



Further Submission to

Productivity Commission

Review of the National Access Regime

***Issues arising from AusCID's appearance at the
public hearings***

The Australian Council for Infrastructure Development

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Representatives of the Australian Council of Infrastructure Development ("**AusCID**") appeared at the Commission's public hearings on its review of the National Access Regime on 7 June 2001. During the course of that appearance several issues arose which AusCID took on notice. This document provides AusCID's response to those questions. AusCID would be happy to elaborate further if the Commission thought that may be helpful.

An objects clause for Part IIIA of the Trade Practices Act 1974

As outlined in AusCID's June 2001 submission, AusCID is keen to see the introduction of an appropriate objects clause into Part IIIA. It suggested that the objects clause should not be used simply when an ambiguity arises in the interpretation of particular issues but should be a guiding principle in the interpretation of various matters arising under Part IIIA. AusCID was invited to propose some wording to achieve this.

Several methods have been used in legislation where provisions are required to be interpreted having regard to legislative purpose. Examples are:

- A sub-section sets out the relevant object and the sub-section or sentence following states, "*This Act has effect, and is to be interpreted, accordingly*"¹;
- A sub-section sets out the relevant section and the sub-section following states,² "*It is the intention of the Parliament that the provisions of this Act shall be interpreted so as to further the object set out in sub-section (1) and that any discretion's conferred by this Act shall be exercised so as to further those objects.*"²;
- A sub-section sets out the relevant object and the sub-section or sentence following states, "*In the construction and administration of this Act, regard shall be had to its objects*"³ or "*It is the intention of the Parliament that this Act shall be construed and administered, to the greatest extent consistent with the attainment of its objects.*"⁴

In its Tier One recommendations, the Commission recommended inclusion of the following objects clause:

"The objective of this part is to:

¹ See Weapons of Mass Destruction (Prevention of Proliferation) Act 1995 s.6;
Meat Inspection Act 1983 s.4;
Futures Industry Act 1986 s.3.

² Freedom of Information Act, 1982 s.3.

³ Home Deposit Assistance Act 1982 s.3;
Home Savings Grant Act 1976 s.3;
First Home Owners Act 1983.

⁴ Child Support (Registration and Collection) Act 1998.

enhance overall economic efficiency by promoting efficient use of, and investment in, essential infrastructure services; and

provide a framework and guiding principles for industry specific access regimes".

The adoption of this proposed form of objects clause provides equal consideration to efficient use of and efficient investment in essential infrastructure services. AusCID believes that this is the appropriate balance to be struck. AusCID noted in its submission to the Commission in response to the Position Paper that there is a significant difference in the effects of over-and under-pricing access to essential infrastructure services. This would suggest that the appropriate balance is one which treats as of equal weight efficient use of and investment in essential infrastructure services.

The approach which is taken to this objects clause is particularly important given that there is nowhere else in the Trade Practices Act where efficiency is given an explicit role. Elsewhere, competition is used as a proxy for efficiency on the basis that competition will usually lead to efficient outcomes. However, this will not necessarily be so and particularly not the case in the case of natural monopoly infrastructure.

For these reasons, AusCID supports the proposed objects clause remaining as drafted in the Position Paper. AusCID would be concerned by a reformulation of the objects clause which placed emphasis on the efficient use of essential infrastructure whilst preserving incentives for investment. Such an approach would not seem to be consistent with the policy balance reflected in the Position Paper and the respective consequences of over-and under-investment.

Access Holidays, Pre-investment and Framework Undertakings

The Commission asked AusCID to comment on how a framework undertaking would operate and our thoughts on access holidays for projects that are "contestable". Access holidays for "contestable" investments will only ever affect a relatively small number of investments, the value of which is dwarfed by the magnitude of investment in upgrading or expanding existing facilities, as well as those new projects which will fall outside the bounds of the contestable access holiday system. The Commission should consider that stimulus to investment provided by an access holiday system should not be limited to "contestable" investments.

On a general level, access holidays should not be used if the effect of a contestable process for access holidays is a bidding process for a monopoly which will then not be subject to any form of ongoing review for a lengthy period of say 20 years. Such a process is likely to distort the basis upon which the contestability of the project is assessed.

A broader system of access arrangements would increase certainty for investors, and reduce the "chilling effect" noted by the Commission. AusCID believes there should be a range of options open to the investor to gain greater certainty for a new investment.

These would be:

- The "contestable" access holiday.
- A pre-investment access undertaking.
- A pre-investment framework undertaking

These three methods offer good support for all types of infrastructure investment, while not providing long term monopoly rents to the investors, against the wishes of the community. Each method offers a different balance between certainty for the investor and the type of investment. A contestable access holiday offers the greatest protection, but only to investments that are new, and risky, and where long term monopoly rents will be difficult to extract. A pre-investment undertaking offers certainty of the terms of access. A framework undertaking would offer the least protection from regulatory risk, but would be easier and faster to implement.

A Contestable Access Holiday

In the course of AusCID's appearance at the Commission's public hearings, AusCID's comment was sought on a proposal that access holidays of some period would be available where the relevant project would be "contestable". The first question which arises is what it is that must be contestable in the relevant sense. If the notion of contestability is intended to be referable to the right to undertake a particular project for example the right to build, own and operate a particular project, such as the Tarcoola to Darwin rail infrastructure, then it would seem to be difficult to see how that notion of contestability could be applied to situations of new investment in existing infrastructure.

