Legislation Review of Clause 6 of the Competition Principles Agreement and Part IIIA of the Trade Practices Act 1974 by the Productivity Commission

Submission by the Law Council of Australia

12 January 2001

Contents

1 Introduction

The issues raised in the Issues Paper generated significant debate within the Trade Practices Committee of the Law Council and a wide range of views were discussed. It is neither possible nor appropriate for this submission to reflect that diversity of views. This submission attempts to reflect a majority position on issues. In some areas where there was significant disagreement this has been noted in the submission.

1.1 Productivity Commission's three questions

The Productivity Commission posed three fundamental questions about third party access at its roundtables held in Melbourne and Sydney on 13 and 17 November 2000. The Law Council's answers to these three questions are set out below the questions in italics.

- What is the problem? Does it warrant a regulatory response?

The problem is access to infrastructure. The problem is not the earning of monopoly rents. The problem arises where a natural monopolist denies access to access seekers. A regulatory response is justified in limited cases, which are explained further in this submission.

- Is access regulation the appropriate answer to the problem, or are there other alternatives?

Access regulation is an appropriate answer to the problem. Section 46 of the Trade Practices Act is not a complete answer, because it has been suggested that the courts are ill-equipped to administer an access regime. If the policy decision is made that the earning of monopoly rents is also a problem, then the appropriate answer to that problem is some kind of prices surveillance legislation.

- If Australia decides to keep access regulation, how should it be improved?

This submission contains detailed suggestions about how to improve the current regime, including a new test for declaration of services.

1.2 Executive summary

Third party access regulation is a very intrusive form of regulation. It may have a serious impact on the dynamic efficiency of an industry, because it lessens the incentive to innovate and invest, and permits free riding on existing infrastructure. Regulation is also costly in itself.

Because of this:

- compulsory access to infrastructure should be granted sparingly, and only in cases where there is acknowledged to be a serious problem;
- there should be no unnecessary delay in the process by which access is granted;
- there should be some guidance as early as possible in the process as to the likely terms and conditions of access (including pricing).

The existing Part IIIA does not achieve these aims.

There are three main points made by the Law Council of Australia in this submission.

First, in accordance with generally accepted economic theory, the Hilmer Committee noted that vertically integrated natural monopolies have an incentive to deny access. Part IIIA goes beyond this. It catches activities that fall short of being natural monopolies and applies even though the facility owner is not vertically integrated. It also permits access to activities that have a minimal effect on the national economy and on the generation of competition. Part IIIA should be confined in its application to the original Hilmer problem.

Secondly, Part IIIA has been augmented to a large extent by industry-specific regimes such as those developed for telecommunications, gas and electricity. Industry-specific regimes address industry-specific issues more comprehensively than a generic access regime could ever do.

The Law Council is of the view that industry specific regimes should be encouraged to the extent that they are truly required to deal with industry specific issues. To the extent that issues are generic across industries, these must be addressed by the common principles in a revised Part IIIA.

Existing industry-specific regimes must be reviewed both periodically to determine if they are still necessary and, if changes are made to Part IIIA, to ensure consistency with Part IIIA.

The Law Council recommends that a modified Part IIIA be retained as a template for future access regimes that are industry-based; industry-specific regimes must comply with Part IIIA's policy blueprint before being adopted. Part IIIA will serve as a kind of 'bill of rights' for future access regimes, and as a 'fall-back' regime only for industries where no specific regime is in place.

Thirdly, the existing declaration process, involving at least three levels of decision making, has proved to be cumbersome and protracted. The Law Council recommends that the process be streamlined by removing the Ministers from the process, by inserting some general pricing guidelines in Part IIIA, and by requiring the National Competition Council ('NCC') to make more specific pricing principles and guidance on terms and conditions in its declarations. The Law Council recognises that it may not be politically acceptable to remove the State and Territory Ministers from the Part IIIA process. If the Ministers must retain their present roles in the declaration process, they should be required to consider the NCC's recommendation and to give reasons for their decision. If they fail to give a reasoned decision within the time period specified, they should be deemed to have declared the service.

1.3 Scope of this submission

Although the existing Part IIIA provides for four pathways to access (declaration, State regimes, industry codes and access undertakings), this submission is concerned primarily with the declaration pathway. Some comments about undertakings and certification are also made.

1.4 Structure of the submission

The submission repeats and responds to selected questions posed by the Productivity Commission in its Issues Paper prepared for this review. It does not repeat all of the issues which have been separately addressed in the Law Council's earlier Discussion Paper, a copy of which has already been provided to the Productivity Commission.

The Issues Paper questions are identified in the text below in bold italics in a box, with the page reference noted.

The Law Council's suggestions for changes to Part IIIA are printed in italics.

1.5 Hilmer Committee report

Before discussing Part IIIA in detail, it is helpful to reconsider the recommendations of the Hilmer Committee in 1993 and the subsequent Competition Principles Agreement.

The Hilmer Committee recommended:

> A right of access to a facility only be created if:
>
> (a) the owner agrees; or
>
> (b) the designated Commonwealth Minister is satisfied that:
>
> (i) access to the facility in question is essential to permit **effective competition in a downstream or upstream activity**;
>
> (ii) such a declaration is in the public interest, having regard to:
>
> (1) the significance of the industry to the national economy; and
>
> (2) the expected impact of effective competition in that industry on national competitiveness; and
>
> (iii) the legitimate interests of the owner of the facility will be protected by the imposition of an access fee and other terms that are fair and reasonable.
>
> Where the owner of a facility has not consented to a declaration, the Minister may only make such a declaration if 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. (emphasis added)

The report on which this recommendation is based contained three important points.

