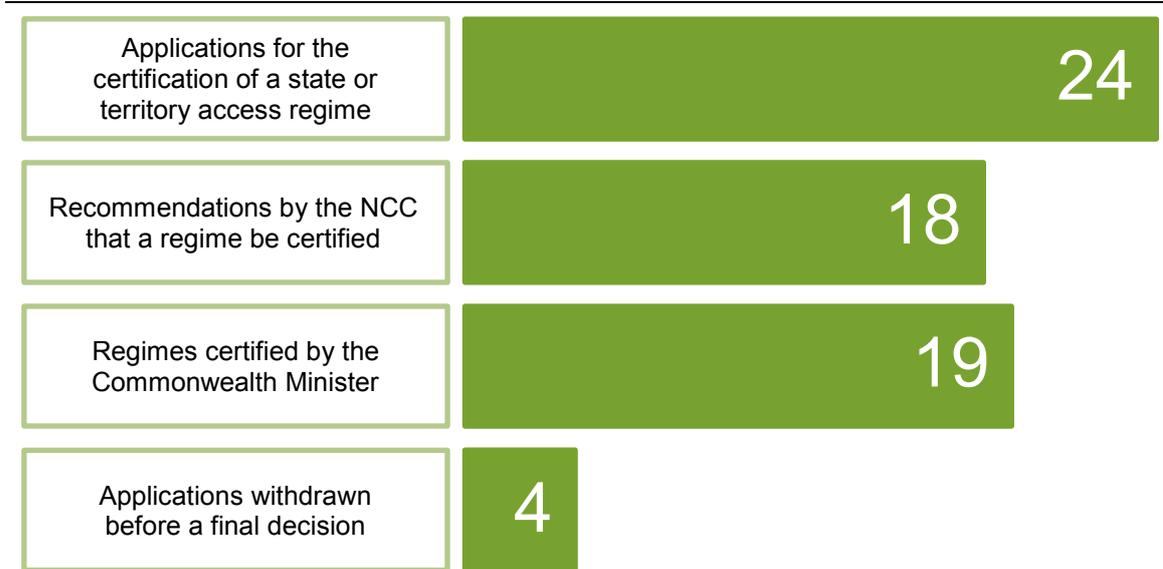
Where [a state or territory] regime provides access on fair and reasonable terms there will usually be no need for declaration under the proposed general access regime, as effective competition in upstream or downstream markets will already be possible. (1993, p. 259)

As a result, certification promotes regulatory certainty (as certifying a regime as effective makes it clear to infrastructure service providers and access seekers which regulatory regime will apply). There may also be costs associated with declaring a service that is already subject to an effective access regime, including the potential for declaration to be less effective than an industry-specific access regime that is tailored to the characteristics of the industry, and additional administrative costs for the NCC, designated Minister and regulators.

Certification in practice

Since the introduction of Part IIIA in 1995, there have been 24 applications for the certification of a state or territory access regime submitted to the NCC. The majority of these regimes have been certified (figure 6.1). (Box 6.1 discusses the Western Australian rail access regime, which the NCC recommended not be certified, but the Commonwealth Minister certified.)

Figure 6.1 **Certification matters under Part IIIA**
November 1995 – October 2013



When certifying a regime, the Commonwealth Minister must also make a decision on the timeframe over which certification should apply. In most cases, regimes have been certified for a period of 10–15 years, although in some cases this has been shorter (for example, the Commonwealth Minister certified the Western Australian rail access regime for five years due to concerns as to how it would operate in practice) and the Tarcoola–Darwin rail access regime was certified for 30 years.

In 2006 all states and territories agreed to certify all their access regimes under the Competition and Infrastructure Reform Agreement (by 2010) and, for the electricity and gas access regimes, under the Australian Energy Market Agreement (by 2007). Most regimes relating to ports, water and rail are currently certified. However, the electricity and gas regimes remain uncertified, except for the Western Australian and Northern Territory electricity regimes (table 2.3).

Box 6.1 **Certification of the Western Australian rail access regime**

On 12 May 2010, the Western Australian Government applied to the NCC requesting certification of its rail access regime. The regime covers the rail network in south-western Western Australia and the Pilbara line operated by The Pilbara Infrastructure.

The NCC recommended that this regime not be certified as it did not consider that the regime met the consistency objective of Part IIIA. This was due to the differing arrangements applying to rail lines within Western Australia, in particular in the Pilbara region.

- The rail line operated by The Pilbara Infrastructure is subject to the Western Australian rail access regime.
- The Goldsworthy line in the Pilbara operated by BHP Billiton is declared under Part IIIA.
- The remaining Pilbara lines operated by BHP Billiton and Rio Tinto are subject to haulage access requirements under state agreements.
- Roy Hill Infrastructure is expected to seek ACCC acceptance for a Part IIIA undertaking for rail haulage services on its proposed Pilbara line, or will otherwise be subject to the Western Australian rail access regime.

The NCC noted that:

... the recent decision regarding access regulation of the proposed [Roy Hill Infrastructure] railway suggests that while the WA Rail Access Regime exists there is no consistency in or certainty to its application. Looking forward there is nothing to suggest that the opportunity and ability to structure rail access regulation outside of the Regime, or potentially structure arrangements such that there is no access regulation, will not continue. (2010e, p. 68)

However, the Commonwealth Minister disagreed with the recommendation from the NCC, and decided to certify the Western Australian regime, because:

... the NCC interprets the words 'in each industry' as requiring consistency of access regulation within the WA rail industry. In my view, the words 'in each industry' refer rather to consistency across different industries ... In any case, even if the NCC's interpretation were accepted, I do not consider that for that reason alone the [WA rail access regime] could be considered not to be an effective access regime, unless such intra-industry inconsistency ... were so significant as to undermine Part IIIA's objectives. (Bradbury 2011, p. 10)

Has certification led to net benefits?

Participants were largely supportive of certification — some participants noted that certification had been successful at providing a framework for access regulation (box 6.2). However, CBH Group (sub. 12), for example, suggested that certification had not been effective in the case of the Western Australian rail access regime.

Box 6.2 Participants' views on certification

Business SA broadly supported certification:

The Council of Australian Government's (COAG) agreement ... requires that [the Essential Services Commission of South Australia] applies for certification of the state specific access regimes. This approach allows for state-specific considerations to be taken into account but also ensures that Australia has a nationally consistent approach to access regulation ... (sub. 5, p. 2)

The Law Council of Australia noted that certification plays an important role:

The Certification regime plays an important role in promoting a consistent approach to the imposition and operation of access regulation by the Commonwealth, state and territory governments. (sub. 32, p. 32)

Anglo American Metallurgical Coal suggested that, while Part IIIA led to some consistency in access regulation, the clause 6 principles are not sufficiently detailed:

Although Part IIIA has been, in part, effective in facilitating a certain level of consistency between State and Commonwealth third party access regimes, the clause 6 principles are not sufficiently detailed to ensure that access regimes are effective in terms of ensuring open and transparent access to capacity (including expansion capacity). (sub. DR50, p. 5)

CBH Group suggested that certification had not been effective in the case of the Western Australian rail access regime:

The opportune time to make changes to the WA rail access regime addressing NCC concerns ... would have been at the time the Minister was faced with deciding whether to [certify] the access regime and not hope that the matters would be dealt with later. As of today, issues flagged by the NCC in 2011 have not been addressed ... (sub. 12, p. 3)

There is evidence to suggest that application of the certification principles has led to broad consistency across state and territory access regimes in key areas. For example, all certified access regimes allow for negotiation between the service provider and the access seeker, provide for the regulator or an independent panel to act as an arbitrator in the event of a dispute, and set access prices based on similar principles.

This is not to say that all access regimes are, or should be, uniform. Industries and jurisdictions have different characteristics, and the principles are deliberately flexible in order to take these characteristics into account. For example, rail access regimes differ across jurisdictions even though the majority of these regimes are certified (box 6.3).

Certification may have led to benefits beyond those attributable to consistency. The clause 6 principles have been incorporated into access regimes, which is likely to have improved the quality of these regimes. For example:

- Asciano (sub. 15) noted that its application for declaration of Queensland rail

services led to changes to the Queensland rail access regime so it could be certified. Prior to seeking certification the Queensland Government removed a clause allowing the designated Minister to declare a service without reference to any criteria — a clause the NCC noted ‘would have been problematic’ (NCC 2010d, p. 16)

- discussions between the NCC and the South Australian and Northern Territory governments as part of the certification process for the Tarcoola–Darwin rail access regime led to changes to the regime — in particular the regime’s approach to access pricing (NCC 2000b).

Box 6.3 Comparison of the certified rail regimes

Four rail access regimes are currently certified — the Queensland, South Australian, Western Australian and Tarcoola–Darwin rail regimes. These regimes are consistent in key areas, but there is variation in some aspects of the regimes.

The negotiation framework

The regimes are all based on a negotiate–arbitrate framework. In all cases, once a request for access is received, the service provider is required to negotiate in good faith with the access seeker. The obligations of the service provider in the negotiations vary across the regimes. For example, in all cases the service provider is required to provide certain information to the access seeker on request, but the exact information requirements vary.

The dispute resolution framework

Each regime provides for a dispute resolution process where negotiations do not proceed in good faith, or an agreement is unable to be reached within a reasonable period of time. In the case of the South Australian and Tarcoola–Darwin regimes, the regulator can attempt to conciliate the dispute prior to arbitration, while in the Queensland regime an independent expert can conciliate. In the South Australian, Western Australian and Tarcoola–Darwin regimes the regulator appoints an independent arbitrator, while in the Queensland regime the Queensland Competition Authority arbitrates the dispute.

Pricing

The regimes all use a price floor/ceiling approach to set access prices. The exact method for calculating the floor and ceiling prices varies between the regimes.

In addition, the Tarcoola–Darwin regime uses a ‘sustainable competitive price’ where there is competition from other transport modes with the rail line. This bases the access price on the highest price the provider could charge having regard to the costs of other transport modes. Finally, in the Queensland regime service providers can be required to have reference tariffs for certain services approved by the regulator.

Sources: Australasia Railway (Third Party Access) Act 1999 (SA); QR Network (2010); Railways Access Code 2000 (WA); Railways (Operation and Access) Act 1997 (SA).

In addition, by limiting the scope for declaration, certification is likely to have led to greater regulatory certainty for businesses regulated under a certified regime.

The main costs of certification are likely to be the administrative costs associated with the NCC and the Commonwealth Minister assessing regimes (although there may be other costs associated with certifying some regimes — the case for certifying the electricity and gas access regimes is discussed later in this chapter). The Commission considers that the benefits of certification — improvements in the consistency and quality of access regimes and avoidance of regulatory duplication — are likely to outweigh these administrative costs. Therefore, the certification path to access should be retained. However, participants raised some issues with both criterion (e) and the clause 6 principles. The Commission has considered these issues, and evaluated the case for reform.

The use of criterion (e)

As part of the declaration process, criterion (e) tests whether a service is subject to an access regime that has been certified as effective. A declaration application meets criterion (e) if access to the service:

- is not already the subject of a regime in relation to which a decision ... that the regime is an effective access regime is in force ... or
- is the subject of a regime in relation to which a decision ... that the regime is an effective access regime is in force ... but the designated Minister believes that, since the Commonwealth Minister's decision was published, there have been substantial modifications of the access regime or of the relevant principles set out in the Competition Principles Agreement. (s. 44H(4)(e))

In assessing all declaration applications, the NCC has considered criterion (e) to be satisfied in its final declaration recommendations, although there have been some cases where the presence of a state or territory access regime has been a factor in a service not being declared.

- An appeal against the Minister's deemed decision not to declare the New South Wales Hunter Valley rail network was withdrawn after an access regime applying to the service was certified.
- In considering an application for declaration of Victorian rail track services in 2001, the NCC did not consider the Victorian rail access regime to be effective. However, the NCC found that declaration was unlikely to lead to a greater level of competition in a dependent market than the Victorian access regime, and thus criterion (a) was not satisfied.

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- In 2010, an application for declaration of the Queensland rail network was withdrawn, after the NCC indicated that an application for the certification of the Queensland rail access regime was likely to be successful.

In addition, the certification of the New South Wales water industry access regime was the trigger to have the declaration for Sydney's sewage transmission and interconnection services revoked.

Uncertainty over whether certification provides protection from declaration

One benefit of certification is the enhanced certainty it offers infrastructure service providers, investors and access seekers regarding which regulatory regime will apply to a service. However, the current certification process may not provide this certainty because:

- criterion (e) notes that a service subject to a certified access regime can still be declared if there have been substantial modifications to the regime or the certification principles since the regime was certified. It is unclear what constitutes substantial modifications
- there is no formal process by which the NCC assesses whether changes to a certified access regime constitute substantial modifications prior to a declaration application, and no requirement to notify the state or territory government that their regime no longer meets the clause 6 principles. Likewise, there is no requirement for a state or territory government to notify the NCC if there have been modifications to any of its certified regimes.

The status of the Northern Territory electricity regime, which was certified for 15 years in 2002, provides an example of this uncertainty. Following certification of this access regime, there were modifications to clause 6 of the CPA — the addition of clause 6(5), which includes requirements for regimes to include an appropriate objects clause and pricing principles. As a result, while the Northern Territory electricity regime is still certified, there may be a question about the effectiveness of the regime against clause 6 of the CPA as it now stands (NCC, pers. comm., 20 November 2012), and thus it is unclear whether certification offers protection from declaration for the services subject to the regime.

A formal mechanism to revoke certification

The Commission considers that assessing whether there have been substantial modifications to a certified state or territory regime once a declaration application is submitted undermines one of the purposes of certification — to enhance regulatory

certainty that a service cannot be declared. Both the NCC (subs. 9 and DR48) and the Law Council of Australia (sub. 32) argued that a substantial modification to a regime should be grounds for revoking certification, rather than being considered in criterion (e) once a declaration application is submitted. Such an approach would mean that, where a certified regime applies to a service, certification would need to be revoked prior to a declaration application being considered, or the service could not be declared. The Commission recommended introducing a mechanism for revoking certification in its draft report, and this was supported by participants including Asciano (sub. DR62) and the Queensland Government (sub. DR71).

A formal mechanism to revoke certification would improve regulatory certainty for service providers and access seekers, because:

- it would be clear whether a certified regime is offering protection from declaration — which would be until the certification expires, unless it is revoked by the Commonwealth Minister due to substantial modifications to the regime or the clause 6 principles
- the NCC could initiate a revocation, which would both provide a mechanism for the NCC to notify governments of any potential issues with their regimes, and allow it to recommend that certification be revoked if a scheme is no longer consistent with the CPA.

Revocation of certification should only be possible if there have been substantial modifications to the certified regime or the clause 6 principles, such that the regime would no longer meet the principles. While CBH Group (trans., p. 5) supported the introduction of a revocation mechanism, it argued that revocation should be possible if it can be demonstrated that a certified regime is not meeting the clause 6 principles, even if there have not been a substantial modifications to the regime or the principles. However, such an approach has the potential to undermine the regulatory certainty provided by certification. In order to provide regulatory certainty, the Commission considers it appropriate that, if the regime or the principles are not modified, the regime remains certified until the certification expires. At that point the regime would become uncertified, and its effectiveness against the clause 6 principles could be reassessed.

Beyond any administrative costs associated with the revocation process, the Commission is unaware of any significant costs, relative to the status quo, that would be imposed by a revocation mechanism. Therefore, the Commission considers that the regulatory certainty provided by a revocation mechanism is likely to provide net benefits to the community.

Criterion (e) as a threshold clause

Currently the protection from declaration provided by certified access regimes is achieved through one of the criteria for declaration — criterion (e). In contrast, the CCA explicitly limits a declaration application from being considered where an undertaking or competitive tender process approved by the ACCC is in place (ss. 44G(1), 44G(1A), 44H(3), 44H(3A)). The fact that criterion (e) is one of the declaration criteria means that the NCC may be required to assess a declaration application against all the declaration criteria, even if a certified regime, that has not had substantial modifications is in place and hence the service cannot be recommended for declaration.

As things stand, the Council and Minister may be required to undertake detailed consideration of the other criteria despite there being no prospect of declaration because of the application of a certified regime. (NCC, sub. 9, p. 20)

This imposes unnecessary administrative costs on infrastructure service providers, access seekers and the NCC. Participants, including APA Group (sub. DR60), Asciano (sub. DR62) and the NCC (subs. 9 and DR48) supported making criterion (e) a threshold clause to be assessed prior to assessment against the declaration criteria. Amending Part IIIA so that this criterion becomes a separate threshold clause stating that an infrastructure service cannot be declared if it is subject to a certified access regime would avoid the administrative costs incurred by infrastructure service providers, access seekers and the NCC of assessing a declaration application against all the declaration criteria, even if a certified regime is in place. Only when this threshold is passed would consideration be given to the declaration criteria.

Uncertified access regimes

APA Group (sub. DR60) noted that criterion (e) was amended in 2010 (such that a regime is only considered effective if it has been certified), and no longer offers any protection for services subject to uncertified regimes. APA Group considered that the pre-2010 formulation of the criterion provided more appropriate protection from dual regulation. The Commission considers that the criterion (or the replacement threshold clause) should continue to apply only to certified regimes.

- Certification provides certainty to market participants that they will not be subject to regulatory duplication, and enhances the consistency and quality of regimes. Assessing uncertified access regimes against the clause 6 principles does not improve certainty, or the quality or consistency of access regimes, and would diminish incentives for state and territory governments to certify their access regimes.

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- Assessing uncertified regimes against the clause 6 principles adds to the administrative burden on the NCC in a declaration application.

The Commission notes that a relevant uncertified access regime could be a consideration for criterion (a) (the promotion of competition test) and criterion (f) (the public interest test). If an application for a service met the declaration criteria (and other tests), then there would likely be net benefits from declaring the service, regardless of whether it is subject to an uncertified access regime.

The certification principles

Clause 6 of the CPA contains a range of principles used by the NCC and the Commonwealth Minister to assess whether a state or territory access regime should be certified as effective (table 6.1). In applying these principles, the NCC groups them into five areas — the scope of the access regime, interstate issues, the negotiation framework, the dispute resolution framework, and the terms and conditions of access (NCC 2011d).

The NCC and the Commonwealth Minister have flexibility in interpreting these principles — section 44DA of the CCA notes that the principles have the status of guidelines only. As discussed above, this acknowledges the need for flexibility in designing access regimes across industries and jurisdictions.

Are the clause 6 principles consistent with Part IIIA?

There are differences between the clause 6 principles, and the provisions in Part IIIA. In particular, the principles relating to coverage of an access regime (clause 6(3)) differ from the criteria for declaration (ss. 44G and 44H of the CCA).

- In 2010, criterion (d), requiring that the Minister be satisfied that access to the service could be provided without undue risk to human health and safety, was repealed as it was considered that such issues can be managed by other relevant regulation (Emerson 2009a). A similar criterion remains in the clause 6 principles.
- The wording of clause 6(3) differs from the wording of the relevant declaration criteria (a), (b) and (c) (although the Commission notes that criterion (c), which relates to the national significance of a facility, may not be relevant for state and territory access regimes (Queensland Government, sub. DR71)).
- The clause 6 principles do not include a public interest test.

In addition, the provisions in Part IIIA relating to safeguards for extensions directed by the ACCC when making an access determination (chapter 4) differ from those in the CPA. Clause 6(4)(j) of the CPA includes some safeguards for infrastructure owners, including that the owner's legitimate business interests in the facility should be protected when directing an extension. However, the CPA does not include the safeguards contained in section 44W of the CCA, including the requirement that an infrastructure service provider should not be required to bear some or all the costs of an extension of its facility. Therefore these safeguards are not required to be included in state or territory access regimes for the regime to be certified.

The NCC (sub. 9) considered that the wording disparities between clause 6 and Part IIIA predominantly reflect the different authorship of the CPA and the CCA, and do not reflect different intentions. The differences also reflect the sequence of reforms — the CPA was agreed prior to the implementation of the Regime. In addition, in some cases the CPA has not been updated to reflect amendments to Part IIIA (for example, the removal of the safety criterion for declaration from Part IIIA (discussed above)). Should the reforms to the declaration criteria recommended in this report be adopted, the divergence between the clause 6 principles and Part IIIA would increase.

Do the inconsistencies between the CPA and Part IIIA matter?

There is a strong rationale for aligning the principles in clause 6(3) with the relevant declaration criteria in the CCA. As noted in chapter 5, the declaration criteria determine the scope of the Regime so it is important that these criteria are targeted at addressing the economic problem. That is, where there is an enduring lack of effective competition in markets for infrastructure services due to natural monopoly. The Commission's proposed reforms to the declaration criteria (chapter 8) seek to achieve this.

If the Commission's proposed amendments to the declaration criteria are not reflected in the clause 6 principles (specifically clause 6(3)), state and territory access regimes may not be appropriately targeted at the economic problem that access regulation should address. This may mean that access regulation is applied where it will not lead to an increase in economic efficiency. In other cases, access regulation may not be applied where it would be beneficial to do so, and potential benefits from increased competition may be lost.

In addition, given the various interpretations of the declaration criteria (chapter 5) the difference in wording between clause 6(3) and the declaration criteria is likely to increase uncertainty regarding the interpretation of both. Indeed, the wording of the

CPA was used in the High Court’s interpretation of criterion (b) in the Pilbara rail case.¹

Textual considerations point away from the construction adopted by the Tribunal and point towards adopting a privately profitable construction of criterion (b) ... [the CPA] principles direct attention to whether it is ‘economically feasible to duplicate the facility’ ... [T]hat expression points away from reading criterion (b) as requiring an evaluation of efficiency from the perspective of society as a whole rather than an evaluation of what would be feasible or practical for an actual or potential participant in the market place. (para. 96)

The Queensland Government noted that there ‘may be merit in amending the coverage principles [in the CPA] to more closely align with a revised set of declaration criteria ...’ (sub. DR71, p. 3).

As discussed in chapter 4, the Commission considers that there is a strong case for the safeguards in section 44W of the CCA to apply to services declared under the National Access Regime. However, some participants raised concerns about the adequacy and workability of these safeguards. The Commission has recommended that the ACCC develop and publish guidelines on how its power to direct an extension of a facility would be exercised in practice, which should include an analysis of the workability and adequacy of the safeguards (chapter 8). Once these guidelines have been published, consideration should be given to including these safeguards in the CPA.

Finally, there may be a rationale for streamlining the clause 6 principles in some cases. The NCC suggested that ‘the principles are numerous, lengthy, overlap and in some cases appear conflicting’ (sub. 9, p. 9). Streamlining the principles could minimise the burden on state and territory governments attempting to ensure that their regimes meet the clause 6 principles. However, as the NCC groups the principles into five categories of related principles when assessing certification applications, streamlining the principles is likely to have fewer benefits, and is therefore less of a priority, than aligning the clause 6 principles with the declaration criteria.

The Commission acknowledges that it will take time and effort to update aspects of the CPA, given that any changes would require the agreement of all states and territories and the Australian Government. Chapter 8 considers this further, and includes a recommendation on this issue.

¹ *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36.

The requirement to certify access regimes

The state and territory governments agreed to submit their access regimes for certification in the Competition and Infrastructure Reform Agreement, and (for electricity and gas) in the Australian Energy Market Agreement. Some state and territory access regimes remain uncertified.

Victoria and New South Wales have in place rail access regimes that are not certified. Victoria's rail access regime was reviewed in 2010 with a view to seeking certification (ESC 2010). The Victorian Government has not responded to this review. New South Wales is currently reviewing its regime, with the intention of seeking certification of the regime following the review (Transport for NSW 2012). All electricity and gas regimes, except for the Western Australian and Northern Territory electricity regimes, remain uncertified.

Inquiry participants did not raise any concerns about the New South Wales and Victorian rail regimes being uncertified. However, some participants raised concerns with the certification status of the electricity and gas regimes.

Will certification of the electricity and gas regimes lead to net benefits?

A number of inquiry participants suggested that the certification of electricity and gas access regimes is needed to improve the consistency of these regimes with Part IIIA, and to increase regulatory certainty for market participants by removing the possibility that an electricity or gas service could be declared (APA Group, subs. 35 and DR60; Australian Pipeline Industry Association, subs. 14 and DR52; NCC, subs. 9 and DR48; Origin Energy, sub. 11; Treasury, sub. 34). The NCC (sub. DR48) also suggested that, if the regimes remain uncertified, an application for the declaration of an electricity or gas service could occur at the same time as a privatisation, leading to regulatory uncertainty.

On the other hand, the Australian Energy Market Commission (AEMC) (subs. 21 and DR75) and the Department of State Development, Business and Innovation (Victoria) (sub. DR63) suggested that the certification of electricity and gas access regimes would offer little benefit over the current regulatory arrangements, and impose upfront and ongoing costs, because:

- there is the potential for duplication of regulatory processes, as the NCC would be required to assess rules that are administered by an independent body (the AEMC), which could undermine the role of the AEMC
- electricity and gas regimes are constantly changing, and under the current certification provisions there is a potential need for the regimes to be recertified

each time there is a change to the rules in the electricity and gas access regimes, to ensure that the protection offered by certification remains

- the AEMC is required to make rule changes in accordance with the national energy objectives, and it is unclear that, having decided that a rule is aligned with these objectives, it could change the rule if the NCC considers that the rule is inconsistent with the clause 6 principles.

The Queensland Government (sub. DR71) also noted that it considered the costs of certifying the electricity and gas regimes would outweigh the benefits.

The Commission considers that the benefits associated with certifying the electricity and gas regimes are likely to be small. Participants suggested that the risk of a declaration application for electricity or gas services occurring or succeeding was low (Department of State Development, Business and Innovation (Victoria), sub. DR63; NCC, sub. DR48). In addition, these regimes are already consistent across participating states and territories as they are applied via template legislation. The Commission notes the views of the Victorian Department of State Development, Business and Innovation (sub. DR63) that consistency with the Regime is less important than consistency with good regulatory practice, and that the institutions associated with the electricity and gas regimes are well placed to ensure that these regimes are of a high standard.

The Commission's review of electricity network regulatory frameworks identified a number of issues with electricity regulation, including in the areas of the timeliness of rule changes, the role of demand management, the efficiency of network expenditure and reliability standards, and included recommendations to address these issues (PC 2013a). The Commission considers that these issues are best dealt with directly, rather than indirectly through the certification process.

On balance, the Commission considers that the costs of certifying the electricity and gas regimes may outweigh the benefits. Reforms to the certification process outlined in chapter 8 may reduce some of the costs of certification. In particular, the potential need to recertify the electricity and gas access regimes following rule changes would likely be removed if the Commission's recommendation to replace the current provisions relating to substantial modifications of a regime with a revoking mechanism is implemented. However, other costs will remain, including the administrative costs of certification, and the risk of undermining the role of the AEMC if the NCC and the Commonwealth Minister determine that the regimes are not effective.

Should the electricity and gas access regimes be deemed to be certified?

Both the AEMC (sub. 21) and the Department of State Development, Business and Innovation (Victoria) (sub. DR63) suggested that the regimes could be statutorily recognised as effective.

... it would be desirable to put this matter beyond doubt, to ensure that infrastructure owners and access seekers alike have certainty over access arrangements. To do so without compromising the effectiveness of the energy regulatory arrangements, the effectiveness of the energy access regimes could be statutorily recognised under Part IIIA, reflecting the Commonwealth's adoption and endorsement of these regimes ... (Department of State Development, Business and Innovation (Victoria), sub. DR63, pp. 7–8)

The Commission does not consider that a deemed certification for the electricity and gas regimes would be appropriate. As noted above, participants suggested that the risk of declaration is low, and thus a deemed certification would have little benefit. A service can only be declared if it satisfies the declaration criteria (which would include an assessment of whether declaration would lead to a greater level of competition in a related market than that generated by the state or territory access regime). If the declaration of the service meets the declaration criteria, declaration would be expected to generate net benefits to the community. Deemed certification would remove the possibility that these potential net benefits could be captured.

The certification of other state and territory access regimes

Other access regimes, such as those for rail, are not applied via template legislation, and thus the regulatory requirements can vary across jurisdictions. Therefore, there may be broader benefits to service providers and access seekers from ensuring that these regimes are certified and thus reflect consistent principles. Given this, the Commission is of the view that it would be beneficial if state and territory governments seek certification of these regimes.

6.2 Undertakings and access codes

Under section 44ZZA of the CCA, the provider of an infrastructure service (or the person who expects to be the provider of a service) can submit an undertaking to the ACCC for acceptance. The CCA does not specify what must be included in an undertaking (except that the undertaking must include an expiry date), but it can include the terms and conditions of access to the service, and obligations on the service provider to provide information and to not hinder access to the service. The terms of an undertaking can be enforced in the Federal Court.

The ACCC may accept an undertaking if it considers it appropriate to do so having regard to a range of matters contained in section 44ZZA of the CCA (chapter 2). Once an undertaking has been accepted, it cannot be varied or revoked for the time it is in place, unless both the ACCC and the service provider agree.

The ACCC can also accept an access code from an industry body prescribed in regulations. (The AEMC is the only currently operating organisation prescribed as an industry body.) An access code does not provide any protection from declaration. Rather, it provides a framework for infrastructure service providers in the industry to submit undertakings that are consistent with the access code. It also streamlines the process for ACCC acceptance of an undertaking from infrastructure service providers within that industry.

What is the purpose of undertakings?

Undertakings allow infrastructure service providers to have an access regime relating to a service accepted by the ACCC. The ACCC noted that:

Undertakings can provide certainty over access terms and conditions, including how prices will be set, and balance the infrastructure operator's interests in recovering its efficient costs (including sunk network costs) and the access seekers' interest in obtaining sufficient certainty about access terms and conditions to reduce the risks associated with complementary investments. (sub. 16, p. 32)

Undertakings can be used to provide certainty to both service providers and potential access seekers over the terms and conditions of access to the service that will be offered. Undertakings often provide detail on issues such as what information will be provided to access seekers, the method to be used for pricing (including, in some cases, reference tariffs), dispute resolution processes, and capacity management. These details can be tailored to the specific industry or jurisdiction.

Undertakings can also be used following declaration to streamline the process for negotiating the terms and conditions of access, particularly where there are multiple access seekers. Undertakings could also be used where a person expects to be the provider of a proposed infrastructure service. There are no examples of Part IIIA undertakings being used in these ways.

Undertakings and access codes in practice

The use of undertakings has been limited. All undertakings under Part IIIA that have been accepted by the ACCC were the result of other government legislation, lease agreements or an intergovernmental agreement. Since the commencement of Part IIIA, the ACCC has accepted:

- undertakings for the Australian Rail Track Corporation's (ARTC) interstate rail network and Hunter Valley rail network
- undertakings from wheat export terminal service providers. The *Wheat Export Marketing Act 2008* (Cwlth) requires vertically integrated bulk wheat exporters to have in place an access undertaking accepted by the ACCC, or be subject to an effective access regime (section 6.1). Currently, four bulk wheat exporters have undertakings in place (chapter 2)
- an access code for the National Electricity Market. The code required a transmission or distribution provider to submit an undertaking noting their compliance with the code in order to be a registered provider. This code has been replaced by the National Electricity Law, and is no longer in operation. The ACCC accepted 23 undertakings in accordance with the code.

The undertakings currently in place are outlined in table 6.2.

Some inquiry participants considered that Part IIIA undertakings have proven effective at providing access to infrastructure services. For example, Dominic L'Huillier stated:

... the undertaking aspects of Part IIIA and at the State level ... have on balance, appeared to work quite well. For example, the 2002 and 2008 Australian Rail Track Corporation Interstate Access Undertakings and Hunter Valley Coal Network undertakings [and] the Commonwealth wheat access undertakings (which resulted in over twenty traders entering the market for export wheat) ... (sub. 7, p. 23)

The ACCC also noted that undertakings have been effective:

The ACCC considers that the access undertakings path under Part IIIA has been effective in promoting economic efficiency and competition and aligning incentives for efficient operation and investment across supply chains. This has particularly been the case in relation to third party access arrangements to wheat port terminals and ARTC's interstate and Hunter Valley rail networks. (sub. 16, pp. 31–2)

Table 6.2 Current undertakings^a

<i>Company</i>	<i>Coverage</i>	<i>Date first submitted to the ACCC^b</i>	<i>Date accepted</i>	<i>Duration of the undertaking</i>
Australian Rail Track Corporation	Interstate rail network operated by the ARTC	8 June 2007	30 July 2008 ^c	10 years
Australian Rail Track Corporation	Hunter Valley rail network operated by the ARTC	23 April 2009	30 June 2011 ^d	5 years
Emerald Logistic Services	Wheat terminal at Melbourne Port	26 March 2013	26 September 2013	1 year
CBH Group	Wheat terminals at Albany, Esperance, Geraldton and Kwinana	31 March 2011	28 September 2011 ^e	3 years
GrainCorp Operations	Wheat terminals at Carrington, Fisherman Islands, Geelong, Gladstone, Mackay, Port Kembla and Portland	22 September 2010	22 June 2011	Until 30 September 2014
Viterra Operations	Wheat terminals at Port Adelaide, Port Giles, Port Lincoln, Thevenard and Wallaroo	23 December 2010	28 September 2011 ^f	3 years

^a In addition to these undertakings, 28 undertakings accepted by the ACCC are no longer in operation — 23 electricity undertakings, 4 wheat undertakings, and 1 rail undertaking. ^b In some cases, undertakings have been resubmitted to the ACCC following suggested amendments. This date is the date the first undertaking relating to the application was submitted. ^c The ARTC interstate rail undertaking was varied on 10 April 2013. ^d The ARTC Hunter Valley undertaking was varied on 17 October 2012. ^e The CBH Group undertaking was varied on 5 December 2012 and 7 August 2013. ^f The Viterra Operations undertaking was varied on 9 May 2012.

Sources: ACCC (2008, 2011a, 2011b, 2011c, 2011f, 2012a, 2012b, 2012c, 2013c, 2013d).

However, other participants pointed to issues with undertakings that may have limited their use and effectiveness.

- The ARTC (sub. 20) and CBH Group (sub. 47) noted that it has been costly to develop and comply with the rail and wheat undertakings.
 - The ARTC’s Hunter Valley rail access undertaking (box 6.4) took more than two years to be accepted by the ACCC, following a year of consultation with stakeholders.
 - In the Commission’s inquiry into wheat export marketing arrangements, wheat exporters noted that the development and acceptance processes cost around \$1 million each. Following this, the undertakings were estimated to impose ongoing compliance costs of up to \$500 000 each annually (PC 2010). CBH Group (sub. 47) stated that its required undertaking had resulted in administrative and compliance costs of between \$2.3 million and \$2.7 million over the period 2009 to 2012.

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- Undertakings and access codes can limit the flexibility of service providers or regulators to change their access arrangements. The AEMC noted that any changes to the national electricity code required ACCC approval, which caused delays and uncertainty. CBH Group (trans., p. 10) noted that it had been unable to get changes to its auction system accepted by the ACCC in time to incorporate them before a wheat harvest.

Box 6.4 Approval process for the Hunter Valley undertaking

The ARTC operates the Hunter Valley rail network in New South Wales. This network is part of the broader Hunter Valley coal chain, which is coordinated by the Hunter Valley Coal Chain Coordinator.

On 23 April 2009, the ARTC lodged an undertaking with the ACCC to cover its Hunter Valley rail network. Following a consultation process, the ACCC reached a draft decision on 5 March 2010 to not accept the undertaking — noting that the Hunter Valley undertaking was complex due to the need to consider broader supply chain issues. The ACCC recommended revisions in areas including:

- clarifying the scope of what is subject to negotiation between the access seeker and the ARTC
- aligning capacity management with the Hunter Valley supply chain
- clarifying consultation processes in relation to additional capacity.

Following this, the ARTC withdrew the application.

The ARTC submitted a new undertaking on 7 September 2010. The ARTC noted that it had taken on many of the ACCC's recommended revisions, but that as a result it was now subject to greater financial risk, which needed to be considered when determining an appropriate rate of return.

The ACCC released a position paper in December 2010, which outlined further suggested changes to the undertaking, including to the framework for capacity investment and the required rate of return.

The ARTC withdrew the application and submitted a new application on 23 June 2011. This application was accepted on 30 June 2011.

Sources: ACCC (2010a, 2010c, 2011b).

Is the acceptance process for undertakings too long and costly?

As noted above, some participants raised concerns that the undertaking process has been long and costly. This may lead to regulatory uncertainty, impose unnecessary costs on service providers, and result in providers being unwilling to voluntarily submit access undertakings. The ARTC stated that:

The extended time needed to develop and approve an access undertaking, as well as the

early reviews of unresolved processes, more general mid-term reviews of undertakings, and conservative approach to the term of undertakings all impose significant additional cost and resourcing on the access provider. (sub. 20, p. 14)

In 2010 (after the initial ARTC Hunter Valley undertaking application) the Australian Government made two amendments to streamline the undertaking approval process (Emerson 2009a).

- The ACCC can now issue amendment notices to an applicant, outlining suggested changes to an undertaking. This allows an undertaking to be revised without it being withdrawn or rejected.
- The ACCC must make a decision on an undertaking within 180 days (subject to various clock-stopping provisions).

The effect of these changes remains unclear, given that these amendments have been in place for a limited time. However, the time limits for an undertaking decision may not have substantially streamlined the Hunter Valley undertaking process — which consisted of two applications being submitted (and withdrawn) before a final application was accepted by the ACCC.

