Legislation Review of

Clause 6 of the Competition Principles Agreement and Part IIIA of the Trade Practices Act 1974

Submission to the Productivity Commission

National Competition Council

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Abbreviations

ACCC	Australian Competition and Consumer Commission
ACTO	Australian Cargo Terminal Operators Pty Ltd
ARTC	Australian Rail Track Corporation Ltd
AUS	Australian Union of Students (1997)
Clause 6	clause 6 of the Competition Principles Agreement
CPA	Competition Principles Agreement
CTO	Cargo Terminal Operator
DEETYA	Commonwealth Department of Employment, Education, Training and Youth Affairs
ECPR	Efficient Component Pricing Rule
FAC	Federal Airports Corporation
IPART	Independent Pricing and Regulatory Tribunal of NSW
NCC	National Competition Council
NCP	National Competition Policy
NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NGPAC	National Gas Pipelines Advisory Committee
ORG	Office of Regulator-General (Victoria)
ORR	Office of Regulation Review
Part IIIA	Part IIIA of the Trade Practices Act
PAWA	Power and Water Authority (Northern Territory)
PSA Act	Prices Surveillance Authority Act
QCA	Queensland Competition Authority
QCMA	Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd (1976) 25 FLR 169

QR	Queensland Rail
QWI	Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd (1989) 167 CLR 177
RAC	Rail Access Corporation
RRIA	Robe River Iron Associates
SAIIR	South Australian Independent Industry Regulator
SAIPAR	South Australian Independent Pricing and Access Regulator
SCT	Specialized Container Transport
SIA	Sydney International Airport
TPA	Trade Practices Act
Tribunal	Australian Competition Tribunal

1 Executive summary

Australia entered the 1990s with an infrastructure base that seriously lagged world best practice. Years of government ownership, often associated with direct Ministerial control and inadequate governance, encouraged the inefficient use of resources, particularly in conventional public utilities. Controls over entry, that prevented competition in areas where it would otherwise have been feasible, perpetuated these inefficiencies, as market disciplines were not brought to bear on suppliers. As a result, costs were too high, prices were extensively distorted and service frequently poor.

The wider process of microeconomic reform made it apparent that these inherited inefficiencies needed to be addressed. Changes in governance, in many cases associated with privatisation or at least corporatisation, clearly had an important role to play in this respect. But changes in governance had to be paralleled by substantial reforms to the context in which suppliers of these services operate. In particular, moves needed to be made to allow competition to work as the regulator where it can and, in the areas where competitive disciplines cannot work, to impose regulatory controls that can protect consumers and promote efficient outcomes.

Consequently, during the 1990s, infrastructure industries in Australia were subject to enormous reform. The electricity, gas, telecommunications, water, rail, air services and port services industries have all progressed substantially along the path toward open markets and competition where feasible. In none of these industries is the reform process complete.

Throughout this reform process, governments have recognised that competition is not feasible in some areas of infrastructure industries and that the shared use of some (so-called bottleneck) infrastructure may be necessary to facilitate competition in markets that rely on this infrastructure.

Commonly during the early stages of the reform process, shared use of bottleneck infrastructure was managed administratively, taking advantage of the fact that much of this infrastructure remained in public ownership. So, for example, the emergence of competition in the electricity, telecommunications and national rail freight industries was managed through the public ownership of the south-east Australian electricity grid, Telecom Australia and Australian National.

The managed competition arrangements were always transitional. The Hilmer report suggested that full competition reform in Australia required the development of effective regulatory arrangements for bottleneck infrastructure. The report considered that while different infrastructure had different regulatory needs, any new regulatory

arrangements for bottleneck infrastructure should, as much possible, apply a common legal framework. The report recommended a new part of the *Trade Practices Act 1974* (TPA) to provide a legislated set of national rules for bottleneck infrastructure.

Part IIIA of the TPA was introduced in 1995. The National Competition Council (the Council) was created to, among other things, provide advice to governments on the design and coverage of access regulation under the aegis of Part IIIA. The Australian Competition and Consumer Commission (ACCC) was formed to, among other things, perform the role of national regulator of bottleneck infrastructure services. Part IIIA also recognised effective existing and prospective state and territory access regulation.

In accordance with the recommendations of the Hilmer report, Part IIIA was designed to provide a set of legal rules to support the negotiation of access between infrastructure owners and access seekers on commercial terms, wherever possible. But because Part IIIA was designed to provide rules in relation to particular (bottleneck infrastructure) businesses only, Part IIIA required a mechanism for identifying businesses that would be subject to the regime.

Under Part IIIA, declaration performs this coverage role. Declaration is a crucial process in setting and limiting the parameters of this national access regime.

Declaration provides a legally enforceable right to negotiate access to declared services. Where commercial negotiation of access to declared services fails, arbitration by the ACCC is available to resolve disputes.

Declaration is 'light-handed' access regulation, designed according to a pure negotiate/arbitrate model as outlined in the Hilmer report. But for some industries, where access seekers are likely to have relatively poor information on which to base negotiations and/or where many access disputes are likely, more prescriptive regulation is desirable. This is especially likely in the early days of access regulation when there is little experience with negotiating access. In these cases, Part IIIA allows for the development of effective industry specific access regimes, as assessed by the Council, and voluntary undertakings by an infrastructure owner, as assessed by the ACCC.

Part IIIA requires the Council to assess the effectiveness of state and territory access regimes against the guiding principles in clause 6 of the intergovernmental Competition Principles Agreement (CPA). This is done on two occasions:

- when an application for declaration of a service covered by a State or Territory access regime is considered; and

- when a State or Territory applies for certification of an access regime as effective.

Declaration is not available for services already covered by an effective access regime.

Undertakings under Part IIIA provide for an individual infrastructure owner to seek ACCC approval of its proposed access arrangements and gain protection from declaration. Because undertakings are voluntary arrangements, the criteria for their acceptance should allow for greater flexibility in the form of the access arrangement than provided for in the declaration and certification criteria.

1.1 Part IIIA so far

Part IIIA has been in operation for a little over five years. Considerable progress has been achieved in the appropriate application of access regulation according to a common framework.

In the electricity industry, the ACCC has approved an undertaking for transmission and distribution infrastructure forming part of the National Electricity Market (NEM). The Council's consideration of the Northern Territory electricity distribution access regime is at an advanced stage. The Council is currently considering an application for declaration of Western Australia's south-west transmission and distribution network.

In the gas industry, all governments have agreed to the implementation of a National Gas Regime and to seek certification of these arrangements by the Council. All governments have implemented the regime, and all, other than Northern Territory and Tasmania, have applied to the Council for certification.

In rail transport, there has been limited national agreement on access regulation. Consequently, most applications for declaration have related to rail services. While no declarations have been put in place, every successful applicant for a declaration recommendation has subsequently negotiated the access (or increased access) originally sought. Further, positive declaration recommendations (and subsequent applications for review of Minister's decisions) have stimulated the development of state and territory rail infrastructure access regimes. In 1997, Governments agreed to a single process provided by the Australian Rail Track Corporation (ARTC) for access to track by interstate train operators. This has not yet been realised and the slow development of these arrangements has impeded the development of effective (and compatible) regulation of intrastate rail services.

Australia's major airports have been brought under the aegis of the *Airports Act 1996* and Part IIIA as they have been privatised. International air-freight handling related services at Sydney Airport have been declared.

Some port infrastructure has been regulated under Part IIIA. Victoria's access regime for commercial shipping channels has been certified as effective, while applications for certification of other port infrastructure is expected.

In the water services industry, it would appear that access regulation would be appropriate for some infrastructure, but as yet, no applications under Part IIIA have been made. One reason for this may be that, until property rights and pricing reforms under the CoAG water agreements are completed, there is limited need for access to transmission services.

Access to telecommunications, postal and financial payments clearing systems is regulated outside Part IIIA; and Part IIIA mechanisms are generally not available.

The Council's Part IIIA processes have been conducted with substantial input from interested parties. Generally these have been conducted in a timely fashion. Declaration processes have taken on average 6 months from receipt of application to the Minister's decision (or deemed decision). The National Gas Regime provides an effective model for resolving coverage issues in an even more timely way. Certification processes have taken longer, reflecting the complex legal, economic and public policy issues that need to be resolved in developing effective access regulation.

Progress with the development of access arrangements under Part IIIA to date has increased certainty regarding the scope of application of Part IIIA. Because declaration is a driver for the development of Part IIIA access arrangements, greater certainty in the interpretation and application of the declaration criteria has appropriately confined Part IIIA to the regulation of bottleneck infrastructure. In particular, in the Sydney Airport case, the Australian Competition Tribunal (ACT) confirmed that:

- the 'uneconomic to develop another facility' criterion is a test of whether the development of competitive infrastructure is contrary to the interests of the whole community because the infrastructure has natural monopoly characteristics; and

- the 'access would promote competition in another market' criterion is a test of whether access regulation would overcome structural impediments to effective competition in a market that relies on the relevant infrastructure service as an input to that market.