First, the existence of a natural monopoly of itself does not indicate an access problem. Where the monopoly owner is not vertically integrated it may have an incentive to allow access to maximise profits.[1] Secondly, access is only necessary where it will promote **'effective competition'** in upstream or downstream activities; a facility owner should not be forced to provide access where it will only generate an insignificant or trivial increase in competition. Thirdly, the terms and conditions of

access, including price, should be determined **early in the declaration process** by the Minister on the advice of the NCC.

1.6 Competition Principles Agreement

Clause 6 of the Competition Principles Agreement also required that the Commonwealth's legislative access regime would be confined to significant infrastructure facilities where 'access to the service is **necessary** in order to permit **effective** competition in a downstream or upstream market'.

2 Rationale for a national access regime: what was the Part IIIA access regime intended to do?

2.1 The nature and significance of the underlying problem

Should Part IIIA apply only to natural monopoly facilities? If so, how should natural monopoly be defined/assessed? Should the focus be on natural monopoly technology (eg rail infrastructure) in the broad, or more narrowly on situations where a natural monopolist has the scope to obtain significant monopoly rents? (p 22)

A natural monopoly is most often defined as the situation that arises where, through economies of scale or scope, the minimum size for an efficient firm is very large relative to the size of the market (demand). Accordingly, in a natural monopoly situation, it is generally economically efficient and socially desirable to allow one firm only to produce all the goods or services required. In these circumstances, competition is a less efficient market structure than monopoly, and would lead to the wasteful use of society's resources, rather than benefit consumer welfare.

Given the impact on the incentive to innovate and invest and the potential for new entry against non-monopolies, there is no reason for Part IIIA to apply to facilities other than natural monopolies. A definition of 'natural monopoly' is suggested in section 3.3 below.

'Natural monopoly' should not be defined to mean 'natural monopoly technology' – for example, rail technology may be natural monopoly technology even though the

[1] Independent Committee of Inquiry, *National Competition Policy* (1993) ('Hilmer Report') p 239 – 41.

owner of the technology may have no market power because roads and planes are effective substitutes for rail. The owner of natural monopoly technology in this sense has no incentive to deny access, even if vertically integrated, because it has no market power to protect.

Are there situations where denial of access would be desirable from the community's point of view? (p 17)

There are many reasons why denial of access could be desirable from the community's point of view. The most obvious reason is that the service to which access is sought has no economies of scale that would make duplication costly and the motivation for the application is that the access seeker merely hopes to free-ride on the investment of the access provider. Every day businesses refuse to do business with a potential supplier or purchaser. The reason may be as simple as that the incumbent believes that the applicant is untrustworthy. In brief, any situation that would lead a firm in a competitive market to refuse to do business is a situation where denial of access would be desirable from the community's point of view.

Should vertically integrated bottleneck facilities be treated differently than non-integrated facilities? Is the real concern underpinning access regimes denial of access, or the price and conditions of access? Are the two concepts separable from a regulatory point of view, or should they be addressed in tandem? (p 17)

All legislation is based on presumptions. Economic statutes only intervene in market processes if there is a strong presumption that the uncontrolled market process is likely to be inefficient.

Economic theory suggests that if the controller of the bottleneck is providing a natural monopoly service one may presume that a denial of access would be desirable from the community's point of view unless the controller is vertically integrated. The reason is simple: unless the controller is vertically integrated the denial is likely to be for reasons of economic efficiency.

This is not to say that unintegrated natural monopolies are likely to behave perfectly efficiently. On the contrary, they are likely to charge monopoly prices that have well-known efficiency problems. If this circumstance needs to be regulated, then a general access regime is not appropriate. This is because access is not the problem.

A vertically integrated natural monopolist is able to, and may have the incentive to, leverage its market power to insulate upstream or downstream activities from competition. It is able to restrict access to the facility so as to restrict competition in downstream or upstream activities. However, denial of access may be desirable from the community's point of view wherever there are significant economies of scope between the activity to which access is sought and the activity in which the access seeker would engage. To sacrifice those economies is a cost to society.

However, some of the Law Council's members have strongly expressed the view that the denial of access problem arises whether or not the natural monopolist is vertically integrated. In their experience, there are non-vertically integrated natural monopolists in Australia who have denied in the past, and continue to deny, access to their essential facilities even though it would be profit-maximising to grant access. Reasons given for this denial include the long-entrenched culture of former State-owned natural monopolists, and a lack of incentives for these firms to achieve commercial returns. Examples given include various owners of rail facilities that are not vertically integrated.

These members consider that it is not enough to base an access regime such as Part IIIA on economic theory; rather, the regime should address practical problems which have arisen in practice. They have reservations about whether it is possible to draft an effective definition of 'vertical integration'. In addition, it is argued that many of the effects of vertical integration can be achieved with contracting. If Part IIIA only applied to vertically integrated natural monopolies, it is argued, this might encourage disintegration and a consequential loss of efficiencies arising from vertical integration.

It was also suggested at the Sydney round table that from the point of view of economic theory, there is no difference between the incentives of a vertically integrated natural monopolist and a non-vertically integrated monopolist. A non-vertically integrated monopolist, it was argued, would achieve by contract what the vertically integrated monopolist would achieve by its integration. The effect of these contracts would be to share monopoly rents and/or to grant exclusive access to the natural monopoly facility. However, it may be that contracts of this nature would risk breaching one or more of the prohibitions of anticompetitive conduct in Part IV.

Part IIIA is an extraordinarily unwieldy mechanism to use to change the culture and economic incentives of these entities- this should be addressed by the relevant State governments and, if conduct breaches Part IV (in particular section 46), the ACCC.