In this context, in referring to new investment AusCID is referring to new investment in the technical sense ie. not investment which is merely related to maintenance but a change in fixed durable inputs that does not simply seek to replace natural degradation of capital, but results in the actual creation of new sources of productive services. When defining what is to be considered as "contestable", AusCID believes that the most practical solution is to include only those investments that can demonstrate a competitive tendering process.

While the issue of the exact definition of "contestable" may be difficult to overcome, AusCID considers the Commission's concept of an automatic access holiday for a contestable investment has merit.

From an economic perspective, the contestability, or more precisely, a competitive tendering provision acts as a proxy determining investments that have a NPV of zero, after factoring in the expected effects on risk and revenue of an automatic access holiday. The effect of knowing that an automatic access holiday would be offered would push investments that would be otherwise considered too risky or unprofitable (NPV negative) over the line and ensure investment.

This system uses the advantages of a competitive market to ensure that not only does the most efficient firm win the tender but that the project is delivered at the earliest possible time, (i.e. the tender will be won by the first investor that believes that the investment is viable). From the perspective of the consumer, there are real gains to be had by having an infrastructure project completed earlier than would

occur without the holiday. For the investor, any losses involved with a "pull forward" effect are mitigated by the access holiday arrangement.

The period for any access holiday proposal should not be set by legislation. It is AusCID's view that the holiday should last for the expected time taken to repay the initial investment in the project including a reasonable, risk weighted return to the investor. This could be agreed ex-ante, to protect against claims that investors would "game" the system.

The acceptance of an access holiday should not be seen as an acceptance by the investor that their investment should be regulated. Once the holiday is complete, the investment should not be considered as declared for the purposes of IIIA, but subject to the same process as for any other investment.

However, there is no reason why *ex ante*, the investor and regulator could not agree to a pre-investment or framework undertaking to take effect after the access holiday is complete. This would, in practice, be very similar to the Petroleum Resource Rent Tax, which encourages a pre-determined benefit sharing arrangement between the investor and community, after the investor has gained a return on his investment.

Due to a perception that the regulator may attempt to "claw back" returns after the holiday has completed, AusCID would expect that many investors gaining an access holiday would want to enter into a pre-investment or framework undertaking. Any perception or attempt by the regulator to regain perceived super profits received during the holiday period is against the spirit of the access holiday concept, and also threatens to nullify any investment incentives that would result from the holiday provision.

Pre-investment Undertakings

In our previous submissions to the Commission we suggested changes to the current undertaking arrangements which would allow a pre-investment undertaking. This agreement between the investor and the regulator would allow the investor to know, before the investment was sunk, the price, terms and conditions of access that would be offered to access seekers.

In our previous submission to the commission we suggested that pre investment undertakings be reformulated:

AusCID's primary submission is that the reformulation of the undertaking criteria should make it explicit that an undertaking is designed to provide a framework for access arrangements and must include a dispute resolution mechanism. Included in the criteria for assessment of an undertaking should be:

- *an explicit requirement that the terms and conditions of access to the service covered by the undertaking promote the efficient use of, and investment in, the relevant facility;*
- *the pricing principles dealt with in Chapter 9 of the Position Paper;*

- *acknowledgment that the role of an undertaking is not to set up a specifically enforceable contract but to establish the framework for negotiation*⁵

Framework Undertakings

The Commission asked AusCID to give details of how a framework undertaking would work in a practical sense. We believe that a framework undertaking would provide investors with the opportunity to be able to plan and understand their exposure to regulatory risk, ex-ante. The framework undertaking would provide for the investor, at the very least the basic details that would underpin an access decision. The framework agreed between the regulator and investor must be enforceable, rather than just an indication of what the regulator is likely to do.

We would recommend that the framework undertaking should contain:

- a commitment by the regulator to specific values for the firm-specific components in the cost of capital calculations (especially beta and the cost of debt);
- alternatively, the regulator could commit in advance to allowing new investment into the RAB at projected cost *plus* a pre-determined premium to reflect the additional risk.

The choice between these two options will not affect the aim of the undertaking, both achieving greater certainty for investors and reducing the extent of regulatory risk. One of the major advantages of this model is that the regulator does not have to commit to an access pricing decision while the details of the investment are uncertain. This leaves the regulator with some scope to make an access decision based upon data that may not be available before the investment is made.

The key advantages of the framework undertaking are:

- Regulator does not have to commit to pricing decisions ex-ante
- A framework undertaking is less information intensive than other processes
- Decisions can be made more quickly by the regulator.
- Greater certainty for the investor, as compared to the current system.

AusCID believes that there is great merit in the Commission's proposal on access holidays. However, a limited access holiday system that only affects a small number of projects will not solve the problems faced by investors that the Commission has previously identified. A wider system for determining access is needed, which balances the investors need to minimise regulatory risk without providing excessive profits. We hope that the further detail provided in this submission on an objects clause and framework undertakings may assist the Commission in determining its final position.

⁵ AusCID, Further Submission on the National Access Regime Enquiry, p25