The effective regulation of access to bottleneck infrastructure services is inevitably difficult and complex. Further, because access regulation involves sensitive issues associated with long-term investment, both in bottleneck infrastructure and activities that rely on that infrastructure, immediate dramatic results cannot and should not, be expected.

Major changes to the architecture of Part IIIA would appear to be inappropriate, given that:

- it has been in place for a relatively short period of time;
- there has been significant progress to date in its application;
- it appears to be capturing (and only capturing) the sort of infrastructure intended; and
- it should be applied with a long-term view of appropriate outcomes.

Nonetheless, some changes are desirable. These are summarised below.

1.2 Declaration

Exemptions in the definition of a Part IIIA service in relation to the supply of goods and production processes appear to have been intended to focus the application of Part IIIA. In the light of experience to date, the continued need for these exemptions should be examined.

The Council considers that s.44G(2) of the Trade Practices Act should be amended to reflect the same test as provided in the clause 6 principles. Clause 6 provides for an appropriate test of materiality that ensures consistent application of access regulation for significant facilities.

Part IIIA contains few restrictions on the time in which applications for declaration must be finalised. In comparison, the National Gas Regime provides defined time limits for regulatory processes, with some flexibility to extend when necessary. The Council considers that defined time limits should be imposed in relation to declaration.

The Council's experience in declaration matters suggests that a limit of four months on the Council's process, from the time of application to forwarding the recommendation to the Minister, would be appropriate. A similar time limit should apply for the Tribunal if a decision is to be reviewed. However, it would be desirable to incorporate a mechanism allowing these periods to be extended, should this be necessary due to the complexity of an application.

The Council considers that the current sixty-day limit for the Minister to make a decision on declaration is appropriate.

1.3 Arbitration

There are a number of issues that generate concern about the way in which the terms and conditions of access are resolved for declared services:

- first, access seekers have relatively little information to draw on in negotiations with infrastructure owners;
- second, delays in access negotiations tend to operate in favour of the infrastructure owner; and
- third, there remains considerable uncertainty about the likely outcome of any access dispute.

These issues are likely to work themselves out over time, at least to some extent.

However, there are also a number of changes that could be made to Part IIIA which would enhance the speed of dispute resolution and provide parties with greater incentives to reach a negotiated outcome.

First, more information should be made available to access seekers on likely arbitrated outcomes for declared services. This could be done by either:

- a declaration recommendation identifying categories of cost information which the service provider is obliged to provide to the access seeker and to the ACCC within 60 days of the declaration taking effect; or
- conferral of power on the ACCC to require provision of cost data to an access seeker at the point when an access dispute is notified.

Second, there appears to be some scope to consider whether current arrangements for the arbitration of disputes concerning declared services strikes the appropriate balance between commercial confidentiality (especially for the infrastructure owner) and providing information to the market on likely arbitration outcomes in the future. One approach could be for the ACCC to publish a report following an arbitration decision which provides details of the methodology used, any relevant non-confidential material, and guidelines on common or likely issues in disputes.

A radical alternative would be to introduce a variant on the classic arbitration model and use a final offer arbitration structure to determine the outcome. As a commercial methodology it has much to

commend it. How far it can be utilised in the policy context of access regulation may be more contentious.

Third, guidance on appropriate pricing in the current criteria for arbitration could be replaced by a presumption in favour of an efficient costs approach. This presumption could be rebutted by showing that, in the particular circumstances, the use of that cost standard would be inconsistent with the promotion of economic efficiency over the longer term. Unless that rebuttal could be made out, the arbiter would be required to apply an efficient cost standard.

1.4 Certification

It would seem desirable for a review process akin to certification to be brought to bear on Commonwealth regimes that have been established outside of the Part IIIA framework: for example, the telecommunications provisions in Part XIC of the TPA, the postal services access regime and the arrangements with respect to airports set out in the *Airports Act 1996* and the PSA.

It is apparent that Parliament, in establishing these regimes outside of Part IIIA, intended them to differ from the economy-wide access arrangements. However, the community ought to have the opportunity to review these regimes in the light of the principles that the Commonwealth has viewed as required of the access regimes set out by other jurisdictions. More specifically, the Commonwealth should accept that even where they cannot achieve certification, the mere fact of periodic review of these regimes will clarify the scope and possible net benefits of moving to more uniform access arrangements nation-wide.

The TPA does not require the Council to make a certification recommendation within a specified time. Nor are time limits prescribed for the Minister or any review by the Tribunal.

The Council is concerned that the absence of time limits can create uncertainty for both access seekers and infrastructure owners. The Council's experience with certification applications suggests that a limit of six months on the Council's processes would be appropriate. A limit of four months could be placed on the Tribunal process, if a decision is to be reviewed. It is not necessary to allow time within the Tribunal's processes for jurisdictions to amend legislation and it is likely that the issues before the Tribunal would not involve an examination of the regime against all the clause 6 principles, only those in contention. A mechanism allowing these periods to be extended should be provided for use where needed due to the complexity of an application.

The Council considers it appropriate that a sixty-day limit apply to the Minister in making a decision.

1.5 Undertakings

There may be some benefit in providing greater guidance on what should be included within an undertaking. This guidance could draw upon the clause 6 principles, in a general sense, as well as the guidelines developed by the ACCC. The guidance would assist operators in developing acceptable undertakings and assist other interested parties in commenting on proposed undertakings.

It is not apparent why decisions with respect to undertakings should not be open to merits review. Relevantly, a State or Territory Government can apply for the review of a decision of the Commonwealth Minister not to certify a state regime as effective.

Undertakings cannot be accepted by the ACCC for a service already subject to declaration. Amending Part IIIA to allow for a voluntary undertaking to be accepted for a declared service could improve certainty for both service provider and access seeker.

1.6 Conclusions

The Australian access regime is an experiment in structural reform. It has brought significant reform as a wide range of activities has been brought within the scope of State, Territory and Commonwealth arrangements. Though it is difficult to link these changes to macro-economic outcomes, what analyses have been carried out of productivity trends suggest that substantial gains have been made.

These gains need to be preserved and where there is scope for further gains to be made, reform must be pushed ahead. There are areas, such as water, where the reform process is still in its early stages. The current framework can do a great deal to ensure that the momentum of reform is maintained and the scope of reform extended.

Despite their significant achievements, the provisions that embody the national access regime are relatively new. It is not apparent that there are serious deficiencies that, at this stage, would make a compelling case for altering the major features of the regime. Rather, it appears that progress has been made in clarifying the nature and implications of the regime.

This is not to say that the regime lacks critics.

However, closer examination suggests that the criticisms made largely lack analytical or empirical substance. They are frequently inconsistent and seem based on economic foundations that are very

weak indeed. As a result, the Council does not believe that the criticisms advanced have substantive merit.

There are, however, a number of areas where improvements could and should be made. These should not require changes to clause 6 of the CPA, but would require amendments to Part IIIA. These changes will help ensure that the national access regime, which forms a central element in Australia's policy of microeconomic reform, contributes as effectively as possible to the overall goal of achieving an efficient and competitive Australian economy.

1.7 The rest of this submission

The remainder of this submission is structured in the following way.

Section 2 reviews the nature of the regime defined by Part IIIA of the TPA and clause 6 of the CPA. It then turns to a discussion of the major criticisms that have been made of the architecture of the regime and as well as the specific criticisms of the declaration provisions in Part IIIA.

Section 3 outlines a number of relatively minor amendments that the Council considers would improve the effectiveness of Part IIIA.

Section 4 outlines the problems that access regulation is designed to address, and considers overseas and Australian responses, focussing on the framework in Part IIIA. The Council goes on to discuss the principles of efficient regulation and considers how effectively Part IIIA addresses these principles.

Section 5 describes the Council's and the Tribunal's approach to the declaration criteria and provides details of all applications considered by the Council and Tribunal.

Section 6 describes the Council's approach to the clause 6 CPA principles and provides details of all applications considered by the Council.

Section 7 describes a number of access regimes that exist either partially or completely outside Part IIIA.

Section 8 describes the different regulatory structural arrangements within Part IIIA, particularly those that exist within state and territory access regimes.

2 Major features of Part IIIA

2.1 Underpinnings of the current arrangements

Clause 6 of the CPA and Part IIIA of the TPA defined an ambitious reform program, aimed at enabling workable competition where it is possible, and otherwise regulating in a manner that improves economic efficiency while protecting consumers. These changes were seen as essential if Australia's infrastructure, and most notably those parts of it historically operated as vertically integrated natural monopolies, was to operate efficiently.