The questions of denial of access, on one hand, and charging monopoly prices on the other, are two conceptually and practically separate issues. Where monopoly prices are the issue and cause inefficiencies that outweigh the inefficiency of price regulation, then they can be addressed by a separate pricing regime (discussed below). Where access is the issue, it should be addressed through an access regime. Pricing determined as part of an access regime should therefore not try to strip out monopoly rents unless a deliberate policy decision is made to do this, and a legislative mandate is given for this in the access regime.

Should Part IIIA focus on access provision, or more broadly on the exercise of monopoly power by owners of 'essential' facilities when dealing with access seekers? Would the latter require a change to the broad orientation of the regime, or could it be accommodated through the regime's detailed requirements? Could other parts of the TPA or prices control/surveillance provide a more effective remedy where access is generally provided, but at monopoly prices? If so, should access regulation focus on vertically integrated infrastructure providers? (p 21)

Part IIIA should focus on access provision. A necessary component of access provision is the price and other terms and conditions of access.

The appropriate regulatory response to a concern about the charging of a monopoly price is price regulation pursuant to a separate pricing regime, if a policy decision is made that monopoly prices are a problem. The current Prices Surveillance Act regime is being addressed by the Productivity Commission's separate review, and various issues have been identified as problematical in the interim report.

The appropriate regulatory response to restriction of competition in activities which are upstream or downstream from a natural monopoly is a mandatory access regime. Facility owners who are not vertically integrated should not be subject to Part IIIA, as there is unlikely to be a denial of access problem.

Section 46 of the *Trade Practices Act 1974* (Cth) ('TPA') prohibits the taking advantage of market power for an anti-competitive purpose. Section 46 does not prohibit the charging of monopoly prices. Further, where the court has been required

to set terms of future dealings in fashioning a remedy for contravention of section 46, it has rejected the proposition that the contravening monopolist should be required to supply at the price that would pertain under competition.[2] Many of the cases brought under section 46 have been 'access' cases.[3] Section 46 is available as a fall-back provision for access problems not covered by a regulated access regime. However, the courts are not ideal bodies for establishing and monitoring pricing or access regimes.

Should access regulation be in the form of a national regime, industry-specific arrangements, or a combination of both? In practice, would the outcome from a national regime as opposed to a series of industry-specific regimes operating under the same principles and broad rules be significantly different?

If a dual system were to be retained, would the current relationship between the national and industry regimes be broadly appropriate? Does Clause 6 of the CPA provide an appropriate link between them? (p 20)

The Hilmer Committee recommended that a generic access regime should be adopted, but in practice, Part IIIA has been superseded to a large extent by industry-specific regimes such as those developed for telecommunications, gas and electricity. This is because the bottlenecks in each industry are different and some industries such as electricity and gas have multiple users. Accordingly, the solution to overcome the bottleneck is seen to be different in each industry. *The Law Council agrees with the proposition discussed at the Melbourne and Sydney round tables that as far as possible the principles which are generic to all industries should be addressed in Part IIIA, with industry specific issues being addressed in separate regimes. Where the generic principles "tree" branches out into industry specific "twigs" will be a matter of degree for each industry.*

The Law Council does not support the indiscriminate enactment of quite similar regimes for different industries, such as the proposed Part XID (postal services). In general, industry specific regimes should use identical wording to Part IIIA and must be consistent with the fundamental principles and policy expressed in Part IIIA. In

[2] *ASX Operations Pty Ltd v Pont Data (Australia) Pty Ltd* (1991) ATPR 41-109. 52,666.
[3] For example, *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177; *ASX Operations Pty Ltd v Pont Data (Australia) Pty Ltd* (1991) ATPR 41-109; *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* (1999) ATPR 41-668.

relation to Part XID, it is not apparent that there are sufficient industry-specific issues to warrant an industry-specific regime and the adoption of different wording.

Consistently with the Law Council's view that regulation should be kept to a minimum, industry specific regimes should be reviewed regularly to check whether they are still needed, or whether the specific regimes could be 'wound back' into the generic regime. If the Productivity Commission recommends changes to Part IIIA as a result of this enquiry, the existing industry specific regimes based on Part IIIA should then be reviewed to see if changes are required to make the regimes as consistent as possible with Part IIIA.

The Law Council does not support having a diversity of regulators under the industry-specific regimes.

The Law Council does not support the proliferation of State-based regimes for single industries, for example in the case of rail.

Part IIIA should be retained as a template for future access regimes that are industry based. Industry-specific regimes should only depart as necessary from Part IIIA's policy blueprint before being adopted. Part IIIA will thus serve as the basis for future access regimes.

The current relationship between national and industry regimes is broadly appropriate, with clause 6 providing a link. If Part IIIA were amended to include an objects clause, Part IIIA itself could operate as the link between the various State and industry specific regimes, and there would be no need for clause 6. Clause 6's existence does add to the current confusion as it is similar, but not identical, to Part IIIA.

3 Improving the current national access regime

3.1 Objectives and coverage

Should the national access regime contain a clearer statement of objectives? What should these objectives be? Is promoting competition in related markets an objective in its own right? Or is it a means to fulfil broader objectives? (p 21)

A purpose or objects provision should be inserted into Part IIIA. The clause should make it clear that the purpose of Part IIIA is to facilitate the grant of access to

vertically integrated natural monopoly infrastructure in some circumstances, and not to strip monopoly rents from infrastructure owners.

Any test must make it clear who the intended beneficiaries of Part IIIA are, and how their welfare is to be promoted.