Both the Hunter Valley and the wheat export undertakings have unique features that may have increased the time and costs associated with developing undertakings and having them accepted by the ACCC. The Hunter Valley undertaking included a large number of stakeholders, and considered broader supply chain issues, which increased the complexity of the undertaking (ARTC, sub. 20). The ACCC noted that many of the factors that led to delays in the Hunter Valley process ‘were within the control of ARTC’ (sub. 43, p. 2). The wheat export undertakings were developed in the context of the transition to a deregulated bulk wheat export market, and were the first agreements of their kind for the industry.

The use of mandatory undertakings

In some cases, in particular for bulk wheat handlers, governments have mandated undertakings, with ramifications for the service provider if it does not comply with this requirement. Participant views on the need for mandatory undertakings were mixed. Gilbert + Tobin (sub. 45) noted that mandatory undertakings can be useful for setting the terms and conditions of access upfront, and the ACCC (trans., p. 92) noted that mandatory undertakings can be useful in specific circumstances. On the other hand, CBH Group (sub. 47) suggested that its wheat terminal undertaking had imposed costs for little benefit, and the NCC expressed concern about bypassing the Part IIIA declaration process, and suggested that the use of mandatory undertakings has ‘significantly enlarged the scope of access regulation’ (sub. DR48, p. 20).

The Productivity Commission has previously considered mandatory undertakings in its inquiry into wheat export marketing arrangements. The Commission found that the wheat access test (which included a requirement to submit undertakings) had worked well as a short-term transitional measure (chapter 2). However, the Commission noted that the arrangements would likely have net costs in the long run, due in part to the perverse effect of the undertakings on investment incentives, and the administrative and compliance costs associated with the undertakings. The Commission recommended that the access test should not be retained beyond 2014 (PC 2010).

Participants suggested that there are further costs associated with mandatory undertakings, noting that mandating an undertaking may result in some of the safeguards included in the declaration pathway under the Regime being bypassed.

First, merits review of ACCC decisions may not be an option for service providers if a deadline for having an undertaking in place is imposed. CBH Group suggested that, in the case of the wheat terminal undertakings, merits review was not a viable option (sub. 47). CBH Group also indicated that it would have applied for merits review of the ACCC decisions on whether to accept the wheat undertakings had there not been the risk of ramifications if it exercised its review rights (trans., p. 7).

Second, when deciding whether to accept an undertaking, the ACCC is not required to have regard to the safeguards in section 44W of the CCA — which include that the ACCC may not prevent an existing user of the service from obtaining a sufficient amount of the service to meet their reasonably anticipated requirements (NCC, sub. 9) (although these safeguards are included in the dispute resolution processes in all current Part IIIA undertakings). In the case of bulk wheat exporters, it was unclear whether the bulk handlers would need to ‘join the queue’ to use their service. This may have stemmed from the objectives of the Wheat Export Marketing Act, which noted that access should be on ‘fair’ terms, and this may have been interpreted as non-discriminatory access (PC 2010).

Finally, the ACCC is not required to assess whether a service should be covered by access regulation in its assessment of undertakings, either upfront or on an ongoing basis. (The ACCC is required to have regard to the objects clause in Part IIIA when considering whether to accept an undertaking). CBH Group stated that mandatory undertakings did not incorporate the same rigour used in the declaration process:

... under [the Wheat Export Marketing Act], some port terminal owners were forced into the National Access Regime without regard to the factors normally taken into account under the declaration process ... Effectively a port terminal owner could not balance off the cost of submitting a voluntary access undertaking against the risk of declaration and loss of control over [the] facility. (sub. 47, p. 5)

In addition, CBH Group (sub. 47) considered that mandatory undertakings were unnecessary for bulk handlers in the wheat sector, and that access would have occurred without the undertakings.

Caution should be exercised before mandatory undertakings are implemented in the future. Where mandatory undertakings are used, they should be subject to upfront and ongoing assessment to ensure that they are used to address an enduring lack of effective competition in markets for infrastructure services. This will help to ensure that undertakings deliver net benefits (chapter 8 considers this further). In addition, opportunities for merits review of ACCC decisions should be preserved, and the safeguards for the provider and other existing users of the infrastructure service should be consistent with those for declared services. These principles should not be departed from lightly, and any departures should not be maintained as an ongoing feature of an access arrangement.

Are deemed declarations an alternative to mandatory undertakings?

As an alternative to mandatory undertakings, the NCC (sub. DR48) suggested that services could be statutorily deemed to be declared and that this would be preferable as the safeguards outlined above are included in the provisions for declared services. However, the NCC also suggested that, in some cases, it may be ‘necessary to limit the application of the safeguards’, for example, where a provider’s use of its facility needs to be curtailed in order to promote competition in related markets (sub. DR48, p 21).

The Commission does not endorse the use of statutorily deeming a service to be declared. The Commission has previously noted that, in the case of airports, deemed declaration could side-step the checks and balances of the declaration process and undermine the light-handed regulatory regime in place in the airports sector (PC 2011b, p. 181).

If a government wishes to have a service declared, it has the option of submitting an application for declaration to the NCC. For example, the Tasmanian Government engaged Pacific National to operate the Tasmanian rail network in 2007, and sought declaration of the track to ensure that rail haulage operators would have a right to negotiate access (DIER 2007). If, after assessing the service against the declaration criteria, the designated Minister elects not to declare the service, this means that there are expected net costs from declaring the service, and statutorily deeming the service to be declared would have resulted in expected net costs to the community. In some cases, other pathways to access may also be available, such as having a

competitive tender process approved by the ACCC (chapter 8), or applying a certified access regime to the service (section 6.1).

As noted in chapter 3, there are costs associated with access regulation, and it is important to carefully design access regimes to limit declaration to instances where regulation is likely to generate net benefits to the community. The Commission has proposed reforms to the declaration criteria to confine the scope of access regulation to where it is most likely to generate net benefits to the community (chapter 8). Further pathways to access that could be used to circumvent the application of the declaration criteria risk broadening the scope of access regulation, imposing costs on the community and adversely affecting incentives to invest in infrastructure services. The Commission considers that the existing pathways to access are adequate, and does not consider that this additional pathway to access is warranted.

Should mandatory undertakings be used after a service is declared?

Some participants also expressed a preference for undertakings to be mandated after a service has been declared. For example:

Voluntary undertakings should be encouraged and or become a mandatory complement to when a service is declared. Commercial negotiation is fine, but some parameters may help its success. Parties involved in potential access negotiations must have some idea of the terms and conditions they would be willing to agree access on. These terms should be embodied in an undertaking and included at the time a declaration application is made. (Dominic L’Huillier, sub. 7, p. 19)

The [NCC] suggests that the Commission consider the introduction of a fuller form of regulation consequent on the declaration of a service. In the [NCC]’s view such a fuller form of regulation should involve a requirement that a service provider (or providers) have an ex-ante access undertaking approved by the ACCC. (NCC, sub. 9, p. 17).

The Commission does not consider that mandatory undertakings after a service has been declared under Part IIIA are warranted. Mandatory undertakings diverge from the principles of the negotiate–arbitrate framework — Part IIIA gives primacy to private negotiation, which the Commission considers appropriate (chapter 4). Where a service provider considers that an undertaking may assist the negotiation process, it has the option of submitting a voluntary undertaking after declaration.

7 Is the National Access Regime achieving its objectives?

Key points

- The National Access Regime should be retained as an overarching framework for access regulation, with Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) playing a backstop role for infrastructure services that are not covered by other access arrangements.
- Renewed emphasis should be given to ensuring that the Regime better targets the economic problem to reduce the risk of imposing unnecessary costs on the community and deterring investment in markets for infrastructure services for little gain.
- There are likely to be net benefits from having the National Access Regime operate as an overarching access regime.
 - The Regime is likely to improve the quality of state and territory access regimes through a demonstration role and the formal certification process.
 - In the absence of the Regime, governments may adopt ad hoc approaches to access regulation that result in less efficient outcomes than under the Regime.
- It is clear that access regulation has the potential to alter investment incentives. By increasing certainty of access terms and conditions it increases incentives for investment in dependent markets, but the cost could be increased uncertainty for infrastructure service providers, and deterred or delayed investment in infrastructure service markets. However, well designed and implemented access regulation can promote efficient investment.
- The empirical evidence on the economic effect of the Regime is insufficient for a modelling exercise and the Commission adopted a largely qualitative approach to its assessment of the costs and benefits of the Regime. The limited empirical evidence reflects:
 - the inability to observe what would have occurred in the absence of the Regime
 - Part IIIA's backstop role and that the effect of the threat of access regulation on incentives for parties to reach negotiated outcomes cannot be measured
 - that it is not possible to robustly assess the costs and benefits to the economy of investment decisions that have been affected by the Regime
 - that the effects of the Regime cannot be isolated from other factors affecting infrastructure investment, productivity and economic growth.
- As a result, it has not been possible to quantify the economic effects of the Regime or its effect on economic growth and productivity.

The objectives of the National Access Regime (the Regime) set out in Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) are to (s. 44AA):

- promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets
- provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

As identified in chapter 3, the economic efficiency objective of the Regime is appropriate and there is a rationale for access regulation to address market failure in certain circumstances. However, there are also costs associated with intervention. Access regulation will only achieve its economic efficiency objective if its benefits outweigh the costs it imposes on the community.

This chapter first outlines the costs and benefits of declaration under Part IIIA and of maintaining an overarching national access regime. It then provides the Commission's assessment of whether the Regime is achieving its economic efficiency objective.

7.1 The Commission's approach

The terms of reference require the Commission to assess the performance of the Regime in meeting its rationale and objectives, and to comment on the full range of economic costs and benefits of infrastructure regulation, including contributions to economic growth and productivity.

What needs to be considered when assessing the costs and benefits of the Regime?

The assessment of whether the Regime generates net benefits and is meeting its economic efficiency objective requires consideration of:

- the scope of the Regime
- the alternative scenario or 'counterfactual' to enable comparison between the costs and benefits attributable to the Regime and what would happen (or would have happened) if the Regime did not exist
- the range of relevant costs and benefits.

The scope of the National Access Regime

The scope of the National Access Regime is broad and the Regime forms a significant part of Australia's overall framework of access regulation. As discussed in chapter 2 and chapter 8, the Regime operates alongside a number of state and territory access regimes, Australian Government industry-specific access regimes, and facility-based access arrangements.

- Queensland has a generic access regime for state-significant infrastructure. The Queensland regime is broadly modelled on the National Access Regime.
- Electricity and gas transmission and distribution networks in each jurisdiction are subject to industry-specific access regimes (electricity regimes in Western Australia and the Northern Territory are certified).
- All states except Tasmania have access regimes for their intrastate rail track (the Queensland, South Australian, and Western Australian regimes are certified) and South Australia and the Northern Territory have developed a regime for the Tarcoola–Darwin rail line (also certified).
- Access regimes exist for several ports in South Australia and for the Dalrymple Bay Coal Terminal in Queensland (both regimes are certified).
- New South Wales has an industry-specific regime for water and sewerage infrastructure (the regime is certified).
- Facility-based arrangements comprising access undertakings under Part IIIA exist as a condition of government legislation for bulk wheat export terminal operators, as a condition of lease agreements for the Hunter Valley rail network and as a condition of an intergovernmental agreement for the interstate rail network operated by the Australian Rail Track Corporation (ARTC).
- Separate access regimes under Commonwealth legislation exist for telecommunications services, postal services and financial payments system services. These regimes are outside the scope of this inquiry and thus are not considered in the Commission's analysis.

Industry-specific regimes and facility-based access arrangements are the primary form of access regulation for the infrastructure services to which they apply. Declaration under Part IIIA therefore plays a backstop role for infrastructure services that are not covered by other certified access regimes or an undertaking accepted by the Australian Competition and Consumer Commission (ACCC) (chapter 6).

Since the establishment of the Regime, access seekers have sought to use declaration under Part IIIA to gain access to services provided by a variety of

infrastructure: rail lines and airports, a jet fuel pipeline, a dam, a sewage transmission and interconnection network, and a computer network (chapter 2). The threat of declaration under Part IIIA could also be quite pervasive, given the wide coverage of the Regime, and may have prompted providers of other infrastructure services to permit access or altered access conditions (which may, or may not, have delivered more efficient outcomes). The threat of declaration may also have prompted state and territory governments to implement industry-specific and facility-based access regimes.

In the future, different services may be subject to declaration applications than has been the case in the past. In its 2010-11 and 2011-12 annual reports, the National Competition Council (NCC) presented a series of horizon studies of services where it anticipates third party access issues relevant to Part IIIA may emerge. The identified services include petroleum import terminal services, water and wastewater services, financial and equity market clearing and settlement services, carbon geo-sequestration facility services, and port services. These studies indicate that although access issues could develop in these industries in the future, in some cases they are only likely to arise if industry conditions change (NCC 2011c, 2012a).

In addition to the backstop role played by Part IIIA, the Regime acts as an overarching framework for other regimes, for example, through certification and as a template for regulation, and so has a broader influence on access regulation.

What is the relevant counterfactual?

The appropriate approach to assessing whether the Regime is generating net benefits to the community is to assess the costs and benefits of the Regime relative to the counterfactual of not having the Regime. In the absence of the Regime, governments would still be able to regulate access to infrastructure services through other regulatory frameworks including, for example, industry-specific and facility-based access regimes.

As noted by the ACCC (2010b), the construction of the appropriate counterfactual when evaluating infrastructure regulation can be difficult, and the approach taken must be consistent with other aspects of the evaluation process, including the relevant policy question, evaluation design and data availability.

In assessing whether the Regime is generating net benefits to the community, it is important to adopt an approach that uses evidence on the effects of the Regime to date to inform a judgment about the likely costs and benefits of the Regime in the future. The Commission considers that the relevant question for policymakers is whether the benefits of having the Regime in the future would exceed the costs,

relative to a situation in which it was revoked. The effects of the Regime to date provide an indication of the range of costs and benefits of the Regime and their likely magnitude in the future. The Commission has therefore focused its assessment on the economic effects of the Regime to date, but has also considered how these effects might develop in the future.

What costs and benefits are relevant?

The Regime's potential benefits relate to the rationale for access regulation and the achievement of the objectives of the CCA (chapter 3).

- Declaration (or the threat of declaration) and undertakings could deliver improvements to economic efficiency (box 3.4) if they reduce monopoly pricing by infrastructure service providers, increase competition in upstream or downstream markets (commonly referred to as dependent markets) or result in more efficient investment in infrastructure services or dependent markets.
- Certification could deliver benefits if it results in state and territory access regimes that are more effective at generating efficient outcomes than if there was no National Access Regime, and by capturing any benefits from greater consistency in access regulation across the economy (discussed in chapter 6).
- The Regime could result in administrative and compliance cost savings and lead to more effective infrastructure regulation, if it supplants other less effective policy responses, or if its role as an overarching access regime improves other access regimes so that they deliver more efficient outcomes for the economy than would otherwise have been the case.

For the community as a whole to be better off, access regulation must deliver improvements in economic efficiency. As discussed in chapter 5, for access to improve efficiency it is not sufficient for there to be an improvement in competition in any market — instead it must result in an improvement in competitive outcomes in a final consumer market. For example, access regulation might require providers to charge lower prices for access than they would have otherwise, without affecting outcomes in a final consumer market. In such a case, access regulation results in a transfer of income from service providers to users rather than an improvement in efficiency.

The Regime may also have a range of costs that should be set against any benefits.

- Declaration, certification and the Regime's role as an overarching access Regime may result in economic distortions including adverse effects on investment caused by regulatory risk, regulatory error and asymmetric truncation (chapter 3). The threat of declaration may also lead to less efficient outcomes if the underlying regulatory framework is flawed.

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- Costs incurred by the NCC, ACCC and other government bodies in administering and refining the Regime.
 - Administrative and compliance costs for business associated with applying for, or participating in the process of, a recommendation or decision under the Regime, and ongoing costs of negotiating and meeting the requirements of access regulation, such as production costs from coordinating multiple users of infrastructure.
 - Strategic behaviour such as lobbying may also impose costs for the parties involved.

What analysis is feasible?

Due to data limitations, in the draft report the Commission included the results of a qualitative assessment of the costs and benefits of the Regime supplemented with quantitative evidence where available.

In commenting on the Commission's approach in the draft report, BHP Billiton criticised the Commission's analysis of the costs and benefits of the Regime.

The Commission has acknowledged that 'ideally, a rigorous cost-benefit analysis would be undertaken', and expressly quoted quantifiable evidence on the extensive costs of access ... However the Commission described the task of undertaking a cost-benefit analysis as 'difficult', and did not attempt it. Difficulty is no justification for omitting a cost-benefit analysis. (sub. DR65, p. 5)

Referring to the Commission's qualitative analysis BHP Billiton stated that 'the Commission ought to address the clear quantitative evidence about the shortcomings of regulation, rather than relying on untested and unsubstantiated qualitative assertions' (sub. DR65, p. 7). The Competition and Consumer Committee of the Law Council of Australia also suggested that the Commission should undertake a quantitative cost-benefit analysis.

While the Committee agrees with the Commission that this task is 'difficult', the Commission has a unique opportunity, and is the best placed inquirer, to undertake a detailed review of the costs and benefits of the Regime ... (sub. DR68, p. 4)

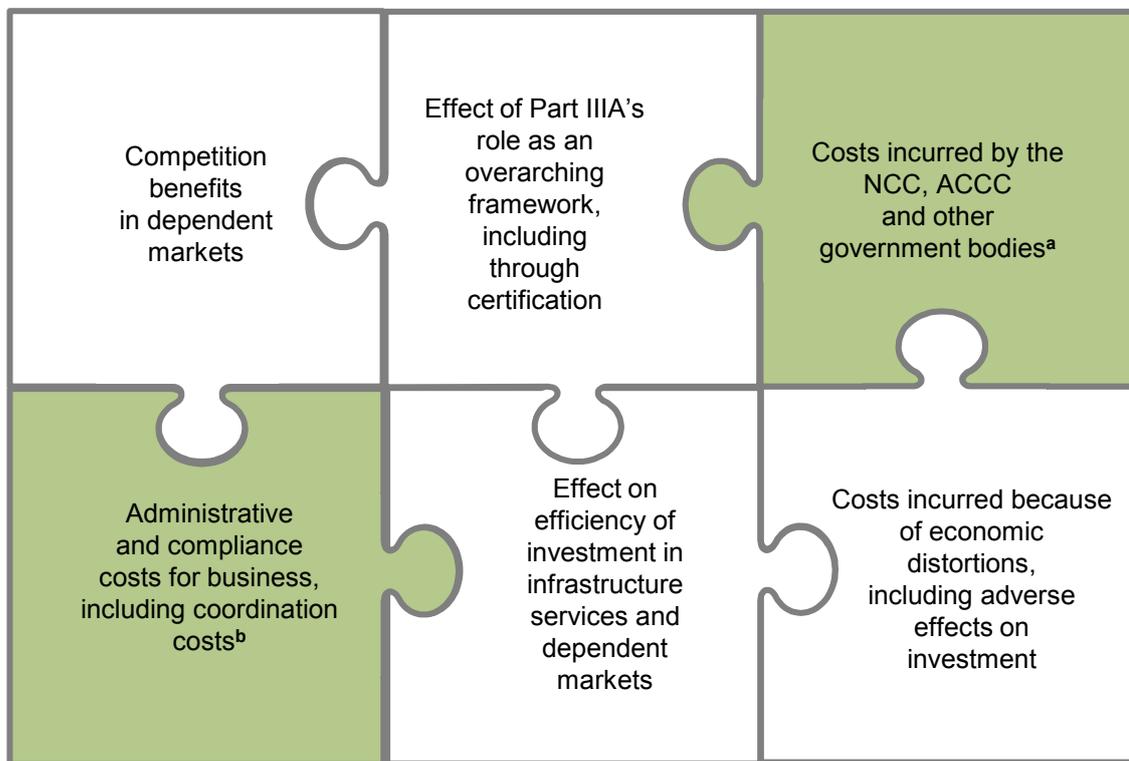
Data availability

A lack of data prevents reliable quantitative estimation of many of the key effects of the Regime. Figure 7.1 summarises the elements that are required for a quantitative analysis and the missing pieces of information.

The Commission has data on the costs of the NCC and state regulators, the administrative and compliance costs of developing and implementing some undertakings (chapter 6), and a rough estimate of the administrative and compliance costs of the rail access cases in the Pilbara Region of Western Australia. The ACCC (sub. 16) presented data in support of access regulation indicating that there have been recent periods of strong investment in several industries subject to access regulation, but it also rightly cautioned against assuming a causal relationship between investment and access regulation.

Figure 7.1 The missing pieces of data required for quantitative analysis of the Regime

Shaded pieces indicate some data are available; unshaded pieces indicate no data that isolate the effect of the Regime are available



^a Data are available on the costs of the NCC and costs incurred by state regulators in implementing industry-specific access regimes. ^b Estimates of the costs for business of undertakings required by the wheat export marketing arrangements, and of the cost of the Pilbara rail case, are available.

BHP Billiton (sub. DR65) also highlighted estimates of the cost of access that it suggested could be used to inform a cost–benefit analysis of the Regime.

- The Dalrymple Bay coal chain and Hunter Valley rail network — which are both multi-user facilities — operate below the rated capacity of the facilities.

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- Modelling presented to the Australian Competition Tribunal (the Tribunal) in the Pilbara rail case¹ by Rio Tinto Iron ore suggested that a three month average delay to Rio Tinto's iron ore rail infrastructure caused by access would result in \$10 billion in lost export revenues and \$4–6 billion in lost GDP.
 - During proceedings in the Pilbara rail case, BHP Billiton stated that third party access was valued at \$7.9 billion on its risk register and that this was more than the estimated \$2 billion cost of building another rail line.

However, the Commission does not consider the estimates highlighted by BHP Billiton could be used to inform a quantitative cost–benefit analysis of the Regime. In the case of the Dalrymple Bay coal chain and Hunter Valley rail network, the difference in efficiency that would be achieved under the counterfactual of an unregulated multi-user facility is not apparent. The estimated costs arising from access to Rio Tinto Iron Ore's Pilbara rail lines relate to a hypothetical access scenario and do not reflect what has occurred under the National Access Regime — the Tribunal took into account the costs of delays to expansions and other costs of access when it decided not to declare two of the Pilbara rail lines in question, and to limit the period of declaration of a third. The ACCC also has discretion not to require the provider to provide access to a declared service (s. 44V(3)). Although it is clear that BHP Billiton considered third party access to be potentially costly, it is not clear how BHP Billiton has calculated the value of this risk, how much of the risk to BHP Billiton would comprise transfers to access seekers, and the circumstances in which the risk would be realised.

The Commission has referred to the costs highlighted by BHP Billiton where appropriate to illustrate the kinds of costs that third party access might entail.

Quantitative approaches

In considering the feasibility of undertaking a quantitative cost–benefit analysis of the Regime, the Commission has evaluated the potential to apply a range of quantitative approaches. Dee (2005) identified three key quantitative approaches commonly used to provide insight into policy effects.

- *Structural modelling (general and partial equilibrium)* seeks to estimate economy-wide or sectoral effects arising from policy changes. A policy is introduced into a model of an economy or sector by changing the parameters, structural equations or constraints of the model to simulate outcomes with and without the policy change. The model may be a general equilibrium model of the whole economy or a partial equilibrium model of a particular sector, for

¹ *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2.

example, a case study of mining, rail and iron ore markets in the Pilbara. Structural models need to be well defined theoretically and have sufficient sources of data to enable meaningful calibration of the key parameters relevant to the policy being evaluated.

- *Cross-classification techniques* seek to isolate the effect of policy by using comparison across sectors to control for other factors. Sectors that are subject to the policy are compared with otherwise similar sectors that are not.
- *Econometric models* seek to estimate how much of the variation in some outcome variable can be explained by variation in a series of explanatory variables. An outcome variable of interest (for example, prices, output, investment or productivity in a sector) is explained using a variable representing the policy in question and control variables representing other factors, to determine the influence of the policy on the outcome of interest.

The Commission has concluded that there is insufficient data to undertake reliable analysis of the Regime using any of these quantitative approaches.

Structural modelling of the effect of the Regime would require comprehensive data on the investment and efficiency effects of the Regime, whether undertaken for the whole economy or for specific case study sectors. A case study approach would allow behavioural relationships (such as the responsiveness of demand to changes in access prices) in relevant sectors to be modelled in some detail. However, modelling case studies of the Regime would require detailed data, and robust estimates would be infeasible where it is not possible to observe key effects of the Regime such as effects on investment incentives. The number of case studies required to capture the effect of the Regime on the whole of the economy would also impede a case study approach. For example, a large number of sectoral studies would be required to capture how the behaviour of service providers and access seekers in different sectors could be expected to respond to the threat of declaration under the Regime.

Cost–benefit analysis of the Regime through general equilibrium modelling would require assumptions about the effects of the regime on model parameters, such as changes to productivity and prices. Parameters would need to be calibrated using estimates from outside the model, for example from case study analysis. As noted above, robust estimates of the effect of the Regime would be infeasible where key effects of the Regime could not be observed. Important assumptions would also be required about behavioural relationships within the model, and to separate the effects of the Regime from other factors affecting investment, productivity and

economic growth. As the Commission stated in regard to modelling the effect of the gas access regime:

In light of the many assumptions that would need to be made, for which there is a lack of supporting evidence, the Commission has concluded that if it were to undertake modelling, the estimates of the net economic benefits derived from modelling would be imprecise and subject to questionable reliability. (PC 2004, p. 85)

The conclusions that could be drawn from cross-classification and econometric modelling would be undermined by the generic nature and backstop role of the Regime. Cross-classification would require an industry that is subject to the Regime to be compared with an otherwise similar industry that is not subject to the Regime or another form of access regulation. However, the broad scope of the Regime means that there would not be a comparable infrastructure industry that is not subject to access regulation under the Regime (including the threat of declaration), or to some other form of access regulation.

A lack of observations from infrastructure industries that are not subject to access regulation would also present a problem for econometric modelling. Econometric modelling requires variation in a policy variable — for example, across different industries or over time — in order to estimate how this affects an outcome variable such as productivity. To analyse the Regime, the policy variable would need to indicate whether an industry is subject to access regulation. There is likely to be insufficient variation in the application of access regulation across infrastructure industries or over time to determine the effect of the Regime on prices, output, investment or productivity.

The Commission's approach

Ideally, an economy-wide quantitative cost–benefit analysis would be undertaken to determine whether the Regime is meeting its economic efficiency objective and generating net benefits to the community. However it is evident that quantifying the economic effect of the Regime is not practical for several reasons.

- While the number of cases proceeding through to declaration is small (suggesting that data gathering should be easy), the fundamental problem is the inability to observe the counterfactual. In the absence of the Regime, would governments have implemented more efficient or less efficient access regimes, or none at all? Would administrative and compliance costs for businesses be higher or lower? Would the access conditions for infrastructure services and the level of investment be different?
- The effect of the threat of access regulation on incentives for service providers and access seekers to reach negotiated outcomes cannot be measured.

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- It is not possible to robustly assess the costs and benefits to the economy of investment decisions that have been affected by the Regime.
 - The effects of the Regime cannot be isolated from other factors affecting infrastructure investment, productivity and economic growth.
 - Quantifying the effect of the Regime would require comprehensive data on the economy-wide efficiency effects of the Regime (including the certification and undertaking pathways).

As a consequence, the Commission has adopted a largely qualitative approach to its assessment of the costs and benefits of the Regime, supplemented with quantitative evidence where available. The use of qualitative data and analysis (as a complement to quantitative methods) is appropriate where there are deficiencies in the available data or where the effects of the policy are not readily quantifiable (ACCC 2010b). A qualitative approach was also used by the Commission in its previous reviews of the Regime (PC 2001a) and the gas access regime (PC 2004).

While some submissions suggested arriving at a cost–benefit estimate would be feasible, none have attempted it or referred to studies that have. If the Commission did undertake a quantitative cost–benefit analysis of the Regime, the results would be highly questionable and potentially misleading.

7.2 The effect of declaration on the efficient operation and use of infrastructure

The objective of Part IIIA is to promote the economically efficient operation and use of infrastructure. As outlined in chapter 3, a facility operator with market power may have an incentive to restrict or deny access or engage in monopoly pricing to generate monopoly rents to the detriment of the community. Declaration (or the threat of declaration) may improve the economic efficiency of the use of infrastructure by enabling third parties to access the service on fair terms and conditions and in doing so increase competition in dependent markets.

The effect of declaration on competition in dependent markets

The Hilmer Committee (1993) intended for the Regime to be applied sparingly. This has been borne out in practice — in the nearly 20 years since the Regime was introduced, six declaration decisions have been in favour of the applicant (figure 2.2). Of these, the Commission is only aware of declaration resulting in

increased access in one case — Virgin Blue’s application for declaration of airside services at Sydney Airport.

In the Virgin Blue case, the airline already had access to airside services but sought access on better terms and conditions. The designated Minister decided not to declare the service, on advice from the NCC that declaration would not promote competition in a dependent market. However, Virgin Blue sought a review of the Minister’s decision by the Tribunal, which concluded that declaration would promote competition and declared the services from 2005 to 2010 (box 7.1).²

Following declaration, Virgin Blue notified the ACCC of an access dispute with Sydney Airport in 2007, however the parties reached a private agreement prior to arbitration. Virgin Australia (previously Virgin Blue) stated that ‘the credible threat of arbitration encourages efficient commercial negotiation and does not result in parties needlessly seeking to arbitrate potential disputes’ (sub. 39, p. 7). The negotiate–arbitrate framework is discussed in chapter 4.

Box 7.1 Virgin Blue’s application for declaration of services at Sydney Airport

In October 2002, Virgin Blue applied to the NCC for declaration of airside services (runways, taxiways, parking aprons and other associated facilities) at Sydney Airport. Virgin Blue had access to the services but objected to Sydney Airport’s decision to change its basis for charging for airside services from an aircraft’s maximum take-off weight (MTOW) to the number of passengers. Virgin Blue argued that the change disadvantaged it relative to Qantas, as Virgin’s aircraft have, on average, a much higher number of passengers per tonne of MTOW when compared with aircraft used by Qantas.

National Competition Council and designated Minister

The NCC found that Sydney Airport had an ability and incentive to exercise market power, but it was sufficiently constrained from raising its prices significantly above competitive levels by the threat of re-regulation and its incentive to maximise non-aeronautical revenue. In addition, the NCC considered that:

- airlines have some ability to price discriminate, which would lessen the effect on demand and reduce efficiency losses from increased charges
- even a large increase in airside service charges would not reduce demand sufficiently to cause an exit from the market or a contraction in the number of flights offered on Sydney routes.

(Continued next page)

² *Re Virgin Blue Airlines Pty Limited* [2005] ACompT 5.

Box 7.1 (continued)

The NCC therefore recommended against declaration on the basis that competition would not be promoted, and the designated Minister decided not to declare the service.

Australian Competition Tribunal

Virgin Blue sought a review by the Tribunal of the Minister's decision. The Tribunal found that Sydney Airport's decision to change its charging practice from MTOW to a per passenger basis was because Qantas preferred it, and Sydney Airport knew that the change would give Qantas a competitive advantage over Virgin Blue. The Tribunal considered this was a misuse of Sydney Airport's monopoly power. Further, the Tribunal considered that:

- the threat of re-regulation and the existence of non-aeronautical service revenue was not an effective constraint on Sydney Airport's exercise of monopoly power
- airlines have a limited ability to profitably pass through any increases in airside service charges without affecting demand and route profitability.

The Tribunal concluded that declaration would promote competition and declared the service from 2005 to 2010.

Sydney Airport appealed the Tribunal's decision to the Federal Court in 2006 but the Tribunal's decision was not set aside. The High Court dismissed an application from Sydney Airport in 2007 to appeal the Federal Court decision.

Sources: NCC (2003); Virgin Australia (sub. 39).

The outcomes of the other applications that resulted in services being declared are as follows.

- In the Australian Cargo Terminal Operators (ACTO) case, two applications by ACTO sought declaration of services at Melbourne and Sydney International Airports to permit ACTO to provide ramp-handling for international aircraft (the loading and unloading of freight from aircraft). Services required to undertake ramp-handling at Melbourne International Airport were declared from 1997 to 1998, and at Sydney International Airport from 2000 to 2005. However, ACTO was voluntarily deregistered as a company in October 1999 (PC 2002), and although two other ramp handlers participated in the declaration proceedings before the Tribunal,³ the Commission has been unable to ascertain whether declaration affected competition.
- Following an application from Services Sydney, sewage transmission and interconnection services provided by Sydney Water were declared for a period of 50 years from 2005. The parties were unable to reach acceptable terms of access and the matter proceeded to arbitration before the ACCC. The ACCC

³ *Re Sydney International Airport* [2000] ACompT 1.

made an access determination but Services Sydney did not seek to activate its access rights and no other party sought access to the declared services (Ambler 2009). Declaration of the services was revoked in 2009 with the introduction of an industry-specific access regime for water and sewerage infrastructure in New South Wales, but no other access seeker has sought access to the services declared under that regime (Sydney Water, sub. 17).

- An application by the Tasmanian Department of Infrastructure, Energy and Resources resulted in Tasmania's government-owned rail track services being declared from 2007 to 2017. The Tasmanian Government had engaged Pacific National to operate the facility and, as part of the agreement between the parties, the Department sought declaration of the network to facilitate third party access (NCC 2007). In 2009 TasRail, a state government owned company, resumed operation of the below-rail infrastructure and purchased Pacific National's Tasmanian rolling stock (TasRail 2010). No other providers have operated competing services on the rail lines (Department of Treasury and Finance (Tas), pers. comm., 17 April 2013).
- Fortescue Metals Group's application resulted in the services provided by BHP Billiton's Goldsworthy rail line in the Pilbara being declared from 2008 to 2028. No third party access has occurred, nor has any third party attempted to negotiate access to the Goldsworthy line as a result of its declaration (BHP Billiton, pers. comm., 11 September 2013).

The NCC (pers. comm., 30 April 2013) advised the Commission that some access seekers made applications for declaration and later withdrew their applications because access was made available by other regulatory means. The NCC gave the following examples.

- Specialized Container Transport withdrew its application for a review of the designated Minister's 1997 and 1998 decisions not to declare certain services provided by rail lines in New South Wales and Western Australia because the declaration matter was overtaken by ARTC's access undertaking.
- Pacific National's 2010 application for declaration of certain services provided by coal rail lines in Queensland was withdrawn prior to the NCC making a final recommendation because the matter was overtaken by the Queensland rail access regime being amended and subsequently certified.

The South Australian Freight Council considered that the lengthy Pilbara rail case (chapter 2) had discouraged other declaration applications, but that there may be more applications in the future:

... the Fortescue Metals Group's long and difficult experience ... in seeking access has discouraged other industry players from making similar applications. We believe that

the High Court decision will result in the implementation of a more streamlined declaration process, which may see an increase in applications for declarations. (sub. 22, p. 2)

Does the threat of declaration constrain the use of market power?

The threat of declaration may constrain the use of market power by an infrastructure service provider. For example, if a service provider considers that declaration of a service provided by its facility is possible, it may be encouraged to provide access on fair terms and conditions to avoid the cost and inconvenience of declaration. In this respect, the ACCC stated:

The threat of declaration can act as a constraint on an infrastructure operator's behaviour and is likely to be a factor in an infrastructure operator's decision to reach a commercial solution to an access issue. ... the existence of a generic access regime may facilitate commercial access negotiations even when the threat of regulated access is low. (sub. 16, p. 22)

Participants' views on the effect of the threat of declaration were split between service providers, who considered that the threat of declaration was real, and access seekers, who did not view the threat of declaration as being credible.

The Australian Airports Association stated that the potential application of Part IIIA to Australian airports, in addition to the restrictive trade practices and prices surveillance provisions of the CCA (Parts IV and VIIA respectively), reinforces incentives for airport operators to negotiate with access seekers.

The combined operation of these Parts and the National Access Regime together provide a regulatory reinforcement for the otherwise compelling commercial incentive for airport operators to agree mutually acceptable access terms and conditions with their airline customers. (sub. 3, p. 6)

Jemena — a provider of natural gas pipeline services — stated that 'in our experience, the threat of declaration/coverage and all that it entails provides a real incentive to negotiate in good faith' (sub. 6, p. 6).

However, other inquiry participants disagreed, arguing that the time and cost of the declaration process is prohibitive and this reduced the constraint on market power posed by the threat of declaration. Peabody Energy stated:

In situations where an owner of unregulated infrastructure fails to negotiate fairly and transparently, the threat of declaration under Part IIIA of the [CCA] is not seen to be a genuine threat to the infrastructure owner. The timeframe for the process is currently so long that it places no incentive on the infrastructure owner to avoid this risk by negotiating fairly, commercially and in good faith. (sub. 30, p. 3)

In the Commission's 2011 inquiry into the regulation of airport services, the ACCC stated that:

... the effectiveness of the threat of declaration under Part IIIA as a constraint on the airports' market power is limited by the considerable costs, time and uncertainty associated with seeking declaration. (2011e, p. 20)

This view was mirrored in Qantas' comments in this inquiry.

... the significant problem with Part IIIA (both as a process and as a credible check on an essential facility owner's monopoly power) is the crippling time-consuming and burdensome process involved in having a service declared. (sub. 28, p. 3)

Similarly, Virgin Australia stated that the time, cost and uncertainty of the outcome of a declaration application means that Part IIIA is ineffective at constraining market power.