Inevitably, there were difficult choices to make, in the implementation of this reform program, about the degree to which reforms would be tailored to the characteristics of individual industries and to the views and circumstances of individual States and Territories. There are gains to differentiation, as this can both allow the closer matching of regulatory arrangements to varying contexts and permit some experimentation to occur. At the same time, however, differentiation imposes real economic costs.

- Ultimately, the productive factors used in the various infrastructure industries are fungible: the industries compete for resources both as between one another and with other uses, as do the various jurisdictions. Differences in regulatory treatment that distort that competition can lead to persistent inefficiencies in resource allocation.

- A proliferation of different approaches prevents the achievement of economies of scale and scope in the design and implementation of regulatory options.

- Uniformity of approach minimises the likelihood and costs of "regime conflicts" that might well arise when differing regimes overlap, as between industries and/or jurisdictions, and enhances the predictability of outcomes. And last but not least;

- Fragmented regimes are costlier to monitor and hence more vulnerable to capture by private interests.

Faced with these potential economic costs, the policy approach adopted sought to define a consistent framework, applicable to as wide a range of relevant infrastructure activities as possible, that could impose a unifying discipline on the reform process. The essence of that framework is set out in clause 6 of the CPA and in Part IIIA.

In understanding the framework that these instruments define, three elements are especially important.

Differentiation is a feature

The first is that the framework has always envisaged some degree of differentiation, as between jurisdictions and at least indirectly, as between industries. In this sense, Part IIIA is not intended to replace, but to guide and supplement, other regimes. Thus, while clause 6 of the CPA commits the Commonwealth to putting forward access legislation, it also defines criteria for State and Territory regimes. These criteria are wide enough to allow different application in different industries, and hence permit all jurisdictions to adapt the regimes they define to the circumstances of specific industries.

Addresses diversity of access situations

The second, related, element is that the framework can cover a wide range of access situations. Thus, at one end of the spectrum, the mechanisms are provided, notably through declaration, for resolving the more narrowly circumscribed access problems that arise when a refusal to allow third party use occasionally arises. At the other end of the spectrum, an entity may be involved regularly in contentious access issues. In these cases, the certification and undertaking mechanisms[1] provide means of ensuring that these ongoing access issues are resolved in conformity with a set of general principles.

Key goals

The third element is that in each of these instances that fall within the framework, the goal is not simply that of negating refusals to supply – a goal which, narrowly interpreted, could be achieved, albeit imperfectly, through s.46 of the TPA. Rather, against the backdrop of activities that have traditionally been provided as integrated monopolies, three inter-related goals are being sought:

- to define the boundaries between those activities that can be supplied competitively and those that genuinely cannot;
- to ensure that obstacles to competition are removed or at least ameliorated in the former; and
- to impose on the latter disciplines that can secure efficiency in investment and in operation.

Theoretical underpinnings

Each of the elements noted above has a strong underlying rationale. Thus, accepting some degree of differentiation, including in terms of differences between jurisdictions, reflects the reality that

[1] These processes are outlined in section 4 of this submission.

circumstances differ. Imposing a straight-jacket on the approaches adopted would impose needless costs – including in terms of some degree of competition as between regulatory approaches; rather, what is required is conformity to a clear set of underlying principles, with the implementation of those principles being responsive to varying contexts.

Equally, it is clear that third party access issues arise in a range of forms. One the one hand, there are specific, narrowly defined access disputes of the kind that arose in *Sydney International Airport; Re Review of Declaration of Freight Handling Facilities* (2000) ATPR 41-754 (the Sydney Airport case), in the application for declaration of certain rail services in Queensland (the Carpentaria case, NCC 1997c) and in the application for declaration of certain rail services in Western Australia, *Hamersley Iron Pty Ltd v National Competition Council and others* (1999) ATPR 41-705. Conversely, there are also the types of issues that arise in structuring continuing, open access systems such as those for gas or electricity transmission and distribution. A single mechanism – such as the declaration model, based on a negotiate/arbitrate process – cannot accommodate that diversity. Rather, the means must be provided both for handling the specific disputes and for determining standing frameworks more appropriate to on-going provision.

Finally, it is questionable whether any purpose would be served by an access regime that simply defined an obligation to supply, without also providing means for determining the terms and conditions of that supply. Any such regime would simply invite evasion, as the obligation could be undermined through the setting of terms that made access unprofitable or ineffectual. As a result, such a narrow construction of the purposes of providing for third party access would merely create further litigation: the courts, once an obligation to supply had been determined, would be thrust into the issue of defining the conditions for that supply; this is a task for which the court system is clearly very poorly suited.[2] The framework regime defined by the 1995 reforms therefore provides processes for setting the terms and conditions of supply.

A specific requirement is imposed that these be determined in such a way as not to compensate the access provider for those losses that are merely the consequence of exposure to competition. Together with the requirement that it is the *legitimate* aspects of the facility owner's

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[2] Indeed, if Part IIIA were to be seen as primarily a response to the inadequacies of judicial treatment exposed in the *Queensland Wire* case, as the proponents of a circumscribed view of Part IIIA allege, then the result of using Part IIIA merely as a tool for negating refusals to supply would ironically lead to the revisitation of those inadequacies.

interests that are taken into account – rather than any interests that owner may have – this makes it clear that the goal of the regime extends to the elimination of monopoly rents.

The framework is therefore broad-ranging in its scope and coverage, while being flexible in its operation.

2.2 Criticisms of the architecture of the regime

The range and depth of the regime inevitably invites questions as to whether mechanisms that are potentially so far-reaching are indeed required.

Four fundamental concerns, which merit some more detailed examination, have been expressed in this respect. These are:

- the scope of the current framework, which allows for entities that are not vertically integrated to be brought within the regulatory process;
- the extent to which mechanisms are really needed, in those instances where coverage is warranted, for determining the terms and conditions of supply; or conversely, whether it is sufficient to merely impose obligations to supply;
- the role the current framework assigns to the "negotiate/arbitrate" model, with the claim being made that this role is over-blown; and
- whether that wider coverage genuinely requires an integrated national framework; or conversely, whether specific regimes, defined on the basis of industry, jurisdiction or both, would be sufficient.

2.2.1 Vertical integration and its impact

Taking these concerns in turn, the view that entities that are not "vertically integrated" should be excluded from the scope of the regime seems to hinge on two errors of analysis.

The first is the assumption that vertical integration is a binary variable: that a firm is either vertically integrated, in which case it has both the means and the incentives to affect competitive outcomes downstream, or it is not. In reality, however, vertical integration is generally a matter of degree, as firms establish linkages between distinct steps in the functional chain through a mix of ownership and contractual mechanisms. For this reason, economists have long recognised that classical vertical integration – in which a single firm supplies two or more steps in a functional chain through facilities

under integrated ownership – is merely one form of the more general phenomenon of vertical control (Ordover 1990, pp127-42).

The problems of classification of a particular relationship as involving vertical integration are very real. In its recent consideration of coverage of the Eastern Gas Pipeline and revocation of the existing coverage of the Moomba to Sydney Pipeline, the Council was faced with a situation of common ownership issues. AGL, a downstream gas retailer owns 30% of Australian Pipeline Trust which in turn owns East Australian Pipeline Limited, the company which owns and operates the Moomba to Sydney pipeline. In a strict sense there is not vertical integration but there is clearly an ownership interest and AGL has overtly recognised its multiple layers of interests both directly in relation to its interest in APT and its other ownership interests in pipelines (NCC 2000b, 2000c).

The second, related error is that of believing that it is only the firm that is vertically integrated in the polar sense set out above that will have incentives to distort competition in dependent markets. From an economic point of view, this belief is simply incorrect.

Thus, it is true that a vertically integrated upstream monopolist may foreclose downstream rivals to monopolise the downstream market.[3] However, this result can be attained even in the absence of vertical integration. In effect, a vertically separate upstream monopoly can deal on an exclusive basis with the most efficient downstream firm, precluding all downstream competitors, and extract the chosen downstream firm's rents by means of a two-part tariff. The downstream firm earns zero economic profit while the upstream firm secures whatever rent is available in the dependent market. Ignoring the possibility that ownership affects managerial incentives and transaction costs, the resulting market structure, profits of the monopolist and prices paid by consumers for a vertically separate upstream monopolist charging a two part tariff will be no different from the structure, profits and prices of its vertically integrated counterpart.

Further, even if two part tariffs are ruled out, it is still true that a vertically separate upstream monopolist will charge an input price that does not attain efficient output. Thus, it is readily shown that an unregulated upstream monopolist, when it is not permitted to charge a two-part tariff, has no incentive to induce downstream firms to produce the efficient level of output.[4] The presence or absence of

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[3] This is not to say that the monopolist, even if vertically integrated, will always act this way: see Sibley, D. S. and Weisman, D. L. 1998, 74-93.