The interface between any Part IIIA objects clause and section 2 of the TPA must be carefully considered. The present section 2 does not make it clear which of the various beneficiaries listed in the section take precedence in a given situation or Part. It is also unclear whether the promotion of competition, fair trading and provision for consumer protection are the means to an end (the enhancement of the welfare of Australians) or goals in their own right.

If necessary, section 2 should be amended to make it clearer who the intended beneficiaries of the TPA are and how their welfare is to be enhanced.

Is the distinction between access to services provided by a facility, and access to the facility, important? (p 23)

Access is granted to a service that is provided by means of a facility. The facility must be of national significance. The definition of these terms is fundamental to the outcome of any application but leads to technical legal argument that may simply waste resources.

In the *Sydney International Airport* case there was considerable argument as to what was the relevant facility and whether the facility was narrower than the whole airport. The alternative definitions of 'facility' were: the concrete hard stands alone; the passenger and freight aprons adjacent to the international terminal; the combination of the hard stands, aprons and the international terminal together; and the airport as a whole.

The Law Council believes that the legislation should be amended to avoid this distinction and the technical legal arguments. The new declaration criteria suggested below avoid these problems, by referring only to 'service'.

3.2 Criteria for declaration

What modifications, if any, are required to the 'promotion of competition in related markets' criterion? (p 25)

Should there be a need to demonstrate that the provision of access would lead to a large increase in competition? Should there also be a requirement to demonstrate resulting benefits for end users? (p 26)

The Hilmer Committee recommended that **effective** competition be promoted.

In the *Sydney International Airport* decision, the Tribunal commented

> the notion of 'promoting' competition in section 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is, the opportunities and environment for competition given declaration, will be better than they would be without declaration.[4]

Access is permitted where it would merely promote some competition, however trivial or insignificant, in another market, rather than it being essential to permit **effective** competition in an **upstream or downstream market**. As presently interpreted by the Tribunal, a trivial increase in competition might justify mandatory access. Furthermore, an increase in competition in **any** market will justify mandatory access, whether or not the facility owner is competing in that market. The Law Council suggests that the criteria be amended to include a reference to the promotion of a substantial increase in competition. Some language is suggested for this below.

The Law Council believes that, wherever possible, the terminology used in Part IIIA should be consistent with the terms used in the rest of the TPA, because these terms have been interpreted by the courts and the Tribunal over 26 years and there is some certainty about their meaning. Accordingly, the test 'promote a substantial increase in competition in a market' has been suggested.

Is the requirement to distinguish the market(s) in which competition will be promoted necessary? (p 26)

Market definition is important to Part IIIA as currently drafted, because a service can only be declared if declaration would promote competition in a market other than the market for the service. However, the use of the term **'market'** also leads to

[4] *Sydney International Airport; Re Review of Declaration of Freight Handling Services* (2000) ATPR 41-754 ('Sydney International Airport decision') para 106#

unnecessarily technical distinctions being made about whether activities are within one market or another.

Assessing the effects of compulsory access on competition under Part IIIA depends to a large extent upon the definition of the relevant market. For example, a gas pipeline from a gas field to a city is arguably a natural monopoly that is also a bottleneck – gas producers rely on the pipeline to send gas to the distribution system in the city. It will not usually be efficiently duplicated. If the relevant markets are defined as the markets for the production of natural gas at a particular field and the consumption of natural gas, then access to the pipeline should promote competition in those markets. If the market is defined more broadly as the production of energy for domestic consumption, then compulsory access to the pipeline may have little impact on that wider market.

There has been considerable debate about the correct approach to market definition to be used by the NCC, the Minister and the Tribunal in assessing Part IIIA applications for declaration. The term 'market' must be construed in the same way under Part IIIA as under Part IV, involving product, geographic, functional and temporal dimensions. However, academic discussion about 'market' in Part IIIA has focused on the functional (or vertical) dimension of markets. One market is separable from another in the vertical dimension if either:

- there are no strong complementarities in demand or supply that would link the two stages; or
- there are strong complementarities between the two stages but these complementarities can be as efficiently accessed by contractual arrangements between two independent enterprises as they could be within a single enterprise.

The focus should be on the promotion of a substantial increase in competition in a market. The re-supply of the service sought to be declared should be excluded.

What modifications, if any, are required to the 'uneconomic to develop' criterion? (p 26)

This is an attempt to express in lay terms the economic concept of 'natural monopoly'. This 'translation' is vague and uncertain and has led to much debate about its meaning. It may cover activities that are broader than a natural monopoly.

The 'uneconomical to duplicate' criterion in section 44G(2)(b) is almost repeated in section 44F(4). The two criteria are treated as essentially the same by the NCC. The reason for the repetition is not clear.

This criterion is not necessary if a more precise definition of 'natural monopoly' is adopted; see section 3.3 below.

What is meant by national significance? What sorts of facilities clearly meet, or fall outside, this test? In seeking to delineate the national and State-based access regimes, could the national significance criterion leave important intrastate facilities outside the purview of any regime? (p 26)

The broad definition of 'facility' adopted by the Tribunal in the *Sydney International Airport* case meant that it was a relatively simple matter to conclude that Sydney International Airport was of national significance given the volume of freight that passed through the airport and was dependent upon the service.

In assessing national significance the Tribunal did not strictly quarantine the assessment of the significance of the freight handling facilities from the fact that they were located at Sydney International Airport. Thus, the freight handling facilities acquired greater significance than they otherwise would because of their co-location with other facilities at Sydney International Airport. Arguably, relatively trivial facilities became the subject of a Part IIIA declaration, quite inappropriately.

The national significance criterion is linked to the facility rather than the effect on competition or the service that is being declared. This is contrary to the Hilmer Committee's recommendation set out above and should be discarded.