The ineffectiveness of Part IIIA as a tool for access seekers means that it is also an ineffective tool for constraining the market power of major airports as major airports do not feel constrained by the threat of arbitration. (sub. 39, p. 4)

The strength of the threat of declaration may also be indicated by the behaviour of service providers — all the undertakings that have been accepted by the ACCC have been submitted due to legislative requirements or other agreements. This might indicate that infrastructure service providers consider their services are unlikely to be declared. On the other hand, it might merely indicate that service providers do not perceive an advantage in submitting an undertaking prior to a declaration application or decision (chapter 6).

The NCC considered that concerns regarding the cost and timeliness of the declaration process are 'attributable to the exceptional and high-profile examples of the Pilbara Rail matters and to a lesser degree the Virgin Blue/Sydney Airport matter' (sub. 9, p. 11). The NCC argued that these cases are not representative of declaration applications in general and that the Regime was significantly streamlined by amendments to Part IIIA in 2010. The NCC stated:

It cannot be deduced from the delays experienced in matters that commenced in 2002 (Virgin Blue/Sydney Airport) and in 2004–2008 (Fortescue/Pilbara railways) that outcomes under the National Access Regime since commencement of the Amendment Act are or will be uncertain or untimely. (sub. 9, p. 11)

... the Council believes that the potential for declaration remains a significant incentive for commercial parties to arrive at access terms and conditions without direct regulatory intervention. (sub. 9, p. 7)

Notwithstanding the airlines' views on the burden of the declaration process, Qantas indicated that it still regularly considers seeking declaration of services.

Although ... there have been comparatively few applications for declaration under Part IIIA, the possibility of seeking declaration of a particular airport's facilities is something that Qantas looks at with reasonable regularity ... (sub. DR66, p. 3)

Although some isolated cases have involved an extraordinarily costly and lengthy declaration process, these are not typical cases. Some infrastructure services have been declared and the Commission considers that the threat of declaration is credible. In addition, amendments to the CCA made in 2010 and the High Court's 2012 decision in the Pilbara rail case mean that merits reviews of Regime decisions by the Tribunal are likely to be more confined, take less time, and thus be less costly, than in the past (chapter 9).

The Commission is unable to estimate the economic effect of the threat of declaration because its influence on incentives for service providers and access seekers to reach privately negotiated outcomes, and what effect it had on the nature of those outcomes, cannot be measured.

7.3 The effect of declaration on investment

The objectives of Part IIIA include promoting efficient investment in infrastructure (s. 44AA). This reflects that access regulation and the consequences for access pricing are likely to alter the incentives to invest in infrastructure services and in dependent markets.

As set out in chapter 3, regulated access could improve the efficiency of investment in dependent markets, or in infrastructure services if:

- greater certainty of access to infrastructure facilities on reasonable terms and conditions enables investment in dependent markets
- greater productive efficiency is driven by reduced incentives to duplicate natural monopoly infrastructure where infrastructure is shared
- investments in infrastructure services are better timed because of reduced incentives for premature investment to capture monopoly rents, or to delay capacity expansion in order to profit from congestion prices.

On the other hand, regulated access has the potential to distort the efficiency of investment if:

- it undermines incentives for third parties to invest in infrastructure facilities of their own

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- asymmetric truncation is expected to expropriate above-normal returns to infrastructure service providers but not compensate for below-normal returns, resulting in the investor's expected rate of return being driven lower than their hurdle rate of return — deterring or delaying investment
 - uncertainty regarding future access conditions compounds the inherent risk of investment in infrastructure services, increasing the hurdle rate for investment above the expected rate of return — deterring or delaying investment
 - incumbent infrastructure service providers underinvest in infrastructure capacity in seeking to avoid regulation of spare capacity
 - access prices are set too low, encouraging overinvestment in dependent markets and deterring investment in infrastructure services.

Whether access regulation results in an improvement in the efficiency of investment in infrastructure services and in dependent markets is a function of the ability of the access regime and regulators to only appropriate genuine monopoly rents. However, regulators have imperfect and incomplete information, and as such, some suboptimal decisions are unavoidable. Consistent with this, the ACCC stated:

Due to information constraints and limitations on the regulator's ability to foresee all potential consequences of regulatory decisions, it is not possible to design access regulation that avoids creating any distortions to infrastructure investment incentives. In regulating infrastructure access, some balancing will be needed of the impacts of regulatory measures on the efficiency of investment, both by the infrastructure operator and by access seekers, and on the efficiency benefits from facilitating competition in downstream markets by regulating access to the essential input. (sub. 16, p. 47)

Establishing the effect of Part IIIA on the efficiency of investment in infrastructure services and in dependent markets is extremely difficult. This is due to a number of factors including the inability to observe the relevant counterfactual — where there is no declaration under Part IIIA but governments are still able to regulate access to infrastructure services through other regulatory frameworks — and the difficulty of isolating the influence of regulation from other factors that may affect investment. The Australian Pipeline Industry Association (APIA) stated:

It is very difficult to measure the direct effect the access regime has had on investment, as it is not possible to observe what investment might have occurred. We can only observe what has occurred. (sub. 14, p. 12)

In addition, the observations that can be drawn on are limited by the small number of declarations that have been made under the Regime and the inability to measure the effect of the threat of declaration. As a consequence, much of the information on the investment effects of access regulation provided by participants was anecdotal

or related to activities in industries that are subject to industry-specific or facility-based access regimes.

Investment in dependent markets

Users of infrastructure services indicated that access regulation has enabled or encouraged investment in dependent markets. With respect to access to rail infrastructure, Asciano stated that the National Access Regime ‘substantially reduces negotiating costs and ensures that access is effectively guaranteed, thus facilitating longer term planning and capital investment’ (sub. 15, p. 13).

Asciano highlighted investments it made following the introduction of above-rail competition in the Queensland coal supply chain (subject to the Queensland rail access regime) as evidence of the positive effect of access regulation on investment in dependent markets.

The introduction of above rail competition in the Queensland coal chain is a good example with investment and innovation by Asciano increasing the throughput of the coal systems and providing coal producers with a competitive alternative to the previous sole supplier of these services. (Asciano, sub. 15, p. 25)

Some participants also argued that without access regulation, infrastructure users would be at risk of hold-up by infrastructure service providers (where the provider raises its access price to extract some or all of the value of the user’s investment) and this would have an adverse effect on future investment. Xstrata Coal (now Glencore) considered that investments had been made in coal mines on the basis that regulated facilities would continue to be regulated, and that if the Regime is amended such that entities are no longer regulated, this ‘may render existing mines unable to compete internationally’ (sub. 19, p. 7). Xstrata Coal further stated that this would ‘add weight to the growing concern amongst global capital providers that Australia’s sovereign risk profile has become too great relative to the benefits of investing in Australia’ (sub, 19, p. 7).

Similarly, the Minerals Council of Australia stated:

Investments have already been made in mines on the expectation that already regulated facilities will continue to be regulated. A significant change may render existing investments uneconomic or unable to compete internationally. (sub. 26, p. 14)

However, separating the effect of access regulation from that of other factors is difficult. For example, the increased investment in rail haulage markets identified by Asciano could be the result of a combination of factors, including access regulation, privatisation of Queensland’s coal rail network and increased global demand for coal.

It is also important to note that some of the gains from access regulation identified by service users may constitute income transfers from infrastructure service providers rather than pure economic efficiency gains.

Investment in markets for infrastructure services

Inquiry participants generally did not claim that access regulation improved the efficiency of investment in the infrastructure subject to access regulation. Instead, participants were split as to whether access regulation had no adverse effect on investment incentives or had distorted the timing and size of investments in infrastructure.

Investment in regulated industries

The ACCC stated that ‘it is not apparent from the data available to the ACCC that access regulation has a “chilling” impact on investment’ (sub. 16, p. 45). The ACCC presented data indicating that there have been recent periods of strong investment in several industries subject to access regulation (rail, energy and bulk grain export).

However, the ACCC cautioned against drawing conclusions about the relationship between investment and access regulation, stating that ‘it is impossible to establish a definite causal relationship between the two variables as there is no quantifiable counterfactual’ (sub. 16, p. 47). The Productivity Commission agrees.

Regulatory risk, error and asymmetric truncation

A number of participants identified declaration under Part IIIA and access regulation in general as contributing to the risks of investing in infrastructure and having the potential to delay or deter investment.

Regulatory risk and asymmetric truncation

There is an important distinction between investment in industries subject to industry-specific and facility-based access regulation and those that may be subject to declaration under Part IIIA. For infrastructure service providers that are subject to industry-specific or facility-based access regimes — such as telecommunications providers and the ARTC — investors are likely to have greater certainty about whether their infrastructure service will be regulated and what regulation will entail. For infrastructure services potentially subject to declaration through Part IIIA, there

may be greater uncertainty about what and how regulation will be applied, and this can increase the riskiness of investment.

BHP Billiton (sub. 29) identified a number of uncertainties from access regulation that affect investment incentives.

- Uncertainty over capacity allocated to third parties and available to the incumbent.
- The effect of multiple users on the operation of the facility.
- The effect of the terms of third party access on the incumbent's business.

BHP Billiton described the effect of this as follows.

This uncertainty over the capacity which will be available to the infrastructure provider discourages and defers infrastructure investment; if access is granted, it may cause investments to be cancelled rather than simply deferred. (sub. 29, p. 29)

Aurizon, referring to the effect of declaration under Part IIIA on greenfield infrastructure stated that:

The current regulatory situation inevitably increases the risks attached to greenfield infrastructure proposals, which could either result in the investment not proceeding or being wound back. (trans., p. 146)

Aurizon indicated that the costs of regulatory risk to greenfield investments are reflected in the strategies undertaken to mitigate risk.

... the risk does not generally result in otherwise economic projects being entirely deterred, but is instead apparent in the risk management strategies used by infrastructure investors to mitigate regulatory risk. This more subtle economic effect is, of course, more difficult to observe than the complete (and unlikely) abandonment of worthwhile infrastructure projects due to the risk of declaration. While the hedging of regulatory risk by investors makes it easier for projects to proceed, its widespread practice in Australian infrastructure projects is not costless, and has a number of undesirable economic consequences. This includes the imposition of costs associated with mitigating the risk commercially (i.e. through indemnities, etc), the incurrence of higher project overheads (i.e. legal costs), the potential inefficient scoping of infrastructure to minimise spare capacity, and the added complexity of project development in the face of sovereign risk. (sub. 72, p. 10)

Much of the commentary provided by participants on the effect of access regulation on investment related to the effect of the gas access regime on investment in gas transmission pipelines. In some respects the regulation of gas transmission pipelines under the gas access regime is similar to that of Part IIIA in that the regimes have nearly identical criteria for declaration or coverage and similar pricing principles.

The Institute of Public Affairs claimed that the South East Australia Gas Pipeline from Victoria to Adelaide was undersized to avoid access regulation.

Adverse experiences with regulation doubtless influenced business strategies for the [South East Australia] Gas pipeline from Victoria to Adelaide. This was built with the intention of avoiding the regulatory costs and distortions of coverage. The partners inflexibly designed the capacity to prevent any availability for other users and therefore any case for declaration. As building-in some provision for increased demand is relatively inexpensive, this represents regulation forcing suboptimal investment. (sub. 23, p. 6)

The effect of access regulation on the South East Australia Gas Pipeline was the subject of contention among participants to the Commission's 2004 review of the gas access regime, with some arguing that regulation had resulted in the pipeline being undersized, while others stated that the fully-contracted pipeline size reflected good business sense (PC 2004). In its report, the Commission made a number of recommendations to improve investment incentives for gas pipelines that have since been implemented, including a light regulation option and no-coverage decisions.

However, some participants indicated that access regulation still results in gas pipeline capacity expansions being made incrementally to avoid regulatory risk or asymmetric truncation. APIA stated that it 'does not consider it can be demonstrated that access regulation has led to efficient investment in gas transmission pipelines' (sub. 14, p. 12). APIA expressed the view that the industry practice of constructing gas transmission pipelines to meet currently contractible demand — despite significant efficiencies in building pipelines to meet readily foreseeable demand — is partly a consequence of regulatory risk.

If spare capacity was built during an expansion (at high economies of scale) and subsequently subject to a regulatory determination, a regulator is likely to consider the cost of accessing the total pipeline capacity, which includes the original depreciated asset and the new expansion ... If a tariff is determined on this basis it would lead to a much lower tariff than that paid by foundation customers of the expansion. All foundation customers on the expansion would insist on the lower tariff and may indeed have contractual rights to a lower tariff. This tariff would not be based solely on the cost of expansion and will have made the expansion uneconomic and the pipeline investor will be unable to recover its investment. (sub. 14, p. 13)

As a consequence, APIA considered that 'in many recent pipeline expansions, a project to further expand the pipeline commences shortly after, or even prior, to completion of an expansion project' (sub. 14, p. 13). At public hearings, APIA reiterated that 'regulatory risk is something that investors take into account when designing their assets and their capacity' (trans., p. 187).

APA Group expressed similar concerns with regard to pipeline capacity expansions.

... for regulated pipelines, capacity investments are likely to only match immediate needs — prospective or speculative investment is all but eradicated by the threat of lower regulated tariffs. This threat is faced by both the service provider (through insufficient rates of return and most favoured nation clauses) and by the user (through capacity being available to competitors at lower prices and with less contracting risk). (sub. 35, p. 4)

APA Group considered that ‘further guidance is required in the National Access Regime, as well as in industry-specific regimes, as to how the regulator should ensure sufficient returns and address the risk of truncation of returns’ (sub. 35, p. 5).

However, during consultations the Commission also heard views that some vertically separated gas providers have economic and engineering prerogatives to increase capacity, that the access regime has not seen a bias towards smaller capacity and that, in any case, the application of compressors can be a cost-effective means to lift capacity. In addition, the ACCC (sub. 16) has stated that regulators are well aware of the potential for access regulation to reduce investment incentives and distort investment decisions, and regulators have implemented practical measures to adapt their regulatory approaches to reduce these risks (discussed below and in chapter 8).

Regulatory error — access pricing

A number of inquiry participants also indicated that regulated access pricing had suppressed investment, particularly with respect to capacity expansions.

The ARTC, which is subject to a Part IIIA undertaking, suggested that regulated pricing had focused on short-term consumer gains at the expense of long-term efficient investment.

Regulatory practice to date has focused more-so on delivering efficient service (and lower end user cost) rather than on investment for sustainability and future growth capacity. Significant gains have been achieved for the industry and now the focus needs to be re-balanced towards the need and incentives for infrastructure owners to renew assets and invest for capacity enhancement. This needs to be recognised in the regulatory framework. (sub. 20, p. 10)

Furthermore, the ARTC stated that it ‘considers that the greatest risk of regulatory error is the risk of under-investment in the infrastructure’ and that ‘the cost and impact of under-investment is evidenced in many industries, including rail’ (sub. 20, p. 17). The ARTC provided the example of capacity expansions to its rail network in the New South Wales Hunter Valley in which it claimed that regulated prices determined by the ACCC were insufficient for it to justify the

capital expenditure. However the investment took place because the ARTC negotiated directly with users and was ‘able to secure what it considered to be an adequate return, higher than that considered adequate by the regulator based on benchmarked parameters and regulatory precedent’ (sub. 20, p. 18). However, the ACCC considered that ‘the ability of the ACCC to accept this negotiated rate of return demonstrates the flexibility of Part IIIA to take into account the specific circumstances of regulated infrastructure’ (sub. 43, p. 3).

The APA Group stated that regulator price determinations had resulted in specialised gas infrastructure businesses divesting regulated assets in favour of non-regulated assets.

These regulated rates of return are plainly insufficient. In the past year APA has divested the majority of its ownership in Allgas distribution network on the basis that it would provide an insufficient return to the business. The [Australian Energy Regulator’s (AER)] decision in respect of the Allgas access arrangement was made in April 2012. More recently, APA advised the market that the AER’s draft decision in respect of the Victorian transmission system was insufficient to justify further investment, and should the draft decision rates be confirmed, APA will make minimal further investments in the Victorian system, only spending enough to keep assets in a ‘safe operating mode’. (sub. 35, p. 5)

Regulator views on regulatory risk, error and asymmetric truncation

The NCC cautioned against ‘placing too much weight on arguments that access regulation or the prospect of such regulation discourages efficient investment’ (sub. 9, p. 7). It stated that ‘despite such concerns being raised, the Council is not aware of any evidence that bears directly on this issue’ (sub. 9, pp. 7–8).

Since the 2006 amendments to the *Trade Practices Act 1974* (Cwlth) (now the CCA), the NCC has been required to report on any evidence of the costs of, or disincentives for, investment in the infrastructure by which declared services are provided (s. 290). The NCC has not reported on any specific evidence but has acknowledged that ‘such analysis is difficult without obvious control groups or counterfactuals for comparison and in a time where the demand for many infrastructure services is expanding rapidly’ (NCC 2011c, p. 38).

The NCC has stated that infrastructure service providers ‘commonly argue that the requirement to share the use of their infrastructure with competitors (albeit on commercial terms and conditions) results in inefficiencies and that the costs of regulated access outweigh the benefits, increasing the risk of deterring future

investment’ (NCC 2010a, p. 34). However, the NCC has indicated that it considers these claims have not always stood up to close scrutiny.

In the Pilbara Rail matters extensive claims were made to the effect that investment would be curtailed by declaration of the relevant services. Except for the possibility that a requirement to negotiate with access seekers when expanding a facility that provided a declared service might give rise to some delay in investment, none of these claims was accepted by any of the Council, Minister, Tribunal or Courts. (sub. 9, p. 7)

The ACCC acknowledged the potential for regulation to distort investment incentives, but argued that regulators were aware of and made provision for this.

The ACCC accepts that poorly designed or implemented regulatory approaches can distort investment incentives and lead to under-investment in infrastructure, with negative implications for economic efficiency and productivity. (sub. 16, p. 98)

... the ACCC considers that regulators are well-aware of these conceptual risks and have implemented practical measures to adapt their regulatory approaches to reduce these risks. (sub. 16, p. 101)

Measures identified by the ACCC to address potential truncation due to demand uncertainty include using ‘price cap regulation instead of revenue cap regulation’ (sub. 16, p. 101).

For greenfield developments, the ACCC (sub. 16) and ARTC (sub. 20) highlighted the potential use of deferred cost recovery under a ‘loss capitalisation’ approach to encourage initial service take-up. Under a loss capitalisation approach, recovery of early year losses from a new investment are deferred until demand reaches an appropriate level. In relation to the application of the loss capitalisation approach in its 2011 undertaking, the ARTC stated that the approach encourages:

... riskier investments (sought and supported by industry) in capacity ahead of demand so as to ensure that the rail network does not become the constraining element in the relevant supply chain as demand increases. (sub. 20, p. 10)

The ACCC also stated:

Other investment risks, such as any perceived stranding risk, have been dealt with by regulators adopting a range of other mechanisms, such as acceleration of depreciation or using expected economic asset lives (as opposed to physical or useful asset lives) in determining depreciation allowances for those assets. (sub. 16, p. 101)

However, as acknowledged by the ACCC and argued by infrastructure owners, access regulation can adversely affect investment incentives. This is unavoidable, but the Commission considers that the potential for economic distortions caused by access regulation can be minimised through appropriate regulatory design and implementation. Existing measures in Part IIIA that provide for proponents of an infrastructure facility to seek an ineligibility decision, and for governments to seek

exemptions for facilities whose construction and operation are to be subject to an approved competitive tender process, already help to reduce regulatory risk (chapter 8). Further, in chapter 5 the Commission outlined a proposal that the NCC and decision makers be required to have regard to the effects of declaration on investment when assessing a declaration application against the ‘public interest test’ (criterion (f)).

7.4 Administrative, compliance and other costs of declaration

Costs are incurred by government in administering Part IIIA and by business when engaging in the regulatory process and negotiating and meeting the conditions of declaration. Compliance, administrative and other costs of declaration that can be attributed to the Regime are those that would not be incurred under the counterfactual, although they may be replaced by other administrative and compliance costs if alternative means of regulated access were used instead.

The administrative costs of certification for government, and administrative and compliance costs for businesses subject to access undertakings, are discussed in chapter 6.

Costs incurred by the NCC, ACCC and other bodies

The most significant administrative costs are likely to be incurred by the NCC, which considers applications for declaration. Since 2006-07 the expenses incurred by the NCC have ranged from about \$2 million to \$4 million annually (table 7.1). This includes administrative costs attributable to declaration, as well as those relating to the NCC’s role in certification of state and territory access regimes (chapter 6) and its obligations under the gas access regime.

In recent years, the task of the ACCC in relation to the Regime has been to consider undertakings in the areas of rail and wheat (chapter 6), and to conduct arbitration proceedings. There have only been two matters notified to the ACCC for an arbitrated determination under Part IIIA. These were notifications by Virgin Blue and Services Sydney, and the ACCC was only required to make a determination in the Services Sydney matter (Virgin Blue’s notification was withdrawn after the parties reached a negotiated agreement) (chapter 4). Thus, it is unlikely that conducting arbitration has imposed substantial costs on the ACCC.

Table 7.1 Examples of regulator expenses attributed to different access regimes

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
	\$m	\$m	\$m	\$m	\$m	\$m
National Competition Council (National and gas access regimes)	2.99	2.83	2.73	3.64	2.47	2.37
Essential Services Commission of South Australia (Tarcoola–Darwin rail regime)	0.09	0.13	0.13	0.11	0.12	0.08
Essential Services Commission of South Australia (SA rail regime)	0.05	0.05	0.06	0.12	0.11	0.09
Essential Services Commission (Victorian rail regime) ^a	0.41	0.17	0.30	<i>na</i>	<i>na</i>	<i>na</i>
Essential Services Commission (Victorian ports regime) ^b	0.03	0.01	<i>na</i>	<i>na</i>	<i>na</i>	<i>na</i>

^a The costs of the Victorian rail access regime in 2005-06, when the regime was implemented, were \$1.2 million. ^b The Victorian ports regime includes a price monitoring regime for ports and an access regime for shipping channels. **na** Not available.

Sources: ESC (2009, 2010); ESCOSA (2008a, 2008b, 2010a, 2010b, 2012b, 2012c); NCC (2008, 2010a, 2012a).

The Tribunal has made a decision in nine cases relating to declaration, and the Federal or High Courts have been involved in three cases (but have made several separate judgments). The BHP Billiton case⁴ occupied approximately 1 of 66 sitting days of the Full Court of the High Court in 2008-09, and the Pilbara rail case⁵ occupied approximately 2 of 72 sitting days in 2011-12. Some additional sitting time of the High Court was occupied by each case for hearings of applications for special leave to appeal to the Court (High Court of Australia, pers. comm., 1 October 2013). The Federal Court of Australia and High Court of Australia have advised that they do not allocate costs by individual cases (pers. comm., 25 September 2013) so the Commission does not have data on the administrative costs that Part IIIA has imposed on the Tribunal and the courts. However, the costs incurred by the Tribunal and courts in hearing Part IIIA cases are unlikely to have been immaterial.

Costs to infrastructure facility owners and access seekers

Access seekers and infrastructure owners incur administrative and compliance costs associated with applying for declaration, and responding to access requests. There

⁴ *BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2008] HCA 45.

⁵ *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36.

are also potential losses in efficiency if regulated access leads to production costs from coordinating multiple users of infrastructure.

Administrative costs

Businesses are likely to face two broad types of costs in relation to submitting, and responding to, a declaration application. First, the time taken to resolve the application can lead to delays in obtaining access and uncertainty for both parties. The time taken to resolve declaration applications has varied across different applications (table 4.2). Where the application does not proceed to a review, it has generally been resolved within 12 months. An atypical example is the Pilbara rail case, which proceeded to review and appeal stages and took many years to resolve.

Second, businesses face the direct costs of applications for declaration. Prior to review, these costs may include the costs associated with writing and responding to the applications, and may include the diversion of management's time (BHP Billiton, sub. DR65) and use of consultants. Where the case proceeds to merits or judicial review, substantial legal costs can be incurred by access seekers, infrastructure service providers and the NCC. Virgin Australia (previously Virgin Blue), which made an application for declaration of airside services at Sydney Airport, stated:

... the process under Part IIIA of the CCA is very costly for both access seekers and for access providers. In relation to the Airside Service at Sydney Airport, Virgin Australia had legal representation throughout the process, including at three separate hearings (one before the Tribunal, one before the Full Federal Court and one before the High Court), and had to provide lengthy submissions to the NCC (including expert economic reports). (sub. 39, p. 8)

Although evidence on the exact costs incurred by business is limited, the most costly declaration application by far is likely to have been the Pilbara rail cases. The Institute of Public Affairs (sub. 23) stated that the costs to business and government of the Pilbara rail cases is over \$300 million but did not provide a more detailed breakdown. BHP Billiton also noted that the overall costs of the applications for third party access to rail services in the Pilbara region of Western Australia were 'in the order of hundreds of millions of dollars' (sub. 29, p. 4).

Costs of negotiating and meeting the conditions of declaration

Once a service is declared, there may be ongoing costs to businesses associated with negotiating access to their services, including legal costs and the costs of providing information. However, given that the Commission is aware of only one case where

a Part IIIA declaration has resulted in increased access (section 7.2), these costs are unlikely to have been significant.⁶

There is potential for Part IIIA declarations to impose compliance costs in the future. Estimates of the compliance costs resulting from industry-specific access regimes may provide some guidance on the magnitude of the compliance costs that may occur if access is obtained under Part IIIA.

- In 2004, ACIL Tasman (2004) estimated the total negotiation and licensing costs to access providers resulting from the national gas and electricity access regimes. These costs were estimated to be approximately \$6–9 million for the gas regimes and \$15–19 million annually for the electricity regimes.
 - The operator of the QCLNG gas pipeline estimated the cost of subjecting its pipeline to full access regulation would be about \$200 000 per year, in addition to upfront costs of around \$300 000 (NCC 2010c).
- The Victorian Government estimated the compliance costs resulting from its rail access regime (which imposes requirements on four access providers) to be in the order of \$200 000 per year (ESC 2010).
- KPMG (2005) estimated the costs associated with Queensland Rail’s compliance with the Queensland rail access regime to be about \$1 million per year between 2004-05 and 2007-08.

There is also a range of other compliance costs that could be associated with the declaration of a service. For example, Synergies Economic Consulting (2010b) suggested that the operator of the Herbert River tramway would have incurred significant costs associated with implementing an approved safety management system if its tramway had been declared. (A requirement to carry other commodities may have resulted in the loss of the tramway’s status as a ‘cane railway’ and its exemption from the obligation under Queensland legislation to have an approved safety management system.) Further, Sydney Water (2004) suggested that declaration of its sewage transmission and interconnection network would lead to costs associated with implementing a competitive retail market.

Production costs from coordinating multiple users of infrastructure

Costs may be incurred if regulated access to a service impedes the efficient use of the infrastructure. This may occur if the infrastructure has limited capacity

⁶ Greater costs are likely to have been incurred in the development and acceptance processes for undertakings required by the wheat export marketing arrangements (chapter 6).

available, or if the infrastructure operates more efficiently without regulated third party access. These costs could be significant for particular infrastructure services.

[The costs of access] include the cost of lost capacity and lost flexibility when single user infrastructure is used to provide third party access. A specific example of where this occurs is the Dalrymple Bay Coal Chain, where the infrastructure elements of the coal chain have been individually rated as capable of delivering 85 [million tonnes per annum (mtpa)], but when operated in unison, the coal chain has not, to date, delivered an annual tonnage outcome above 64 mtpa. (BHP Billiton, sub. 29, p. 4)

In the Pilbara rail case, the Tribunal considered the likely costs of access caused by delays to planned expansions because of the need to consult with third-party rail line users. The Tribunal heard a range of evidence but gave particular weight to analysis indicating that a three month average delay to expansion by Rio Tinto Iron Ore would result in \$10 billion in lost export revenues and \$4–6 billion in lost GDP. The Tribunal commented that the evidence suggests the average delay to expansions resulting from access may well be longer than three months.

Given the potential for significant administrative and compliance costs from access regulation, the Commission has identified opportunities to improve consideration of these costs in the declaration criteria. (Chapter 5 outlines a proposal to amend the ‘uneconomical to duplicate another facility test’, criterion (b), to require consideration of certain coordination costs when determining whether a facility meets criterion (b), and the ‘public interest test’, criterion (f), to require that regard be given to the administrative and compliance costs of declaration.)

Other costs — strategic behaviour

The returns third parties can earn by successfully using access regulation to enable them to compete more effectively in a dependent market could be significant. Conversely, if infrastructure service providers can successfully avoid access regulation they would avoid the risk of regulatory errors curtailing their returns, and they would be able to protect monopoly rents where access regulation would have promoted competition in dependent markets. Where the stakes are high, access seekers and infrastructure service providers will have a commercial interest in testing the legal boundaries of the Regime to reach their preferred outcome, however tightly the legislation is drafted. Access seekers may make speculative declaration applications, understating the costs and overstating the benefits of access, and allocate resources towards persuading decision makers. Likewise, there may be an incentive for infrastructure owners subject to a declaration application to overstate the costs of access and understate the benefits.

On strategic behaviour, the Competition and Consumer Committee of the Law Council of Australia stated that ‘the difficulty is where there are high stakes, there are strategic reasons. People talk about gaming, but there’s gaming on both sides’ (trans., p. 208). The Commission notes concerns expressed by several participants about the potential for undue influence to be exerted on ministerial decisions. However, such concerns appear to stem from the nature of the decisions and the sizeable property rights involved rather than from the identity of the decision maker. Indeed, one of the participants who raised concerns about this issue also acknowledged that regardless of whether the minister is involved in Regime decision making, and no matter how well the legislation giving effect to the Regime is crafted, there will always be ‘incentives and opportunities for lawyers and firms to merely test the margins at every juncture’ (Bob Baxt, trans., p. 115).

Such behaviour can result in costs for the parties involved, increase the potential for regulatory error, and delay or deny declarations that could enhance economic efficiency. If the Regime was revoked, costs from strategic behaviour in relation to declarations under Part IIIA may be replaced by costs of lobbying governments to implement (or not implement) other forms of access regulation such as industry-specific or facility-based access regimes. This could include lobbying to implement access regimes where they are not warranted, or to implement inappropriate regimes (chapter 8).

The reforms proposed by the Commission seek to clarify the intent of the Regime, with particular focus on the criteria for declaration, as these determine when access regulation will and will not apply. The Commission’s reforms, if implemented, would reduce avoidable administrative costs of access cases by improving certainty for access seekers and infrastructure service providers, and reduce the likelihood of unsubstantiated and speculative declaration applications, reviews and appeals.

7.5 The National Access Regime as an overarching framework

In addition to the potential costs and benefits of consistency across access regimes discussed in chapter 6, some participants commented that the Regime serves a beneficial role as an overarching framework for access regulation of significant infrastructure facilities. The Regime may generate benefits if it supplants other less effective access regimes by serving as a template for more appropriate regulation of natural monopoly infrastructure, or as a repository of best-practice regulatory principles.

Growth in industry-specific and facility-based access regulation

Participants generally considered that the Regime has led to growth in industry-specific and facility-based access regulation, although these regimes may have supplanted less efficient regulation.

Perhaps one of Part IIIA's greatest benefits has been that it has acted as a catalyst for the development of industry and state-based regimes which clause 6(2) of the Competition Principles Agreement explicitly provides for. State-based access regimes have added to and improved the body of knowledge relating to the process of access and economic regulation in general. (Dominic L'Huillier, sub. 7, p. 4)

Given the increase in competition in industries which have been subject to more formalised and wide ranging access regimes it seems self-evident that the National Access Regime and other industry-specific regimes based on the National Access Regime have supplanted less effective regimes. (Asciano, sub. 15, p. 25)

The generic access regime in Part IIIA was originally expected to simplify access regulation and perhaps do away with industry-specific access regimes. That did not happen, and the inherent structure of Part IIIA, which is designed to deal with access issues on a piecemeal basis, would limit its ability to provide an effective substitute for industry-specific regimes. (Michael Cunningham, sub. 18, p. 3)

There are some examples where the backstop provided by Part IIIA has allowed for more light-handed regulation — for example, in the case of airports. In other cases, Part IIIA appears to have been a direct driver of industry-specific and facility-based regulation — for example, the New South Wales water access regime was established after the declaration of Sydney Water's sewage transmission and interconnection services. The balance between the scope of infrastructure services covered by the National Access Regime and those covered by industry-specific and facility-based access regimes is discussed in chapter 8.

The effect of the Regime on industry-specific and facility-based access regimes

By acting as an overarching framework, Part IIIA may improve the quality of industry-specific and facility-based access regimes even if they are uncertified.

In relation to the role of Part IIIA as an overarching access regime, the ACCC stated:

While there are clearly differences between the specifics of each of these access regimes, Part IIIA is the umbrella or template. The principles in these industry-specific regimes are drawn from the more general access provisions of Part IIIA. (sub. 16, p. 22)

Asciano stated that its support for the Regime was in part because the Regime ‘acts as a common reference point for other access regimes’ and ‘acts to ensure that state-based regimes provide for access in a manner that meets the standards of the Competition and Consumer Act’ (sub. 15, p. 28).

APIA expressed a similar view.

For industry-specific access regimes [the National Access Regime] provides a necessary reference and ‘benchmark’ to maximise consistency across regimes and to ensure the principles which deliver economic dividends to the economy are preserved. (sub. 14, p. 2)

However, in this context some participants expressed concern at the divergence of some industry-specific access regimes from the Part IIIA template. RBB Economics stated:

In some of these areas, the NCC has flagged that there is a risk that governments may turn to industry-specific regimes to side-step the safeguards contained in the [National Access Regime] and is (rightly) concerned about the risks of undermining incentives for investment and dynamic efficiency in those sectors. (sub. 31, pp. 9–10)

APIA considered that ‘convergence between the [gas and electricity] access regimes appears to be at the expense of consistency with the National Access Regime’ (sub. 14, p. 3).

Convergence between the regimes has seen, and is likely to continue to see, elements of the gas access regime replaced by more prescriptive and intrusive regulatory arrangements at the expense of more efficient commercial outcomes. As a result, APIA considers that both regimes, but particularly the electricity regime have drifted from the National Access Regime. The Gas regime has drifted less and is considerably more consistent with the National Access Regime. Moreover, the gas access regime offers better access regulation ‘fit’ for the gas sector and a drift towards the prescriptive and intrusive approach [of] the electricity regime with its emphasis on consumer outcomes over economic efficiency is undesirable. (sub. 14, p. 4)

The Commission considers that the Regime has benefits as a relatively light-handed template for access regulation — the negotiate–arbitrate framework provides a sound basis for resolving access disputes (chapter 4). The Regime is therefore likely to improve the quality of state and territory access regimes through a demonstration role (in addition to the formal certification process).

Inquiry participants also expressed concern about what would replace the Regime if it were revoked. In the absence of the Regime, governments may adopt ad hoc approaches to access regulation that result in less efficient outcomes than under the Regime. Access arrangements at the facility level, for example, can impose net costs on the community if they are incorrectly applied, and provide incentives for lobbying. Efficiency outcomes could also be worse if governments adopt more heavy-handed regulatory approaches that risk regulatory overreach.

7.6 The Commission's assessment

As outlined in chapter 3, there is a rationale for access regulation to address market failure due to an enduring lack of effective competition where infrastructure service providers deny access to, or restrict output and charge monopoly prices for, its services. However, government intervention also has costs.

The discussion above, and in chapter 6, highlights that although the conceptual rationale and costs of access regulation are well understood, the empirical evidence on the effect of the Regime in practice is limited. It has therefore not been possible to quantify the economic effects of the Regime or its effect on economic growth and productivity.

In part, the limited empirical evidence on the costs and benefits of the Regime reflects Part IIIA's backstop role, and that the majority of access regulation occurs under industry-specific and, to a lesser extent, facility-based access regimes. As a consequence (and as intended by policymakers), few infrastructure services have been declared under Part IIIA. Further, the effect of the threat of access regulation on incentives for service providers and access seekers to reach negotiated outcomes cannot be measured.

The Commission has received statements, but does not have empirical evidence (either positive or negative) of the Regime's effect on investment incentives. However, it is clear that access regulation has the potential to alter investment incentives. By increasing certainty of access terms and conditions it increases incentives for investment in dependent markets, but the cost could be increased uncertainty for infrastructure service providers and deterred or delayed investment in infrastructure service markets. However, well-designed and implemented access regulation can promote efficient investment.

Based on its qualitative assessment of the costs and benefits of the Regime, on balance the Commission considers that there are likely to be net benefits from the Regime operating as an overarching framework for access regulation, and from Part IIIA playing a backstop role for infrastructure services that are not covered by other access arrangements.

- Although participants proposed a number of reforms to Part IIIA, many inquiry participants (both infrastructure service providers and access seekers) were supportive of the Regime, and very few participants considered that it should be revoked (box 7.2).
- The negotiate–arbitrate framework provides a sound basis for resolving access disputes and the pricing principles provide sufficient scope for the ACCC to consider investment incentives in its determinations (chapter 4).
- The Commission’s reforms (chapter 8), if implemented, would better target the Regime to the economic problem. In doing so the reforms would reduce avoidable administrative costs of access cases by improving certainty for access seekers and infrastructure service providers, and reduce the likelihood of unsubstantiated and speculative declaration applications, reviews and appeals.
- Amendments to the CCA made in 2010 and the High Court’s 2012 decision in the Pilbara rail case mean that merits reviews of Regime decisions by the Tribunal are likely to be more confined, take less time, and thus be less costly, than in the past (chapter 9).
- The Regime is likely to improve the quality of state and territory access regimes through a demonstration role and the formal certification process (chapter 6).
- Undertakings can be used to provide certainty to both service providers and potential access seekers over the terms and conditions of access to the service.
 - However, mandating an undertaking may result in bypass of some of the safeguards included in the declaration pathway under the Regime (chapter 6).
- If the Regime was revoked, governments may adopt ad hoc approaches to access regulation that result in less efficient outcomes than under the Regime.