[4] See for example Valletti, T. 1998, 305-23.

vertical integration will, in other words, not reduce the social costs of monopoly power, including that component of those costs effected through the reduction in competition in dependent markets.[5]

Given these results, which are well established as a matter of economics,[6] the exclusion from the scope of the regime of entities that are not vertically integrated would have two effects.

To begin with, it would induce socially costly avoidance and evasion. Avoidance would occur as entities restructured merely so as to avoid coverage. This would result in once-off costs; additionally, the loss of economies of scope, and the possibility that the vertical separation would result in double marginalisation, mean that continuing social costs would be incurred. At the same time, the difficulties inherent in defining what is meant by "vertical integration" would incite evasion, as entities structured their affairs so as to 'walk the line'. The very great difficulties that have been faced, in the context of s.45A(2) of the TPA, in giving meaning to the concept of a "joint venture" highlight the extent of the problems that are likely to arise.

Secondly, such a restriction would allow behaviour that is socially costly to escape from the main remedy available in the Australian competition policy regime.[7] As no benefits to the community can be identified from this outcome, the rationale for making coverage dependent on the presence of vertical integration is extremely weak.

2.2.2 Whether an access obligation is sufficient

A second claim that has been made is that the regime is too far-reaching because it not only allows an obligation to supply to be imposed, but also provides mechanisms for determining the terms and conditions of that supply.

Taken as it stands, this claim is not easy to interpret. As has already been noted, merely imposing an obligation to supply would have little

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5 Indeed, to the extent to which vertical integration facilitates efficient price discrimination, the social costs of monopoly will be higher in the vertically disintegrated situation.

6 See, *inter alia*, Besanko, D. and Perry, M. 1993, 647-667; Bonanno, G. and J. Vickers 1988, 257-65; Dobson, P. and Waterson, M. 1994; Ordover, J. A. and Panzar, J. 1982 , 659-75; and Rey, P. and Stiglitz, J. 1988, 561-8.

7 The claim that this behaviour would be caught by the provisions of Part IV of the TPA is scarcely credible. Even abstracting from the real limitations of the relevant provisions, the claim fails to explain why Part IV would be sufficient to cure rent-taking in cases involving firms that were not vertically integrated, but would not be sufficient where the access provider was vertically integrated.

or no effect, as that obligation could be nullified or materially impaired by the terms and conditions imposed on access seekers. Few would argue that the courts are well-placed to remedy such conduct – all the more so given the great reluctance Australian courts have shown for getting involved in the setting of access charges.[8] As a result, the claim that this function ought not to form part of the regime must be associated with the proposal that it be exercised elsewhere.

One option in this respect would be to devolve that function to some form of price control – such as that exercised under the Prices Surveillance Act (PSA). Within this option, two possibilities are worth considering.

The first is that the price control would be exercised over the access service itself. It is not apparent what gains, if any, would flow from this, as all that would have been achieved would be to use two legislative instruments – access regulation and separately, price control – where one would otherwise suffice.

A second possibility is that the price control would be exercised upon some final good or service. The access charge would then most likely be determined by reference to that final price.

It is not easy to see any merit in this second possibility. To begin with, an important part of the rationale for access regulation is to eliminate, to the greatest extent possible, the need for downstream price control. This recognises the fact that the dependent activity is potentially competitive, and that controlling prices in that activity risks distorting price levels, price structures and price/quality combinations.[9] A move

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[8] The most notable instance where Australian Courts have ventured into the question of terms and conditions of access was in relation to the supply of electronic stock market information through "Signal C": *ASX Operations Pty Limited v Pont Data Australia Pty Limited* (1991) ATPR 41-069 41-109 (1990) ATPR 41-007; 41-038. In that case at first instance and on appeal breaches of s.46 of the TPA were found (although the breaches upheld on appeal were narrower in scope than those found at first instance). At first instance the trial judge imposed an obligation on ASX Operations Pty Limited to supply the electronic stock market information to Pont Data Australia Pty Limited essentially at a nominal price reflecting low supply costs and the imposition of some margin "similar to that charged by competitive suppliers in the data industry". On appeal, the Full Court of the Federal Court varied the orders by providing for previous terms and conditions of supply between the parties (i.e. the terms and conditions which applied prior to the infringing conduct) to be reinstated. Neither of these approaches provides a satisfactory basis for establishing terms and conditions for third party access.

[9] Experience shows that competitive markets are distinguished not only by competition over price levels, but also by innovation in price structures (such as the use of multi-part charges) and in price/quality combinations. Price control tends to seriously distort if not entirely suppress these important dimensions of the competitive process.

to impose price controls in these instances would not only seem lacking in economic justification but would also be prima facie inconsistent with the clear intent of the CPA, under which Governments committed themselves to controlling prices for activities which could not be supplied competitively.[10] The Australian experience with price control, for example in telecommunications, highlights the good sense that underlies this intent: for the control of utility prices to final consumers is inherently a highly politicised process, which is rarely likely to lead to outcomes consistent with efficiency principles.

Additionally, the approach seems to seriously under-estimate the difficulties inherent in going from a given final price, even if efficiently set, to the determination of appropriate charges for the supply of intermediate inputs (such as access).

These difficulties are starkest when different bases are used for setting prices at each of these levels. In telecommunications, for example, the government-determined final price controls envisage extensive cross-subsidisation between services. At the same time, the ACCC has sought to determine the terms and conditions of access by relying on resource costs. Major tensions and inconsistencies have arisen between these approaches, most clearly in the setting of charges for the resale of local calls.

The Efficient Component Pricing Rule (ECPR) may be thought to offer a ready means of avoiding these difficulties; but that belief is readily shown to be illusory. Thus, at a practical level, application of the ECPR, even in its most mechanical form, is no easy task.

Final prices are rarely simple constructs – and when final prices are non-linear (as they should be for most utility industries), the definition of the base price for use in the ECPR will be essentially arbitrary. Also, the definition of "avoided costs" is by no means straightforward, as these will depend on the extent of the output change that is envisaged and the degree to which obligations to supply may cause a continued requirement to provide capacity, even if no services are being supplied.

As a result, the setting of final prices cannot fully determine the access charges that will be relevant in any fact situation. Rather, this requires a particularised assessment of that fact situation, and hence some process must be determined for that assessment to be carried out.

Moreover, even if these practical difficulties are put aside, the efficiency properties of the ECPR simply do not hold if it is applied as

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[10] Section 2(4)(c) of the CPA.

a mechanical principle: that is, if access charges are determined by merely subtracting avoidable costs from the pre-determined final price. This is because the services provided by the access supplier and the access seeker are not likely to be perfect substitutes; and the lower the degree of substitution between these services, the greater the efficiency cost mechanical application of the rule will entail.[11] For this reason too, while the ECPR may in some instances provide a starting point, it cannot replace the particularised determination of access charges.

In short, attempts to replace access price regulation by the setting of final prices are likely to be both costly and futile. They will be costly because they will extend regulation to activities that do not require it. Moreover, the political saliency of these activities means that regulatory control is more likely to hinder than promote efficient provision. At the same time they will be futile, as the determination of final prices cannot, as a practical matter, substitute for the process of seeking efficient charges for intermediate services. As a result, regulatory burdens will be duplicated, increasing both the resource cost of regulation and its likely harm to economic activity.

Rather, it seems desirable to bring together, within a single legislative framework, the determination of the obligation to supply and of the terms and conditions of that obligation. This ensures that the obligation has some substance; and by defining the broad parameters of the manner in which the terms and conditions will be set, the framework also makes it possible to assess the impact that imposing the obligation will have on competition and on efficiency more generally. It would, in this respect, be desirable for those pricing parameters to be articulated in the legislation more clearly than they currently are; this issue will be discussed in more detail below.

Given the determination, within the single legislative framework, of the terms and conditions of supply, it seems consistent with the overall policy goal for those to be established on the basis of efficiency considerations. To begin with, the overall objective of micro-economic reform is to promote efficiency, and through it the competitiveness and long term growth prospects of the Australian economy; the objectives of access regulation should mirror, and contribute to, that wider goal. Moreover, no other set of considerations can provide outcomes that, from the point of view of the community as a whole, are superior to those that will be obtained through application of an efficiency criterion. Finally, critics of this criterion do not seem capable of advancing any serious and workable alternative.

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[11] See Armstrong, M., Doyle, C. and Vickers, J. 1996, 131-50.

The terms and conditions of access ought therefore to be determined in a way that promotes economic efficiency. It follows from this that the regime should not allow suppliers to set access prices in a way that distorts economic efficiency. Yet firms with market power may often, in seeking to raise monopoly rents, set inefficient prices. Further, the presence of monopoly rents, especially when protected, whether explicitly or implicitly, by regulation, encourages highly wasteful rent seeking activity. As a result, it is often important that the terms and conditions of access be aimed at reducing the prospect of monopoly rents.