The Law Council agrees that it is necessary to screen access applications using a national significance test. However, it recommends that national significance be included to assess the importance of the service to which access is sought.

Given the other criteria, is a specific public interest test in Part IIIA necessary? If so, should the legislation spell out the matters to be considered under the test? Should the focus of the test be on efficiency, or is this better spelt out in the overall objectives for the regime, with the test providing a way to take other issues into account? What guidance, if any, should be provided to regulators on the relative importance of particular public interest test considerations? (p 28)

The NCC has noted in its draft guide to Part IIIA that a key public interest consideration is the effect of declaration on economic efficiency. The NCC stated that it will always consider whether granting access would be economically efficient and in doing so the NCC will assess the benefits and costs of declaration.

It is also recognised by the NCC that if applied inappropriately, access could have an adverse effect on innovative activity and the incentives for investment. The NCC states that it will avoid applying the access regime in ways which may yield short-term 'static' gains in technical and allocative efficiency but which constrain the realisation of longer-term 'dynamic' efficiency gains. The problem is that this decision is not open to the NCC, because once declared, pricing is subject to negotiation by the parties and, if they fail to agree, is determined by the ACCC.

As well as potential dynamic efficiency losses, granting access may reduce economic efficiency if there are significant economies of scope between the activity to which access is sought and the adjacent activity. In these circumstances, access would increase society's costs of the whole (combined) activity, perhaps so much as to outweigh any increased gains from competition in the adjacent activity. There is value in having a criterion under which the costs of splitting an activity can be addressed directly, as it avoids arguments about the precise definition of the natural monopoly market as an end in itself.

Other public interest considerations which the NCC might consider include:

- ecologically sustainable development;
- social welfare and equity considerations including the maintenance of community service obligations;
- economic and regional development; and
- the interest of consumers generally, or a class of consumers.

There are strong parallels between the reference to 'public interest' in Part IIIA, the notion of 'public benefit' in Part VII's authorisation and notification procedures, and the references to 'public interest' in the Competition Principles Agreement. It is arguable that the 'public interest' in all of these extends beyond the use of purely economic criteria to include social welfare considerations.

Because 'public benefit' has a recognised meaning in Part VII, the same term should be used in Part IIIA. An express mention of economic efficiencies should be made in the test rather than in the overall objectives clause.

3.3 New declaration criteria

In order to overcome some of the problems identified in relation to the existing criteria and to link more accurately the wording of Part IIIA with the underlying bottleneck problem, the Law Council recommends the adoption of the following declaration criteria.

A service should only be declared if:

(a) the service is a natural monopoly ('natural monopoly service'); and

(b) the natural monopoly service is of significance to the national economy of Australia, taking into account:

(i) the importance of the natural monopoly service to constitutional trade and commerce; or

(ii) the importance of the natural monopoly service to the national economy; and

(c) the natural monopoly service is supplied by an entity that is also supplying goods or services upstream or downstream of the natural monopoly service; and

(d) access to all or part of the natural monopoly service is necessary to promote a substantial increase in competition in a market (excluding competition in relation to the re-supply of the natural monopoly service); and

(e) access is likely to result in a net public benefit, taking into account, among other things:

(i) economic efficiencies;

(ii) whether access can be provided at an economically feasible cost; and

(iii) where there is a safety requirement, that appropriate regulatory arrangements exist or can be implemented.

'Entity' may need to be defined to include controlled entities.

While 'natural monopoly' is well understood by economists, a definition of this term should be included in the legislation.. A possible definition is:

A service or the smallest group of services that can be most efficiently supplied by a single entity.

While the Law Council is not in favour of the indiscriminate use of industry- and State-specific access regimes, if these continue to exist, then a service should not be declared if one of these regimes already applies to the service.

3.4 Applying the new declaration criteria to the existing case law

In order to demonstrate the ambit or scope of the proposed amended Part IIIA, we have applied the new criteria to some of the pre-existing case law.

Sydney International Airport decision

Although the services supplied by the Sydney Airport Corporation Limited at Sydney International Airport satisfy the definition of 'natural monopoly', the application would not succeed.

First, the supplier of the natural monopoly service was not vertically integrated into the market for ramp handling services, an activity downstream from the activity of operating the airport. Secondly, the introduction of a new provider of ramp handling services was not necessary to promote a substantial increase in competition in a market - there was already effective competition in the relevant activities and the

introduction of one more ramp handler would not have led to a substantial increase in competition in any market. Thirdly, the natural monopoly service (the leasing of land for ramp handling at Sydney International Airport) would arguably not be of significance to the national economy, even though the airport itself clearly was.

Hamersley Iron case[5]

The application by Robe River would not have succeeded.

If the use of the railway line was a natural monopoly service, access to the line was probably not necessary to promote a substantial increase in competition in either iron ore mining or iron ore blending or shipping activities. Access might have been convenient, but was probably not necessary. Any increase in competition would not have been substantial.

If the whole mining – transporting – blending – shipping process was a natural monopoly service, access to the railway line would not be necessary to promote a substantial increase in competition in the downstream activities (the global iron ore markets). There would have been only a trivial or slight increase in competition.

In either case, the natural monopoly service was probably not of national significance.

Carpentaria Transport[6]

The relevant natural monopoly services was the use of the above-ground track. Queensland Rail carried out downstream activities (freight transportation). Carpentaria sought access in order to compete with Queensland Rail in relation to the same freight transportation activities. Granting access to the track would promote a substantial increase in competition. The natural monopoly service would arguably be of significance to the national economy, even though it was confined to a part of the State. Access would be granted.