The Commission therefore considers that the Regime is achieving its economic efficiency objective and should be retained. However, renewed emphasis should be given to ensuring that the Regime better targets the economic problem to reduce the risk of imposing unnecessary costs on the community and deterring investment in markets for infrastructure services for little gain. The Commission’s proposed reforms to the Regime, outlined in the remainder of this report, are designed to achieve this.

Box 7.2 Many participants supported the National Access Regime

Although participants proposed a number of reforms to Part IIIA, many — including infrastructure service providers and access seekers — were supportive of the Regime.

If the National Access Regime were removed and not replaced with an alternative regime then many activities currently undertaken, including above rail activities, would become problematic at best. (Asciano, sub. 15, p. 13)

The National Access Regime and industry-specific and jurisdictional regimes have addressed [the essential facilities] problem effectively in key industries and for particular facilities. (Jemena, sub. 6, p. 2)

Peabody fully supports the existing regulatory framework for third party rail access arrangements at both the Commonwealth and State/Territory level. However, [there are] specific and practical areas of concern that should be addressed ... (Peabody Energy, sub. 30, p. 3)

The National Access Regime directly provides a stable, common framework for much of the infrastructure that underpins Australia's economy. (APIA, sub. 14, p. 2)

It is probably not time to remove the National Access Regime given the purposes it currently fulfils; however, it should continue to be used sparingly. (Business Council of Australia, sub. 36, p. 6)

Aurizon broadly supports the Commission's final conclusion, namely, that Part IIIA and declaration itself should be retained for the present time. (Aurizon, sub. DR72, p. 8)

However, some participants considered the Regime should be revoked.

The provisions requiring access under Part IIIA and the role given to the NCC should be removed. Those provisions serve no positive purpose while having the demonstrable effects of causing considerable costs in litigation and the potential for even greater costs in terms of regulatory induced investment deferrals. It is now difficult to envisage new circumstances where a natural monopoly might arise. No overarching national regime is needed. (Institute of Public Affairs, sub. 23, pp. 9–10)

8 Reforming the National Access Regime

Key points

- The Commission's proposed reforms to the National Access Regime seek to confine the scope of the Regime, so its use is limited to the exceptional cases where the benefits of regulated access are likely to outweigh the costs.
- The declaration criteria should be amended to better target the economic problem.
 - Criterion (a) (*the competition test*) should be amended so that it becomes a comparison of competition with and without access through declaration.
 - Criterion (b) (*the uneconomical to develop another facility test*) should be amended such that total foreseeable market demand could be met at least cost by the facility after including any production costs from coordinating multiple users of the facility.
 - Criterion (f) (*the public interest test*) should be amended so that declaration promotes the public interest. Decision makers should also have regard to the effect of declaration on investment, and administrative and compliance costs.
- The arrangements for certification should be amended.
 - Criterion (e) (*the certification test*) should be removed. A threshold test stating that a service cannot be declared if it is subject to a certified access regime, along with a clause enabling certification to be revoked, should be introduced.
 - COAG should consider amending clause 6 of the Competition Principles Agreement so it aligns with the relevant provisions in Part IIIA of the CCA, and consider streamlining the principles where appropriate.
 - COAG should release the states and territories from the requirements to certify their electricity and gas access regimes.
- Mandatory undertakings should be subject to upfront and ongoing assessment by the NCC to ensure they are used to target the economic problem.
- The ACCC's power to direct extensions should be amended to confirm that it encompasses capacity expansions so that the safeguards in Part IIIA also apply to directed expansions. The ACCC should publish guidelines on how the power would be exercised. Preparation of the guidelines should include an analysis of the workability and adequacy of the provisions to direct extensions and its safeguards.
- Further industry-specific regimes should apply only where there is sufficient similarity between infrastructure services in the industry, and where the industry has features that justify different regulatory treatment from that of the generic Regime.
- Facility-based arrangements impose net costs if incorrectly applied and provide incentives for lobbying. Such arrangements should be limited to where there is a clear net benefit from tailoring access arrangements for a specific facility.

8.1 A package of reforms

In the preceding chapters, the Commission established a case for access regulation and concluded that the National Access Regime (the Regime) should be retained, acting as a framework for state and territory access regimes and playing a backstop role for infrastructure services that are not covered by other access arrangements. Notwithstanding this, reforms to the Regime are required. In particular, the scope of the Regime should be confined to ensure its use is limited to the exceptional cases where the benefits of regulated access are likely to outweigh the costs.

In considering the options for reform, the Commission has paid particular attention to the need for the Regime to remain generic enough to cover a range of different circumstances. Some of the reforms proposed by participants would not be appropriate for a generic regime.

The Commission has also been mindful that its proposed reforms to the Regime will have transitional costs, particularly given that any legislative amendments will be tested by affected parties, and it will take time for case law to be established. The proposed reforms may also have implications for state and territory access regimes where the language of the legislation mirrors that of Part IIIA. Accordingly, the Commission's proposed reforms to the Regime are confined to where it considers the greatest gains can be made.

If the Australian Government chooses to implement the Commission's proposed reforms, clear guidance on the intent of any legislative amendments, including through second reading speeches and explanatory memorandums, would assist in the interpretation of any amended provisions and help to limit transitional costs.

8.2 Targeting the declaration criteria at the economic problem

The Commission considers that each of the declaration criteria should serve a specific purpose and work together to target the economic problem — an enduring lack of effective competition, due to natural monopoly, in markets for infrastructure services where access is required for third parties to compete effectively in dependent markets. The Commission has proposed changes to declaration criteria (a), (b) and (f) that focus on aligning the criteria with their respective purpose, such that the criteria as a whole better target the economic problem. Criterion (e) (the

certification test) is considered in section 8.3, which discusses the process for certifying state and territory access regimes.

- **Criterion (a)** (*the competition test*) should only be satisfied where declaration would promote a material increase in competition in a dependent market.
- **Criterion (b)** (*the uneconomical to develop another facility test*) should be used by decision makers to identify facilities that give rise to an enduring lack of effective competition in markets for infrastructure services.
- **Criterion (c)** (*the national significance test*) should ensure that only services that are significant in an economy-wide context can be declared.
- **Criterion (f)** (*the public interest test*) should be used by decision makers to establish that declaration would likely generate overall gains to the community.

By better targeting the criteria at the economic problem, the Commission's reforms would, if implemented, reduce the risk of inappropriate declaration outcomes, and in doing so, confine the scope of access regulation to where it is expected to generate net benefits to the community. This would provide greater certainty to infrastructure service providers and access seekers about the circumstances in which access regulation may apply, and limit the potentially significant costs associated with access regulation — including any adverse effects to incentives for investment, and costs associated with regulatory error.

Criterion (a) could better capture the effect of declaration on competition

Criterion (a) should be amended so that it is only satisfied where access to an infrastructure service on reasonable terms and conditions through *declaration* (rather than access per se) would promote a material increase in competition in a dependent market. This amended criterion would require a comparison of the future state of competition under the status quo (including where access may already be available under the status quo) against the future state of competition where access is granted on reasonable terms and conditions through declaration.

A declaration-focused competition test is the most effective way to target the economic problem that the Regime is intended to address. This competition test would not be satisfied where there is already effective competition in dependent markets. It would also not be satisfied where access is already granted to all third parties on reasonable terms and conditions, as declaration would not be expected to alter the terms and conditions of access.

RECOMMENDATION 8.1

The Australian Government should amend paragraphs 44G(2)(a) and 44H(4)(a) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (a) becomes a comparison of competition with and without access on reasonable terms and conditions through declaration.

Criterion (b) could better target infrastructure facilities that are associated with the economic problem

Criterion (b) should be amended such that it is satisfied where total foreseeable market demand for the infrastructure service over the declaration period could be met at least cost by the facility compared with where demand is met by two or more facilities. Total foreseeable market demand should include the demand for the service under application as well as the demand for any substitute services provided by facilities serving that market. In infrastructure service markets, an enduring lack of effective competition will usually occur where the incumbent facility can meet total market demand for the service at least cost (chapter 5).

The costs that are relevant to determining whether a facility can meet total foreseeable market demand at least cost are the production costs that would be incurred in meeting total foreseeable market demand. This assessment of costs should include an estimate of any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility. The production costs from coordinating multiple users of infrastructure can be significant, particularly in highly integrated supply chains. In some cases, these coordination costs will outweigh the benefits of access (chapter 3).

The National Competition Council (NCC) and designated Minister have in the past interpreted subsections 44F(4) and 44H(2) — which require a consideration of whether it would be economical for anyone to develop another facility that could provide *part* of the service — in the same way as criterion (b) (Borbridge 1997; NCC 1997, 2013b). Thus, the interpretation of criterion (b) is also relevant to these subsections.

RECOMMENDATION 8.2

The Australian Government should amend paragraphs 44G(2)(b) and 44H(4)(b) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (b) is satisfied where total foreseeable market demand over the declaration period could be met at least cost by the facility. Total market demand should include the demand for the service under application as well as the demand for any substitute services provided by facilities serving that market. The assessment of costs under criterion (b) should include an estimate of any production costs incurred by the infrastructure service provider from coordinating multiple users of its facility.

The definition of ‘anyone’ under a private profitability test

In the Pilbara rail case, the High Court determined under the private profitability test that the term ‘anyone’ can include the incumbent operator of the facility to which access is sought (chapter 5). The Commission considers that if criterion (b) continues to be applied as a private profitability test, the term ‘anyone’ should not include the incumbent service provider (there was support for the Commission’s recommendation on this matter in the draft report). This is because an incumbent service provider would avoid access regulation if it successfully argued that it could profitably duplicate its own facilities (although it would not be required to do so). All else equal, having the incumbent duplicate, or say it will duplicate, its facility would do little to nothing to promote competition. The definition of anyone would not be an issue if criterion (b) were amended as recommended by the Commission above, given that the Commission’s preferred approach is focused on the costs of meeting demand using the facility under application rather than the profitability of a project.

RECOMMENDATION 8.3

If criterion (b) continues to be applied as a private profitability test, the Australian Government should amend the definition of ‘anyone’ in paragraphs 44G(2)(b) and 44H(4)(b) of the Competition and Consumer Act 2010 (Cwlth) to exclude the incumbent service provider.

The hurdle for assessing the public interest in criterion (f) should be raised

The Commission is proposing three changes to criterion (f) that would help to ensure that declaration only occurs where it is likely to generate overall gains to the community (chapter 5). First, criterion (f) would be better drafted as an affirmative test that requires the public interest to be *promoted* (as opposed to access being ‘not contrary’ to the public interest).

Second, criterion (f) should be amended to require the NCC and designated Minister to *have regard to* relevant factors not expressly covered by the other declaration criteria. As noted in chapter 7, the investment effects, and administrative and compliance costs associated with access regulation can be significant. Accordingly, assessments under criterion (f) should specifically include any effects on investment (positive or negative) in markets for infrastructure services and dependent markets, and the administrative and compliance costs that would arise due to declaration. Such a requirement would not exhaustively define the scope of the public interest test.

Finally, criterion (f) should be amended so that it is framed as a test that assesses factors that affect the public interest with and without declaration. This is comparable to the access–declaration distinction associated with criterion (a) discussed above.

RECOMMENDATION 8.4

The Australian Government should amend paragraphs 44G(2)(f) and 44H(4)(f) of the Competition and Consumer Act 2010 (Cwlth) such that criterion (f) becomes a test of whether access on reasonable terms and conditions through declaration promotes the public interest. As part of their assessment of the public interest, the National Competition Council and designated Minister should be required to have regard to the effect of declaration on investment in markets for infrastructure services and dependent markets, and administrative and compliance costs.

8.3 Improving certification arrangements

Certification can help to improve the consistency and quality of state and territory access regimes, promote regulatory certainty for infrastructure service providers and access seekers, and reduce the scope for regulatory duplication. In chapter 6, the Commission concluded that the certification path should be retained. However, participants raised some issues with both criterion (e) and the principles in clause 6 of the Competition Principles Agreement (CPA), which are used by the NCC and Commonwealth Minister to assess whether a state or territory access regime should be certified. The Commission has sought to address those issues that would increase the net benefits associated with certification.

Criterion (e) as a threshold clause

Under criterion (e) (paragraphs 44G(2)(e)(ii) and 44H(4)(e)(ii) of the *Competition and Consumer Act 2010* (Cwlth) (CCA)), a service subject to a certified access regime can be declared if there have been substantial modifications to the certified regime or the clause 6 principles of the CPA. This causes regulatory uncertainty as to whether a service covered by a certified regime can be declared under Part IIIA. Further, even if a declaration application would not pass criterion (e), due to the presence of a certified regime that has not had substantial modifications, the NCC may be required to assess the application against the remaining declaration criteria. This imposes unnecessary administrative costs on service providers, access seekers and the NCC.

To reduce the administrative costs associated with declaration, the Commission considers that criterion (e) would be better formed as a separate threshold clause stating that an infrastructure service cannot be declared if it is subject to a certified access regime. Only when this threshold is passed would consideration be given to the declaration criteria. If criterion (e) is removed and formed as a threshold clause then consequential amendments to Part IIIA may be necessary to ensure that the designated Minister is able to revoke the declaration of a service if that service becomes the subject of a certified regime.

Once established as a threshold clause, substantial modifications to the certified regime or the clause 6 principles of the CPA, such that the regime would no longer meet the clause 6 principles, should be grounds for revoking the certification of a state or territory regime. Certification should continue to provide protection from declaration until certification expires or is revoked by the Commonwealth Minister.

A formal mechanism for the Commonwealth Minister to revoke certification (instead of the current substantial modifications clause in criterion (e)) would improve regulatory certainty for infrastructure service providers and access seekers. To operate effectively, a revocation application should be able to be initiated by an infrastructure service provider covered by the certified regime, an access seeker, the relevant state or territory government or the NCC at any time. Allowing the NCC to initiate a revocation would enable it to notify governments that a regime is no longer considered effective prior to the assessment of an application for declaration. The Commonwealth Minister should only be able to revoke certification following a recommendation from the NCC.

RECOMMENDATION 8.5

The Australian Government should amend Part IIIA of the Competition and Consumer Act 2010 (Cwlth) to:

- *remove paragraphs 44G(2)(e) and 44H(4)(e)*
- *introduce a threshold clause stating that a service cannot be declared if it is subject to a certified access regime*
- *include provision for the Commonwealth Minister to revoke the certification of an access regime, following a recommendation from the National Competition Council (NCC), if there have been substantial modifications to the certified regime or the principles in clause 6 of the Competition Principles Agreement (CPA), such that the regime no longer meets the principles in clause 6 of the CPA*
- *enable infrastructure service providers covered by the certified regime, access seekers, or the relevant state or territory government to apply to the NCC to make a recommendation to the Commonwealth Minister for the revocation of certification. The NCC should also be able to initiate the revocation of certification (consistent with the current arrangements for revocation of declaration and ineligibility decisions).*

The protection from declaration offered by certification should apply until the expiration of the certification, unless the certification is revoked by the Commonwealth Minister. Consequential amendments may be necessary to ensure that the designated Minister is able to revoke the declaration of a service if that service becomes the subject of a certified access regime.

Aligning the clause 6 principles with Part IIIA

There are some differences between the principles in clause 6 of the CPA, and the provisions in Part IIIA. In particular:

- there are differences between clause 6(3) (relating to the coverage of an access regime) and declaration criteria (a) and (b) in Part IIIA. Should the reforms to the declaration criteria recommended in this report be adopted, the divergence between the clause 6 principles and Part IIIA would increase
- the safeguards for extensions directed by the Australian Competition and Consumer Commission (ACCC) in section 44W of the CCA are not included in the CPA and thus are not required to be included in state and territory access regimes for the regime to be certified.

There is a strong rationale for aligning the principles in clause 6(3) of the CPA with the relevant declaration criteria in the CCA. Clause 6 of the CPA provides a framework for state and territory access regimes. Therefore, if the Commission's proposed amendments to the declaration criteria are not reflected in clause 6(3), state and territory access regimes may not be appropriately targeted at the economic problem that access regulation should address. The differences in wording between clause 6(3) and the declaration criteria are also likely to increase uncertainty over the interpretation of both.

There may also be a case for including the safeguards in section 44W of the CCA in the CPA. Where an infrastructure service provider is required to extend its facility, appropriate safeguards are needed to preserve investment incentives (chapter 4). The Commission has recommended (in section 8.5 below) that the ACCC develop and publish guidelines on how its power to direct an extension of a facility would be exercised in practice. If this recommendation is adopted, then following publication of the guidelines, COAG should consider including the safeguards already in the CCA in the CPA.

There may also be benefits from streamlining the clause 6 principles to reduce the administrative burden on governments attempting to ensure that their regimes meet the principles. However, streamlining is likely to have fewer benefits, and therefore is less of a priority, than aligning the clause 6 principles with the declaration criteria. Any streamlining of the clause 6 principles should be undertaken in consultation with the NCC.

The Commission acknowledges that there will be some costs associated with amending the clause 6 principles. In particular, it will take time and effort to update aspects of the CPA, given that any changes would require the agreement of all states and territories and the Australian Government. In addition, there may be some transitional costs if the principles are changed, including the potential to affect the certification status of state and territory access regimes.

Aligning clause 6(3) of the CPA with the declaration criteria in Part IIIA could be achieved by referencing the relevant declaration criteria in subsection 44G(2) or 44H(4) of the CCA in clause 6(3) of the CPA, so the principles remain aligned should there be changes to the declaration criteria in the future. Alternatively, subsections 44M(4) and 44N(2) of the CCA (which outline the factors the NCC and Commonwealth Minister must have regard to when considering certification) could be amended so that the NCC and Commonwealth Minister must have regard to the relevant declaration criteria when making a recommendation or decision on certification (NCC, sub. DR48).

RECOMMENDATION 8.6

If the Commission's recommendations to amend the declaration criteria are implemented, the Council of Australian Governments (COAG) should consider amending the Competition Principles Agreement (CPA) to align the principles in clause 6(3) with the relevant declaration criteria in Part IIIA of the Competition and Consumer Act 2010 (Cwlth) (CCA). COAG should also consider streamlining the clause 6 principles in the CPA, in consultation with the National Competition Council, where appropriate.

If the Commission's recommendation that the Australian Competition and Consumer Commission develop and publish guidelines on its power to direct facility extensions is adopted, then following publication of the guidelines COAG should consider including the safeguards in section 44W of the CCA in the CPA.

Releasing states and territories from the requirements to certify electricity and gas access regimes

All electricity and gas access regimes, with the exception of the Western Australian and Northern Territory electricity regimes, are uncertified. The Commission considers that the benefits of certifying electricity and gas access regimes are likely to be small. The regimes are already consistent across states and territories as they are applied via template legislation, and participants suggested that the risk of declaration is low (chapter 6).

While the above reforms to the certification process would reduce some of the costs of certifying electricity and gas access regimes, other costs will remain. The costs include the potential for duplication of regulatory processes and the administrative costs of certification. On balance, the costs of certifying the electricity and gas access regimes may outweigh the benefits. Therefore, the Commission considers that COAG should release the states and territories from the existing requirement to submit their electricity and gas regimes for certification (although the state and territory governments would be free to seek certification of their regimes if they considered there would be net benefits from doing so).

RECOMMENDATION 8.7

The Council of Australian Governments should release the state and territory governments from the requirements in the Competition and Infrastructure Reform Agreement and the Australian Energy Market Agreement to submit their electricity and gas regimes for certification. States and territories would be free to seek certification of their regimes if they considered that there would be net benefits from doing so.

8.4 Ensuring undertakings are used to target the economic problem

All undertakings that have been accepted by the ACCC under Part IIIA have been submitted due to legislative requirements or other government agreements. While some inquiry participants considered that the Part IIIA undertakings have proven effective, others considered particular undertakings to be unnecessary, or were concerned that mandating an undertaking may result in some of the safeguards included in the declaration pathway under the Regime being bypassed (chapter 6).

Caution should be exercised before mandatory undertakings are implemented in the future. Where mandatory undertakings are used, the relevant government should request that the NCC assess the service against the declaration criteria before the undertaking is implemented and at appropriate intervals after the undertaking is in place, to ensure that the undertaking is used to target the economic problem that the Regime should address. This will help to ensure that the use of mandatory undertakings provides net benefits to the community.

RECOMMENDATION 8.8

Where an infrastructure service provider is required by a government to have an access undertaking in place in the future, the relevant government should request that the National Competition Council assess the service against the declaration criteria before the mandatory undertaking is implemented and at appropriate intervals after the mandatory undertaking is in place.

8.5 Safeguards should apply to directed expansions

Under section 44V of the CCA, the ACCC may make a determination in an access dispute that requires an infrastructure service provider to extend the facility or permit interconnection to the facility by a third party. The ACCC has never exercised its power to direct an extension under Part IIIA (nor has it been called on to do so).

A decision by the ACCC to direct an extension would require complex operational, commercial and legal considerations. Many participants in this inquiry have expressed serious concerns about when, and how, the ACCC would exercise the power to direct an extension, the practicality of exercising the extension power, the workability of the safeguard provisions in Part IIIA, and the potential to adversely affect service providers' investment incentives (chapter 4). The Commission shares these concerns.

However, the power is necessary for the proper operation of the Regime and the ACCC should develop guidelines on how the power to direct extensions would be used such that it is expected to generate net benefits to the community. This guidance should detail the principles the ACCC would use in determining:

- whether an extension of an infrastructure facility is warranted, the tests and considerations the ACCC would broadly apply in determining this, and how the safeguards embedded in Part IIIA would be operationalised
- responsibility for funding the extension and the recovery of capital contributions (although a service provider should not be required to pay the upfront costs of the directed extension)
- how the legitimate business interests of the service provider will be taken into account, and the types of direct costs to be considered by the ACCC when making a determination directing the extension of a facility
- the allocation of capacity to a directed extension, such as whether particular users have priority of access, and how that allocation would be determined over time if additional access seekers applied after the extension was completed.

Of particular concern to the Commission and inquiry participants is the applicability and workability of the safeguards set out in Part IIIA, and whether they will adequately protect the legitimate business interests of service providers. The preparation of the guidelines should include an analysis of the workability and adequacy of the provision to direct extensions and its safeguards.

The guidelines should be developed using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation so the provision to direct an extension is exposed to close scrutiny.

RECOMMENDATION 8.9

As soon as practicable, the Australian Competition and Consumer Commission (ACCC) should develop and publish guidelines on how its power to direct facility extensions would be exercised in practice such that it is expected to generate net benefits to the community. The guidelines should be developed by the ACCC using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation.

The safeguards provisions in the CCA (section 44W) are expressed as referring only to extensions of a facility, but the Tribunal and others have interpreted ‘extend’ to include both geographic extensions of a facility and expansions of a facility’s capacity. The Australian Government Solicitor has advised that it has not been decided judicially whether ‘extend’ includes capacity expansions, and so this is not

beyond doubt (chapter 4). Part IIIA should be amended to confirm that the ACCC's power to direct extensions also encompasses capacity expansions to ensure that the safeguards set out in section 44W also apply to directed expansions.

RECOMMENDATION 8.10

The Australian Government should amend the Competition and Consumer Act 2010 (Cwlth) (CCA) to confirm the prevailing interpretation by the Australian Competition Tribunal that the terms 'extend', 'extensions' and 'extending' in sections 44V, 44W and 44X include expansions of a facility's capacity. The intent of this amendment is that when making an access determination, the Australian Competition and Consumer Commission can require a service provider to expand the capacity of its facility (in addition to being able to require a geographical extension) and that the safeguards in sections 44W and 44X apply to directed capacity expansions.

In framing the amendments, consideration should be given to the use of the terms 'extend', 'extensions' and 'extending' in other provisions of the CCA, to ensure that the amendments do not give rise to any unintended consequences.

8.6 Facilitating efficient investment in infrastructure

The Commission's proposed reforms seek to confine the scope of the Regime so that its use is limited to the exceptional cases where the benefits arising from increased competition in dependent markets are likely to outweigh the costs of regulated third party access to infrastructure services. This will promote greater regulatory certainty and improve the efficiency of infrastructure investment. Notwithstanding these reform proposals, access regulation can have unintended adverse effects on investment in infrastructure services, both for greenfield infrastructure and in upgrading and maintaining existing infrastructure. As outlined in chapters 3 and 7, access regulation can have a negative effect on investment incentives as a result of:

- *regulatory risk* — access regulation can compound the inherent riskiness of investments in infrastructure services due to uncertainty about how regulation may be applied. This uncertainty can raise the required hurdle rate of return of the proposed investment above the expected rate of return and thereby delay or deter investment
- *asymmetric truncation* — access regulation may lead to the expropriation of above-normal returns but not compensate for below-normal returns. This can

reduce the expected rate of return of the proposed investment below the required hurdle rate of return and thereby delay or deter investment.

However, as also noted in chapter 7, it is not possible to design access regulation in a way that completely avoids affecting infrastructure investment incentives.

Are existing measures helping to reduce regulatory risk?

Part IIIA has two direct measures that aim to reduce regulatory risk for new investments in infrastructure services.

- *Ineligibility provisions.* A person with a material interest in a proposed infrastructure service can request the service be pronounced ineligible for declaration for at least 20 years. The NCC and designated Minister can only recommend or decide that the service is ineligible if they are satisfied that the service provided by the facility would *not* meet at least one of the declaration criteria. Ineligibility decisions are different from access holidays, which allow an infrastructure service to be immune from declaration even if it would meet the declaration criteria. Access holidays are not available under Part IIIA.
- *Competitive tender processes.* A service provided by an infrastructure facility that is to be owned by a Commonwealth, state or territory government cannot be declared if the facility was subject to a competitive tender process for its construction and operation and this process was approved by the ACCC. The tender process must result in reasonable terms and conditions of access to the proposed facility. If the ACCC approves a competitive tender process it may specify the period for which the decision is in force and may extend that period. (The time period is 20 years where a deemed decision applies — that is, when the ACCC does not publish a decision within 90 days.)

Ineligibility provisions

A decision that a proposed infrastructure service is ineligible to be declared is intended to ‘enhance regulatory certainty for potential investors in major new infrastructure facilities’ (Emerson 2009a, p. 35). There have been no applications for an ineligibility recommendation since the ineligibility provisions came into effect in 2010. In addition to the provisions being relatively new, there could be a number of reasons why infrastructure developers have not used the provisions.

- An ineligibility ruling may not be sufficient to materially change an investment decision.

There is no doubt that ineligibility clauses improve regulatory certainty; however for

long lived assets such as pipelines the increase is not sufficient to materially improve a willingness to invest. This is because there is no certainty of the outcome after the ineligibility period. (Australian Pipeline Industry Association, sub. 14, p. 9)

- If a prospective service provider perceives the threat of declaration of the proposed service as low, it may be unlikely to seek ineligibility if doing so means that investment plans will be delayed while the application is being assessed. Instead, the service provider may prefer to risk declaration after the facility has been built. Aurizon (sub. DR72) suggested that the ineligibility process introduces additional uncertainty into the timeline for a project. (The NCC is required to make a recommendation on ineligibility within 180 days of an application, after which time the Minister has 60 days to make a decision.)
- Some participants (including Aurizon, sub. DR72) suggested that a negative decision from the designated Minister could increase the risk of the service being regulated. A decision that a service is not ineligible to be declared is not a decision that the service should be declared (a separate application would be required under section 44F after the facility has been constructed) (Emerson 2009a). Nevertheless, the publication of a decision that the service is not ineligible for declaration (and the reasons for this) may alert prospective access seekers to the potential for declaration. This could weaken the service provider's negotiating position. It may also be that the application assessment process itself exposes a project proponent's intentions to competitors, which could jeopardise the investment.

In commenting on the ineligibility provisions, the NCC considered that greater flexibility in the ineligibility period was desirable (currently the period must be at least 20 years). The NCC proposed that applicants be permitted to propose a period and that the NCC make a recommendation on this period. It suggested that 'this could make these recommendations more available and help avoid inappropriately lengthy ineligibility periods' (sub. 9, p. 20). As an alternative, the NCC suggested that consideration be given to introducing a mechanism for access seekers to apply for revocation of ineligibility decisions (sub. DR48).

The Commission's view

Ineligibility decisions could reduce regulatory risk for projects where the threat of declaration is sufficient to delay or deter an investment. The Commission considers that the current approach is necessary to provide sufficient regulatory certainty to prospective investors. Ineligibility decisions apply for at least 20 years and can only be revoked if the service is so materially different from the proposed service that the NCC is satisfied that it meets the declaration criteria.

As noted above, public exposure of project plans, or the prospect of a decision that a service is not ineligible for declaration, may deter the use of the provisions. This could potentially be addressed by allowing applications to be submitted and assessed confidentially. However, confidentiality would reduce transparency and limit the NCC's opportunity to publicly assess the application. Aurizon (sub. DR72) suggested that confidentiality arrangements could be used to allow infrastructure proponents to formally gauge the view of the NCC or Minister prior to public consultation. It is unclear whether such an arrangement would provide sufficient regulatory certainty for proponents of new infrastructure as any view provided by the NCC would be non-binding and subject to change following public consultation. Prospective applicants are also able to obtain their own independent legal and expert advice prior to submitting an application to the NCC.

The Commission therefore supports the ineligibility provisions as they stand.

Competitive tender

The rationale for the competitive tender provisions in Part IIIA is that 'the competitive tendering process is likely to see any monopoly rents expected to be attached to the facilities concerned dissipated in reasonable terms and conditions for service users, rather than accruing to the service provider' (Costello 2006, p. 4).

The ACCC can only approve a competitive tender process if, among other things, it is satisfied that the process will result in reasonable terms and conditions of access to the service. This means that once chosen as the sole provider, the tenderer is unable to use its position to refuse access or monopoly price. Approval of the process also enables access arrangements to be established in advance, eliminating the need for further regulatory involvement in access matters. This can provide regulatory certainty and help ensure that asymmetric truncation does not inhibit investment in infrastructure services, given it enables infrastructure providers to define the access price they require before committing to the project. Regulatory certainty could also facilitate investment in dependent markets.

There have been no applications for ACCC approval of a competitive tender process since the provisions took effect in 2010, although the Productivity Commission understands that the Australian Government is considering the provisions as one of several regulatory and non-regulatory options to develop the planned Moorebank Intermodal Terminal facility in Sydney, as a common-user, open access facility (Department of Finance, pers. comm., 14 October 2013) (box 8.1).

Why have the competitive tender provisions not been used?

A possible issue with the competitive tender provisions is that it may be too difficult to gain ACCC approval for a tender process (Treasury, sub. 34). Queensland Treasury and Trade (sub. 42) suggested that the Commission consider whether the criteria for assessing a competitive tender are too onerous for infrastructure proponents to satisfy.

Box 8.1 Moorebank Intermodal Terminal

The Australian Government has announced the construction of an open access Intermodal Terminal (IMT) at Moorebank in Sydney (Wong 2012). The IMT will involve a rail link from Port Botany to a new freight terminal and warehousing facilities at Moorebank. The site for the IMT facility is on Commonwealth-owned land.

The design, construction and operation of the IMT facility will be undertaken by the private sector through a competitive tender process in which tenderers will be 'provided with an opportunity to contribute to the overall funding of the project' (Department of Finance 2013). The terms and conditions of access to the IMT facility are expected to be overseen by the Moorebank Intermodal Company Limited (MIC) — a government business enterprise. The Commonwealth and MIC are currently considering how the open access objective for the facility can be achieved most effectively. The agreed option(s) will help to inform the procurement process for the builder and operator of the IMT facility. For example, it is likely that the lease to be agreed between MIC and the Commonwealth in respect of the IMT site will include common-user principles with which the operator of the IMT facility must comply (Department of Finance, pers. comm., 14 October 2013).

The Department of Finance has conducted initial consultations with the ACCC on competition and open access issues relevant to the IMT facility, including means to alleviate competition concerns should an operator with upstream or downstream interests be appointed by MIC (Treasury, sub. 34). Further engagement with the ACCC may be necessary once the preferred approach on open access is determined and agreed by MIC, the Department of Finance, and the Department of Infrastructure and Regional Development (Department of Finance, pers. comm., 14 October 2013).

To be approved by the ACCC, the tender process must, among other things, include criteria that will ensure that a tender will be selected principally on the basis that the service will be provided at the lowest sustainable access price, or on terms and conditions that are otherwise most likely to promote the objects of Part IIIA (subregulation 6FB(9) of the Competition and Consumer Regulations 2010). However, governments may wish to prioritise other criteria when selecting a preferred tenderer, such as environmental or social objectives. While a tender may address such objectives, it is unclear what weight the ACCC would give to differing

criteria when assessing a tender process. A state or territory government may prefer to seek protection from declaration under Part IIIA through certification of an access arrangement, rather than seek approval of a competitive tender process.

Another potential issue is that the scope of competitive tender processes that can be approved by the ACCC could be too narrow. The provisions currently apply to tender processes for the construction and operation of infrastructure facilities that are to be government-*owned*. The ACCC has indicated that the provisions do not appear to apply to government-*sponsored* competitive tender arrangements (trans., p. 106). This may exclude some competitive tender arrangements, for example, where a government runs a competitive tender process involving a privately owned and operated infrastructure service to be provided on government-owned land.

Michael Cunningham also noted that there are circumstances where the provisions do not seem to apply, such as when a government conducts a tender for the operation of an existing facility or for ‘some concessions of the Build, Own, Operate and Transfer (BOOT) form, for example, if assets are to be transferred to another franchisee at the end of the concession period’ (sub. 18, p. 15).

The Commission’s view

Competitive tender can be an effective way to establish access arrangements if the successful tender is designed correctly and if it includes reasonable terms and conditions of access. It is appropriate that infrastructure services be granted immunity from declaration under Part IIIA where the right to construct and operate the facility has been awarded through a competitive tender process that has been approved by the ACCC. This provides greater certainty to the infrastructure service provider and access seekers about the terms and conditions of access that will apply. Establishing access arrangements upfront can avoid costs later if, in response to monopoly pricing or denial of access, governments respond with unanticipated (and perhaps reactionary and poorly designed) regulation.

Uncertainty about whether the arrangements could be applied to infrastructure facilities that are to be privately owned but awarded through a government-sponsored competitive tender may limit the use of the provisions. Given this uncertainty and because the provisions are relatively new, it would be preferable for the provisions to be tested to determine whether any amendments are required to broaden their scope or improve their effectiveness.

Are other measures needed to address regulatory risk and asymmetric truncation?

In chapter 7, the Commission concluded that while there is limited empirical evidence of the effect of the Regime on investment incentives, it is clear that access regulation has the potential to alter investment incentives, both positively and negatively. The Commission also considered that well designed and implemented access regulation can promote efficient investment and that the Commission's proposed reforms to the Regime would help to achieve this. Nonetheless, several inquiry participants proposed additional Part IIIA measures to reduce regulatory risk, in particular for greenfield infrastructure projects.

Access holidays

Queensland Treasury and Trade (sub. 42) suggested that the Commission explore the merits of access or regulatory holidays for greenfield infrastructure facilities. Some other participants pointed to issues with their use. The Commonwealth Treasury noted that 'access holidays may allow an integrated infrastructure service provider to establish over time an overwhelming advantage in markets dependent upon their services' (sub. 34, p. 5). Similarly, the ACCC noted that 'where the infrastructure operator is vertically integrated, a cautious approach would be warranted to guard against entrenching the market power of the infrastructure operator's upstream or downstream business' (sub. 16, p. 48).

The Commission also has reservations about access holidays. While potentially effective in reducing regulatory risk and addressing asymmetric truncation, they have efficiency costs and there are issues with their implementation. For example, there would be a risk that during the access holiday period, an infrastructure service provider would be in a position to exert market power that inhibits competition in dependent markets. Implementation issues include determining how long an access holiday should be, and which infrastructure services should be eligible for an access holiday (for example, whether access holidays should apply to greenfield investments or all types of infrastructure investments).

A limited form of access regulation

Aurizon (sub. DR72) considered that the risk of declaration is a disincentive to invest in greenfield infrastructure. It suggested that a form of limited open access regulation could apply, including where:

- for greenfield projects, the ACCC could accept a limited open access undertaking that prescribes the mechanics of open access (including dispute

resolution) but does not authorise the ACCC to impose a price or capital return for the duration of the undertaking

- declaration decisions could involve light regulation determinations, which would be equivalent to a price regulation exemption.

Aurizon's proposal would likely involve efficiency costs. In particular, a price regulation exemption would allow the provider of a declared service (or the provider of a service immune from declaration due to acceptance of an undertaking) to charge monopoly prices for access to the service. This could inhibit competition in dependent markets. The proposal would also remove the threat of the ACCC regulating access prices, which is an important component of the Part IIIA negotiate–arbitrate framework as it provides an incentive for parties to reach private agreement.