This, it is important to emphasise, is not to say that the elimination of monopoly rents is an end in itself. The national framework for competition policy ought not to be concerned with the distribution of income – distributional goals are best pursued by other, more direct, means. Rather, the nation's competition policy should seek to ensure that market mechanisms work where they can to promote the best use of resources. It is within this wider objective, of promoting efficiency, that the reduction of monopoly rents needs to be seen. As indicated, these rents impose costs both directly and indirectly through rent seeking. Directly, prices that embody monopoly rents will, in many circumstances, involve some distortion of consumption and production.[12] Additionally, and perhaps more importantly, the possibility of earning monopoly rents induces rent-seeking behaviour, aimed at securing and maintaining those rents for particular interests. Resources consumed to alter regulatory barriers which create rents are a pure social loss.[13] Such losses typically greatly exceed conventional allocative inefficiencies associated with above-cost pricing.[14] Eliminating or at least reducing this loss can therefore bring substantial social gains.

However, it needs to be recognised that it is not possible or desirable in all circumstances to completely eliminate excess returns. More specifically, there is a trade off between setting prices so as to reflect costs on the one hand, and providing incentives for continued improvements in productivity and efficiency on the other. A pricing regime that sought to force price continually to cost would erode the

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[12] This will most likely be the case when a firm with market power deals with a large number of different customers who are not readily distinguished and which gain relatively small amounts of consumer surplus as compared with the costs of negotiation.

[13] See Tullock, G. 1967, 224-32 and Posner, R. 1975, 802-27.

[14] Rent-seeking converts monopoly profits into excess costs. One important form of this, evident both in public and private monopolies, is the provision of inefficient perquisites – for example, in the form of unnecessarily costly working conditions, including in terms of excess staff.

incentives regulated firms had to drive costs down or in other ways to innovate. Unless the party setting the charges can identify all cost reduction opportunities and direct the firm to exploit them, the result of any such regime will be that productivity will grow more slowly than it could and should. Incentive regulation recognises this trade-off by determining charges, including for access, in ways that allow the regulated entity to profit, albeit temporarily, from productivity improvements. In many circumstances, but not all, the instruments of incentive regulation provide a practicable way of preserving the motivation regulated firms have to innovate where heavier-handed approaches would fail to do so.

This highlights the fact that the appropriate means of setting charges will inevitably differ from situation to situation. Reflecting this, the goal of efficient pricing needs to be pursued in a manner that is responsive to the circumstances of individual cases but is developed within a consistent set of legislative principles.

In summary, the claim that the regime ought not to extend to the setting of access prices seems very poorly founded, and in some versions at least, simply illogical. Rather, combining the determination of supply obligations with a process for setting access charges is indispensable if access rights are to have content. In turn, that content should be soundly based on efficiency considerations and hence ought to ensure that the community is not unnecessarily forced to accept the payment of monopoly rents. However, access charges are not an area where "one size fits all". It is consequently desirable for the framework to provide the flexibility needed to determine those charges taking account of the wide variety of contexts in which access issues arise.

2.2.3 Role of the "negotiate/arbitrate" model

In practice, the legislative framework that emerged from the reform process has placed considerable emphasis on the "negotiate/arbitrate" model – that is, on mechanisms in which regulatory intervention are triggered once attempts to resolve issues on a commercial footing have proven unsuccessful. This has given rise to extensive criticism.

Before turning to the substance of that criticism, it is important to set the role the framework assigns to the negotiate/arbitrate process in proper perspective. Reliance on a negotiate/arbitrate model is only specifically required in the context of the declaration and certification mechanisms; undertakings may, and indeed have, been offered and accepted that do not involve a negotiate/arbitrate process. As a result, the negotiate/arbitrate sequence need only apply where access providers are being forced into the regulatory process – where the coercive powers of government are being used, either through regimes that are eligible for certification or through the declaration process, to

bring access providers within one step or another of the regulatory scheme.

Reliance on coercion is inevitably costly. No matter how efficient regulation may be, it always involves some loss of flexibility and adaptiveness relative to that found in commercial dealings. Moreover, the prospect of being coerced into particular outcomes can undermine investors' confidence and hence deprive the community of socially worthwhile projects. Finally, all regulation imposes some administration and compliance costs, consuming resources that might otherwise be put to more valuable uses.

It consequently seems economically reasonable, as well as being entirely consistent with natural justice, to ensure that the parties that might otherwise be coerced have the opportunity to settle matters on a commercial basis before coercive powers are called into play. The current framework seeks to do this by ensuring that the negotiate/arbitrate mechanism is used at each stage in the regulatory process, other than in the context of voluntary undertakings.

Criticisms of the negotiate/arbitrate model

It is against this backdrop that the criticisms of the negotiate/arbitrate model need to be seen. The substance of these criticisms seems to be that the negotiate/arbitrate model is at best time-wasting and useless – as negotiations too often fail – and at worst harmful, as it permits collusion.

These criticisms, though often expressed by the same parties, seem somewhat inconsistent – for if the negotiate/arbitrate process were an effective means of splitting rents, it presumably would not fail as frequently and systematically as its critics claim. However, even putting this inconsistency aside, the claims themselves seem poorly founded.

To begin with, the claim that negotiations inevitably fail does not appear to be based on any empirical evidence. Evidence from legal proceedings more generally suggests that disputes are frequently settled outside the adjudicative process. To the extent to which they are not in the context of access issues, that is likely to reflect some uncertainty as to the outcomes access adjudication will yield. This is partly a matter of allowing experience, and hence useful precedent, to accumulate; but it may also require some changes to the adjudicative process, that is to the arbitration mechanism, and to the pricing principles that guide it. These are discussed in section 3.

Moreover, the fact that negotiations may not succeed in resolving *all* issues does not mean that they do not succeed in resolving *any* issues. Rather, experience suggests that even where commercial negotiation cannot resolve all of the issues in contention, it can clarify

the points in dispute and hence make intervention more efficient. It is consequently important to preserve the scope for commercial negotiation to occur, with regulatory intervention as a back-up or safety net for those instances where agreement cannot be reached.

The claim that negotiations in the context of declaration or the availability of declaration will serve as the fig-leaf for widespread rent-sharing seems no better founded. Here again, no evidence has been put to substantiate the strong statements made. This lack of corroborating evidence is unsurprising, as the claims seem to abstract from the regulatory context in which the relevant negotiations sit.

The essence of that context is that any access seeker can trigger the arbitral process, once the facility at issue has been brought within the scope of the regime. A rent splitting arrangement will attract further entrants up to the point at which the quasi-rents are just sufficient to cover the fixed costs involved in entry.[15] Since the parties to the original, allegedly rent-splitting, deal will anticipate this, the access seeker will not commit itself to terms that would leave it with losses once further entry occurred. Under most conditions, there is simply no deal that – given the availability to all comers of the regulated price – will allow durable rent-splitting to occur. The availability of declaration, therefore, provides a strong disincentive to rent-sharing deals between infrastructure owners and users that might otherwise be attractive (as discussed above).

In short, the claims that have been made against the negotiate/arbitrate model seem lacking both in factual evidence and in analytical foundation. This is not to deny that there are changes, discussed in more detail below that could enhance this model's effectiveness. These changes, however, reinforce rather than detract from the important role that model plays in the overall regime.

Differences from commercial arbitration

While the negotiate/arbitrate model plays, and should continue to play, a central role in the access regime, it is not a rigid or mechanical construct. Specifically, it is important to understand the significant differences that distinguish the negotiate/arbitrate model as it is defined under clause 6 of the CPA and Part IIIA from ordinary commercial arbitration.

In ordinary commercial practice, arbitration is an essentially private matter – indeed, it is its private character that often makes it attractive as an alternative to dispute resolution through the courts.

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[15] This is no worse an outcome than would occur if the regulator simply announced a linear price.

The objective of commercial arbitration is largely to define a balance between the interests of the parties; the considerations that bear on the process are in practice confined to the parties' private interests. Reflecting this private character, and the fact that the arbitration process is intended to act as an alternative to the public system of adjudication, arbitral decisions do not give rise to decisions that have precedential weight and are generally subject to only limited review[16].

Arbitration in the Australian framework of access regulation retains some elements of its commercial counterpart. In particular, it is intended to be less constraining in terms of rules of procedure and evidence than is judicial determination; this is intended to reduce costs, to make the process more timely, and to facilitate reliance on expert decision-making. However, there are also very substantial differences. Five such differences are worth noting.

First, while commercial arbitration is inherently voluntary, arbitration under the access framework is not. Rather, it is capable of being imposed by one party on the other. It is, in this sense, a tool of public policy.[17]

Second and related, arbitration under the access framework, rather than focusing on the private interests of the parties, is oriented toward the objectives of public policy. Considerations of the public interest, notably through the promotion of competition and more generally of efficiency, cannot be ignored in the arbitral decision.