[5] *Hamersley Iron Pty Ltd v National Competition Council* (1999) 164 ALR 203
[6] *Carpentaria Transport Pty Ltd* (1997) ATPR (NCC) 70-003

Austudy[7]

This application failed under the existing Part IIIA because a computer database might not be a facility, and was not of national significance.

This application would also fail under the new declaration criteria. The use of the database is probably not a natural monopoly service. Even if it was, access would not be necessary to promote a substantial increase in competition. The natural monopoly service would probably not be significant to the national economy.

Bunbury[8]

Although the Port of Bunbury was not the subject of a Part IIIA application, it illustrates how an application would be treated under the new declaration criteria.

The supply of towage in the Port of Bunbury would satisfy the definition of a natural monopoly service, but the port authority was not vertically integrated. A grant of access would be unlikely to promote a substantial increase in competition in the Bunbury market for towage services, as the Port could not sustain more than one tug operator in the medium to long term.

APRA[9]

Although APRA's activities were not the subject of a Part IIIA application, the facts of the case also illustrate how an application would be treated under the new criteria.

The crucial issue here would be which part of APRA's activities amounted to a natural monopoly. If the use of the database alone was a natural monopoly, access might be sought to it under the proposed new Part IIIA.

If APRA's licensing and enforcement activities were part of a natural monopoly service, then APRA did not compete in upstream activities (such as songwriting or performing) or downstream activities (such as running entertainment venues or radio stations), so access could not be sought.

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[7] *Re Australian Union of Students; Re Austudy Payroll Deduction Service* (1997) ATPR 41-573

[8] *Stirling Harbour Services Pty Ltd v Bunbury Port Authority* (2000) ATPR 41-752; [2000] FCA 1381 (Full Federal Court)

[9] *Australasian Performing Right Association Limited* (1998) ATPR (Com) 50-256

Conclusion

The new declaration criteria would only apply to a much smaller number of cases.

3.5 Negotiate/arbitrate issues

Is the emphasis in Part IIIA on prior negotiation between the parties likely to encourage efficient access arrangements, or better outcomes than would eventuate in an unregulated environment?

The so-called negotiate/arbitrate model of Part IIIA is not unusual to lawyers. It is well-known to litigators that some 90 per cent of litigation is settled prior to trial. In effect, the judge is only called upon to arbitrate at trial if the parties to the dispute cannot negotiate their way to a settlement. The courts have always been relaxed about this: models of negotiation suggest that settlement will only occur if it is reasonably close to the decision that a judge would be likely to reach if the matter proceeded to trial (otherwise one or other of the parties would find it in their interest not to agree to the settlement).

Some commentators have expressed concerns about leaving it to the parties to negotiate towards a settlement. In brief, the argument is that is that the parties may find that their interest lies in a monopolistic-type outcome. But the analysis of the normal negotiations of pre-trial settlements also applies to settlements that are negotiated under Part IIIA. That is, once clear rules are established by the ultimate arbitrator, the parties will always settle on outcomes that are reasonably close to the rules of the arbitrator. Efficient results (whether from negotiation or from arbitration) rely on the arbitrator's developing rules and practices that promote efficiency. If that occurs, negotiation will be fine.

What are the pros and cons of separating the decision to declare a service under Part IIIA from any subsequent arbitrated decision on terms and conditions? Would handling the two together always be feasible?

Would a half way house be to establish some pricing principles or indicative terms and conditions at the time of declaration, to provide some guide to the access seeker about whether it is worthwhile to continue pressing the claim? If so, how specific could any such prices or conditions feasibly be? (p 25)

One of the issues which arises because of the two stage process is that some issues which may ultimately prevent access being granted may not be dealt with in the

declaration stage, Stage 1, and so the parties may have to undertake both Stage 1 and the negotiate/arbitrate stage (Stage 2) before access is finally denied. For example, in the *Sydney International Airport* decision SACL argued that the Tribunal should consider issues to do with the viability of the access seekers. The Tribunal refused, saying that this was an issue that could be dealt with in Stage 2. The protected contractual rights issue raised in the *Hamersley Iron* case is another example of this. *Desirability and feasibility should be considered together to avoid the time and costs of Stage 2 if ultimately access is not feasible.*

The Hilmer Report recommended that the legitimate interests of the owner – including the imposition of fair and reasonable terms – be considered at the declaration stage.[10] The Hilmer Committee envisaged that the decision whether or not to grant access was entwined with the parameters of the access that would be granted and the terms and conditions of that grant, and that the NCC and the Minister should set those parameters. Declarations were contemplated as being applicable to either a particular user or a class of users.[11]

A very real problem with a two-stage procedure is that if an access provider is concerned with the price that the ACCC might eventually set, it will strenuously fight declaration because if the access seeker gains declaration, that will greatly weaken the ability of the access provider to bargain over price. The Law Council recognises that while it is not possible to provide detailed pricing guidelines which will be applicable in all situations, the problem identified can be partially addressed by providing some very broad guiding principles. These fundamental principles should go some way to allaying the fears of access providers about inappropriate pricing if they are subjected to arbitration.

This is compounded by the fact that the meaning of some of the terms used in the arbitration criteria in sections 44V and 44W are unclear. It is also uncertain whether all the criteria must equally be satisfied, or whether some may be traded off against the others.

The Law Council recommends that these issues could be addressed in two ways. First, the principles by which the ACCC must decide an arbitration must be made

[10] Hilmer Report p 252.

clearer so the parties can be more certain about the outcomes of an arbitration. Secondly, Part IIIA should be amended to provide some general pricing principles that must govern all access. These would include matters such as:

- *access pricing must not create incentives to delay or accelerate investment in infrastructure; and*
- *access pricing must reflect the level of risk associated with investment in infrastructure; and*
- *access pricing should not create incentives for inefficient by-pass of natural monopolies; and*
- *access pricing should encourage an efficient rate of use of facilities.*

The principles should not attempt to remove monopoly rents – this issue should be addressed by a separate pricing regime, if this is considered a problem.