Declaration of proposed infrastructure services

Part IIIA does not include provisions for declaration of a proposed infrastructure service. The Queensland Government (sub. DR71) suggested that the Commission consider specific provisions for declaration of a service that has not been constructed or commenced operation. It considered that there would be merit in settling access issues upfront to provide certainty to parties about the future terms and conditions of access. In this context, the Queensland Government suggested that access seekers may face difficulties negotiating access to greenfield facilities and may wish to seek recourse to the negotiate–arbitrate framework provided under an access regime, noting that:

Declaration at an earlier stage would allow access seekers to negotiate with prospective access providers with the benefit of the legislated negotiation protections under the regime ... While individual jurisdictions' planning legislation and project approval processes have a role in promoting the development of greenfield infrastructure on an open access basis, these do not provide the legislated negotiation framework an access regime provides. (sub. DR71, p. 7)

It is unclear if access seekers generally face difficulty negotiating access to greenfield infrastructure and whether a provision enabling upfront declaration would provide substantial benefits compared with the current declaration arrangements. Upfront declaration could facilitate investment in dependent markets by providing certainty for access seekers about the regulatory arrangements that will apply to the facility. Such certainty could also be achieved by seeking declaration of the infrastructure service once the facility has been constructed or commenced operation. The potential benefits of upfront declaration would therefore be earlier investment in dependent markets.

At the same time, upfront declaration could risk adversely affecting incentives for investment in infrastructure services. If upfront declaration involves arbitration of access terms and conditions, and this does not allow the investor to earn sufficient returns, the investment could be delayed or deterred (chapter 3). While there may be regulatory approaches available to address this risk — such as risk-adjusted rates of return (chapter 4) or deferral of cost recovery (chapter 7) — the arbitration process could nevertheless introduce additional uncertainty into the timeline for the proposed project.

There would also be practical issues involved in declaring a service prior to its construction. In particular, it may not be possible to be affirmatively satisfied that a proposed infrastructure service involves an enduring lack of effective competition (that is, that the declaration criteria are satisfied) prior to the construction of a facility. This is because decision makers would have less information available on the proposed facility and its likely effect on competition than they would have for an existing facility. Inadequate information may also increase the prospects for poor regulatory decisions and make it difficult to choose the appropriate point in the development of a project at which access seekers should be able to apply for declaration.

For the above reasons, the Commission does not favour the introduction of specific declaration provisions for proposed infrastructure services. Such an approach risks broadening the scope of access regulation for little gain and adversely affecting incentives to invest in infrastructure services.

Where a lack of effective competition is expected to arise in relation to a proposed infrastructure service, including where the development of competing facilities is limited through government planning legislation or project approval processes, other options may be available to governments, such as a competitive tender process or facility-based access arrangement. Broader issues relating to the consideration of upfront access arrangements for greenfield and privatised infrastructure are considered in chapter 10. The use of facility-based arrangements is discussed in section 8.8 below.

8.7 The balance between Part IIIA and industry-specific access regimes

In addition to the Regime, there is a range of national, state and territory industry-specific access regimes (chapter 2). These regimes cover many of the major infrastructure industries, including telecommunications, post, electricity, gas, and some rail, port and urban water infrastructure services.

The advantages and disadvantages of industry-specific approaches

Industry-specific approaches to access regulation have a number of advantages.

- They can be tailored to the individual circumstances of specific industries. This can provide greater certainty to infrastructure service providers and access seekers compared with a generic regime. For example, because of its special characteristics and history, the telecommunications sector has its own access regime that reflects these unique features.
- They can reduce transactions costs for industries that are likely to have multiple third party access seekers. This is likely to be the case in the gas access regime, where a service provider covered by full regulation is required to submit an access arrangement setting out the terms of access to a covered pipeline.
- They can provide greater regulatory certainty to infrastructure service providers and access seekers regarding coverage. For example, the South Australian ports access regime applies to specific port services at six ports in South Australia. There is less certainty for service providers and access seekers under a generic regime, where an application for declaration is required for each service.

State and territory industry-specific approaches can also have disadvantages. For example, where inconsistent regulatory approaches are applied, such as to the valuation of capital, this could lead to inefficient investment patterns (ACCC, sub. 16). Different regulatory approaches could also hinder the development of national or interstate markets. This was one of the reasons for implementing the national gas access regime (PC 2004).

Participants' views on industry-specific regimes

Inquiry participants expressed varied views on industry-specific access regimes (box 8.2). There was acknowledgment of the advantages and disadvantages of industry-specific approaches and the role of the Regime in providing a framework for industry-specific regimes (chapter 7). There was also a view that industry-specific access regimes are more intrusive compared with the national regime and that the range of industry-specific regimes should be reviewed.

A case-by-case assessment of industry-specific access regimes is outside the scope of this inquiry. A consideration that is relevant is whether there is an appropriate balance between the Regime and the current suite of industry-specific access regimes. In this context, a number of inquiry participants raised concerns about the effectiveness of the Regime in some industry settings and called for additional or nationally consistent access regulation, in particular for rail (Australian Rail Track Corporation (ARTC), sub. 20; Asciano, sub. DR62), heavy vehicle access to some

road infrastructure (Office of the National Infrastructure Coordinator, sub. 41), urban water (Sydney Water, sub. 17) and airport services (Qantas, subs. 28 and DR66).

Box 8.2 Some participants' views on industry-specific access regimes

Asciano acknowledged the potential advantages and disadvantages of industry-specific approaches noting that they:

... are likely to result in regulatory functions being duplicated and as such these approaches will increase costs. Such access regimes may also increase benefits if they better meet the needs of the industries and the markets involved but detailed proposals would need to be put forward to allow such benefits to be considered. (sub. 15, p. 29)

The Department of Infrastructure and Transport noted that:

... the current dual approach, which draws on the strengths of both the generic [National Access Regime] and industry-specific approaches, continues to provide the most flexible and appropriate mix of regulatory tools to governments and the rail and aviation industries. (sub. 37, p. 10)

Gilbert + Tobin suggested that:

The fact that access arrangements across telecommunications, energy, railways, airports and other network industries have evolved so differently reflects the value of protecting and encouraging industry specific access policy wherever possible. (sub. 45, p. 10)

Michael Cunningham preferred industry-specific approaches:

Because access regimes are usually introduced to complement other competition reforms, it is appropriate that they are usually formulated by policy makers as industry-specific regimes. (sub. 18, p. 3)

The APA Group was concerned that there were no policy principles to govern when an industry-specific regime was preferable to reliance on the National Access Regime:

This is of particular concern as industry-specific regimes tend to err on the side of more intrusive regulation (compared to the national access regime), despite the significant risks associated with inappropriate regulatory intervention. (sub. 35, p. 7)

Similarly, RBB Economics suggested that there was a need to consider the effectiveness of the range of industry-specific access regulation:

The problem is that there does not appear to be an effective mechanism in place to contain the growth of these industry-specific regimes. (sub. 31, p. 14)

The case for establishing additional access regimes at the industry level hinges on whether it can be shown that:

- there is a lack of effective competition, due to natural monopoly, in markets for infrastructure services in the industry under question that warrants access regulation (that is, there are expected to be net benefits to the community from access regulation)

-
- the infrastructure services in the industry are sufficiently similar to make an industry-specific approach the most appropriate approach (that is, the benefits of establishing and operating an industry-specific regime outweigh the costs)
 - there are features of the industry that justify different regulatory treatment for third party access from that offered by the generic National Access Regime.

A nationally consistent approach for rail access regulation?

Most of Australia's rail network is already covered by an access regime — either under a state or territory rail access regime, or under Part IIIA through declaration or undertakings. However, approaches to access regulation for rail vary across states, and in some cases within states — for example, there are at least four different access arrangements applying to different rail lines in Western Australia (see box 6.1).

Some inquiry participants considered that there was a need for a nationally consistent approach to rail access regulation, but with sufficient flexibility to cater for differences in the types of rail networks.

... economic regulation should be applied consistently across the national rail network. This is not to say that uniform regulation in the form of access regimes or undertakings should apply in all circumstances ... there should be differentiation between access regimes based on the access providers' market and industry position ... consistency could apply with respect to the decision (made by a single national body) to cover the network and to the form and intensity of regulation to apply ... consistency should apply with respect to the requirement for the access provider to submit an access undertaking (or similar) to the relevant regulator for approval. (ARTC, sub. 20, p. 7)

... there may be benefits in having different detailed access and pricing approaches to rail access for different users and applications. However, if different access and pricing approaches are required due to market, user or operational factors then these access regimes should be explicitly based on the access needs arising from these factors rather than be based on jurisdictional borders. (Asciano, sub. DR62, p. 8)

A nationally consistent approach to rail access regulation would have a number of costs and benefits.

- The benefits most relevant to the rail sector are likely to include a reduction in compliance costs for rail operators that deal with multiple access regimes and economic regulators, and a reduction in the administrative costs of regulating access. The Commission has previously noted that the reforms agreed by COAG in 2006, including those in the Competition and Infrastructure Reform Agreement (CIRA), presented a way forward for achieving consistency (PC 2006b). (Chapter 10 discusses the status of the reforms outlined in the CIRA.)

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- The costs of a nationally consistent approach to rail access regulation include those associated with a reduction in regulatory flexibility. While a national approach does not necessarily mean one size fits all, it may limit the ability of governments to tailor access arrangements to the circumstances of their jurisdictions. Aurizon (sub. DR72) considered that it was reasonable that rail continues to be regulated by a mix of state and Commonwealth legislation, rather than under a single uniform set of nationally consistent arrangements, given the significance of rail to the state economies. Further, given the current differences in rail access regimes, there would likely be significant time and effort involved in negotiating and developing a national approach for rail access — especially if flexibility to cater for the different types of rail networks was to be a feature of a nationally consistent approach.

Would nationally consistent rail regulation provide net benefits to the community?

The Commission's experience in evaluating regulatory reforms, including those relating to the development of a single national law and regulator for rail safety, has provided insights into the conditions necessary for successful national reform. In particular, a manageable reform agenda should concentrate on actions that are likely to bring substantial benefits and where achievement requires a COAG framework. Additional success factors include having a coherent agenda focused on significant reforms, prioritising areas that are practical and achievable, paying attention to the costs of developing reforms and to the timeframes required to achieve benefits, and recognising that harmonisation will not always be the right answer (PC 2012c).

The Commission was not presented with sufficient evidence that the current approach to rail access regulation is imposing substantial costs on access seekers or rail operators. Asciano indicated that the administrative costs of dealing with different rail access regimes were probably not large and that the benefits of consistency would flow to a small number of national rail providers (trans., p. 140).

Asciano pointed to other issues in dealing with different rail access regimes where it considered a national regulator and national rail regulation would provide benefits. These related to the level of expertise and capacity constraints of state regulators, and differences in operational rules between access frameworks, for example, relating to allowable speeds (trans., pp. 133, 140, 141). There may be other options available to address these matters that would likely be less costly than developing a national rail access regime and regulator. For example, regulator forums can help to facilitate coordination between regulators, encourage an exchange of views on good practice, and build professional capability (PC 2013e). Certification of the currently

uncertified rail access regimes may also help to achieve greater consistency in some areas of rail access regulation (chapter 6).

In light of the limited evidence on the costs of the current regulatory approach to rail access, and the considerable time and effort that would be involved in the development of a national approach, particularly given COAG's current national reform agenda, the Commission does not consider that a national approach to rail access would generate substantial net benefits to the community at this time.

Should road infrastructure be subject to access regulation?

During the Commission's consultations participants highlighted that heavy vehicle operators are unable to access parts of the road network and that access regulation could address this issue. The Office of the National Infrastructure Coordinator noted that future heavy vehicle productivity growth is linked to increasing road access for larger, more productive vehicle types and proposed the use of an 'investment-access' undertaking under the Regime, stating that it:

... would, as in the rail freight industry, offer a consistent legal right to negotiate on infrastructure investment, a built-in consultation mechanism and independent arbitration of disputes by the Australian Competition and Consumer Commission. This could encourage road freight operators and their customers to organise to propose and fund additional road investments benefiting industry productivity. (sub. 41, p. 1)

The ARTC also considered that road infrastructure should be subject to economic regulation suggesting that it was 'inconsistent with the achievement of efficient transport investment that the road network is not covered under the National Access Regime whilst the competing rail network is' (sub. 20, p. 11). (The ARTC's interstate rail network and Hunter Valley rail network are covered by Part IIIA undertakings.)

In contrast, the Department of Infrastructure and Transport noted that:

The Department is not aware of any case where a road asset owner also operates heavy vehicles. As a result, state and local governments do not have a commercial incentive to deny access to heavy vehicle operators. The Department understands that Part IIIA is designed to address issues where access is denied by an infrastructure owner and competition in a related market would be improved by providing access to that infrastructure, not to address situations where access cannot be provided for technical, safety or engineering reasons. (sub. 37, p. 5)

The Commission does not consider that the particular issue of heavy vehicle access to, or investment in, road infrastructure should be addressed under the Regime. The purpose of the Regime is to address market failure in infrastructure service markets

where infrastructure service providers deny or monopoly price access to other users, and where access is required for those users to compete effectively in dependent markets. The Commission was not presented with any evidence to conclude that road asset owners deny access to heavy vehicle operators with the intention or effect of limiting competition in a dependent market. Restrictions as to which roads can be accessed by heavy vehicles are generally based on technical, safety or engineering reasons. These are not issues that the Regime is designed to, or should, address.

Further, issues relating to heavy vehicle access and investment in road infrastructure are being considered under the COAG Heavy Vehicle Charging and Investment Reform project (formerly known as the COAG Road Reform Plan) (Department of Infrastructure and Transport, sub. 37). The reform aims to provide better access for heavy vehicles and improved decision-making for road infrastructure investment (HVICI 2013). Asciano (sub. DR62) noted that these policy processes should be worked through before issues of road access and pricing are finalised. The ACCC also said that a number of policy issues would need to be resolved (including specification of the problem) before a Part IIIA solution for heavy vehicle access to roads was considered (trans., p. 90).

Industry-specific access regulation for urban water

New South Wales has an industry-specific access regime for water and sewerage infrastructure in the Sydney and Hunter regions (box 2.7) and Queensland's generic state-wide access regime covers water and sewerage infrastructure services. Draft legislation to establish an access regime for water and sewerage infrastructure in South Australia was tabled in the South Australian Parliament in September 2013 (Government of South Australia 2013). The Commission also understands that Victoria is considering implementing a water access regime. There have been no applications for third party access to water infrastructure services under the Queensland regime or the New South Wales regime, the latter of which is currently subject to review (Metropolitan Water Directorate 2013). There has been one urban-water-related access case under Part IIIA — an application by Services Sydney (2004). The Services Sydney application resulted in declaration but this was revoked soon after, when the New South Wales water access regime was certified. A second water-related case — initiated by Lakes R Us (2004) — was for access to Snowy Hydro's water storage and transport services.

There was little discussion from inquiry participants on the role of access regulation in the urban water sector. Sydney Water suggested that a national urban water access regime could be explored:

... with increasing involvement by the private sector in the urban water industry (for example the recent refinancing of the Sydney Desalination Plant) there may be net benefits to Australia in exploring further the potential for a national urban water regime administered by a national regulator. (sub. 17, p. 5)

In contrast, the Water Services Association of Australia considered that:

The [National Access Regime] is predicated on the existence of vibrant upstream or downstream markets ... But in the urban water industry, upstream and downstream markets are only now beginning to emerge ... It is the characteristics of the water industry across the value chain that have limited the extent of natural competition, rather than the actions of utilities in blocking access. (sub. 25, p. 11)

Is there a case for industry-specific access regulation in the urban water sector?

The Commission has previously concluded that the misuse of market power is not a large problem in the urban water sector (PC 2011a). While the potential misuse of market power has led to high levels of government direction and regulation of prices, the potential for monopoly pricing is considered to be small if utilities are government owned and if governments are committed to efficient pricing and establishing good governance arrangements and processes (PC 2011a).

Greater private sector involvement in the contestable elements of the urban water supply chain (potentially bulk water services, wastewater treatment and discharge services, and retail services) may mean that access to the natural monopoly component of the supply chain (water, wastewater and stormwater transmission and distribution networks) is required. However, third party access issues would be expected to be less significant where water utilities are structurally separated. There has been a move towards vertical separation of water utilities in some metropolitan areas. The Commission has also recommended options for structural reform to introduce competition into the urban water supply chain (PC 2011a).

Accordingly, the Commission considers that at this stage there would be greater efficiency gains from implementing the reforms outlined in the Commission's 2011 inquiry into the urban water sector than there would be from establishing industry-specific access regulation. These include reforms that focus on establishing clear objectives for the urban water sector, improving the performance of institutions with respect to roles and responsibilities, governance and competitive procurement of supply, and applying flexible (more cost reflective) pricing at the retail level (PC 2011a).

Industry-specific access regulation for airports

Major airports in Australia, such as Melbourne (Tullamarine) and Sydney (Kingsford Smith) airports, are currently subject to price monitoring for aeronautical and car parking services. Part IIIA also offers a backstop option in the event that access to airport services cannot be privately negotiated by the parties. There have been three aviation-related declaration applications (Australian Cargo Terminal Operators (1996), Virgin Blue Airlines (2002), and the Board of Airline Representatives of Australia (2011)). The first and second of these resulted in declarations that have expired.

Inquiry participants' concerns about the application of Part IIIA to airports primarily related to whether Part IIIA is able to facilitate airline access to airport services on reasonable terms and conditions, rather than access per se. For example:

Because the market power of airports is not effectively constrained by the [National Access Regime] or the light-handed [price monitoring] regulatory regime, airports have little incentive to engage in a commercially constructive way with airport users. (Qantas, sub. 28, p. 5)

... the [National Access Regime] is ... unlikely to offer any credible avenue for international airlines to pursue in response to unacceptable pricing behaviour by an Airport Operator. This is because while unacceptable price and non-price conduct by an Airport Operator may reduce the commercial opportunities for international airlines to operate and compete in Australia, it is unlikely to mean that the markets served by international airlines will be characterised as being uncompetitive. (Board of Airline Representatives of Australia, sub. DR49, p. 1)

Qantas (subs. 28 and DR66) considered that there was a need for an industry-specific regime for airports to facilitate commercial negotiations between airlines and airport operators, and that this could be introduced by way of deemed declaration of aeronautical services or potentially a code of conduct. Under deemed declaration, airports and airport users would continue to negotiate a commercial agreement. Should an agreement not be reached, the airport user could invoke ACCC arbitration without having to apply to have the airport's services declared under Part IIIA. Virgin Australia (sub. 39) proposed a similar model.

In contrast, the Australian Airports Association suggested there was no need for amendments to the Regime insofar as airports are concerned and also noted that:

Because airports are not (and under the *Airports Act 1996* no potentially relevant airport can legally be) vertically integrated with an airline, ordinary commercial imperatives dictate that airports negotiate and agree mutually acceptable terms and conditions for airline access. (sub. 3, p. 2)

This submission was supported by the Brisbane Airport Corporation (sub. 27).

Is there a rationale for industry-specific access regulation for airports?

The Commission has considered the economic regulation of airports in a number of inquiries (PC 2002, 2006a, 2011b). The conclusion from these inquiries was that while some airports have considerable market power arising from barriers to entry and limited substitutes, this market power is somewhat constrained by commercial opportunities and pressures, such as non-aeronautical revenues and airline countervailing power (PC 2002, 2006a), and in some cases, growth in the low-cost carrier segment of the market (PC 2011b). Further, as airports are vertically separated, they are unlikely to have an incentive to deny access to their major customers — the airlines. Where airports are vertically integrated with landside services through car parking businesses, there is the potential for airports to impede access to off-airport car park operators and other ground transport operators (although the Commission has found that access fees do not appear to be excessive) (PC 2011b).

In its 2011 airport inquiry, the Commission supported a further period of price monitoring for aeronautical and car parking services at some major airports. The Commission also recommended that an airport-specific arbitration regime, activated by deemed declaration of airport services under Part IIIA, should not be introduced. The Commission noted that deemed declaration could undermine light-handed regulation and be far more intrusive than the current price monitoring approach, and that, given the evidence of progress made in commercial negotiations since moving to light-handed regulation, ‘it would seem retrograde to allow a reintroduction of heavy-handed regulation that could displace commercial negotiations and encourage gaming’ (PC 2011b, p. 203). The Commission remains of this view.

Industry-specific access regulation for ports

No applications have been lodged to declare a port or associated maritime service under Part IIIA and only one state, South Australia, has a dedicated industry-specific access regime for ports (Victoria’s shipping channels access regime was repealed in 2011). In some cases, facility-based access arrangements have been used. For example, the multi-user coal terminal at Dalrymple Bay is declared under the *Queensland Competition Authority Act 1997* (QCA Act), for which an access undertaking (under the QCA Act) is in place (QCA 2010a), and mandatory access undertakings have been used for wheat export terminal operators. New South Wales, Victoria and South Australia have also implemented price monitoring for certain port services at some ports.

The Department of Infrastructure and Transport noted that ‘given the lack of incentives for port operators to deny access to upstream and downstream customers, the lack of applications for declaration of port infrastructure under the [National Access Regime] is unsurprising’ (sub. 37, p. 7). Few other inquiry participants commented directly on the role of industry-specific access regulation or the exercise of market power in relation to port services, although the Federal Chamber of Automotive Industries suggested that:

... while there may be some restraint on the exercise of market power by publicly owned port corporations by virtue of their adherence to legislative objectives, this is not the case for other major ports hosting automotive terminals ... (sub. 24, p. 6)

More often, inquiry participants’ concerns related to the privatisation of ports or coordination of rail and port capacity as part of the supply chain of export commodities (chapter 10). Coordination difficulties are not intrinsically the result of third party access problems.

Is there a rationale for industry-specific access regulation for port services?

There is considerable diversity in the nature of ports in Australia. Consequently, the scope for access problems to emerge depends on the specific circumstances facing the port or port service in question.

A number of factors can limit the market power of port service providers, or their capacity to use any market power. While the relevance of different factors will vary across port services, the Commission’s inquiry into wheat export marketing arrangements is instructive in identifying key constraints on the capacity of port operators to exercise market power. The Commission found that, following a transitional phase after deregulation, light-handed regulation (including the threat of declaration under Part IIIA) was appropriate for vertically integrated bulk wheat handlers that operate port terminals because their capacity to exercise market power was constrained by:

- a highly competitive global wheat market, which meant that any market power could not be passed on in global markets where bulk wheat handlers are price takers
- the scope for wheat to be consumed within Australia rather than exported, if the costs of exporting wheat are too high
- competition from port terminals in other states
- countervailing market power held by other major wheat exporters
- the threat of entry through building new port terminals (PC 2010).

Some or all of these factors are likely to be relevant, to a greater or lesser extent, across a broad range of port services. While the bulk wheat handlers considered by the Commission were vertically integrated, the factors identified can also constrain the ability of vertically separated port operators to charge monopoly prices. In any case, vertically separated port operators will usually have little incentive to deny access as competition in dependent markets will allow them to maximise their profits. Constraints on the market power of port operators can mean that they will have an incentive to maximise throughput rather than deny access or monopoly price (chapter 3), so that there will often not be a clear need for access regulation.

Under the CIRA, governments agreed that ports should only be subject to economic regulation where a clear need for it exists in the promotion of competition in dependent markets or to prevent the misuse of market power. Victoria and South Australia apply price monitoring at certain ports on the basis that there is a potential for some ports to exert market power, although recent reviews have acknowledged that there is no clear evidence that these ports have misused their market power (ESC 2009, 2011; ESCOSA 2012a). Indeed, following a review of ports regulation in Victoria in 2009, some Victorian ports are no longer subject to price monitoring.

In light of constraints on the capacity of port operators to use any market power they might have, and the lack of evidence that ports have misused market power, the Commission considers that the costs of additional industry-specific access regulation for ports are likely to exceed the benefits at this time.

The Commission's overall assessment of the need for additional industry-specific regimes

The current approach of industry-specific access regimes operating alongside the Regime is likely to provide greater net benefits than relying solely on either approach. Industry-specific access regimes have the advantage of being tailored to the circumstances of industries and jurisdictions and existing industry-specific regimes appear to have worked well (Asciano, sub. 15; Aurizon, sub. DR72; Business SA, sub. 5; Dominic L'Huillier, sub. 7; Gilbert + Tobin, sub. 45). At the same time, Part IIIA plays a backstop role for infrastructure services that are not covered by other access arrangements.

Before any additional industry-specific access regimes are introduced, governments should seek to demonstrate that there is a policy problem that is best addressed by access regulation, and that there is sufficient similarity between infrastructure services in the industry to make an industry-specific approach the most appropriate approach. Governments should also seek to demonstrate that there are features of the industry that justify different regulatory treatment for third party access to

infrastructure services from that offered by the generic National Access Regime. In the Commission's view, there is insufficient evidence to suggest that additional industry-specific regimes would generate substantial net benefits at this time. Further, there does not appear to be significant momentum behind the introduction of additional industry-specific access regimes.

The Commission considers that the current balance between the scope of infrastructure services covered by the Regime, compared with those covered by the range of industry-specific regimes, is broadly appropriate.

8.8 Facility-based access regulation

In addition to regulating access through the Regime or on an industry-specific basis, access arrangements can be established for individual infrastructure services (box 8.3). There are various ways this could occur, including:

- as a government requirement of project or development approvals
- as a condition imposed by government as part of privatisation of government assets — either through the sale of those assets or the sale of long-term leases
- through specific provisions in legislation or government agreements.

In principle, facility-based arrangements for regulating access can be appropriate if they involve transparent, accountable and robust decisions and clearly meet the objectives of access regulation. Facility-based access arrangements should only be used (as with access regulation generally) where there is an enduring lack of effective competition, due to natural monopoly, in the market for the particular infrastructure service and where regulation is expected to materially promote competition in a dependent market. Further, the use of facility-based arrangements should be limited to where there are clear net benefits from tailoring access arrangements for a specific facility.

Advantages of facility-based approaches

Facility-based approaches allow access arrangements to be tailored to the circumstances of the particular facility. Anglo American Metallurgical Coal considered that where there are issues specific to a location, this would tend to suggest access arrangements directly applicable to that location or development (trans., p. 45). It noted that the facility-based arrangements for port terminals

operated by Port Waratah Coal Services and the Newcastle Coal Infrastructure Group have been effective in governing third party access to these facilities (sub. DR50).

Facility-based access arrangements can be a way of establishing access arrangements prior to the construction of an infrastructure facility or before government infrastructure is privatised. Determining access arrangements upfront can provide certainty to infrastructure service providers and access seekers about the terms of access that will apply to the infrastructure service. This can help to facilitate further investment in dependent markets.

Box 8.3 Examples of facility-based access arrangements

Project approvals

- In 2010, the Queensland Government approved as an ‘infrastructure facility of significance’, a project proposal from Hancock Coal (owned by GVK and Hancock Prospecting (GVK Hancock)) to build a rail line to transport coal from GVK Hancock’s coal mines in the Galilee Basin to the port of Abbot Point (known as the north–south corridor). A second rail corridor (an east–west corridor) was approved in 2012 to be developed by QR National (now Aurizon) and Adani. The government has indicated that the new lines will be open access (Seeney 2012c). Following this, Aurizon and GVK Hancock have agreed to coordinate and jointly develop a rail line from the Galilee Basin to Abbot Point.

Lease and sale agreements for government assets

- Common user requirements for the operation of the proposed Moorebank Intermodal Terminal in Sydney are likely to be addressed in the lease between the Moorebank Intermodal Company Limited (a government business enterprise) and the Australian Government (Treasury, sub. 34).
- Port Waratah Coal Services provides coal loading facilities at the Port of Newcastle. The terms of its lease with the New South Wales Government require it to offer non-preferential access to road, rail and ship operators (PWC 2007).

Legislation and government agreements

- The Hamersley, Robe River, Mount Newman and Goldsworthy rail lines in the Pilbara region of Western Australia are all subject to state agreements (contracts between government and proponents of resource projects that are ratified by an Act of the State Parliament), which require the operators to provide access to haulage services where it will not prejudice or interfere with their own operations.
- The intergovernmental agreement establishing the ARTC provided that the ARTC would lodge an access undertaking with the ACCC once it had secured the necessary lease arrangements with the states (ACCC, sub. 16).

Disadvantages of facility-based approaches

Xstrata Coal (now Glencore) expressed concern about governments adopting facility-based approaches.

Such approaches fail to take into account the broad range of stakeholder considerations, risk not being derived through sufficient consultation and risk capture by interest groups. (sub. 19, p. 8)

If incorrectly applied, facility-based approaches would impose net costs on the community. They could create regulatory and investment uncertainty if inconsistently applied to similar infrastructure services. Such concerns have been raised by the NCC about the use of state agreements to regulate rail lines in Western Australia (box 8.4). Negotiating individual facility-based arrangements also provides incentives for lobbying and can result in short-term considerations and interests being prioritised over benefits to the wider community.

Box 8.4 Use of state agreements to regulate access to rail

In considering an application in 2010 from the Premier of Western Australia to certify the Western Australian rail access regime, the NCC stated that there was a lack of consistency in the regulation of access to railways in Western Australia (NCC 2010e, p. 9). The NCC recommended that the Western Australian Rail Access Regime (established by the *Railways (Access) Act 1998* (WA) and the Railways (Access) Code 2000 (WA)) not be certified as it did not consider that the regime met the consistency objective of Part IIIA (see chapter 6).

In its final recommendation on the matter, the NCC raised a concern relating to the compliance of the scheme with clause 6(3)(a) of the CPA. Clause 6(3)(a) states that state and territory access regimes should apply to services of significant infrastructure facilities where it is not economically feasible to duplicate the facility, where access to the service is necessary to permit effective competition in a downstream or upstream market, and access can be provided safely at a reasonable cost. The NCC was concerned that the application of the access regime through amendments resulting from state agreement acts might lead to the inclusion of services without being subject to sufficient scrutiny (NCC 2010e).

The Minister decided to certify the regime but noted in the statement of reasons that by using state agreements, there is potential for the Western Australian Government to apply the rail access regime to a new railway in the future that may not possess the characteristics set out in clause 6(3)(a). However, the Minister further noted that the addition of a new railway in a manner inconsistent with the CPA may amount to a substantial modification of the regime, in which case a service subject to the regime may be declared (Bradbury 2011).

The influence of the Regime on the design of facility-based arrangements

The Regime can help to discipline the design of facility-based arrangements and thereby help to limit their potential costs (chapter 7). Where facility-based regimes are designed in a way that is consistent with Part IIIA, there is scope for the services subject to these regimes to be protected from declaration. Depending on the approach taken:

- an application to certify a facility-based arrangement could be submitted to the NCC — for example, the access regime applying to the Dalrymple Bay Coal Terminal in Queensland was certified as effective in 2011
- the facility-based arrangement could form an undertaking to be submitted to the ACCC for acceptance. Any use of mandatory undertakings in the future should be subject to upfront and ongoing assessment to ensure undertakings are used to address a lack of effective competition in markets for infrastructure services and include safeguards for service providers consistent with those for declaration (section 8.4 and chapter 6)
- a competitive tender process that has been approved by the ACCC could be used for the construction and operation of a proposed facility that is to be owned by government.

Where facility-based access arrangements do not make use of Part IIIA pathways to access, there is a risk that the infrastructure service could be declared under Part IIIA. This would mean that declaration of infrastructure services, where appropriate, could lead to a more effective level of competition in dependent markets.

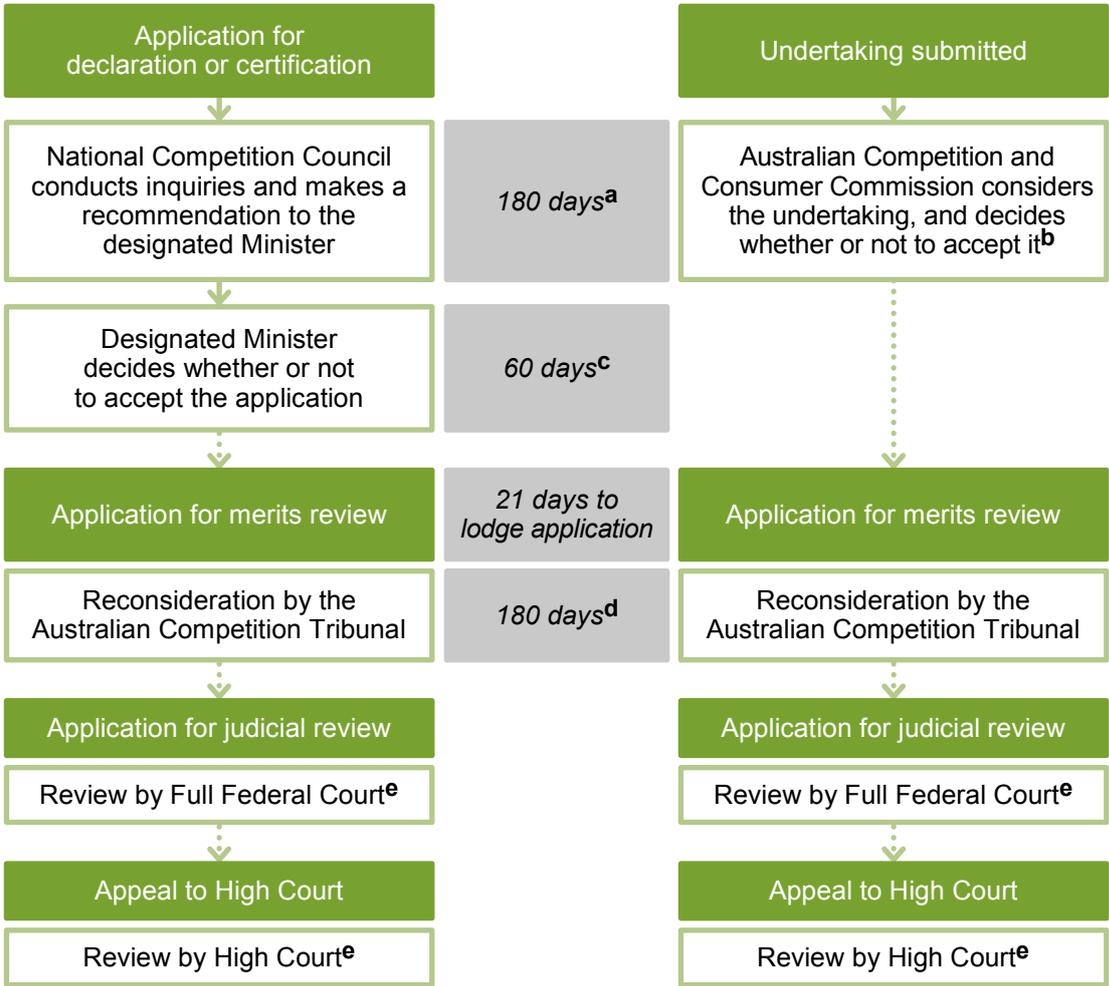
9 Institutional arrangements

Key points

- Decision making under the National Access Regime involves multiple institutions and steps.
 - Multiple institutions ensure decisions about the coverage of the Regime are separate from decisions about its application; and that review mechanisms are available given the complex nature of the judgments that need to be made.
 - The multiple steps and the varying interpretation of some provisions of Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) have led to some initial decisions being changed or set aside, creating uncertainty for all parties.
- In a handful of cases, reviews and appeals of Regime decisions have taken years and entailed significant costs. This has led to calls to remove steps such as merits review from the decision-making process.
 - However, many participants argued that merits review by the Australian Competition Tribunal contributes to good decision making, promotes confidence in the Regime, and in some cases provides the only avenue for error correction.
 - Amendments to the CCA made in 2010 and the High Court's 2012 decision in the Pilbara rail case mean that merits reviews of Regime decisions are likely to be more confined, take less time, and thus be less costly, than in the past.
 - On balance, the availability of merits review as now framed should contribute to sound decision making, which is particularly important given the 'at large' nature of the Regime and its application to infrastructure of national significance.
- The National Competition Council (NCC) faces challenges in managing its fluctuating workload and maintaining the capability to undertake its difficult tasks in a rigorous way. However, moving its functions to another organisation would reduce the actual or perceived independence of the advice provided to decision makers, which would outweigh any benefits arising from such a change.
- Designated ministers from Australian, state and territory governments should retain their current role in making decisions on declaration and certification applications.
- Amending Part IIIA of the CCA to change deemed ministerial decisions on applications for declaration, so that they follow NCC recommendations rather than automatically rejecting the application, would improve transparency and provide a statement of reasons that can be used as a basis for judicial review of deemed decisions.
- The Australian Competition and Consumer Commission has played a small role in the Regime to date, and there is currently no need to alter its role.

Decision making under Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) involves multiple institutions and steps (chapter 2). When an application for declaration or certification is made, the National Competition Council (NCC) provides advice to inform the designated Minister’s decision. The merits and legality of decisions made by the designated Minister and the Australian Competition and Consumer Commission (ACCC) can be reviewed by the Australian Competition Tribunal (the Tribunal) and the Federal and High Courts upon application by an affected party (figure 9.1).

Figure 9.1 Process and timeframes for consideration of applications for declaration and certification, and acceptance of undertakings



→ Must occur → Occurs only upon application. ^a 180-day period may be extended by clock stoppers. In addition, the NCC may extend the time available to it for making a recommendation in certain circumstances and under certain conditions (including notifying the designated Minister) (chapter 4). ^b If no decision is made within the 180-day period, the ACCC is taken to have made a decision not to accept the undertaking. ^c If no decision is made on an application for declaration within the 60-day period, the Minister is taken to have decided not to declare the service. If no decision is made on an application for certification, the Minister is taken to have accepted the recommendation made by the NCC. ^d 180-day period may be extended by clock stoppers and extensions of time. ^e In judicial review, a court reviews a decision to ensure that the decision maker used the correct legal reasoning or followed the correct legal procedures.

If parties are unable to reach a negotiated agreement for access to a declared service, the ACCC may determine terms and conditions of access (or may find that there are no terms and conditions on which access should be granted). The ACCC also assesses and makes decisions about undertakings, access codes and competitive tender processes for government-owned facilities.