Third, and again reflecting its policy role, arbitration under the access framework does not take the parties as it finds them. Rather, because there are likely to be significant information asymmetries between the parties, there needs to be scope to act so as to ensure that information can be more evenly distributed. This enhances the efficiency of any negotiations that may surround the arbitration, and also makes the arbitration itself more effective in identifying the range of acceptable and legitimate outcomes.

Fourth, the process of arbitration under the access framework should generate decisions that have precedential weight, at least in the sense that they can guide the expectations of parties to future disputes. This

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16 Under most of the State Commercial Arbitration Acts, there are rights of appeal on questions of law.

17 For example, by altering firms' expectations about the outcome of arbitration, the procedural approaches taken by the regulator in determining when and how to intervene in bargaining between the access seeker and provider can influence the range of bargaining equilibria to favour outcomes which lead to a reduction in monopoly rents.

makes it all the more important that the arbitral decision be accompanied by a detailed set of reasons.

Finally, the potentially coercive nature of the process, and the importance of providing credible and consistent guidance with respect to future decisions, mean that the outcomes of arbitration need to be subject to appeal and review.

Negotiate/arbitrate model as part of a wider framework

These differences highlight the fact that in the access framework, the negotiate/arbitrate process is not an isolated element but rather is part of a wider regime. Consideration needs to be given, within that wider regime, to providing the bases for the negotiate/arbitrate process to operate efficiently: mechanisms for redressing information asymmetries are especially significant in this respect, and have been stressed by the Council in its certification reviews. At the same time, the negotiate/arbitrate process itself needs to be structured in a way that ensures its cost-efficiency.

Structuring the negotiate/arbitrate process in a manner consistent with cost-efficiency requires attention to the context in which it is intended to operate. While a number of factors are potentially relevant here, the transactions costs involved in determining the conditions of third party access seem especially important. More specifically, the appropriate nature of the negotiate/arbitrate process will differ as between instances.

At one extreme are instances where access involves a small number of parties, whose reliance or potential reliance on the negotiate/arbitrate process is likely to be infrequent; this might be the case, for example, in rail.

At the other extreme are instances where access involves or could involve fairly large numbers of parties, with similar issues occurring in each interaction; this could be the case, for example, in gas and electricity.

In the first case, at least in the initial phases of the access regime, it would not be efficient to seek to develop, in advance of notified disputes, particularly detailed guidance for the parties. The limited number of interactions, and the likely unique or at least localised character of the issues, means that the fixed costs involved in attempting to provide detailed *ex ante* guidance are not outweighed by material savings in determining disputes when these do arise. As a result, in these instances, it is appropriate from an efficiency perspective to rely on broad norms and standards to guide particularised decision-making, rather than seeking to evolve pre-defined rules.

In the second case, in contrast, the repetitive nature of the interactions and the similarities between cases mean that there is room to achieve economies of scale and scope in dispute resolution. More specifically, it is worth making the investment required to develop rules to guide decisions in advance of cases, as the fixed costs entailed can be spread over a larger base. The savings secured by such investments are all the greater when access issues have a multilateral (rather than inherently bilateral) character, and when the costs of delay in determining charges are high (the setting of nodal charges in an electricity grid being an obvious example).

The national access framework provides the flexibility to cater the negotiate/arbitrate process to these varying characteristics. As the Council has recognised in its consideration of specific access regimes, discussed further in section 6, there are strong arguments for allowing or even mandating the definition of reference terms and conditions for access in the context of (for example) monopoly gas pipelines. In the case of electricity transmission, the multilateral nature of the access issues, and the (at least) potential importance of allowing charges to be posted on a spot basis, mean that rules that amount to posted prices may be appropriate. In these cases, a high degree of predictability has been sought by access seekers and facility owners alike, and has not seemed inconsistent with the public policy goals being pursued.

The negotiate/arbitrate process is consequently not a case of "one size fits all": rather, here too, an efficient regime must accommodate some degree of diversity. Nonetheless, it remains important to retain, to the extent possible, room for commercial arrangements to be struck. This is an issue that will require continuing attention, so as to ensure that arrangements do not become unnecessarily prescriptive in practice.

Over time, there should be some convergence as between the contexts where a more prescriptive approach has been taken (say, in gas) and those where less guidance has been defined for the parties involved in access issues. In the former, both access seekers and facility owners should acquire greater confidence in the regime, and hence be willing and able to operate within a more flexible framework than characterised the initial stages of the access regime. In the latter, the development of precedent and more generally the accumulation of experience will help guide parties' expectations. The changes the Council recommends to the pricing provisions (see section 3) should also help here, as they will define a clearer framework for determining the terms and conditions of access than currently exists.

The negotiate/arbitrate model will therefore be more surely set within the context of an overall approach to dispute resolution. Commercial flexibility should be a key element in this framework, but within a body of rules and precedents that provide parties with guidance as to likely outcomes.

2.2.4 The choice between economy-wide and industry-specific arrangements

The framework for access regulation that emerged from the microeconomic reform process was intended to be economy-wide. The advantages of such an economy-wide orientation include:

- an economy-wide approach maximises the chances that progress will be made on a broad front, without particular jurisdictions or industries falling behind;

- such an approach also makes for consistency as between industries and as between jurisdictions, enhancing predictability and reducing the risk that resource allocation will be distorted by the differing treatment of like cases; and

- an economy-wide approach is likely to be less vulnerable to capture or manipulation by well-organised interest groups within particular industries or jurisdictions.

Inevitably, however, an economy-wide orientation does impose some trade-offs. Legislation capable of accommodating a wide range of circumstances cannot be as specific and detailed as that designed say, to regulate a particular industry. Tailoring this broader framework to specific situations will therefore occur more largely at the administrative level, rather than being directly determined in and by the legislature.

There is, however, no reason to believe that this imposes net costs. So long as the criteria that govern the application of the regime to individual instances are sufficiently precise, and so long as decisions made in application of these criteria are subject to appropriate review, delegation of decision-making functions should not give rise to particular concerns. In the specific case of Part IIIA, though there are areas where improvement is possible, the experience overall confirms the wisdom of the policy design. Indeed, the main criticisms of the access arrangements have arisen in the context of truly industry-specific regimes, for example in airports and telecommunications, rather than of the arrangements developed under Part IIIA.

Section 2.5 of this submission discusses further the benefits and costs of a generally applicable access regime in relation to industry specific regulation. The section also considers the question of state-based versus national regulation.

2.3 Criticisms of the declaration process and its governing criteria

The main conclusion to be drawn from the material presented above is that the broad architecture of the current national access regime is

sound, in terms of its goals, coverage and overall structure. Particular criticisms have nonetheless been advanced of the declaration criteria, and it is worth addressing these criticisms in detail. While these criticisms take a range of forms, they typically involve:

- the materiality of the threshold test for the promotion of competition;
- the scope and phrasing of the test with respect to the development of an another facility to provide the service; and
- the test with respect to the public interest.

Each of these criticisms is considered below. The declaration criteria and their application by the Council, Minister and Tribunal are discussed further in section 5 of this submission.

2.3.1 The promotion of competition

The test with respect to the promotion of competition has been criticised for being too complex and for setting too low a threshold.

The complexity allegedly arises from the requirement that another market be defined in which competition would be promoted. This, it has been claimed, is burdensome, with the same result being achievable by merely requiring that competition be promoted in another activity.

This criticism seems deeply confused. Competition occurs in markets; to make out the case that competition will be promoted, it must be possible to identify a market in which this effect will occur. Any reasonable test for the promotion of competition must therefore involve some process of market definition. As for the requirement that the competition being promoted be in some other market, this is dictated by the view that the purpose of access regulation is not to facilitate the mere resupply of a natural monopoly service; rather, it is to prevent bottleneck power from being used in ways injurious to the community. That requires identifying the market in which that power is or could be so used.

The insubstantial nature of this particular strand of criticism can also be seen by considering the proposed alternative. This involves rephrasing the test so that it is cast in terms of the promotion of competition in another “activity”. However, the concept of “an activity” is exceptionally imprecise; nor are there any known economic criteria for distinguishing between one activity and another. In contrast, the concept of a market has developed over a period of many years, and is familiar to practitioners and advisors. It therefore makes for greater predictability in application, as well as being directly linked to the policy goal being pursued.

As regards the extent to which competition must be promoted, the criticism seems to be that even insubstantial enhancements in competition could meet the statutory test. Given this, it is said, the current test ought to be amended to require that declaration result in a "substantial" promotion of competition. This would import into Part IIIA the language of Part IV of the TPA.

This proposal abstracts from important features of the test set out in Part IIIA. More specifically, the test in Part IIIA requires that declaration will promote competition – it is not a test of likelihood but rather one that requires a degree of certainty. In contrast, the Part IV provisions are cast in terms of likelihood, which can simply be taken to mean more likely than not.