In addition, the NCC should be required to produce situation-specific pricing principles and other general terms and conditions when making a recommendation for declaration. This would resolve the dilemma that exists at present; it is logically difficult to argue at the declaration stage, for example, that access would be economically efficient if it is not known what the terms and conditions of access will be.

3.6 Certification and undertakings

How well are the certification and undertaking mechanisms working? What improvements could be made to them? What are the reasons for the limited use of undertakings to date? (p 28)

As noted at the Sydney round table, there has been some convergence in the undertaking and certification procedures under Part IIIA in practice. Unfortunately, the similarities between these processes potentially lead to regulator-shopping, as the NCC and the ACCC each assess different access mechanisms, and to the proliferation of the State regimes.

[11] Ibid.

The Law Council considers that the numerous State regimes in national industries such as rail is potentially a far greater problem than the numerous industry-specific regimes.

3.7 Role of Ministers

Where are the main bottlenecks in Part IIIA processes? How might these be addressed? (p 31)

What are the pros and cons of Ministerial involvement in Part IIIA processes? Is involvement necessary to maintain support for a national access regime? Does it help to reduce the scope for regulatory failures? Is there sufficient onus on Ministers to justify departures from recommendations by the NCC? Would it be possible, or desirable, to provide for a greater onus in the legislation? What is the rationale for the different decision making structure for undertakings? (p 30)

There are at least three stages in the declaration process. This has led to double-handling and delay. After an application is made to the NCC for a declaration recommendation, the NCC has an unlimited amount of time to conduct its investigations and make the recommendation. The NCC and the parties may spend considerable time and resources in carrying out, and responding to, an enquiry. For example, when considering the application made by Robe River Associates for access to Hamersley Iron Pty Ltd's railway, the NCC not only prepared a discussion paper, but also commissioned a report about the feasibility of duplicating the railway.

At this stage, the process may be delayed by an interested party applying to the Federal Court for a declaration, for example, about the NCC's construction of the criteria in section 44G. Once the declaration is made, the relevant Minister considers the matter, applying the same criteria that the NCC used, under section 44H. The same kind of delaying tactic (seeking a Federal Court declaration) could be used at this point by an interested party. When the Minister's decision is known, within 60 days of receiving the NCC's recommendation, an appeal lies to the Tribunal, which must consider the matter afresh, exercising the same powers (and considering the same issues) as the Minister. Judicial review may also be available at various stages, further delaying the process. The Tribunal is not required to hand down a decision within any particular timeframe. When it does eventually hand down its decision the access seeker still does not have actual access, only a right to negotiate access, with a threat of ACCC arbitration if negotiation does not succeed. In the *Sydney*

International Airport decision the Tribunal did not hand down its decision until 15 months after the hearing, some 28 months after Australian Cargo Terminal Operators made its initial application to the NCC. This extraordinarily long time period is unacceptable.

The repetition of similar processes which an applicant must undergo in order to obtain an access declaration means that the applicant incurs substantial transaction costs. The various agencies involved will also incur substantial costs.

The repetition in the consideration of the criteria leads to the risk that the same issues will be addressed differently by each of the three bodies and any courts involved, leading to confusion about the criteria to be applied. There is no strict legal requirement that the NCC or a Minister is bound by their previous decisions. There are no provisions about how an application made under Part IIIA is to be accommodated or reconciled with an application made under another access regime, except where the Part IIIA decision maker has to take into account whether or not the service in question is subject to an effective access regime (section 44G(2)(e)).

Only the Minister has a time limit within which he or she must make a decision about access. While every access application is different, involving different issues and levels of difficulty of analysis, it would give applicants more certainty if the NCC and the Tribunal had limited amounts of time in which to assess matters and hand down their decisions. The NCC's initial estimates of assessment time of eight to 16 weeks now seem wildly optimistic. Time would also be saved if access seekers could choose to go directly to the Tribunal, with the ACCC acting as an assistant or 'friend' to the Tribunal, rather than having the ACCC arbitrate an access dispute and then having the parties re-argue the dispute in front of the Tribunal.

Not all of the access regimes which are linked to Part IIIA have as many stages or bodies involved. For example, the airports access regime under Part 13 of the Airports Act involves only the ACCC making an access declaration, and there is no appeal from this decision, although judicial review would probably be available.

Ministerial involvement in the process seems to add no value whatsoever. In many cases under Part IIIA to date, the Ministers have not even made a decision in the required time period. Ministerial reasons have been scanty and poorly explained, if

provided. State Ministers appear to ignore the NCC's reasons and do not follow its recommendations. Ministerial involvement appears to be simply a time-wasting element in the whole lengthy process.

The Law Council recommends that all Ministers should be removed from the declaration process. State and Federal governments already have some input through their appointments to the NCC and the ACCC.

The Law Council recognises that it may not be politically acceptable to remove the State and Territory Ministers from the Part IIIA process. If the Ministers must retain their present roles in the declaration process, they should be required to consider the NCC's recommendation and to give reasons for their decision. If they fail to give a reasoned decision within the time period specified, they should be deemed to have declared the service.

Strict but appropriate time limits should be imposed on all stages of the process (NCC, Ministers, Tribunal, Commission), recognising the degree of complexity of the issues.