9.1 Are there too many institutions and steps?

Decisions as to whether (and on what terms) third party access should be granted to nationally significant infrastructure requires judgments to be made on complex and technical issues. It is necessary to have a rigorous process for making such judgments, even though such rigour may increase the time taken to reach decisions. In this context, Allan Fels highlighted the complexity and long-term consequences of Regime decisions.

Applying the National Access Regime (and declaration decisions in particular) involves regulatory decisions of quite exceptional complexity that require lengthy economic, technical and commercial analysis and considerable information. The process is complicated and time-consuming and entails a significant degree of discretion by regulators ... the length of time required for decisions ... must be viewed in the context of decisions that can be for twenty years or more. (sub. 40, p. 4)

Despite there being up to six institutions and multiple steps involved, a number of participants expressed satisfaction with the current arrangements. For example, APA Group supported ‘the retention of the separate roles of the National Competition Council, the designated Minister, the Australian Competition and Consumer Commission and the Australian Competition Tribunal in respect of the different stages and needs of the declaration, regulation and review processes’ (sub. DR60, pp. 2–3). Asciano stated:

Overall the roles of institutions involved in Part IIIA are clear. Asciano believes that it is appropriate for some of these roles to be separated into different institutions such as the NCC and ACCC. Overall the current structure results in clear and accountable decision making. Asciano notes that this clarity does not necessarily extend to all state based regimes or institutions. (Asciano, sub. 15, p. 26)

Conversely, the presence of multiple institutions and steps prompted concerns from many inquiry participants (see, in particular, chapters 4 and 7). Broadly, the concerns centre on the role of the institutions involved in Part IIIA decision-making, the capability of some of the institutions, and the timeliness and cost of each step. Reviews and appeals of decisions made under Part IIIA have taken years in some cases — the Pilbara rail cases are the standout example of declaration matters that became mired in complex legal disputes that took many years to resolve. While

Tribunal review of declaration decisions is quite common, the time taken to reach a conclusion in the Pilbara rail case is not typical of Part IIIA matters.

Unduly long decision-making processes add to legal and administrative costs, and have an adverse effect on investment incentives for infrastructure service providers and access seekers. Therefore, in considering the Regime's decision-making structures, administrative processes and the relationship between institutions, the Commission has paid particular attention to:

- the role played by each of the institutions and steps in the decision-making process (or conversely, whether any institutions or steps could be removed or further streamlined)
- the potential for any changes to lead to more timely decisions or reduce the costs of the Regime, without undermining the benefits the Regime provides.

Concerns about Part IIIA institutions and processes are not new. The Commission's 2001 report made recommendations designed to address 'the widely acknowledged need to improve the timeliness of access processes and reduce their costs' (PC 2001a, p. 372). In particular, the Commission recommended that target time limits apply to all steps of the Part IIIA decision-making process. Time limits similar to those recommended by the Commission were introduced to Part IIIA in 2010 (box 2.2). The 2010 amendments also included changes to the Tribunal's review powers. In essence, the changes restrict the Tribunal to considering only information taken into account by the original decision maker, subject to the ability to request additional information the Tribunal considers reasonable and appropriate.

The 2010 amendments to Part IIIA were 'designed to improve regulatory certainty and streamline administrative processes' (Emerson 2009b, p. 11468). However, the operation of the amended legislation has not been fully tested, as only four applications for either declaration or certification have been made since the amendments commenced. The NCC met its timeframes for all of these applications, and the Tribunal reviewed none. The extent to which the amendments have achieved their intended effect therefore remains to be determined.

9.2 The National Competition Council

Role

As noted in chapter 2, the current role of the NCC emanates from, but does not directly reflect, the findings of the Hilmer Committee, which recommended that:

... a National Competition Council be established jointly by the Commonwealth, State and Territory Governments to play a key role in policy decisions. ... While the composition of the body would be settled by all governments, the objective is to provide a high level and independent analytical and advisory body in which all governments would have confidence. (1993, p. xxxvi)

Thus, the NCC is primarily an expert advisory body. It is:

... the statutory agency responsible for advising decision making Ministers on the scope of third party access to infrastructure services under the National Access Regime ... The Council makes recommendations in relation to applications for the declaration of infrastructure services and for the certification of state and territory access regimes. (NCC, sub. 1, p. 1)

The NCC must make recommendations on declaration and certification applications within 180 days, subject to the operation of clock stoppers and extensions (chapter 4). In addition, the NCC must report annually on its own operations and on issues affecting the operation of Part IIIA.

The NCC also makes recommendations and decisions under the National Gas Law (box 9.1).

Box 9.1 The National Competition Council's role in the National Gas Law

The NCC has a number of roles and powers under the National Gas Law (NGL). Several of those roles are similar to those it performs under the National Access Regime. In particular, it:

- makes recommendations to the relevant Minister about whether or not a particular pipeline should be, or remain, covered by the NGL
- makes recommendations on exemptions from regulation for new pipeline projects.

Under the NGL, the NCC also has a decision-making role. It:

- classifies pipelines as transmission or distribution pipelines
- makes decisions on the form of regulation (light regulation or full regulation) to apply to a covered pipeline.

Source: NCC (2011a).

Upon request, the NCC gives assistance to the Tribunal for the purposes of the Tribunal's review. This can include, for example, providing information and preparing reports (see section 9.5 below).

The NCC received budget appropriations of \$2.81 million in 2011-12 and incurred expenses of \$2.38 million (although its budget and expenditure have varied in recent years — chapter 7). In addition to its three councillors, the NCC has 7.47 full time equivalent secretariat staff. Staff costs (including salaries, leave entitlements and superannuation contributions) account for around 60 per cent of the NCC's annual expenditure (NCC 2012a).

Participants' views on the NCC's role, capacity and operations

Role and independence

Several participants expressed support for the NCC's current role as an independent advisor to the designated Minister. For example, the APA Group stated that it:

... considers that it is important that the responsible Minister be advised by a knowledgeable and well-resourced body, as is the case with the NCC. (sub. 35, p. 8)

APA Group also commented on the importance of maintaining the current separation between decisions about the coverage of the Regime and decisions about the Regime's application.

APA considers that it is critically important to maintain a separation between the decision to regulate and regulation itself, as is the case in relation to the separate roles of the ACCC and the responsible Minister [who takes advice from the NCC]. (sub. 35, p. 8)

The Law Council of Australia expressed a similar view.

The NCC has developed considerable expertise in the consideration and application of the declaration criteria, and there appears to be broad support for the NCC's role in this aspect of regulation to continue. The [Competition and Consumer] Committee [of the Law Council of Australia] does not believe there is a clear case to combine the decision to declare services and the determination of terms and conditions in a single body. (sub. 32, p. 36)

Despite its concerns about its own viability over the longer term (see below), the NCC considered that its role:

... should not be subsumed within the ACCC (the dispute arbitrator under the National Access Regime) or other regulatory body given the prospect of real or perceived regulatory conflicts. It is also undesirable for assessment of declaration applications to be undertaken within the Treasury since the Treasurer or a Minister within the Treasury portfolio is commonly the designated Minister for decisions on applications. At this

stage the Council does not see a viable alternative to the current arrangements. (sub. 9, p. 27)

In contrast, other participants considered that there would be merit in alternative arrangements.

The National Competition Council (NCC) ... has failed to provide any value ... The agency should be abolished. (Institute of Public Affairs, sub. 23, p. 2)

Applications for Part IIIA declaration should be made directly to the Tribunal. (BHP Billiton, sub. 29, p. 3)

Bob Baxt (subs. 33 and DR53) also expressed support for decisions being made by the Tribunal in the first instance, in the context of proposals for broader change to the negotiate–arbitrate model (chapter 4).

Capacity and operations

Some inquiry participants expressed concerns about the capacity and performance of the NCC. These concerns were not related to the NCC’s reporting functions (inquiry participants did not comment on the way in which the NCC fulfils its reporting roles). Rather, the concerns were particularly focused on the NCC’s assessment of declaration applications. For instance, BHP Billiton considered that:

The NCC’s task is complicated because much of the information it requires is commercially sensitive and subject to confidentiality claims which prevent the infrastructure provider and the applicant from fully and directly engaging with each other’s submissions ... The NCC is manifestly under-resourced, lacking both the finances and expertise required to fulfil its statutory task. It is not able to undertake the rigorous analysis required to reach the correct outcome ... particularly not within prescribed statutory time limits. If the NCC retains its current function, the resources and skills to which it has access will need to be radically overhauled in order for it to be able to fulfil its function in a manner that does not jeopardise the quality of declaration outcomes. (sub. 29, pp. 5–6)

Similarly, Rio Tinto Iron Ore stated that the NCC ‘has a very limited ability to rigorously test parties’ assertions’ and the Tribunal ‘has significant advantages over the NCC’ (sub. 8, pp. 16–17). Gilbert +Tobin said:

We share the reservations of other respondents in relation to the continuing role of the National Competition Council in the declaration and certification process, given the limited number of declaration and certification applications. The NCC has itself acknowledged this may limit its longer term viability. (sub. DR70, p. 9)

BHP Billiton highlighted the importance of decision makers having ‘specific experience in, or knowledge of, the industry to which the declaration application

relates' (sub. 29, p. 11) (although this comment was made in the context of BHP Billiton's proposal for Part IIIA applications to be made directly to the Tribunal).

In considering its own role and capacity, the NCC noted that:

In recent years the Council has faced an unpredictable and fluctuating workload. This has created some difficulties in managing the Council's operations. In particular the Council needs to ensure that it can handle the busier periods while ensuring staff are occupied during the times when workloads are reduced. In the short to medium term this is an issue that can be addressed internally. However in the longer term ... it may be necessary to consider the viability of the Council and examine alternative structures. (sub. 9, p. 27)

In relation to the NCC's workload and capacity, the Department of Resources, Energy and Tourism (sub. 46) and the Law Council of Australia (sub. 32) commented on the likelihood of more material being put before the NCC as a result of changes to the operation of the Tribunal (section 9.5).

The Commission's view

Role and independence

As noted in previous chapters, the Commission recognises that decision making as part of the Regime requires considerable judgment. This alone might reasonably be seen as justification for retaining an independent organisation to conduct analysis and provide advice to the Minister. In addition, the 'at large' nature of the Regime and its application to infrastructure of national significance create a need for particular caution in guarding against any potential for unwarranted extension of the scope of the Regime. By separating the advisory functions of the NCC and the regulatory functions of the ACCC, legislators have sought to provide an important safeguard.

Suggested alternative structures would compromise the separation between responsibility for advising on the scope of the Regime and responsibility for regulation of covered services. In particular, making the ACCC the sole administrator for Part IIIA, as well as the decision maker in some cases, would prompt concerns from stakeholders, and particular concern on the part of many service providers. Irrespective of the validity of such apprehensions, even the perception of heightened regulatory risk is likely to have an adverse impact on investment.

While making the ACCC solely responsible for administering Part IIIA would create apprehension, similar concerns have been expressed at the prospect of the

NCC's role instead being performed by the Commonwealth Treasury. Again, irrespective of the validity of such concerns, any perception of heightened regulatory risk would be likely to entail some adverse effect on investment. Thus, the Commission considers that the costs of expanding the ACCC's role or creating an explicit role for Treasury in Part IIIA processes are likely to outweigh the benefits.

One possible means of overcoming such concerns would be for the NCC to be located within, but operate independently of, the ACCC, potentially in a similar manner to the current structure of the Australian Energy Regulator (AER). The AER is established under the CCA and has an independent board, but its staff, resources and facilities are provided by the ACCC (AER 2012).

However, making this approach work effectively could be challenging in practice. Difficulties associated with the AER in its governance structure were reported to the Commission in its inquiry into Electricity Network Regulatory Frameworks (PC 2013a). They include:

- low levels of stakeholder confidence and trust
- inadequate resourcing and capacity, compounded by competition for high-quality staff from other areas of the ACCC
- concerns about errors in the AER's decisions.

To some extent, these difficulties echo those expressed by participants about the NCC (see above). It therefore appears unlikely that an AER-type model would provide effective solutions to concerns expressed about the NCC.

Another alternative put forward by BHP Billiton (sub. 29) and Bob Baxt (subs. 33 and DR53) would be to remove the designated Minister — and potentially the NCC — from the decision-making process, instead relying on the Tribunal to make decisions in the first instance. This suggestion is considered in section 9.3 below.

In light of the sound reasons for retaining an independent advisory body, and the drawbacks of potential alternatives, the question of the capacity and operations of the NCC comes to the fore.

Capacity and operations

The Commission shares the concerns expressed by participants about challenges faced by the NCC in building and maintaining expertise and managing its fluctuating workload. However, the Commission also recognises that any method of addressing these concerns will need to account for conflicting factors.

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- On the one hand, the NCC is required to conduct detailed analysis of complex issues within a relatively short period of time. On occasion, this could include considering an application relating to infrastructure facilities and markets that it has not previously had any exposure to. Maintaining the capacity to conduct this analysis in a rigorous manner, and to obtain high-quality expert advice on relevant technical issues, requires the NCC to be sufficiently well resourced and flexible to undertake tasks as they arise, including engaging expert consultants.
 - On the other hand, the small number of applications received since the Regime's inception (chapter 4) suggests that there are likely to be periods in which the NCC is not actively considering applications or preparing reports. As the NCC acknowledged, it experiences periods of 'reduced' workload, during which time it can be difficult to ensure staff are occupied (sub. 9, p. 27).

Recent and proposed changes could potentially amplify these opposing pressures.

- Changes to review arrangements for Part IIIA decisions arising from legislative amendments made in 2010 and from the High Court's judgment in the Pilbara rail case,¹ mean that the Tribunal will now conduct merits review based primarily on the information that was before the Minister. This change is likely to encourage access seekers and service providers to submit more information in the first instance, in the hope of ensuring that all relevant information is available to the Minister and in any subsequent review. It is therefore likely that in future access matters, a larger volume of information will be submitted to the NCC than has previously been the case.
- As noted in chapter 7, the Commission's proposed amendments are designed to better target the Regime at the economic problem. This would reduce administrative costs, by improving certainty for access seekers and service providers and reducing the likelihood of unsubstantiated declaration applications, reviews and appeals. To the extent that the proposed changes achieve this objective, there would be another reduction in the workload of the NCC.

The Commission recognises that staffing a body with an intermittent workload is a difficult task. Engaging expert consultants and using staff secondments can provide flexibility to manage fluctuating workloads. In this context, the Commission notes that the NCC 'expects to develop further secondment arrangements as a means of balancing staff resources and workloads' (sub. 9, p. 27).

However there may be further scope to strengthen the capacity and enhance the future operations of the NCC. The Commission considers it important that the NCC

¹ *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36.

has the capability to undertake its difficult tasks in a rigorous way that ensures it has credibility with its stakeholders. Factors that are known to influence the credibility of, and stakeholder trust in, a regulatory body such as the NCC include:

- the consistency and fairness of its decision-making processes
- the transparency of its operations
- its expertise, including both technical competence and an appreciation of the limits of that competence (Bratspies 2009).

Similar factors were also highlighted by the Regulation Taskforce on Reducing Regulatory Burdens on Business:

Maintaining confidence and credibility in regulatory regimes requires regulators to adopt a balanced, consistent and transparent approach to decision-making and enforcement. It is also important that regulators are accountable for their decisions. This promotes trust among market participants by raising the level of predictability and understanding of the regulators' approach. (Regulation Taskforce 2006, p. 92)

While the Commission has not made a recommendation in this area, it draws this issue to the attention of the Australian Government.

Other suggested changes to the operations of the NCC

Changes to the operations of the NCC — including empowering the NCC to screen applications and to dismiss those that are unlikely to be successful — have been suggested. However, such changes do not appear to be warranted (box 9.2).

The NCC also raised two operational issues.

- First, the NCC suggested amending the CCA to provide it with additional flexibility in maintaining a quorum. While the Commission is not in a position to fully assess the merits of this proposal, to the extent that it has merit, there would be benefit in the Australian Government acting to address concerns about the NCC's quorum at the same time as it enacts any of the reforms proposed by the Commission.
- Second, the NCC suggested that it be provided with a statutory role before the Tribunal and, to the extent possible, the courts. This proposal is considered in section 9.5 below.

Box 9.2 **Should the NCC do more to screen applications?**

In a report produced for the Minerals Council of Australia, Ergas and Owen suggested that 'before launching a declaration process, the NCC should be satisfied there is a reasonable prospect of the criteria for declaration being met' (2012, p. 48). Similarly, Aurizon noted that 'there are currently no conditions precedent to the making of an application [for declaration]' and suggested that the NCC be allowed to dismiss an application, as opposed to making a recommendation not to approve, if:

- the application has not been made in good faith;
- the applicant cannot demonstrate that it has made genuine attempts to commercially negotiate access to the facility; [or]
- the application is not accompanied by evidence that it would not be profitable for the applicant to duplicate the facility. (sub. DR72, p. 15)

The Commission acknowledges that requiring the NCC to screen applications could potentially lead to decisions being reached more quickly, thereby reducing the costs incurred by the service provider, the access seeker and the NCC. However, there is little need to screen applications on the basis of whether the access seeker sought to negotiate access, as the cost and time involved in making a declaration application already provide strong incentives for the access seeker to try to obtain access on commercial terms in the first instance. There could also be considerable practical difficulty in defining what a 'genuine attempt' at commercial negotiation must entail.

Several other methods are already employed to restrict the potential for wasteful consideration of applications that are unlikely to succeed. By providing information and advice to potential applicants, the NCC already curtails the number of inappropriate, trivial and vexatious applications it receives. The NCC can also reject applications (other than those made by Ministers) that it considers were not made in good faith (subsection 44F(3) of the CCA). In addition, by adopting expedited processes where warranted (such as in assessing the application by the Australian Union of Students for declaration of Austudy payroll services (Daniels 1996)), the NCC has demonstrated flexibility in tailoring its methods to the context of particular cases.

There are also procedural issues that would need to be resolved before an application screening process could be established. In particular, if assessment against each of the declaration criteria is conducted as part of the screening process, and if screening decisions are subject to merits review, screening may differ little in practice from existing assessment methods. It may therefore risk becoming an additional step in the assessment process, instead of contributing to process efficiency.

In addition, there is the risk that in screening applications the NCC could be seen as departing from its current role as an independent advisor to the Minister, instead becoming a *de facto* decision maker. The screening process would compound this risk, because screening is, by its nature, a fast preliminary assessment in which only the applicant presents a case.

In light of these considerations, the Commission considers that there is no need to introduce a requirement for the NCC to screen applications.

9.3 The role of ministers

As discussed in previous chapters, designated ministers are responsible for declaring services and certifying regimes under Part IIIA. Responsibility for decisions relating to applications for declaration of services provided by infrastructure facilities owned by a state or territory lies with the Premier or Chief Minister. Responsibility for other declaration decisions and for certification decisions lies with the Commonwealth Minister administering the CCA — typically the Treasurer or Assistant Treasurer.

Participants' views

Inquiry participants expressed a range of views on the appropriate role of the designated Minister in Part IIIA decision making, particularly in relation to:

- whether ministers should continue to make decisions under Part IIIA
- whether the designated Minister should be obliged to follow recommendations made by the NCC when making declaration decisions.

Ministers as decision makers

The role of ministers as decision makers broadly reflects the Hilmer Committee's recommendation that 'decisions of this kind should be made by an elected Minister' (1993, p. 322). There have, however, been several departures from the way in which the Hilmer Committee envisaged the minister's role (see box 2.1 and below). Allan Fels highlighted the original rationale for ministerial involvement in decision making under the Regime:

The Hilmer Report ... stressed that the granting of third party access should be a Ministerial decision, to which political responsibility would attach, highlighting the seriousness with which the Report viewed the over-riding of property rights through the mandatory granting of third party access. (sub. 40, p. 54)

Several participants, including the Institute of Public Affairs (sub. 23), emphasised that wider public interest considerations involved in coverage decisions continue to make ministerial input particularly important. Other comments included:

The Council considers that the power to make a decision to subject a service to the National Access Regime appropriately rests with a politically accountable minister acting on (but not bound to follow) independent expert advice. (NCC, sub. 1, p. 9)

In APIA's experience with ministerial decisions (coverage and certification decisions) the Minister's role has seemed appropriate. (Australian Pipeline Industry Association, sub. 14, p. 15)

In contrast, other participants questioned the value of continued ministerial involvement using sometimes divergent arguments.

The current legislation assumes the Minister plays an important role in the declaration process. However, both the statutory timeframes which apply to the Minister's decision as well as the complexity of the issues raised mean that the Minister is not able to make a substantive and independent contribution to the decision-making process. (BHP Billiton, sub. 29, p. 6)

We see the declaration decision as one more appropriately made by a technical regulator (either the ACCC or, perhaps preferably, the Tribunal) than the Minister. (Gilbert + Tobin, sub. DR70, pp. 8–9)

There is no justification, in my view, for the Minister ... to have the influential role that he or she currently enjoys. If the relevant Minister (representing the views of the particular Commonwealth, State or Territory Government) believes that certain criteria or issues are so critical to the particular application for access being considered by the Council (or arguably the Tribunal) the Minister should be able to make submissions or provide information to the Council or Tribunal. (Bob Baxt, sub. 33, p. 5)

... decisions made by a designated Minister only bring to bear the experience of the relevant politician, his or her advisers and the NCC — they do not have the advantage of specialist legal, economic and business expertise, and evidence that has been tested under cross examination, as is the case with the Tribunal. (Rio Tinto Iron Ore, sub. 8, p. 17)

The Competition and Consumer Committee of the Law Council of Australia made a number of suggestions for changes to the Minister's role.

... one option may be to remove the role of the Minister in declarations, or circumscribe it to either an advisory or a veto role. Further, to the extent the Minister's role is retained, there should be greater transparency and accountability. (sub. 32, p. 5)

... it is appropriate to consider the role of State and Territory Ministers in making declaration decisions. While the Committee recognises that some significant infrastructure facilities remain the property of States and Territories, it is not clear that this justifies a decision-making role for State and Territory Government in relation to the declaration of such facilities. It is arguable that facilities that are exposed to the possibility of regulation under Part IIIA are, by definition, facilities of national significance, access to which is properly a matter for the national Government. (sub. 32, pp. 35–36)

Many participants also expressed dissatisfaction with deemed ministerial decisions (see below).

Requirement to have a positive recommendation from the NCC

Rio Tinto Iron Ore considered that the Tribunal has advantages over the Minister as decision maker, and noted the risks entailed in ministerial decision making. It also

highlighted that the Minister's role differs from that envisaged by the Hilmer Committee.

... declaration decisions are potentially exposed to political influences and capture by private interests ... The Hilmer Committee recommended that the Minister's power to declare be made subject to a safeguard that the Minister could only declare a service if the NCC had made a positive recommendation in favour of declaration following public inquiry. (sub. 8, p. 3 and p. 20)

The Law Council of Australia questioned the appropriateness of this departure from the Hilmer Committee's recommendations.

... if the NCC is considered best qualified to make findings on economic and technical criteria, what is the rationale for allowing the Minister to review and reverse those findings? ... a Minister overriding the recommendation of the NCC should be required to set out in detail why that decision has been taken. (sub. 32, p. 35)

Similarly, CBH Group said:

CBH agrees with the Hilmer Committee and is of the view that decisions should follow the advice and findings of an independent body (i.e. the NCC). This removes any political or commercial pressures that may be faced by Ministers to make declarations or certifications which favour private interest rights. (sub. 12, p. 2)

The Commission's view

Ministers as decision makers

Concerns about the role of the designated Minister were originally expressed by the Hilmer Committee, which noted that:

... the existence of a broad discretionary regime may create pressures on the Minister to declare an essential facility to advance private interests. (1993, p. 250)

The Commission takes a similar view, and considers that it is important for the integrity of the Regime that there is transparency in decision making, especially as it is a broad regime that could apply in a range of circumstances and requires considerable judgment in its application. Transparency, both real and perceived, is an important feature of a well-designed regulatory system. It also helps to reduce the risk that access regulation is applied inappropriately, or not applied when it should be.

However, the Commission is of the view that significant public policy judgment is involved in decisions to make services subject to access regulation. While the need for policy judgment and the presence of the public interest test do not necessarily imply that the Minister must be the decision maker in every circumstance, these

factors add considerable weight to calls for continued ministerial involvement in Part IIIA decisions. This aligns with the views of the High Court, which in its judgment in the Pilbara rail case considered that:

... conferring the power to *decide* on the Minister (as distinct from giving to the NCC a power to *recommend*) is consistent with legislative recognition of the great breadth of matters that can be encompassed by an inquiry into what is or is not in the public interest and with legislative recognition that the inquiries are best suited to resolution by the holder of a political office. (para. 42, emphasis in original)

Decisions about the appropriate application of the Regime involve tradeoffs between protection of private property rights and wider considerations of efficiency and public interest that might be best advanced through regulatory intervention. As the Hilmer Committee noted:

The efficient operation of a market economy relies on the general freedom of an owner of property and/or supplier of services to choose when and with whom to conduct business dealings and on what terms and conditions. This is an important and fundamental principle based on notions of private property and freedom to contract, and one not to be disturbed lightly. (1993, p. 242)

It is the need for careful judgment in deciding whether to disturb such rights that is the strongest case for the retention of designated Ministers as primary decision makers in the Regime. The Commission thus concurs with the view that important tradeoffs, such as the tradeoffs between property rights and economic efficiency that are made as part of the Regime, should be made by elected representatives rather than by regulators.

Further, the Commission does not consider that undue weight should be placed on the desire to streamline and speed up Part IIIA decision making when considering the appropriate role for ministers. In the context of a process where decisions are commonly reached after many months (or, in a handful of cases, years), and in which ministerial decisions (or deemed decisions) are available after 60 days, the involvement of ministers is not a significant source of delay.

The desire to avoid delays in decision making was also a reason put forward by those who suggested that decisions about Part IIIA matters be made by the Tribunal in the first instance (box 9.3).

Box 9.3 **Should the Tribunal become the primary decision maker?**

BHP Billiton (sub. 29), Bob Baxt (sub. 33) and Gilbert + Tobin (sub. DR70) suggested that the Tribunal should become the primary decision maker for all Part IIIA matters, or for declaration decisions (which would imply that both the NCC and the designated Minister would be removed from the decision-making process for decisions about declaration applications). Potential advantages of this approach include:

- that the Tribunal has ‘judicial analytical skills [which] are so vital to the Part IIIA declaration process’ in combination with ‘commercial and economic skills of non-judicial Tribunal members’ (BHP Billiton, sub. 28, p. 7)
- providing a mechanism to ‘fast-track issues in relation to access applications’ (Bob Baxt, sub. 33, att. 1, p. 9).

The Commission has a number of reservations in regard to the suggestion that decisions about Part IIIA matters be made by the Tribunal in the first instance.

- It is unclear how merits review could be provided for decisions made by the Tribunal. In particular, if the Tribunal were to review its own decisions, concerns about the independence of the review process could emerge.
- If merits review remains available, it is not clear whether Tribunal decision making could result in time savings in practice. The Tribunal would presumably require a similar timeframe to the 180 days it currently has in which to conduct reviews. This is the same length of time currently available to the NCC to assess applications, and thus would not represent a significant time saving.
- Where decision-making power has been transferred to the Tribunal, there is little evidence of the effectiveness of that transfer. For instance, since 2007 the process for seeking authorisation of mergers on public benefit grounds under Part IV of the CCA has required applications to be made directly to the Tribunal. ‘Since this change came into effect, no merger parties have applied for authorisation by the Tribunal’ (Sims 2013a).

In light of these concerns, the Commission does not consider that the Tribunal should become the primary decision maker for Part IIIA decisions at this time (although it should retain its current review role — see section 9.5).

In addition, the Commission is conscious that current arrangements for ministerial decision making are a product of negotiation and agreement between the Australian, state and territory governments and would therefore be difficult and costly to alter. Privatisations of state- and territory-owned infrastructure facilities have reduced the likelihood that state and territory ministers will be involved in making Part IIIA declaration decisions. This is because when infrastructure facilities are privatised, responsibility for making decisions on declaration applications transfers from the designated state or territory Minister to the Commonwealth Minister. To the extent that the designated Commonwealth Minister is increasingly likely to be the decision maker under Part IIIA, the need to implement changes in Part IIIA to alter the role

of state and territory ministers is reduced. (In chapter 10, the Commission emphasises the importance of ensuring that appropriate access arrangements are considered before privatisations take place.)

On balance, the Commission considers that state, territory and Commonwealth ministers should maintain their current responsibilities for making decisions on applications under Part IIIA.

Requirement to have a positive recommendation from the NCC

Several participants drew on a recommendation made by the Hilmer Committee, which suggested that the designated Minister's discretion to declare a service should be limited by a requirement that declaration was recommended by the NCC. However, there would be two shortcomings in such an approach.

First, as outlined above, there is a need for decision makers to exercise considerable judgment in making decisions that potentially have economy-wide implications. Such judgments are best made by elected representatives acting on, but not constrained by, rigorous independent advice.

Second, as the Law Council of Australia noted:

The role of the NCC is to provide expert input to the Minister, focussed mostly on 'technical' economic criteria – notably criteria (a) and (b). The view of the NCC may be expected to be less influential in relation to criterion (f), which involves public interest issues of a broad political kind. (sub. 32, p. 25)

If the decision on criterion (f) includes consideration of the broader public interest (which would continue to be the case if the Commission's recommendations on this criterion are adopted — chapter 8), then it would not be reasonable to then require the Minister to adhere to the NCC's recommendation about that criterion. A requirement that declaration was recommended by the NCC would effectively make the NCC's judgment on criterion (f) binding on the Minister in cases where the NCC's views on that criterion lead it to recommend against declaration.

One suggestion made to the Commission was to limit the Minister's role in declaration decisions to consideration of the public interest test in criterion (f). Such consideration would occur following a positive recommendation from the NCC based on the other declaration criteria. There are risks inherent in this approach. In particular, it would change the nature and purpose of criterion (f), from being part of a broader test to becoming a stand-alone test that works in isolation from the other criteria. This would in turn fundamentally alter the role of all criteria because

they are designed to work together (chapter 5). The Commission therefore does not support restricting the designated Minister's role to consideration of criterion (f).

Deemed ministerial decisions

If the designated Minister does not publish a decision on an application for declaration or certification within the legislated time limit of 60 days, a decision is deemed to have been made. If no decision is made on an application for declaration within the 60 day period, the Minister is taken to have decided not to declare the service, and decisions on certification applications are deemed to follow the recommendation made by the NCC. Deeming provisions for declaration decisions have been in place, and remained unchanged, since the Regime was introduced in 1995.

Participants' views

Several inquiry participants were critical of the arrangements surrounding deemed ministerial decisions, and expressed particular concern about the potential for deemed declaration decisions to restrict opportunities for review.

A significant drawback of a deemed ministerial decision not to declare a service is that the Minister does not publish any reasons for his or her 'decision' ... it is difficult to base an application for judicial review on a decision for which there are no reasons. (Qantas, sub. 28, p. 16)

Key Ministerial decisions under Part IIIA can occur by deeming rather than positive decision. In these situations, there is no record of the Minister's consideration of the application, and no decision upon which an action for judicial review could practically be based. (Law Council of Australia, sub. 32, p. 1)

The NCC proposed changes to address these concerns.

The preferable approach is for the Minister to be deemed to have made a decision in accord with the Council's recommendation and to have adopted the Council's reasons where an affirmative decision is not made within the statutory time limit. Any aggrieved party affected by a declaration decision (and not just the access seeker as is the case for a deemed 'no') would then have a basis upon which to assess whether the decision is in accord with the law and if not so satisfied to seek [review]. (NCC, sub. 9, pp. 22–3)

The NCC also considered that similar deeming provisions should apply to coverage decisions under the NGL (sub. DR48). Under current arrangements, the relevant Minister must use his or her best endeavours to make a decision about NGL coverage within 20 business days after receiving a coverage recommendation. Thus, inclusion of a decision time limit and associated deeming provisions in the NGL

could increase certainty about the timeframes within which NGL coverage decisions will be made.

The Queensland Government noted that while the declaration process under the *Queensland Competition Authority Act 1997* does not provide for deemed ministerial decisions for access declarations, ‘the Queensland Government considers that Ministers are well placed to decide matters in the public interest and, without a deeming provision, the onus is on the Ministers to make the decision within statutory time frames’ (sub. DR71, p. 4).

The Commission’s view

The Commission shares the concerns expressed by inquiry participants about the deeming process for declaration decisions. Allowing the recommendations of an advisory body to be automatically rejected (as opposed to an elected representative purposefully making a different judgment), and for no explanation to be provided for that rejection, reduces transparency.

The current deeming process for declaration decisions can also mean that judicial review is severely impaired or impossible. Judicial review is an examination of the legal reasoning or procedure used in reaching a decision, and thus relies on there being a clear statement of reasons (see section 9.5). As there is no requirement that the designated Minister provide reasons for the deemed decision, in situations where the NCC recommended declaration and there is no published record of the Minister’s consideration of the declaration application, there is no decision upon which an action for judicial review could practically be based.

The Commission remains of the view it expressed in its 2001 report on the Regime — ‘a deemed decision based on a balanced assessment of the issues by the NCC is preferable to an automatic presumption in one direction without regard to the facts of the matter’ (PC 2001a, p. 408).

In 2001, the Commission recommended that if Ministers do not publish a decision on a declaration recommendation within 60 days, this should be deemed as acceptance of the NCC’s recommendation (PC 2001a). This was a recommended change to the nature of the deemed decision. (The Commission made the same recommendation for deeming of certification applications, and the Australian Government accepted that recommendation, enacting it in 2010.) Although not accepted in 2001, the Commission’s recommendation that deemed declaration decisions follow the NCC’s recommendation was subsequently included in draft legislation in 2009. However, during consideration of the draft legislation, two

members of the Legislation Committee of the Senate Standing Committee on Economics commented that:

While this proposal could be regarded as an efficiency or time saving measure, it is important that any procedural assumption applied in this situation should fall in the favour of the asset owner, rather than the asset seeker, and that a non-response to an NCC recommendation is to be deemed as accepting of the NCC's recommendation as a concern. (2009a, p. 34)

Following this comment, amendments were made to the draft legislation, so that applications for declaration would continue to be deemed not to be declared. The Commission is not aware of a public statement by the Australian Government on reasons for this change in approach.

The Commission considers that the procedural assumption should fall in favour of achieving the objectives of the Regime, promoting transparency and ensuring the availability of judicial review, all of which are best achieved when a deemed declaration decision follows NCC recommendations and the reason for that recommendation. This proposed change would:

- ensure written reasons are provided for all decisions about declaring a service (in the form of the NCC's recommendation or the designated Minister's statement of reasons)
- where the designated Minister does not wish to follow an NCC recommendation to declare a service, impose a requirement on the Minister to make an active decision not to declare the service and to provide reasons for that decision.

RECOMMENDATION 9.1

The Australian Government should amend subsection 44H(9) of the Competition and Consumer Act 2010 (Cwlth) such that if the designated Minister does not publish a decision on a declaration recommendation within the 60 day time limit, this is deemed to be acceptance of the National Competition Council's recommendation.

The Commission included a recommendation to this effect in the draft report, and was supported by Gilbert + Tobin (sub. DR70), the NCC (sub. DR48) and Qantas (sub. DR66). The Law Council of Australia considered that there is:

... merit in these proposed reforms as, on balance, they are likely to enhance the transparency of decisions made under the Regime whilst preserving a degree of political accountability for decisions which have the potential to significantly impact on private property rights. (sub. DR68, p. 6)

While the Commission is not in a position to make specific recommendations in relation to the national gas access regime, similar considerations about the

importance of ensuring that decisions are consistently available in a timely manner and that written reasons are provided for all decisions are also likely to apply with respect to coverage decisions under the NGL.

9.4 The role of the Australian Competition and Consumer Commission

As noted in previous chapters, the ACCC's role under Part IIIA of the CCA is to:

- arbitrate disputes over access to declared infrastructure services
- assess access undertakings put forward by owners/operators of infrastructure facilities and access codes put forward by an industry body
- decide whether or not to approve competitive tender processes for government-owned facilities.

Few participants commented on the role or performance of the ACCC, and many of those who did so drew attention to the limited role that the ACCC has played in the Regime to date. For example, the Law Council of Australia said 'the effectiveness of decision-making by the ACCC, in the context of Part IIIA, is yet to be seriously tested' (sub. 32, p. 36).

Dominic L'Huillier commented on the difficulty of the regulator's role:

Administering economic regulation and access regimes is rarely simple in practice. It requires complex economic, legal and financial judgements by the regulator. Moreover, regulators are dependent on other parties for information ... Ambit claims are often put forward by both access providers and the potential access seekers (users of the infrastructure) often at polar extremes which further exacerbate the assessment process. (sub. 7, p. 26)

Given the limited role that the ACCC has played in Part IIIA to date and the absence of any serious concerns about its role, operations or performance, there is little basis for drawing definitive conclusions or recommending any institutional changes. As such, the Commission does not currently consider that there is a need to alter the ACCC's role in the Regime (although there is a need for greater clarity about the ACCC's power to direct extensions and how that power would be exercised in practice — see chapter 4). Specific issues relating to the operation of undertakings and access codes are discussed in chapter 6.

9.5 Review of decisions made under Part IIIA

Decisions made under Part IIIA may be subject to merits review and judicial review. Judicial review is concerned with the legality of the decision-making process (ARC 2012). Merits review generally involves reconsideration of the facts, law and policy as they apply to a particular decision, in order to determine the correct or preferable decision (although many merits review regimes provide ‘limited merits review’, in which the discretion of the reviewer to achieve the correct or preferable decision is restricted in some way). The general objectives of merits review are:

- ensuring the fair treatment of all persons affected by a decision
- improving the quality and consistency of decisions
- enhancing the openness and accountability of decisions made by government (ARC 1999).