It would be difficult, in many instances, to be certain that declaration would substantially promote competition – just as in many Part IV cases, it is not possible to be certain that conduct will substantially lessen competition. Indeed, the burden would be considerably greater in the typical Part IIIA case than in respect of most instances falling within the province of Part IV. This is because Part IIIA cases often relate to industries which have traditionally been operated as vertically integrated monopolies and in which patterns of competition have not yet fully evolved; judgements of competitive effects are consequently more complex and controversial. In these circumstances, to require both that the effect be certain and that it be substantial could materially alter the balance of Part IIIA. Given the manifest difficulties already involved in securing declaration, it is not clear what policy justification there could be for making such a change.

As a practical matter, "competition" in Australian trade practices regulation has long been understood to mean competition that is workable rather than perfect. The notion that the promotion of competition could be taken to require allowing further access until a market had become perfectly competitive is therefore somewhat fanciful. Rather, it is only when declaration will allow a market that is not workably competitive to come closer to being so that the test can be met; once a market is workably competitive, the comparison between "the world with declaration" and "the world without" would not evidence a sufficient difference to warrant policy intervention.

The test the Tribunal applied in the Sydney Airport case is consistent with this approach. The Tribunal asked whether there were structural impediments to competition that declaration would remove. It found that SACL (the airport operator) had excluded a class of firm from competing in the market, and considered that that class of firm had a distinctive contribution to make to the full functioning of the competitive process. It therefore concluded that declaration would promote competition, as it would remove impediments to the competitive process.

This seems precisely the goal that the access regime is intended to address. Criticisms of this aspect of the declaration test therefore seem misplaced.[18]

2.3.2 Phrasing of the test with respect to development of another facility

While Part IIIA is primarily designed to regulate natural monopolies, the term does not appear as such in the test for declaration.[19] Rather, consideration is required of whether another facility can be developed to provide the service. It has been claimed that the criterion would be clearer and more precise if it were explicitly targeted at natural monopolies.

The meaning of the current test has been largely settled through the Tribunal's decision in respect of the Sydney Airport case. Specifically, the Tribunal determined that the test hinges on whether it would be efficient, from the point of view of society as a whole, that another facility be developed.

In understanding this decision, it is important to note that the "other" facility need not be a new facility – that is, an additional one relative to those that already exist. "Develop" does not mean "build": all that is required is that there be a viable alternative which could be used to provide the service at issue. [20] In many, if not all, instances, the inquiry aimed at determining whether or not this is the case will amount to a consideration of whether the facility is a natural monopoly.

In the Sydney Airport decision, the Tribunal considered the likelihood of the development of another airport to provide competing services:

> *...SIA as a whole exhibits very strong bottleneck characteristics. From an economic perspective therefore the option to develop another facility is*

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[18] The criticisms which have been made seem largely directed to the question of whether or not competition would be promoted by declaration of the relevant services in the Sydney Airports case. It is important to draw a distinction between the test which the Tribunal used to determine whether or not competition would be promoted and the application by the Tribunal of the facts before it to that test.

[19] Second Reading Speech to the Competition Policy Reform Bill 1995, 30 June 1995, Hansard, 2799.

[20] The claim that the test as it stands would be met in a perfectly competitive market (as there would be no incentive to build an additional facility in such a market) is consequently simply incorrect.

> *foreclosed because the relatively small size of the Australian freight market would not support the development of another separately-owned airport. The realities are reflected in the Government's decision that SACL will be responsible for the development of Sydney West as a supplement to, rather than a replacement for, SIA (Sydney Airport decision, 40793).*

The test of uneconomic to develop another facility is, therefore, not a test of whether more than one facility exists, or is likely to exist. It is a test of whether, absent access regulation, it is likely that any problem of bottleneck market power will be resolved by the development of competing infrastructure. Thus, on the assumption that competition between infrastructure is a better regulator of bottleneck market power than the application of access regulation, the test is designed to identify infrastructure where competition is undesirable from an efficiency perspective. Otherwise, the application of access regulation would be inappropriate because it would tend to deter the economically viable development of competitive infrastructure.

The current test is a superior approach to any explicit test of natural monopoly. Testing for whether a facility is or is not a natural monopoly in a technical sense is a complex and controversial process, which generally involves the estimation of econometric cost functions. For example, even prior to the recent wave of technological change, twenty years of intense debate among leading econometricians about whether local telecommunications networks are genuinely natural monopolies did not yield any firm conclusions. Explicitly rephrasing the criterion in terms of natural monopoly would simply invite the presentation of ever more complex and costly economic evidence, with little gain in terms of the quality of the ultimate decision and some loss in terms of its predictability.

In contrast, the current test is very much in the pragmatic tradition of Australian trade practices. Rather than concentrating on abstract inquiries, that tradition directs attention to questions of fact. Thus, in its landmark decision in *Re Queensland Co-operative Milling Association Ltd; Re Defiance Holdings Ltd* (1976) 25 FLR 169 (the QCMA case), the then Trade Practices Tribunal asked: "If the firm were to 'give less and charge more', would there be, to put the matter colloquially, much of a reaction? And if so, by whom?" (QCMA 1976, p.190). Similarly, the current phrasing directs attention to the practical matter of whether there is, or is not, another facility that could be developed to provide a competing service. It therefore seems clearer and provides greater guidance to decision-makers than would a test couched in terms of natural monopoly.

2.3.3 The public interest test

A final issue that needs to be addressed is that of the public interest criterion. That criterion is set in the negative, so that it only comes into play if it can be shown that declaration would not be in the public interest. It has been suggested that this test should be rephrased into the affirmative, meaning that a facility could only be declared if declaration would be in the public interest.

This proposal involves a significant departure from the principles underpinning Australian trade practices legislation in general and the CPA in particular. Central to these principles is the presumption in favour of competition as the primary means controlling the allocation of resources in commercial activity. This presumption can be rebutted – as the authorisation provisions of the TPA make clear. But the onus is placed squarely on those who would argue against competition to demonstrate that it is, in the particular circumstance at issue, undesirable.

There are strong justifications for thus locating the burden of proof.

Most importantly, the lessons of economic history confirm that competitive markets are the most superior way of securing efficiency and protecting consumer interest. Additionally, in many of the contexts in which Part IIIA is being applied, the prevalence of monopoly over a period of many years means that there is relatively little experience with competitive markets. As a result, it is not easy to affirmatively demonstrate that the promotion of competition will, in each instance, attain particular goals; some degree of generalisation from wider experience is needed. Relying on well-established presumptions in these cases, but allowing for them to be rebutted, seems consistent with good public policy.

3 Refining Part IIIA

While the overall design and major elements of Part IIIA seem satisfactory, experience does suggest some areas where improvements could be made. Specifically, it seems desirable to:

- clarify and enhance the provisions with respect to access undertakings;
- enhance the provisions for dispute resolution and arbitration;
- provide greater guidance with respect to the pricing principles to be applied in arbitrations;
- strengthen the provisions for examination of access arrangements against the Part IIIA criteria;
- ensure consistency between the criteria for assessing infrastructure significance under the declaration provisions and clause 6(3); and
- improve the timeliness of processes within Part IIIA through the inclusion of time limits.

Each of these refinements is considered below.

This section also suggests that the current exemptions from the definition of 'service' under Part IIIA should be examined further.

3.1 Access undertakings

Under Part IIIA, an infrastructure owner or operator may give a written undertaking to the ACCC which sets out the terms and conditions on which a business will provide access to its services. People considering developing infrastructure can also seek to enter an access undertaking.

The undertaking process is an alternative to the declaration process. Once an undertaking is accepted by the ACCC, the infrastructure services in question cannot be declared.

A primary purpose of access undertakings is to allow access providers to obtain, in advance of an access dispute, a degree of certainty as to the terms and conditions on which access will be made available. At the same time, the undertaking mechanism allows some economy to be achieved in the use of public resources, by avoiding the declaration process and clarifying in advance the conditions to be applied in arbitrations. The Council notes that the undertaking provisions have only been successfully used to date in the electricity sector. This

must give rise to questions as to whether the current provisions are as effective as they could be. The Council considers the following amendments would improve the provisions:

- providing greater guidance in the criteria for acceptable undertakings;
- allowing for review of ACCC determinations on undertakings; and
- allowing for undertakings to be accepted for declared services.

Criteria for approval

The criteria that the ACCC applies in determining whether to accept an undertaking are set out in s.44ZZA of the TPA. The criteria are more general than the principles for effective access regimes specified in clause 6 of the CPA, but are consistent with the overall objectives of clause 6. Both the undertaking criteria and clause 6 focus on considering the legitimate business interests of the service provider, the public interest and the interests of those who might want access to the service.

In its guide to access undertakings, the ACCC has stated that:

> *The Commission's overriding objective, however, will be to ensure that access to facilities covered by undertakings is provided in a way that promotes competition and economic efficiency consistent with the objectives of Part IIIA and the criteria it establishes* (ACCC 1999, p.4).