Are additional measures needed to promote open and transparent procedures for decision making under Part IIIA? If so, what might these involve? (p 32)

The current arbitration process under Part IIIA and Part XIC involves much repetition.

The Law Council recommends that the ACCC's decision should be called a 'determination' and the process should be made more transparent, similar to the ACCC's Part VII process. The process should be changed so that multiple disputes over access to similar or identical services could be heard together.

4 Pricing issues

Should Part IIIA include some explicit pricing principles/rules? Is there a need to tailor pricing regimes to the circumstances of particular industries? Does this militate against going beyond the inclusion of broad pricing principles in the legislation? (p 33)

Pricing principles must be tailored to meet specific industry (or even case) situations. For example, it may not be politically acceptable to permit a vertically integrated

State-owned natural monopolist to price using the Baumol-Willig pricing mechanism, as this may permit the monopolist to continue earning a monopoly rent. However, in some cases, it may be economically efficient to allow a private sector owner of monopoly infrastructure to use this method of pricing.

As suggested above, Part IIIA should contain some general principles and the NCC should be required to produce more specific ones at the time of declaration.

Are access holidays an appropriate option for addressing some of the adverse impacts of mandated access on investment in infrastructure facilities? What scope does Part IIIA currently provide for such arrangement? Under an access holiday approach, what sort of investment should be eligible? Should the duration of the holiday be uniform, as for a patent, or dependent on the facility concerned? (p 35)

The Law Council's view is that it is preferable to restrict the scope of Part IIIA to situations where a problem actually arises – ie to the case of vertically integrated monopolies. However, if this suggestion is not accepted, 'access holidays' would be one way of alleviating the negative impact of third party access on investment. A guaranteed minimum duration of access holiday could be provided, to give some certainty to investors in infrastructure, with the opportunity of applying for extensions of this time. Access holidays must of necessity be situation-specific, depending on the investment in infrastructure, the likelihood of mandatory access being sought, and the nature of the industry.

The Issues Paper does not specify how access holidays might be granted. It should be noted that the undertaking process may not be a suitable process in all cases, as the process is a very public one. Where infrastructure is being developed in a competitive, confidential situation, such as telecommunications, it may be advisable to assess and approve an undertaking proposing an access holiday confidentially.

5 Implications for Clause 6, industry-specific access regimes and other regulation

Is there a need to ensure a greater consistency in the practical application of the principles for an effective State or Territory access regime? If so, how might this be addressed? (p 37)

The increasing number of State regimes and State regulators is a cause for concern, where there is no specific consistency in regimes for the same industry between

States, even if there is broad (clause 6) consistency. The proliferation of regimes increases uncertainty and impacts on incentives to invest. In addition, the extremely long periods of time which it appears to take to certify a State regime add to uncertainty for owners of (and prospective investors in) infrastructure.

It should be noted that even Part IIIA is not entirely consistent with clause 6.

The Law Council recommends that if clause 6 is retained, then inconsistencies between clause 6, Part IIIA and other regimes must be addressed.

If Part IIIA is retained, what should its relationship be to other parts of the TPA which an access seeker or provider might invoke? Are the current overlaps a problem, or does exposure to other parts of the TPA provide some protection against anti-competitive negotiated outcomes? Would it be possible, or desirable, to address the overlap issue by exclusion – that is, specify that matters covered by Part IIIA are excluded from consideration under other parts of the TPA? Do overlaps between Part IIIA and other pieces of legislation create problems which need to be addressed? (p 37)

Part IIIA seems to have been inserted into the TPA with little thought about how its objects and terminology interface with the rest of the statute. This leads to confusion about its purpose, operation and scope, and confusion about how its introduction has affected the purpose, operation and scope of the other parts of the TPA. This lack of forethought weakens Part IIIA and potentially the rest of the TPA.

In particular, the overlap between Part IIIA and Part VII (Authorisations and notifications) is unsatisfactorily unclear. For example, an access determination might specify certain price arrangements, and these arrangements could be agreed to by a number of participants in a market. The arrangements might amount to a price fixing agreement, but would the participants be 'immunised' from the operation of Part IV because of the determination under Part IIIA, or would they need to apply for a Part VII authorisation? If the parties had a Part VII authorisation would it be possible for an access application to be made over the top of the authorisation? The Commission does not have power to deal with access declaration issues, in many cases, and so it may not be able to deal adequately with these issues in the context of authorisation applications.

Some commentators and regulators are of the view that Part IIIA and Part IV/Part VII deal with 'completely different issues', and consequently consider that there is no

need to clarify the interface between Part IIIA and the other parts of the TPA. Section 46, for example, should remain 'in waiting' as a tool in the armoury of the ACCC to be used in cases of emergency. This is a naïve and impractical approach. Facility owners and access recipients must be given certainty about whether their actions in agreeing to terms and conditions of access breach other Parts of the TPA. Authorisation and notification applicants under Part VII are entitled to know whether some of the protection gained by their lengthy and expensive authorisation process could essentially be devalued by subsequent activity under Part IIIA.

The interface between Part IIIA and other legislation must be clarified to make sure there is no overlap. If access to an activity is obtained under Part IIIA through a determination by the ACCC, a registered contract or an undertaking, then no other access regimes should apply, and Parts IV and VII of the TPA should not apply in respect of the conduct covered by the determination, registered contract or undertaking.

Section 46 must be retained to deal with the problem posed by leveraging in cases where the facility owner has substantial market power but there is no natural monopoly, or where there is a natural monopoly but no vertical integration.

6 Contact details

For further information about this submission, please contact these members of the Law Council:

Louise Castle
Partner, Allen Allen and Hemsley
Tel (02) 9230 4609
Louise.Castle@allens.com.au