Merits review is available for a wide range of decisions and ‘should be available for decisions that affect the interests of a person unless there are particular reasons to exclude it’ (Attorney-General’s Department 2011, p. 11).

Although there are important similarities between the two types of review, one notable difference is that judicial review of administrative decisions is provided for in the Australian Constitution (ARC 2012), whereas merits review is only available when provided for by legislation (box 9.4). It therefore makes sense to consider the scope of judicial review in the federal jurisdiction — what it does and does not provide — before considering the suitability of, and any need for reform to, current merits review arrangements under Part IIIA.

Box 9.4 Part IIIA decisions that may be reviewed by the Tribunal

Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) provides that the Australian Competition Tribunal may reconsider:

- ministerial decisions to declare or not to declare a service (s. 44K)
- ministerial decisions not to revoke declaration of a service (s. 44L)
- ministerial decisions on making and revoking an ineligibility decision (ss. 44LJ and 44LK)
- ministerial decisions on whether a regime is an effective access regime (s. 44O)
- ACCC decisions on whether to approve a competitive tender process for proposed government owned facilities, and revocation of such approval (ss. 44PG and 44PH)
- ACCC access arbitration determinations (s. 44ZP)
- ACCC decisions on access undertakings and access codes (s. 44ZZBF).

Judicial review

Judicial review occurs when a court reviews a decision to verify that the decision maker used the correct legal reasoning or followed the correct legal procedures (ARC 2003). Judicial review is provided for in the Australian Constitution, and as such, is available for all decisions of an administrative character in the federal jurisdiction (ARC 2003).²

As judicial review is an examination of the correctness of legal reasoning or procedure, ‘the court cannot look at the substance of the decision maker’s assessment of the facts, only the process by which that decision was made’ (Attorney-General’s Department 2011, p. 14). This means that:

... there will be circumstances in which although a decision is not the correct or preferable decision on the facts, it will not be open to judicial review. (ARC 2003, p. 9)

Simply put, ‘there is no error of law simply in making a wrong finding of fact’.³ Conversely, circumstances may arise in which a decision is the correct or preferable one, but it is set aside because it has been subject to legal error.

The matters considered by the courts in determining the correctness of legal reasoning or procedure can be quite broad. For example, in relation to various laws administered by the ACCC, Justice Gleeson has stated that ‘it remains a matter of law whether any particular meaning established by economists is the meaning intended in the instrument in question’ (Gleeson 2004, p. 34). Determining what is, or is not, a question of legal reasoning and procedure in a particular case can therefore require considerable judgment, and is an ongoing source of debate.

The nature of our constitutional system is such that the scope of judicial review of executive decision-making is a topic guaranteed to occupy the minds of courts and government. (ARC 2003, p. 13)

If an error in legal reasoning or procedure is found during judicial review of a decision, courts generally cannot remake the decision (Attorney-General’s Department 2011). Thus:

... if a court finds that a decision has been made unlawfully, the powers of the court will generally be confined to setting the decision aside and remitting the matter to the decision-maker for reconsideration according to law. (ARC 2003, p. 9)

² There are important differences between judicial review in the states and territories and at the federal level (ARC 2012), but given the Commission’s focus is on the National Access Regime as enacted through Part IIIA of the CCA, these differences will not be considered here.

³ *Waterford v Commonwealth* [1987] HCA 25, para. 14.

Merits review of Part IIIA decisions

Once the decision maker has made a decision under Part IIIA (or a deemed decision is taken to have been made), affected parties can apply to the Tribunal for review of that decision. The Tribunal ‘reconsiders’ the matter based on the information that was taken into account by the decision maker. It may also:

- request information that it considers reasonable and appropriate for the purposes of making its decision on a review (s. 44ZZOAAA)
- require the NCC to give assistance for the purposes of reviewing declaration decisions, including by providing information or making reports (s. 44K).

The Tribunal has 180 days to make a decision, although this time limit may be extended by clock stoppers and extensions of time (chapter 4).

Participants’ views on merits review

Many participants were strongly supportive of merits review in the context of Part IIIA (box 9.5). In contrast, several participants considered that judicial review would suffice (box 9.6).

BHP Billiton noted that there is some uncertainty, following the High Court’s Pilbara rail decision, about whether the Tribunal’s general power to take evidence on oath, and issue summons for the attendance at hearings at the production of documents, apply to the Tribunal’s reconsideration of declaration decisions under section 44K of the CCA (sub. 29) (see box 9.8 below).

The Law Council of Australia also commented on the effect of the 2010 amendments to Part IIIA and the High Court decision.

... the 2010 amendments to the CCA significantly changed the review process for declaration decisions, in particular by reducing the scope of the review process in the Tribunal. This is likely to simplify and shorten the review process. The scope of the Tribunal review process is likely to be further reduced by the findings of the High Court. However, the Committee notes that neither the 2010 amendments nor the High Court’s decision have yet been given sufficient time to operate so as to enable their effect to be fully tested. (sub. 32, p. 5)

... it seems likely that the High Court’s decision and the 2010 amendments will result in a more cost-effective, timely and transparent decision making process than was previously the case. (sub. 32, p. 45)

Box 9.5 Participants' support for retaining merits review

There is no principled basis for removing the role of the Tribunal, or the availability of merits review, in relation to Part IIIA decisions. The national significance, public interest and private property consequences of Part IIIA decisions heighten the imperative for merits review to be retained under Part IIIA. (Law Council of Australia, sub. 32, p. 51)

Merits review plays a critical role in improving the quality, transparency and accountability of regulatory decision making ... in the light of the constraints already imposed on the Tribunal's role, and the importance of correcting errors in the application of the regime, it seems difficult to argue appeal opportunities should be further limited. This is especially so given the unique features of the Australian access regime, notably the economy-wide scope of its application. (Allan Fels, sub. 40, pp. 58–60)

The ability to seek merits review ... is crucial to ensuring confidence in the declaration process and enabling the correct decision to be reached (Rio Tinto Iron Ore, sub. 8, p. 3)

Reforming Part IIIA so that declaration decisions are only subject to judicial review, and not to merits review, would seriously jeopardise the quality of declaration outcomes under Part IIIA. In the current framework, merits review is an essential safeguard to avoid the harm of a wrong declaration decision ... The Tribunal is the only one of the existing three "decision-makers" with the resources and skills to test most of the relevant criteria, to determine the complex issues involved in declaration proceedings fully and accurately, and to make the correct decision. (BHP Billiton, sub. 29, pp. 6–7)

Judicial review can assess the decision maker's adherence to law and procedure; it cannot assess the decision maker's judgement. In regulatory decisions where the regulator's discretion can impact hundreds of millions of dollars in revenue and there is a real possibility of error in judgement, there must be the ability to review the merits of a decision. (Australian Pipeline Industry Association, sub. 14, p. 15)

The [Australian Competition Tribunal] is a specialist review body with significant experience in this area ... limiting the review of the Minister's decision under Part IIIA to judicial review is not appropriate under Part IIIA. (Qantas, sub. 28, pp. 15–16)

Given the significant property rights that are at stake and the ramifications of coverage/declaration for an existing business, both financially and operationally, it is critical that correct decisions are made ... There have been a number of instances ... where merits review has resulted in the correction of errors. In all likelihood, those errors would have been beyond the scope of judicial review. (Jemena, sub. 6, p. 6)

Asciano supports [the Draft Report's position that merits review of access declaration decisions should be retained] as merits review provides a limit on the regulator's power and should act as an incentive for the regulator to make a thorough decision. (sub. DR62, p. 10)

Gilbert + Tobin endorses the important role of limited merits review under Part IIIA. We also consider that it is too early to form a concluded view of the effectiveness of the modifications made to the merits review processes and role of the Tribunal under Part IIIA by the amendments introduced in 2010 and, more recently, through the decision of the High Court in *Pilbara Infrastructure*. (Gilbert + Tobin, sub. DR70, p. 9)

While the scrutiny that has been focused on the delays and costs associated with the disputes over access to rail infrastructure in the Pilbara ... may have led to ... calls for sweeping reforms, the Committee sees merit in the Commission's view that the recent High Court decision in *Pilbara Infrastructure* and the 2010 amendments to Part IIIA may have addressed at least some of those concerns. (Law Council of Australia, sub. DR68, p. 4)

Box 9.6 Participants' support for judicial review as the only form of review

[The NCC] questions whether merits review is the appropriate form of review. The Council considers judicial review is the preferable approach: judicial review ensures that Ministers' decisions on declaration applications are made fairly and in accord with law without putting the Tribunal in a position where its opinions on a range of public interest and other issues arising in the declaration process potentially override those of a politically accountable ministerial decision-maker. Further, the merits review regime has in the Council's view increased uncertainty and extended delays in the declaration process. (NCC, sub. 1, p. 9)

... it is neither necessary nor an efficient use of resources to provide two levels of inquiry and fact-finding in declaration matters. (NCC, sub. 9, p. 16)

The process which the NCC and regulators adopt in coming to their decisions are both rigorous and transparent with extensive consultation. It seems unnecessary to open that up to what is effectively 'cherry picking' and 'gaming' behaviour ... Perhaps it's time to reform the appeal framework and review its incentive properties to create an environment where the umpires' decisions are accepted. Otherwise, why have the umpires in the first place? (Dominic L'Huillier, sub. 7, pp. 18–21)

On balance QTT considers that judicial review has proven to be an appropriate form of review for access regulation, promoting a level of certainty and finality to decisions made under the regime, yet still allowing robust judicial scrutiny of decisions to ensure that decisions are lawfully made. (Queensland Treasury and Trade, sub. 42, p. 9)

The Commission's view on merits review

Potential advantages of removing merits review from the Regime

There are several reasons why merits review may not be appropriate in the context of the Regime. For instance, decisions involving extensive inquiry processes such as 'public inquiries and consultations that require the participation of many people' that 'would be time-consuming and costly to repeat on review' may be unsuitable for merits review (ARC 1999). This is of particular relevance in the case of the Regime, given that the NCC may (and routinely does) invite public submissions to inform its recommendations, and the ACCC may do likewise when considering applications for access undertakings and access codes.

In addition, there are grounds to question whether the merits review process necessarily adds value in cases where there are likely to be divergent views about what constitutes the preferable outcome. The benefits of reviewing a decision and reaching a different, but valid, judgment may not outweigh the costs of undertaking the review, particularly when those costs are significant and the review process is lengthy. There is precedent for access regimes to operate without provisions for merits review (box 9.7).

Box 9.7 Availability of merits review in other access regimes

Merits review of decisions made under the telecommunications access regime was available when that regime was established, but was removed in 2011. The explanation given for this removal was:

To promote regulatory certainty and timely decision-making, merits review of decisions under Part XIC is no longer available. Judicial review is still available, however, for parties wishing to appeal a point of law. (Conroy 2010a, p. 5)

Similarly, many state and territory access regimes — including those relating to ports, water and rail — do not currently provide for merits review. There have, however, been suggestions that the water pricing decisions by the New South Wales Independent Pricing and Regulatory Tribunal should be subject to merits review (NSW Commission of Audit 2012).

The regimes that provide for access to the national electricity and gas networks incorporate limited merits review, although these arrangements have recently been reviewed and are likely to be amended (SCER SCO 2012).

It has also been noted that, in some cases, Tribunal review has contributed to the considerable — and some have said excessive — length of time taken to reach a final decision under the Regime. For the six reviews of declaration decisions that the Tribunal undertook before the time limit was introduced in 2010, it took an average of 21 months to reach a decision. Although the amendments introduce a time limit for the Tribunal's decision, those time limits can be extended if the Tribunal is unable to make a decision within the prescribed 180 day period.⁴

Another relevant concern is that, in seeking to correct errors in decisions made by the Minister or the ACCC, it is possible that the Tribunal may introduce errors of its own.

... while reliance on review by formal adjudicative structures reduces the risk of rent-seeking and may help correct errors made by the regulatory body, it can introduce errors, and consequent error costs of its own. (Ergas 2009c, p. 83)

⁴ To extend this period, the Tribunal must give a notice in writing to the designated Minister, explaining why it was unable to reach a decision and specifying a new deadline. It must also inform the applicant, other affected parties and the NCC or ACCC, and publish a notice about the extension in a national newspaper. There is no limit on the number of times a review may be extended (chapter 4).

Potential advantages of retaining merits review

There are many reasons why robust institutional arrangements that include merits review may enhance the operation of the Regime and help to ensure that access regulation is judiciously applied. Where a deemed decision in response to a declaration application has been made and the Minister did not choose to give a statement of reasons, merits review provides the only avenue for review. While the Commission has recommended changing the deemed declaration arrangements (recommendation 9.1 above), this recommendation may not be accepted or implemented by government. Were this to be the case, the removal of merits review would seriously compromise the ability of affected parties to obtain any kind of review of deemed declaration decisions.

In other cases, merits review may be the only way to correct decisions that were made on the basis of incorrect facts. This is because judicial review will rarely allow factual errors in ministerial decisions to be corrected. The Administrative Review Council has noted this limitation, considering that ‘generally, the cases where an error of fact will amount to an error of law are limited’ (ARC 2012, p. 141). A system in which errors of fact can consistently be corrected therefore requires merits review.

A related concern is that failure to provide a generally accessible mechanism for error correction would diminish confidence in Part IIIA processes and increase sovereign risk. Participants’ strong support for current merits review arrangements (box 9.5) — together with the generic nature of the Regime, its application to infrastructure of national significance and the need for decision makers to exercise considerable judgment on complex matters — heighten this concern. Reduced confidence in the Regime could in turn affect incentives to invest in infrastructure services and dependent markets (chapter 7).

There are also grounds to consider that removing merits review would be premature at this time, given that current merits review arrangements are the product of amendments to the CCA made in 2010 and the High Court’s 2012 decision in the Pilbara rail case.

Current merits review arrangements

Information that may be considered by the Tribunal

Prior to the 2012 High Court decision on the Pilbara rail case, the Tribunal took an expansive view of its powers to obtain new information. The High Court held that the Tribunal had erred in conducting such broad additional investigations. However, this decision was based on the legislation as it was prior to the 2010 amendments to Part IIIA. The combined effects of the High Court's 2012 Pilbara decision and the 2010 amendments have not been tested and cannot be known for certain. Nevertheless, it is the Commission's view (after receiving advice to this effect from the Australian Government Solicitor) that the Tribunal's powers are more confined than those it had previously sought to exercise on review under subsection 44K(4), and that Tribunal processes may be shorter than they have been in the past. This view was supported by the Law Council of Australia, which considered that it:

... seems clear that future reviews by the Tribunal are likely to be simplified, both in terms of the evidence that may be presented and the time which can be taken by the Tribunal to hear a matter. (sub. 32, pp. 44–5)

It also appears that there will be greater discipline imposed on applicants and respondents to submit evidence at the NCC stage rather than hold off until the case reaches the Tribunal. The NCC considered that:

While the Tribunal can request additional information where it considers such information to be reasonable and appropriate for the purpose of making its decision, the requirement limiting the review to the information originally submitted will in the Council's view assist in reducing the ability for a party to 'game' the review to delay a decision. (2012a, p. 31)

Again, this view was shared by the Law Council of Australia, which said:

There will be a greater discipline imposed on applicants (and respondents) to submit their best evidence at the initial NCC stage. This should provide increased clarity at an early stage of the proceedings regarding the relevant issues, and limit the ability of access providers to prolong proceedings by introducing new issues, evidence and materials. (sub. 32, p. 45)

To the extent that this is the case, it would further simplify and expedite the Tribunal's task. The inapplicability of the Tribunal's general powers to Part IIIA review confirms the narrow scope of its task for Part IIIA reviews (box 9.8).

Box 9.8 Applicability of the Tribunal’s general powers to Part IIIA review

Part IX of the CCA sets out general powers of the Tribunal, as well as other procedural provisions. These powers include the power to take evidence on oath, and to summon a person to appear before the Tribunal to give evidence or produce documents. Several participants considered that these powers continue to apply to Tribunal review of decisions made under Part IIIA.

However, it is the Commission’s view (after receiving advice to this effect from the Australian Government Solicitor) that the High Court’s Pilbara decision has made it clear that:

- these procedural provisions do not apply in relation to Part IIIA reviews by the Tribunal, at least insofar as review of declaration decisions is concerned
- the 2010 legislative amendments do not alter the applicability or otherwise of the Part IX provisions to review of Part IIIA decisions.

Hence, one of the arguments put forward by inquiry participants as a perceived advantage of Tribunal review — the power to take evidence on oath and to summon people and evidence set out in Part IX — should not be considered in assessing the advantages of current Part IIIA review arrangements, as the Tribunal does not have these powers in respect of Part IIIA review.

Timeframe for Tribunal decisions

In light of the reduced scope of the Tribunal’s task, there may be grounds for questioning whether the 180-day time limit for Tribunal decisions should be reduced. The 180-day limit may appear generous in comparison to the 60 days allowed for ministerial decisions. Similarly, there may be grounds for removing provision for clock stoppers or extensions of time, so as to remove avenues for decisions to take longer than the 180-day time limit.

However, reducing the time allowed for Tribunal decisions — whether through changes to clock stoppers, extensions of time or to the time limit itself — appears to be premature at this stage, for several reasons.

- The Tribunal has not been involved in any Part IIIA cases since the time limits were introduced. Ideally, the Tribunal would consider 180 days to be the outer limit and would see value in making its determination earlier where possible.
- The restrictions on the use of clock stoppers and need for extensions of time to be publicly reported (which include, respectively, requirements to notify the designated Minister and to publish a notice in a national newspaper) may serve as an effective brake on their use. When clock stoppers and extensions of time were introduced, it was anticipated they would rarely be used (Emerson 2009b).

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- The current provisions apply to all Tribunal decisions, not just those made by the Minister on declaration applications. Any reduction to the time limits or to the ability of the Tribunal to avail itself of extra time when required — even if such a reduction was reasonable for review of ministerial decisions on declaration — could potentially have an adverse impact on the Tribunal’s ability to properly review some other types of decisions (such as arbitration decisions made by the ACCC).
 - The extent to which the timeliness of future reviews can be predicted based on past reviews is unclear. As Allan Fels noted in his submission to the review of the limited merits review regime for the national electricity and gas regulatory frameworks:

... one ought to be cautious about predicting the timeliness of future proceedings on the basis of the history of merits review to date. It is certainly to be expected that, as the Tribunal, the AER and the industry become accustomed to the new regulatory framework, timelines will reduce ... Further, given the gravity of the issues at stake, one ought to be cautious about pursuing timeliness for its own sake. (Fels 2012, p. 34)

To the extent that similar concerns are present in Part IIIA, they provide weight to arguments against making changes to time limits, clock stoppers or extensions of time for Tribunal decisions.

Other aspects of merits review

As noted above, the NCC considers that there would be benefits to granting it a statutory role before the Tribunal and the courts (subs. 9 and DR48). However, it is unclear that such a change is necessary at this time (box 9.9).

In addition to introducing time limits for Tribunal decisions, the 2010 amendments to the CCA granted the Tribunal the power to order a party to a review of a declaration decision to pay all or part of the costs of another party (s. 44KB). This was designed to ‘reduce incentives for delaying tactics, frivolous review applications and other inappropriate behaviour’ (Emerson 2009b, p. 11472). To the extent that the power to award costs achieves this aim, it will limit parties’ use of the review process to draw out proceedings, or to engage or exhaust the resources of the other parties.

Box 9.9 Should the NCC have a statutory role before the Tribunal and the courts?

The NCC expressed concern about the costs and delay that could be involved in establishing the NCC's 'role and right to participate' in Tribunal and court proceedings relating to declaration matters (sub. 9, p. 25). It suggested that in order to avoid these potential costs and delays, the NCC should be given a statutory role before the Tribunal and, to the extent possible, the courts. In support of its suggestion, the NCC cited a 1999 decision of the Full Court of the Federal Court (the Hamersley case) which found that 'the body entrusted with [Part IIIA] by Parliament should have some say in litigation concerning fundamental principles as to its operation'.⁵

However, there is limited evidence of an actual or potential problem with current arrangements. The NCC itself noted that, to date, 'the Tribunal and courts have accepted that the Council has an important role to fulfil in review proceedings and litigation' and 'parties have been unsuccessful in efforts to exclude or confine the Council' (sub. 9, p. 25). It thus viewed the risk of being excluded from proceedings as a 'lower-order risk' (trans., p. 177).

Similarly, the Law Council of Australia noted that 'the NCC has intervened in a number of cases and, so far as I know, never been excluded, much to some parties' chagrin' (trans., p. 207). The Law Council did not see the need for the NCC to be given a statutory role before the Tribunal and the courts, because 'the court can make the appropriate decisions about joinder of parties' (trans., p. 207).

The Commission considers that there does not appear to be a strong case for recommending the NCC be given a statutory role before the Tribunal or the courts at this time, given:

- the NCC's existing statutory role in proceedings before the Tribunal, and the lack of any widespread concerns with how the associated legislative provisions have been operating to date
- the fact that the NCC, according to its submissions, appears to have been successful to date in managing to appear before the Tribunal
- the present ability of the Tribunal and the courts to exercise their discretion, using established principles of law, as to whether it is appropriate for the NCC to appear and make submissions in any particular case, and as to what the nature and scope of those submissions ought to be.

⁵ *National Competition Council v Hamersley Iron Pty Ltd* [1999] FCA 1370.

10 The broader policy context

Key points

- The Competition and Infrastructure Reform Agreement (CIRA) is intended to promote simpler and more consistent approaches to the regulation of significant infrastructure, including specific initiatives for rail and port regulation.
 - The CIRA reinforces principles of competitive neutrality for government business enterprises. Governments should regularly review their competitive neutrality policy statements and consider whether they are relevant and reflective of contemporary practice.
 - Based on the limited evidence available to the Commission, the CIRA should be retained. However, the CIRA should not be used to deliver new initiatives unless there would be clear net benefits from doing so.
- The National Access Regime is an element of the operating environment in Australia for both private companies and government business enterprises. Corporate entities that purchase or build infrastructure have a commercial incentive to assess whether the Regime is likely to apply to their infrastructure services and take appropriate action based on that assessment.
 - Before privatising public monopolies involved in infrastructure service provision, governments should consider whether access arrangements and other regulatory structures are warranted, consistent with the principles set out in the Competition Principles Agreement.
 - Project approval processes for greenfield infrastructure can be used to consider whether access and other regulatory arrangements should be applied. However, it may not always be feasible to establish whether regulating access to new infrastructure services would generate net benefits — and, if so, devise appropriate regulatory frameworks — before facilities are constructed or commence operations.
- Infrastructure investment within multi-user commodity supply chains can be complex, with misaligned preferences and incentives leading to short-term — but costly — capacity constraints. This is primarily a coordination, rather than an access, issue.
 - Regulatory measures that mandate how parties should plan and coordinate investment decisions are unlikely to promote economic efficiency, given that the ‘right’ decisions will depend on the specific circumstances in the supply chain.
- A further review of the National Access Regime would be warranted no more than ten years after the Australian Government responds to the final recommendations of this inquiry.

The Commission has examined challenges for competition and infrastructure regulation in many of its past inquiries and research. As noted by the former Chairman of the Productivity Commission:

... getting it right on infrastructure involves more extensive policy territory than the regulatory arrangements for monopoly providers. (Banks 2012a, p. 11)

The ‘to-do list’ of potential productivity-enhancing initiatives includes improving governance arrangements for public utilities, performing rigorous cost–benefit analysis for any public investment in major infrastructure projects, and designing price regulation systems that do not deter efficient commercial investment in infrastructure (Banks 2012b). During the course of this inquiry, many participants have pointed to these matters — and others — as relevant to the broader policy context for infrastructure reform.

In addition to specific consideration of the provisions of Part IIIA of the *Competition and Consumer Act 2010* (Cwlth) (CCA) and the Competition Principles Agreement (CPA), the terms of reference for this inquiry require the Commission to examine broader matters of infrastructure regulation. These are to:

- review the effectiveness of the reforms outlined in the Competition and Infrastructure Reform Agreement (CIRA), including the measures enacted by the Australian, state and territory governments to give effect to those reforms
- provide advice on ways to promote best-practice regulatory principles, support efficient investment in infrastructure, and improve processes and decision making in relation to greenfield infrastructure projects
- comment on other relevant policy measures to ensure effective and responsive delivery of infrastructure services.

This chapter draws together commentary on the outcomes of the CIRA, and considers the scope for regulatory and other policy measures to align incentives for efficient private sector investment in, and development and use of, infrastructure services. It also sets out the case for a further review of the National Access Regime (the Regime).

10.1 The Competition and Infrastructure Reform Agreement

The CIRA was agreed at the February 2006 meeting of the Council of Australian Governments (COAG). In addition to various administrative provisions, the CIRA:

- provides a broad framework for simpler and nationally consistent regulatory

approaches for significant infrastructure. This includes commitments to introduce time limits for decision making, provide principles for regulated access pricing, and seek certification of state and territory access regimes. Certification is discussed in chapter 6

- emphasises specific regulatory arrangements for nationally significant rail and port infrastructure. The approaches to access regulation in these sectors are considered in chapter 8. Comments on government reviews of rail and port regulation, which were required under the CIRA, are contained below
- complements amendments to Part IIIA that provide for infrastructure facilities that are to be government owned to be immune from declaration where their construction and operation occur under a competitive tender process that is approved by the Australian Competition and Consumer Commission (ACCC), as discussed in chapter 8
- reinforces principles of competitive neutrality for government business enterprises (GBEs) engaged in significant business activities. The principles provide that public ownership should not give advantage to the commercial operations of GBEs. The application of these principles is discussed below.

Aspects of the CIRA are supported by the National Partnership Agreement to Deliver a Seamless National Economy (NPA–SNE) (COAG 2009). Under the NPA–SNE, the Australian, state and territory governments have undertaken to achieve milestones (commitments for policy reform and implementation), some of which refer to the CIRA. The COAG Reform Council reviews the performance of jurisdictions in meeting their milestones each year. The Council’s most recent assessment shows that governments have not yet satisfied all CIRA commitments under the NPA–SNE (box 10.1).

Rail freight infrastructure

The CIRA was intended to promote a ‘simpler and consistent national system’ of access regulation for nationally significant rail infrastructure. Governments agreed that the access undertaking applying to operations of the Australian Rail Track Corporation (ARTC) would provide a template for implementing a national regulatory approach to:

- *interstate* rail track from Perth to Brisbane, depending on the outcomes of commercial negotiations
- major *intrastate* freight corridors, where their inclusion in a national approach was assessed to have net benefits.

Box 10.1 Governments' completion of CIRA milestones, December 2012**Certification of state and territory access regimes**

State and territory government achievement of certification milestones has been mixed.

- In total, five of the state access regimes (excluding gas and electricity) listed in the CIRA implementation plan have been certified, while two regimes were repealed. Additionally, the New South Wales Government sought and received certification of its water industry access regime, which was developed after the CIRA took effect.
- No jurisdiction's gas access regime has been certified, and most jurisdictions have not obtained certification of their electricity regimes.
- The Victorian rail access regime has not been certified.

Access regulation of rail track and networks

Although the CIRA sets out broad objectives for simpler, nationally consistent rail regulation, the agreed milestones for access regulation of rail track and networks were limited to two pieces of interstate rail track — between Kalgoorlie and Perth, and the Queensland – New South Wales border and Brisbane (see below). The COAG Reform Council has assessed all rail-related milestones as completed.

Regulation of significant ports

State and territory governments were required to undertake transparent, public reviews of the regulatory arrangements for their significant ports to ensure consistency with the principles for port regulation contained in the CIRA. The COAG Reform Council confirmed that all jurisdictions completed the required reviews, although the implementation of review recommendations has been patchy (see below).

Competitive tender principles

The Australian Government fulfilled a commitment to implement a consistent set of competitive tender regulations. These regulations gave effect to the amendments to Part IIIA that allowed for declaration to not apply to government-owned infrastructure constructed and operated under an ACCC-approved competitive tender process.

Competitive neutrality

All jurisdictions have satisfied the competitive neutrality milestone through the production of the annual Heads of Treasuries matrix report, notwithstanding concerns about the quality of information provided by some governments (see below).

Sources: COAG Reform Council (2011, 2012).

The implementation plan for rail-related CIRA obligations expressly identified two segments of the interstate rail network that stood outside the existing ARTC access undertaking: rail from the Queensland – New South Wales border to Brisbane, and

from Kalgoorlie to Perth. The specific milestones under the NPA–SNE required governments to consider:

- whether control of the rail track between the Queensland – New South Wales border and Brisbane should be transferred to the ARTC
- whether to commission a cost–benefit analysis for applying the ARTC undertaking model to rail track between Kalgoorlie and Perth.

Operating rights for the relevant Queensland track were leased to the ARTC, leading to its coverage under the undertaking. There was no agreement on applying the provisions of the ARTC undertaking to the relevant Western Australian track, which is instead subject to the state rail access regime. (As noted in chapter 6, the Western Australian rail access regime has been certified as effective.) No milestones were set in relation to major intrastate freight corridors.

There is little evidence for evaluating the relevant rail regulation policies and their implementation under the CIRA. However, the milestones set under the NPA–SNE, and the subsequent actions of governments to achieve those milestones, appear narrower than the original goals for streamlining rail regulation expressed in the CIRA. This may reflect changing views on the relative costs and benefits of different options for achieving greater consistency in rail regulation — in particular, certification of state access regimes versus the pursuit of a single national regime for significant rail infrastructure (chapter 8).

Port competition and regulation

Under the CIRA, state and territory governments agreed to commission public reviews of the regulation of their significant ports and port authorities. ‘Significant’ ports were defined to include major capital-city ports, bulk-commodity export ports (except those considered part of integrated production processes) and regional ports focused on agricultural and other exports. Port regulation was to be assessed against various principles for ports contained in the CIRA, including that:

- regulation should only be used where it is necessary to promote competition in dependent markets or prevent the misuse of market power
- where regulation is applied, it should conform to a national approach
- competition in the provision of port and related infrastructure should be permitted, except where it is found that competition would impose net costs.

In an assessment undertaken for the COAG Reform Council, KPMG examined whether the state and territory port reviews were consistent with each government's CIRA obligations (KPMG 2009). As table 10.1 summarises, there was variation in the quality of the reviews and how governments responded to them. KPMG highlighted:

- Queensland's reliance on consultation rather than economic principles to inform its review of regulatory arrangements
- Western Australia's failure (at that time) to publicly release a final report of its review — although KPMG noted that the Western Australian Department of Premier and Cabinet had advised that the report, which was still before cabinet, concluded that there was no case for further regulation of the state's ports
- the slow progress of governments, apart from those in Victoria and South Australia, in responding to the reviews and implementing consequent reforms.

The COAG Reform Council followed up on KPMG's work in its annual progress reports. As of December 2012, New South Wales, Victoria, Queensland and South Australia were all found to have met their obligations in implementing recommendations from their port regulation reviews. Queensland was also required to consider the appropriateness of the regulatory arrangements for the Dalrymple Bay Coal Terminal. This milestone was satisfied in 2011 when an access regime for the terminal was certified. However, the COAG Reform Council (2012) found that:

- the Northern Territory had satisfactorily addressed only some of the matters raised in relation to regulation of the Port of Darwin
- Western Australia had not satisfactorily responded to the recommendations of its review (after publicly releasing its final report in January 2009), instead referring port governance to a further review in December 2010 (the final report for which was released in February 2012).

Neither KPMG nor the COAG Reform Council assessed the economic implications of port regulation or any policy changes that might have followed the states' regulatory reviews. In this regard, KPMG and the COAG Reform Council's high-level observations offer little guidance as to the effectiveness of the port regulation provisions of the CIRA, or the costs and benefits to the community from their implementation.

Table 10.1 Jurisdictional reviews of port regulation^{a, b}
October 2009

<i>Criteria</i>	<i>NSW</i>	<i>Vic</i>	<i>Qld</i>	<i>SA</i>	<i>WA</i>	<i>NT</i>
Did the jurisdiction attain high-level consistency with the CIRA principles?	●	●	●	●	◐	●
Was the review of sufficient quality to meet the CIRA principles?	●	●	◐	●	◐	◐
Was appropriate consultation undertaken and considered as part of the review?	●	●	◐	●	●	●
Were the review recommendations consistent with the CIRA principles?	●	●	●	●	●	●
Did the jurisdiction respond to the review and implement its recommendations?	◐	●	◐	●	○	◐

^a Tasmania and the Australian Capital Territory do not have any 'significant' ports, and hence were not required to undertake reviews. ^b Legend: ● indicates that KPMG considered the jurisdiction to have demonstrated full consistency with the relevant criterion (indicated in the first column), ◐ indicates partial consistency, and ○ indicates inconsistency requiring additional efforts to be satisfied.

Source: KPMG (2009).

Competitive neutrality of government business enterprises

A broad framework for jurisdictions to approach competitive neutrality issues was agreed in the CPA (first signed in 1995 and amended in 2007). Among other things, the CPA required governments to publish policy statements on competitive neutrality by June 1996. The CIRA builds on these CPA commitments by 'enhancing the application' of competitive neutrality principles for GBEs engaged in significant business activities where there is actual or potential competition with private sector operators (box 10.2).

Competitive neutrality policies

Although there is some variation in the design and implementation of competitive neutrality policies, each jurisdiction's statements cover such matters as corporate governance, cost attribution and recovery, and the tax (or tax-equivalent) and regulatory treatment of significant GBEs. All policies also include mechanisms for dealing with competitive neutrality complaints, which are handled by government departments, regulators or other agencies depending on the jurisdiction.

Box 10.2 What is competitive neutrality?

The CPA sets out the basic premise of competitive neutrality.

The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities. (clause 3(1))

Put another way, where a GBE undertakes a significant business activity, its commercial (for-profit) operations should be conducted on equivalent terms to those faced by (or would be faced by) the private sector.

The CIRA commits jurisdictions to 'enhance the application' of competitive neutrality principles. For each GBE engaged in significant business activities in competition with the private sector, the principles require:

Objectives

- a. That the enterprise has clear commercial objectives.
- b. That any non commercial objectives or obligations established for the enterprise are clearly specified and publicly reported.
- c. That enterprises do not exercise regulatory or planning approval functions in circumstances in which they compete with private sector enterprises.

Governance

- d. That the responsibilities of the governing board of the enterprise and the performance measures against which the board will be held accountable are published.
- e. That the governing board is appointed on the basis of particular skills needed by the board.
- f. That having received strategic guidance from the government about the achievement of its objectives, the enterprise has operational autonomy in the day to day management of its affairs.
- g. That the dividend policy applicable to the enterprise should be clearly and publicly specified.
- h. That any payments to the government as shareholder or for the purposes of competitive neutrality, such as taxes, tax equivalent payments, special dividends, capital repayments, are identified in a transparent manner.

Reporting

- i. That at least annually the enterprise will report publicly on its commercial performance and on its performance of any non commercial activities.
- j. That any directions given to the enterprise by the government are published.
- k. That where the legislation establishing an enterprise derogates from competitive neutrality the derogation has been published. (clause 6.1)

Sources: COAG (2006, 2007b).

The Victorian Competition and Efficiency Commission found that 112 competitive neutrality complaints were investigated across all jurisdictions between 1996 and 2012, and that more than half of these applied to Victorian Government GBEs. There has been a significant reduction in the number of investigations since 1996, with only five complaints investigated in Australia during 2011-12 (VCEC 2013). However, as the Victorian Competition and Efficiency Commission also noted, its data may understate the number of competitive neutrality complaints, since some jurisdictions refer matters to mediation ahead of formal investigation.

The Business Council of Australia (BCA, sub. 36, p. 9) criticised competitive neutrality policies as being ‘dated and unclear’, and highlighted what it considered to be shortcomings in the requirements for the Australian Government to respond to investigations of the Australian Government Competitive Neutrality Complaints Office (AGCNCO, which is a unit of the Productivity Commission). For example, the BCA was not satisfied that the procedures for determining which minister was responsible for responding to complaints — whether the Treasurer or the portfolio minister for the relevant enterprise — were clearly understood. Nor did the BCA consider there to be sufficient rigour in how the Australian Government responded to investigation outcomes, especially where it sought to exempt a particular entity from meeting competitive neutrality requirements. The BCA proposed that all governments adopt time limits for responding to competitive neutrality complaints, and that all complaints, investigation reports and formal responses be made publicly available online.

The AGCNCO has highlighted potential weaknesses in the Australian Government’s competitive neutrality policy statement. In its investigations into both NBN Co and PETNET Australia (respectively, AGCNCO 2011, 2012), the AGCNCO was tasked with examining GBEs that were operating in a start-up phase. It was not considering whether the Australian Government’s competitive neutrality policy had been breached, but whether it would in future be breached based on the business plans and other available information about the entities’ forecast business activities.

In both cases, complainants submitted that the entities were not pursuing commercial rates of return. Competitive neutrality policy requires GBEs to earn a commercial rate of return over a ‘reasonable timeframe’ — a start-up enterprise would not be expected to earn its targeted return on investment for several years. In this regard, the AGCNCO noted that ‘competitive neutrality policy and guidelines provide limited guidance as to what is considered to be a reasonable timeframe in which to earn a commercial rate of return’ (2011, p. 34). This suggests that there would be benefit in clarifying competitive neutrality policy statements to include

advice on how new GBEs should develop their business plans, so as to avoid triggering concerns about non-compliance with competitive neutrality policy.

Most jurisdictions have not revised their competitive neutrality policy statements for at least a decade. The ongoing applicability of competitive neutrality processes depends on governments maintaining up-to-date policies. The issues noted above pertaining to newly established GBEs, complaints handling processes, and government responses to complaint investigations all highlight the benefits of reviewing competitive neutrality policies, and revising them where necessary.

On the basis of the evidence provided by inquiry participants, and through its own investigations, the Commission considers that the Australian, state and territory governments should regularly review competitive neutrality arrangements for GBEs engaged in competition with the private sector. Such reviews would help to ensure that competitive neutrality policies remain relevant and reflect contemporary practice.

Monitoring competitive neutrality

Under the implementation plan for the CIRA, governments agreed that the enhanced application of competitive neutrality principles would be monitored by the Heads of Treasuries. This monitoring takes the form of an annual ‘matrix report’, for which each jurisdiction identifies the compliance of each of its GBEs that are engaged in significant business activities in competition with the private sector (COAG 2012).

As noted in box 10.1, the COAG Reform Council (2012) found that all governments had met their obligations to contribute to the matrix report. The COAG Reform Council noted concerns that the Western Australian Government had not explained why some of its GBEs had not adhered to all of the competitive neutrality principles outlined in the CIRA, although the COAG Reform Council was satisfied that this deficiency was being rectified in time for the next annual matrix report. However, with no further competitive neutrality milestones to be assessed, the COAG Reform Council will not be required to report on competitive neutrality issues in the 2012-13 financial year. Furthermore, as the Commission has previously identified, achieving a national partnership agreement milestone does not guarantee ongoing benefits from reform — especially if, once a milestone is satisfied, governments do not carry initiatives forward with ongoing policy commitments (PC 2012b).

The BCA (sub. 36) criticised the timeliness of the matrix reports, noting that reports routinely were not produced until at least 12 months after the end of the relevant financial year. The most recent matrix report, for the 2010-11 financial year, was considered by COAG at its July 2012 meeting (COAG 2012). The BCA proposed that competitive neutrality compliance should be reported within six months of the end of each financial year.

In completing the matrix reports, most jurisdictions indicate compliance with yes or no answers, with any noes supplemented by explanatory footnotes. Moreover, most answers are unlikely to change from year to year. The benefit of more timely accountability for competitive neutrality outcomes is likely to outweigh any administrative costs associated with meeting a deadline to produce a report. The Commission is satisfied that a six-month target for the publication of matrix reports is justified.

RECOMMENDATION 10.1

The Australian, state and territory governments should regularly review their competitive neutrality policies to ensure that they remain relevant and reflect contemporary practice. Specific matters that should be considered include:

- *clearer guidelines on the application of competitive neutrality during the start-up stages of newly established government business enterprises that are or will be engaged in significant business activities*
- *whether processes for handling competitive neutrality complaints are identifiable, independent and accessible*
- *how governments respond to the findings of competitive neutrality complaint investigations.*

To strengthen accountability for competitive neutrality outcomes, the Heads of Treasuries should set a target for producing their annual competitive neutrality matrix report within six months of the end of each financial year.

The effectiveness of the CIRA and supporting reforms

As the Commonwealth Treasury (sub. 34) has noted, no evaluations of the CIRA — or individual components of it — have been conducted. The COAG Reform Council's assessments monitor whether milestones are met, but compliance with CIRA commitments does not prove the existence of benefits, nor is non-compliance a measure of costs.

In its draft report, the Commission requested further information on the costs and benefits of the CIRA and its associated reforms. Participant commentary on this matter was limited. As one example, representatives of the CBH Group indicated during public hearings that they could not identify any discernible benefits from the CIRA (trans., p. 6). Similarly, the COAG Reform Council stated that it ‘does not have formal views on the costs and benefits of [the CIRA] reforms’ (sub. DR76, p. 1). These comments typified many of the Commission’s consultations regarding the CIRA, highlighting a general paucity of data. Consequently, the Commission is not in a position to undertake a quantitative evaluation of the effectiveness of the reforms outlined in the CIRA, or of the actions and reforms undertaken by governments to give effect to those reforms.

A small number of inquiry participants expressed general views about the effects of aspects of the CIRA. The Federal Chamber of Automotive Industries argued that the CIRA has not been effective in preventing the ‘potential abuse of market power by private operators’ of some ports, and that state governments ‘have generally not complied with their CIRA obligations to allow competition’ in automotive terminal services (sub. 24, p. 7). CBH Group raised concerns about unwarranted port regulation and inconsistent rail regulation, stating that it did ‘not see evidence ... that [the] CIRA has been effective in guiding the actions of the signatories to it’ (sub. 47, p. 7). By contrast, the BCA (sub. 36) commended the CIRA initiatives on rail and port regulation. The COAG Reform Council supported the ‘appropriate accountability and reporting arrangements’ required to satisfy a number of CIRA commitments (sub. DR76, p. 1).

In summary, the anecdotal observations provided to the Commission pointed to concerns about implementation issues, but not objections to the CIRA itself. There were also very few comments on particular reforms that should be made to strengthen or supplement the CIRA.

There is a lack of comprehensive evidence on which to base any precise assessment of the CIRA’s effectiveness. Nevertheless, based on the limited information available, it is considered appropriate that the CIRA be retained. However, the CIRA should not be used to deliver any new initiatives unless there would be clear net benefits from doing so.

10.2 Private sector provision of infrastructure services

As noted in previous chapters, many participants raised concerns about the effect of the National Access Regime on the incentives for efficient private sector investment in infrastructure. The Commission has proposed changes to the Regime that would help to strengthen investment incentives. Ultimately, access regulation remains a relevant institutional consideration for investors. Corporate entities that invest in existing infrastructure or build new infrastructure must assess the potential effect of the Regime on their infrastructure services, and respond accordingly.

Some of the problems raised by participants touched on issues broader than the operation of the Regime. Specific matters of concern included inadequate regulatory certainty for greenfield and privatised infrastructure, and the complexity of negotiating between infrastructure investors, owners and users in commodity supply chains.

Improving regulatory certainty for privatised and greenfield infrastructure

Infrastructure investments are irreversible (usually involving large, sunk, fixed costs), leaving investors open to considerable risks from subsequent regulatory interventions that may curtail their returns (Guthrie 2006). Governments can minimise such risks — and the degree to which they influence decisions by the private sector about whether to invest in infrastructure — by determining upfront what, if any, regulatory arrangements should apply. This means considering whether and how to regulate an infrastructure service as a condition of privatisation, or prior to the construction or commencement of greenfield infrastructure (or any new infrastructure where government approval is required).

As established in chapter 3, access regulation should only be applied where there is (or, for greenfield infrastructure, is expected to be) an enduring lack of effective competition due to natural monopoly. Policymakers should consider whether access regulation would provide overall gains to the community — consistent with best practice principles for general infrastructure regulation (box 10.3). In some instances, policy tools other than access regulation may better address any underlying concerns about the ownership and operation of monopoly infrastructure.

Box 10.3 Best practice principles for infrastructure regulation

The significance of infrastructure to the national economy places a premium on getting overarching policy settings right. To unlock greater potential for competition, investment and innovation, emphasis has shifted over time from public ownership of core assets to effective regulation by governments.

Regulation should only be introduced where it is necessary — that is, if it generates the greatest net benefits to the community of all policy options that could be used to target a clearly defined problem. Regulation will be most effective where it is informed by meaningful consultation with stakeholders, and where it is subject to rigorous upfront and regular policy review. When regulating prices, policymakers should preserve incentives for innovation and infrastructure investment. Price regulation should not be used to meet social objectives that could be better targeted by more direct measures.

Public ownership

Public ownership may confer advantages on GBEs when competing against the private sector. As discussed in section 10.1, competitive neutrality is an important principle for regulating such enterprises. More broadly, publicly owned entities can be subject to conflicting objectives, with profit drivers being offset by non-commercial goals. Privatisation is one option for orienting GBEs to market incentives, but may not always be feasible. For those enterprises that remain publicly owned, regulation should ensure that pricing of goods and services reflects the full cost of their provision, investment priorities are determined by maximising returns, and managers are accountable for entities' performance.

Structural reforms

Some GBEs operate as vertically integrated monopolists, responsible for natural monopoly infrastructure along with potentially contestable operations in upstream or downstream markets. Structural separation of infrastructure ownership will not be appropriate in all cases — the costs from losses in economies of scope, transactions costs and one-off adjustment costs may exceed the benefits from promoting competition in contestable elements of the production chain and applying appropriate regulation to those infrastructure services that remain monopolies. However, a careful evaluation of where the gains are likely to be greatest should be undertaken to ensure that effective governance and regulatory structures are in place before any privatisation, rather than trying to 'unscramble the egg' later.

Conduct of policy reviews

To support effective regulatory development, governments should apply in-depth, independent and public review processes. High quality reviews emphasise evidence as the basis for policy decisions, drawing on research and consultation. Conclusions should be tested, such as by releasing draft reports on which stakeholders can provide feedback. While reviews should be well targeted, they should not be unduly constrained either: in particular, reviews should examine all relevant policy alternatives.

Sources: PC (2008b, 2011c).

Regulatory considerations for privatised infrastructure

Privatising publicly owned infrastructure can be beneficial, particularly where the sale of facilities or lease of operating rights attracts new investment and encourages improvements in service delivery. However, privatisation will not by itself unlock efficiency gains — the right governance and regulatory arrangements must be established to maximise the benefits for the community (chapter 2). Moreover, as the BCA (sub. DR69) identified, effective regulatory frameworks can enhance the scope for governments to privatise infrastructure.

Inappropriate (including nonexistent) regulatory arrangements could allow infrastructure service providers to earn monopoly profits, with benefits accruing to investors at the expense of users, competitors and — in some cases — end consumers. This can dampen investment in markets that depend on access to the monopoly infrastructure, thereby denying at least some of the benefits that the community could obtain from greater competition.

Anglo American Metallurgical Coal argued that ‘a privatised asset which did not have appropriate access arrangements put in place prior to the privatisation is unlikely to be the subject of effective scrutiny post-privatisation’ (sub. DR50, p. 3). The Minerals Council of Australia noted that ‘the consequences of any poorly implemented privatisation [can impose costs] for some (potentially considerable) time’ (sub. DR74, p. 4). Several participants highlighted perceived deficiencies in the implementation of existing or prospective privatisation programs, notably for rail and port infrastructure (box 10.4).

Governments may reconsider regulatory arrangements if the inadequacies of an ex ante framework are exposed. However, ex post regulation can impose additional costs on the parties, and the community more generally, if it is poorly designed or implemented. As the OECD observed from international experience:

A degree of regulatory certainty is paramount to an effective sale process ... Particularly problematic cases have arisen in the past when, for instance, telecom and airport operators have been privatised in their original corporate form and demands for structural separation and related competition concerns raised by regulators only pursuant to the entry of private owners. Such ‘late attempts’ at remedying an initially unstable market structure are ... hardly ideal and can seriously jeopardise the credibility of a privatisation program. (2009, p. 19)

Box 10.4 Participants' views on privatisation of ports and rail track

- The Federal Chamber of Automotive Industries (sub. 24) claimed that in privatising the Port of Brisbane, the Queensland Government had failed to establish adequate safeguards to address the potential abuse of market power by the port operator.
- The Federal Chamber of Automotive Industries (sub. 24) was also concerned about the privatisation of Ports Botany and Kembla, especially that the NSW Government's price monitoring regime is not administered by an independent regulator. Separately, the ACCC has signalled that it will intervene if it considers that the privatisation of key ports in New South Wales would likely result in a substantial lessening of competition (Sims 2012).
- Anglo American Metallurgical Coal (sub. DR50) was broadly complimentary about the privatisation of, and associated access arrangements for, the Dalrymple Bay Coal Terminal — although it noted some concerns about delays in capacity expansion and investment coordination. It contrasted the experiences at Dalrymple Bay with the Abbot Point Coal Terminal, which is now controlled by one coal miner without any ongoing access regime — access is currently governed by contracts entered into prior to privatisation, resulting in uncertainty for other coal producers.
- Glencore expressed scepticism about the benefits of privatising port infrastructure, with the short-term benefit to government revenues from asset sales and leases offset by the long-term cost imposed on users of the infrastructure. It argued that:

In every instance of monopoly coal chain infrastructure being sold into private ownership in the last ten years there has been an associated significant increase in the cost of access to that infrastructure, through both the imposition of higher access charges and/or the reallocation of risk back onto the users of the infrastructure. (sub. DR64, p. 1)
- Mining companies commented on their dealings with rail provider Aurizon, formerly QR National, which was privatised by the Queensland Government in 2010. Xstrata Coal (now Glencore) stated that Aurizon, as an owner of rail track and operator of rail haulage services, 'has a strong potential to deny access to competitors or extract monopoly rents to protect its position in an upstream or downstream market' (sub. 19, p. 9). Xstrata Coal considered that the natural monopoly characteristics of the rail track were what had led governments to invest in the infrastructure, and that privatisation of the infrastructure necessitated a robust access regime.
- Xstrata Coal (sub. 19) suggested that if the ARTC (owned by the Australian Government) were to be privatised, and no adequate access regime were in place, it could be detrimental to the coal industry in New South Wales.
- CBH Group considered that there was insufficient transparency around the lease arrangements under which operation of Western Australia's grain handling rail network was privatised.

We're the only user of the grain network but we don't know the performance standards of the grain network ... Or the maintenance standards, or what investment proposals are put forward on all sorts of things. (trans., pp. 19–20)

Unanticipated regulatory measures applied after contracts have been signed can undermine investor confidence in governments' commitments, potentially leading to reduced interest in any future privatisation initiatives. A well-designed regulatory regime that is conceived ahead of any privatisation can inform expectations for all parties, and provide an environment conducive to ongoing investment within the infrastructure sector and its dependent markets.

There are tradeoffs between providing regulatory certainty and ensuring that policymakers have sufficient flexibility to handle changing market conditions and address unforeseeable problems. Guidance on what principles a regulator will employ when making decisions (including, for example, how it might balance investors' and infrastructure users' interests in resolving disputes) is likely to be more responsive to emerging challenges than prescriptive setting of terms and conditions between parties (Kessides 2005).

Some participants considered that governments should be required to consider regulatory arrangements upfront when privatising publicly owned infrastructure. For example, Gilbert + Tobin proposed that:

... the COAG framework should be amended to require State or Federal Governments to consider the establishment of access arrangements at the time of any project approval or privatisation process with scope for investors and/or market stakeholders to be consulted in relation to any such decision. (sub. 45, p. 3)

Additionally, CBH Group considered that the NCC should review proposed access arrangements for privatised infrastructure, and that 'any NCC findings or recommendations are actually implemented prior to an access regime being confirmed and the relevant infrastructure then being privatised' (trans., p. 6).

Clause 4(3) of the CPA sets out matters that governments should consider when privatising publicly owned monopolies. These include the merits of structurally separating competitive and monopoly aspects of the enterprise, and the types of regulation that may be required to promote efficient outcomes. These principles remain relevant today, and should continue to guide governments' privatisation plans. Gilbert + Tobin observed that clause 4(3) contained no specific reference to access arrangements, although such a reference could be 'regarded as implicit' (sub. DR70, p. 2). As the CPA is a statement of principles and not 'black letter' law, the added value in explicitly citing access regulation in clause 4(3) appears limited. The Commission does not see a need at this time to supplement clause 4(3) with any additional requirements relating to privatisation.

Regulatory considerations for greenfield infrastructure

As with privatisation, investment decisions for greenfield infrastructure will be affected by the regulatory framework in place, or expectations about what regulatory arrangements will apply. The more certainty there is about how regulation will be used, the stronger the basis will be for investors to make decisions regarding new infrastructure projects.

Some participants considered that new initiatives were necessary to improve regulatory decision making for greenfield infrastructure. As noted above, Gilbert + Tobin (sub. 45) proposed that COAG require all governments to consider access arrangements as part of project approval processes for new infrastructure. Similarly, the Minerals Council of Australia (sub. DR74) considered that access terms for new infrastructure in multi-user commodity supply chains (see below) should be clearly set out as part of project approval processes. This would replicate the role played by clause 4(3) in relation to privatised infrastructure — at this time, no equivalent exists for greenfield infrastructure.

In principle, the Commission acknowledges the value of governments considering what, if any, regulatory arrangements should be introduced as part of project approval processes. However, getting the regulatory settings right for greenfield infrastructure is challenging. Chapter 8 notes the difficulties associated with assessing potential competition effects (whether for the infrastructure service, or in dependent markets) in advance of a new facility coming online. The precise operation of a proposed facility, and how it would handle access seekers, may not be known at the time of an initial investment or when project approval is sought. Introducing regulation may deter investment if the imposed conditions are inappropriate — whether due to an inadequate return on investment from the proposed infrastructure facility, or because the hurdle for access would be too high for any prospective access seeker.

Notwithstanding the above, it is likely to be in the interests of governments, infrastructure investors and prospective access seekers to establish effective regulatory frameworks *ex ante* where it is appropriate and feasible to do so. (Chapter 8 discusses some options for facility-based access arrangements. Additionally, the ineligibility provisions available under the Regime could provide certainty for investors in ruling out the prospect of particular infrastructure services being declared.) Whatever policy tool is used, the aim should be to provide investors and infrastructure users with as much certainty as possible, as early as possible, in preference to resolving regulatory failures after the fact.

Coordination within multi-user commodity supply chains

Commodity exporters may require access to linked but separately operated infrastructure as part of their supply chains: for example, rail lines to transport output from mines, and port terminals from which the commodity can be exported. In some cases, rail and port facilities are owned and operated by the miners themselves — for example, BHP Billiton, Rio Tinto Iron Ore and Fortescue Metals Group all maintain their own rail and port infrastructure. However, on Australia’s east coast, such infrastructure is typically shared between multiple users, with a mix of ownership and operation. As outlined in box 10.5, several inquiry participants commented on the difficulties associated with coordinating infrastructure investment and use across supply chains where there are multiple infrastructure services, providers and users. While negotiations between infrastructure service providers and users regarding supply chain coordination may involve setting terms and conditions of access, coordinating the investment and use of infrastructure services is not, of itself, a problem that the Regime is intended to address.

Several factors complicate coordination in multi-user supply chains: forecasts of supply and demand, risk preferences, the life cycle of core assets and access to capital markets can all vary across infrastructure service providers and users. These factors will in turn affect the judgments of providers and users about when and what types of capacity expansions should be undertaken. Strategic behaviour may also lead some parties to hold out on investing to encourage other parties to bear a larger portion of the project cost and risk, or to extract other favourable terms. Hence, the larger the number of parties that must sign an agreement, the more complicated the negotiations will be — and the more likely that new or expanded supply chain infrastructure will be delayed beyond the ‘ideal’ investment time (taking account of the lengthy lead times from project inception to delivery that are associated with large-scale infrastructure projects).

Citing the misalignment of interests that can occur in multi-user supply chains, some participants called for the development of specific investment coordination mechanisms. Anglo American Metallurgical Coal (sub. 44) and Xstrata Coal (sub. 19) suggested that the establishment of independent supply chain coordinators should be mandatory, with the guiding terms and principles for each coordinator being negotiated by service providers and users, or imposed by the regulator or minister in the event that negotiations fail to reach agreement. By contrast, Aurizon suggested that ‘what are perceived to be coordination failures in export supply chains ... are often simply signs of competition itself’ (sub. DR72, p. 19) — a consequence of the commercial interactions between multiple service providers and users, in contrast to the centralised decision making inherent in single-user integrated supply chains.

Box 10.5 **Multi-user commodity supply chains: what's the problem?**

Rio Tinto Iron Ore summarised what it perceived as the core problem for multi-user commodity supply chains:

[Coordination] difficulties across stakeholders with varied interests impacts upon investment and multi-party use creates little incentive for producers to invest directly in infrastructure where others benefit or are able to crowd the investor out. As a result, they were not able to change operations and expand as quickly to the changed market conditions and so were not able to take full advantage of the export growth opportunities that arose. (sub. 8, p. 24)

The Minerals Council of Australia pointed to 'delayed and asynchronous expansion of port and rail capacity, inefficient use of existing capacity and patchy regulation of infrastructure owners' (sub. DR74, p. 4). The Department of Resources, Energy and Tourism (sub. 46) observed that coal producers seek to maximise profits by expanding capacity to meet global demand while maintaining low freight costs; while rail track and port owners want to increase the rate of return from users, which may not align with capacity expansion.

BHP Billiton (sub. 29) cited its experience in Queensland's Dalrymple Bay coal chain, where actual capacity in the system has consistently fallen short of what some elements of the chain are notionally capable of handling. BHP Billiton also noted that capacity expansion approaches can vary between different elements of New South Wales's Hunter Valley coal chain: port expansions are triggered by preset contractual thresholds, while rail expansions are the decision of the track owner (box 10.6).

Aurizon (sub. DR72) observed that distortions arising from policymakers' interventions in regulated aspects of the supply chain could also have adverse implications for competitive, unregulated components of the chain. Aurizon stated that its rail haulage business in the Hunter Valley was 'forced to operate inefficiently over-powered trains' as it found that the regulated access charges for the rail track favoured trains running more locomotives than necessary for the maximum number of wagons per train that the rail track was capable of handling (sub. DR72, p. 21).

The ARTC, which provides access to the rail track used in the Hunter Valley coal chain under an access undertaking approved by the ACCC, considered that:

... failure of other un-regulated elements of the coal chain to act to support the wider coal chain objective can undo any good outcomes that might arise through the application of [rail-specific access arrangements]. (sub. 20, p. 20)

In response to this criticism, the ACCC (sub. 43) noted the importance of maintaining contracts with all service providers that consider capacity constraints across the supply chain as a whole, rather than within its individual components.

Effectiveness of government intervention in multi-user commodity supply chains

There are mixed views on the effectiveness of existing models of regulatory intervention in commodity supply chains. For example, the Minerals Council of Australia (sub. 26) commended the improved supply chain management and

investment conditions in the Hunter Valley (box 10.6). However, other participants were dissatisfied with the capabilities of the Hunter Valley Coal Chain Coordinator (HVCCC). For example, although BHP Billiton (sub. 29) acknowledged capacity constraints had eased since the introduction of the HVCCC, it argued that the rail network still operated at 13 to 15 per cent below contracted capacity. BHP Billiton suggested a cause for this underperformance was that ‘there is little if any prospect of clearly identifying and allocating responsibility for shortfalls’, which reduced incentives for improving service provision (sub. 29, p. 21).

Xstrata Coal was critical of a similar model used in the Dalrymple Bay coal chain, noting that ‘progress has been slow with limited discernible improvement in coordination and looming capacity shortages’ (sub. 19, p. 16). Gilbert + Tobin suggested that the measures in the Dalrymple Bay coal chain have ‘proved largely ineffective to date’ (sub. 45, p. 8). A possible explanation for the problems in the Dalrymple Bay coal chain is that, as the Department of Resources, Energy and Tourism (sub. 46) noted, coal export infrastructure is more dispersed in Queensland than in New South Wales, with partial interconnection between different Queensland coal chains.

The Commission’s view

There are risks associated with requiring participants in multi-user supply chains to accept particular structures for coordinating investment. As discussed in chapters 4 and 7, regulators (or other decision makers) will not have the same access to, and understanding of, information as infrastructure service providers and users. This information imbalance introduces the risk of costly regulatory errors. Moreover, as noted above, misdirected or poorly designed regulatory interventions can deter rather than encourage efficient infrastructure investment. Governments should be wary of imposing uniform or prescriptive mechanisms in complex negotiating environments, as the optimal approach will largely depend on the circumstances at hand.

Nevertheless, there may be scope for governments to remove regulatory barriers that obstruct efficient infrastructure investment. For example, the Association of Mining and Exploration Companies (sub. 4) expressed concerns about the quality of planning and approvals processes — a matter that the Commission is considering in its study of Major Project Development Assessment Processes (PC 2013b), and has examined in its recent inquiry into Mineral and Energy Resource Exploration (PC 2013c). In all circumstances, efficient infrastructure investment will depend (among other things) on a regulatory framework that is based on sound economic principles, provides procedural transparency, and maximises certainty of outcomes for all infrastructure investors, owners and users.

Box 10.6 The Hunter Valley coal chain

The Hunter Valley coal chain covers 35 coal mines, connected by 450 kilometres of rail track for coal haulage to export terminals at the Port of Newcastle. A surge in demand for coal exports in 2004 led to vessel queues off the Newcastle coast.

While the initial response to the coal chain issues was to manage the queues (through short-term capacity balancing systems authorised by the ACCC) until additional port capacity came online, the ACCC noted that there were long-term issues that needed to be addressed. These issues included infrastructure service providers contracting without considering the coal chain capacity as a whole; and the inability to use long-term contracts with individual users to underpin investments, due to the port's common user provisions.

A combination of measures has been implemented to help address capacity constraints in the Hunter Valley — the HVCCC, a Capacity Framework Agreement for the port, and an access undertaking under Part IIIA for the rail track.

Hunter Valley Coal Chain Coordinator

The Hunter Valley Coal Chain Planning Group was established in 2003 as an industry solution to the coordination issues in the coal chain. In 2009, this evolved into the HVCCC, which conducts day-to-day scheduling of coal exports in accordance with contractual obligations. It is also responsible for long-term capacity planning based on a system-wide view of the coal chain. However, the HVCCC's role is advisory only — it does not have the power to force rail or port operators to expand capacity.

Capacity Framework Agreement

In 2009, the ACCC authorised a long-term Capacity Framework Agreement for the coal terminals at the Port of Newcastle. The key features of the agreement include:

- provision for long-term ship-or-pay contracts to allocate capacity
- triggers for determining whether a terminal expansion is required, and the ability for operators to impose a levy on terminal users to facilitate capacity expansions
- principles to facilitate alignment of contracts with providers across the coal chain.

Australian Rail Track Corporation undertaking

The ARTC Hunter Valley access undertaking was accepted by the ACCC in 2011, and includes provisions related to allocating and investing in capacity.

- The ARTC must consult with the HVCCC on capacity allocation issues prior to proposing an access arrangement with an access seeker.
- The ARTC can seek industry approval of projects to expand capacity, and can obtain user funding for a project under certain conditions.

Sources: ACCC (2009a, 2011b); HVCCC (2009).

10.3 Further review of the Regime

Much of what has transpired since the Commission's first inquiry into the National Access Regime could not have been foreseen in 2001. This highlights the merit of periodic monitoring of the Regime's operation. The long-term efficiency consequences and effectiveness of the Regime as a whole require ongoing assessment.

In its draft report, the Commission proposed a further review of the Regime no more than ten years after the Australian Government responds to this inquiry. The Association of Mining and Exploration Companies considered this timeframe to be 'far too long for an issue that is critically important for the ... national economy' (sub. DR54, p. 2). Given the long lead-in times associated with new infrastructure projects, and the length of time that may be required to implement the Commission's recommended changes (if adopted), there is likely to be little value in undertaking a review before sufficient time has elapsed for evidence to emerge. The Commission considers that a further review of the Regime, including any related initiatives endorsed by COAG, would be warranted no more than ten years after the Australian Government releases its formal response to this inquiry's final report.

RECOMMENDATION 10.2

The Council of Australian Governments should commission a further independent review of the National Access Regime no more than ten years after the Australian Government has formally responded to the recommendations of this inquiry.

A Conduct of the inquiry

The Commission received the terms of reference for this inquiry on 25 October 2012. Following receipt of the terms of reference, the Commission placed notices in the press and on its website inviting public participation in the inquiry. Information about the inquiry was also circulated to people and organisations likely to have an interest in it.

The Commission released an issues paper in November 2012 inviting public submissions and indicating particular matters on which it sought information.

In total, 76 submissions were received. A list of submissions is contained in table A.1 (those submissions received after publication of the draft report are denoted in table A.1 with the prefix 'DR'). All submissions are available online at www.pc.gov.au/projects/inquiry/access-regime.

During the course of the inquiry, the Commission held informal consultations with governments, regulatory bodies, industry groups, as well as a number of companies and individuals (table A.2).

Roundtables were held in Melbourne on 12 February 2013 and Sydney on 13 February 2013 (table A.3).

The Commission released a draft report for public comment on 28 May 2013. It subsequently held public hearings in Perth on 16 July 2013, Sydney on 25 July 2013 and Melbourne on 29 July 2013 (table A.4).

The Commission would like to thank all those who contributed to the inquiry.

Table A.1 Submissions received^a

<i>Individual or organisation</i>	<i>Submission number</i>
Anglo American Metallurgical Coal	44, DR50
APA Group	35#, DR60
Asciano	15, DR62
Association of Mining and Exploration Companies	4, DR54
Aurizon	DR72
Australian Airports Association	3, DR61
Australian Competition and Consumer Commission (ACCC)	16, 43, DR58
Australian Energy Market Commission	21, DR75
Australian Pipeline Industry Association (APIA)	14, DR52
Australian Rail Track Corporation (ARTC)	20
Baxt, Bob	33#, DR53#
BHP Billiton	29, DR65
Board of Airline Representatives of Australia	2, DR49
Brisbane Airport Corporation	27
Brockman Mining Australia	DR67
Business Council of Australia (BCA)	36, DR69
Business SA	5
CBH Group	12, 47
Chamber of Commerce and Industry of WA	DR59
COAG Reform Council	DR76
Cunningham, Michael	18
Department of Infrastructure and Transport	37
Department of Resources, Energy and Tourism	46
Department of State Development, Business and Innovation (Victoria)	DR63
Energy Users Association of Australia	DR51
Federal Chamber of Automotive Industries	24*
Fels, Allan	40
GDF SUEZ Australian Energy	13
Gilbert + Tobin	45, DR70
Glencore (formerly Xstrata Coal)	DR64
Institute of Public Affairs (IPA)	23
Jemena	6
L'Huillier, Dominic	7
Law Council of Australia (Competition and Consumer Committee, Business Law Section)	32, DR68
Minerals Council of Australia	26, DR74
National Competition Council (NCC)	1, 9, DR48
Office of the National Infrastructure Coordinator	41
Origin Energy	11
Peabody Energy	30
Qantas	28*, DR66
Queensland Competition Authority (QCA)	38, DR57
Queensland Government	DR71

(Continued next page)

Table A.1 (continued)

<i>Individual or organisation</i>	<i>Submission number</i>
Queensland Treasury and Trade	42
RBB Economics	31
Rio Tinto Iron Ore	8#, DR55, DR73
Smart, Michael	10, DR56
South Australian Freight Council	22
Sydney Water	17
Treasury (Commonwealth)	34
Virgin Australia	39
Water Services Association of Australia	25
Xstrata Coal (now Glencore)	19

^a An asterisk (*) indicates that the submission contains confidential material NOT available to the public. A hash (#) indicates that the submission includes attachments.

Table A.2 **Visits and consultations**

<i>Individual or organisation</i>
ACT
ACT Government (Treasury Directorate)
Department of Infrastructure and Transport
Department of the Prime Minister and Cabinet
Department of Resources, Energy and Tourism
Department of Sustainability, Environment, Water, Population and Communities
Energy Networks Association
Ergas, Henry
Treasury (Commonwealth)
Xstrata Coal
New South Wales
Australian Energy Market Commission
Australian Grain Exporters Association
COAG Reform Council Secretariat
Department of Premier and Cabinet
Hunter Valley Coal Chain Coordinator
Independent Pricing and Regulatory Tribunal (IPART)
Infrastructure Australia
NSW Minerals Council
Rio Tinto Iron Ore
Steinwall, Ray
Treasury (NSW)
Northern Territory
Department of the Chief Minister
Department of Treasury and Finance
Utilities Commission

(Continued next page)

Table A.2 (continued)

Individual or organisation

Queensland

DBCT Management
Department of the Premier and Cabinet
GVK Hancock Coal
Queensland Competition Authority (QCA)
Queensland Treasury and Trade

South Australia

Australian Rail Track Corporation
Department of Environment, Water and Natural Resources
Department of Manufacturing, Innovation, Trade, Resources and Energy
Department of Planning, Transport and Infrastructure
Department of the Premier and Cabinet
Department of Treasury and Finance
Essential Services Commission of South Australia

Tasmania

Department of Treasury and Finance
Office of the Tasmanian Economic Regulator

Victoria

Australian Competition and Consumer Commission (ACCC)
BHP Billiton
Business Council of Australia
Department of Primary Industries (now Department of Environment and Primary Industries)
Department of Transport
Department of Treasury and Finance
Essential Services Commission
Everett, Sophia
Gómez-Ibáñez, José
Law Council of Australia
National Competition Council (NCC)
National Transport Commission
Port of Melbourne Corporation
Robinson, Ross

Western Australia

Brockman Mining Australia
Co-operative Bulk Handling (CBH Group)
Department of Finance
Department of Mines and Petroleum
Department of the Premier and Cabinet
Department of State Development
Department of Transport
Economic Regulation Authority
Fortescue Metals Group

Table A.3 Roundtable participants

<i>Organisation</i>	<i>Name of invited participant</i>
Melbourne — 12 February 2013	
Allen Consulting Group	FitzGerald, Vince
Allens Linklaters	Quinn, Verity
Ashurst	Mulhebach, Alice
Australian Competition and Consumer Commission (ACCC)	Pearson, Mark
Australian Competition and Consumer Commission (ACCC)	Schroder, Matthew
Department of Treasury and Finance (Vic)	Anthony, Geraldine
DLA Piper	Uthmeyer, Simon
Frontier Economics	Williams, Philip
Frontier Economics	York, Richard
Herbert Smith Freehills	Baxt, Bob
King & Wood Mallesons	Ridgeway, Stephen
Monash University, National Competition Council (NCC)	King, Stephen
National Competition Council (NCC)	Campbell, Ross
National Competition Council (NCC)	Feil, John
Queensland Treasury and Trade	Homan, Tania
RBB Economics	Siolis, George
Treasury (Commonwealth)	Gardner, Michael
Treasury (Commonwealth)	Kiang, Tommy
Sydney — 13 February 2013	
Australian Competition and Consumer Commission (ACCC)	Schroder, Matthew
Australian Competition and Consumer Commission (ACCC)	Sheppard, Sarah
Clayton Utz	Corrigan, Michael
Clayton Utz	Webb, Kirsten
Corrs Chambers Westgarth	Jones, Thomas
Department of Premier and Cabinet (NSW)	Hurst, Tim
Department of Premier and Cabinet (NSW)	Newman, David
Essential Services Commission of South Australia	Petrus, Nathan
Essential Services Commission of South Australia	Wilson, Adam
Gilbert + Tobin	Snow, Simon
King & Wood Mallesons	Leach, Wayne
National Competition Council (NCC)	Crawford, David
National Competition Council (NCC)	Feil, John
Queensland Competition Authority	Bilyk, Paul
Treasury (Commonwealth)	Lee, Tamara
Treasury (Commonwealth)	Thomas, Brenton
Treasury (NSW)	Rejante, Nin
University of New South Wales	Marks, Robert

Table A.4 Public hearings

<i>Individual or organisation</i>	<i>Transcript page numbers</i>
Perth — 16 July 2013	
Co-operative Bulk Handling (CBH Group)	3–27
Sydney — 25 July 2013	
Office of the National Infrastructure Coordinator	30–39
Anglo American Metallurgical Coal	40–55
Gilbert + Tobin	56–71
Smart, Michael	72–84
Melbourne — 29 July 2013	
Australian Competition and Consumer Commission (ACCC)	87–108
Baxt, Bob	109–115
Glencore (formerly Xstrata Coal)	116–130
Asciano	131–142
Aurizon	143–154
National Competition Council (NCC)	155–180
Australian Pipeline Industry Association (APIA)	181–191
Law Council of Australia (Competition and Consumer Committee)	192–209

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- 2009b, *Submission to the Department of Broadband, Communications and the Digital Economy: 'National Broadband Network: Regulatory Reform for 21st Century Broadband'*.
- 2010a, *Australian Rail Track Corporation Limited — Hunter Valley Coal Network Access Undertaking — Draft Decision*, March.
- 2010b, *Evaluating Infrastructure Reforms and Regulation: A Review of Methods*, Working Paper, August.
- 2010c, *Position Paper in Relation to the Australian Rail Track Corporation's Proposed Hunter Valley Rail Network Access Undertaking*, December.
- 2011a, *Co-operative Bulk Handling Limited Port Terminal Services Access Undertaking — Decision to Accept*, September.
- 2011b, *Decision in Relation to Australian Rail Track Corporation's Hunter Valley Rail Network Undertaking*, June.
- 2011c, *GrainCorp Operations Limited Port Terminal Services Access Undertaking — Decision to Accept*, June.
- 2011d, *Merger guidelines November 2008*, Canberra.
- 2011e, *Submission to the Productivity Commission's Inquiry into the Economic Regulation of Airport Services*.
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- 2012b, *Decision in Relation to Australian Rail Track Corporation's Hunter Valley Rail Network Access Undertaking — Initial Indicative Service Variation*, October.
- 2012c, *Viterra Operations Limited Port Terminal Services Access Undertaking: Decision to Consent to Variation*, May.
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- 2013c, *Co-operative Bulk Handling Limited's Port Terminal Services Access Undertaking: Decision to Consent to Variation*, August.
- 2013d, *Final Decision: Australian Rail Track Corporation's Proposed Variation of the Interstate Access Undertaking to Include the Southern Sydney Freight Line*, April.
- 2013e, *Wheat Export: Port Terminal Services Access Undertakings*, www.accc.gov.au/content/index.phtml/itemId/846439 (accessed 21 January 2013).
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