The ACCC has recognised that the clause 6 principles, while not explicitly applying to undertakings, provide guidance on what an appropriate framework for an access arrangement might include (ACCC 1999, p.21). As an undertaking is a voluntary process, dealing with the terms and conditions of access to a specific infrastructure service, it is appropriate that the criteria for its acceptance contain greater flexibility than the clause 6 principles. Specifically, clause 6 requires that a regime include processes to allow for commercial negotiation of access. This requirement limits a regime's ability to 'post' terms and conditions of access. There is no similar restriction in the undertaking criteria and infrastructure operators can seek to have undertakings approved that prescribe the terms and conditions of access. This may be appropriate and suit the interests of the operators and prospective users.

Despite the benefits of flexible criteria for undertakings, there may be some benefit in providing greater guidance on what should be included within an undertaking. At present s 44ZZA provides only the

broadest of guidance to the ACCC, infrastructure owners and access seekers on the things that an access undertaking should contain. The specification of considerations that are less general in nature would improve certainty in undertaking processes and in this component of Part IIIA.

This guidance could draw upon the clause 6 principles, in a general sense, as well as the guidelines developed by the ACCC. The guidance would assist operators in developing acceptable undertakings and assist other interested parties in commenting on proposed undertakings. There would be a greater understanding of appropriate outcomes.

Specifically, the criteria could outline that an undertaking should include:

- provisions that accommodate the reasonable needs of access seekers by facilitating access through timely and clear processes;
- provisions to ensure appropriate information provision, particularly if the undertaking adopts a negotiate/arbitrate model;
- an appropriate dispute resolution process;
- an approach to pricing that reflects the efficient use of, and investment in, the infrastructure;
- an extensions/expansion policy, including rights to interconnection where appropriate;
- processes to ensure vertically integrated service providers do not advantage their own businesses in an anti-competitive manner; and
- prohibitions on hindering access by any party.

Review of determinations

It is not apparent why decisions with respect to undertakings should not be open to merits review. As the Sydney Airport decision highlights, the review process can make for clarification of the relevant criteria, thereby enhancing the efficacy of the regime as a whole. This would also be consistent with the existing right of a State or Territory Government to apply for a review of a decision of the Commonwealth Minister not to certify a state regime as effective.

Access undertakings for declared services

Currently, an access undertaking cannot be accepted by the ACCC for a service already subject to declaration. Amending Part IIIA to allow for a voluntary undertaking to be accepted for a declared service could

improve certainty for both service providers and access seekers, by avoiding the need to determine terms and conditions through arbitration. Further, reducing the reliance on arbitration might increase the efficiency of the regime, particularly if there are likely to be multiple access seekers. The general arbitration provisions would remain for declared services not covered by an undertaking. This would ensure that an infrastructure owner develops an undertaking in a timely manner, and does not use the undertaking process to delay arbitration.

3.2 Dispute resolution and arbitration

There are a number of issues that generate concern about the way in which the terms and conditions of access are resolved for declared services. Under the Part IIIA model, commercial negotiation is the principal mechanism for determining terms and conditions, with recourse to arbitration where negotiations are unsuccessful.

Information asymmetry

The first issue concerns the information asymmetry arising between an access seeker and the infrastructure owner. This results in cynicism on the part of the access seeker about the reliability of the information provided to it by the infrastructure owner, given what is often a limited ability to test the reliability of that information.

Delays favour infrastructure owner

Second, delays through negotiation and arbitration processes operate in favour of the infrastructure owner. This is because, apart from anything else, Part IIIA does not contain an equivalent to the backdating provisions of s.152DNA under Part XIC. The result is that any arbitrated terms and conditions only apply from the date on which an access determination is made. Therefore, the longer any ultimate determination takes (which would include the time required for review by the Australian Competition Tribunal) the later the date on which arbitrated terms and conditions of access will apply. Further, Part IIIA, again unlike Part XIC, does not provide scope for the ACCC to issue an interim determination.

Lack of certainty

Third, there remains considerable uncertainty about the likely outcome of an access dispute. This lack of certainty would ordinarily provide an incentive for both parties to reach a commercial resolution rather than expose themselves to the time, expense and uncertainty associated with a compulsory dispute resolution mechanism. Yet this has not been the case, with a number of access arbitrations arising in the telecommunications sector in particular.

It is not clear why this is occurring. Possible reasons include:

a) the fact that for an infrastructure owner an agreement with one party may have consequences for the resolution of disputes with other access seekers even if there is no requirement to publish the terms of any final resolution;

b) the inability of an access seeker to assess whether an offer represents a value within the range of possible outcomes which would arise in an arbitration; and

c) the parties have widely differing expectations when they enter into the dispute resolution process due to information asymmetry.

Many of these issues would be likely to work themselves out over time, at least to some extent, as parties gain more experience in working within the Part IIIA framework.

However, there are a number of changes that could be made to Part IIIA which would enhance the speed of dispute resolution and provide parties with greater incentives to reach a negotiated outcome.

Strengthening the environment for commercial negotiation

The success of any dispute resolution mechanism fundamentally depends on the evaluation by the parties of the risks associated with next best outcomes faced by each. To external observers it is often a mystery as to why there is disagreement where agreement appears to be in the interests of both parties. A frequently given reason for this is:

> *"that the parties have divergent and relatively optimistic expectations regarding the ultimate outcome if they fail to agree ... In the case where a third party will render a decision if the parties fail to agree, both parties expect to receive a relatively favourable decision from the third party."* (Farber and Bazerman, 1989).

In a structure such as the arbitration mechanisms provided for under Part IIIA, this involves optimistic expectations at two stages - that of the initial decision maker (the ACCC) and that of the review body (the Australian Competition Tribunal).

If there is a strong desire for commercial negotiations to be the prime method to resolve access disputes, with arbitrated outcomes as a fallback position to be used infrequently, then consideration needs to be given to mechanisms which can provide better incentives to the parties to achieve a negotiated outcome.

A suggestion made in the Hilmer Report which was not taken up in Part IIIA was an initial obligation on the service provider to provide certain information. The Hilmer Committee said:

> *To facilitate negotiation of appropriate access agreements once a facility has been declared, the owner of the facility should be required to provide relevant cost or other data to the party entitled to seek access and, if need be, to the arbitrator* (Hilmer Review 1993, p.256).

It seems that this suggestion has considerable merit. There are, no doubt, a number of variants but it seems that there are broadly two ways in which such an information disclosure obligation could be structured.

One approach is to make this obligation part and parcel of the declaration recommendation by the Council and of the declaration decision by the relevant Minister. Thus, declaration would identify categories of cost information which the service provider is obliged to provide to the access seeker and to the ACCC within 60 days of the declaration decision taking effect.

The alternative is to confer powers on the ACCC to require provision of cost data to an access seeker at the point when an access dispute is notified.

Strengthening the arbitration framework

Overall, the arbitration process for declared services needs to be seen as simply an element in an approach aimed more broadly at dispute resolution. While the above amendments would make the process of dispute resolution more effective and reduce the reliance on arbitration, it is clearly important to ensure that the arbitral processes, when triggered, function as efficiently as possible.

To date, there has been limited experience of arbitration under Part IIIA. Most of the arbitrations that have occurred within the context of a regulated access regime have been telecommunications arbitrations under Part XIC of the Act. There are currently two access arbitrations which have been determined under Part XIC of the Act that are the subject of review applications before the Tribunal.

Whilst services at both Sydney and Melbourne Airports have been declared, no dispute has arisen on the terms and conditions of access to those services.[21] There has been one arbitration under the NSW Rail Access Regime, which has been certified as effective under Part IIIA.

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[21] Melbourne Airport now relevantly falls under the provisions of the Airports Act.

The statutory framework for the arbitration process provides constraints on the methods that the ACCC can use to most efficiently resolve any disputes. This reflects the tension between the commercial nature of the arbitration process and the desire to have issues common to many arbitrations resolved in a co-ordinated way, thus minimising transaction costs. There are clearly issues that operate for and against a more overtly public process given the commercially sensitive nature of the prices which are being determined and also which limit the desirability of combining arbitrations even where common issues arise. Nonetheless, there appears to be some scope to consider whether current arbitration arrangements strike the appropriate balance between commercial confidentiality (especially for the infrastructure owner) and providing information to the market on likely arbitration outcomes in the future.

In this respect, the nomination of the ACCC as the arbitrator of access disputes for declared services offers some particular advantages. The nature of the ACCC as a body means that any investigation will be comprehensive, empirical and focused on broad policy outcomes as much as specific resolution of an individual dispute. In this sense, nomination of the ACCC reflects the fact that there is a wider public interest in access regulation rather than just the interests of particular parties. This could be affirmed by providing for the ACCC to publish a report following an arbitration decision that provides details of:

- the methodology used by the ACCC in reaching its views;
- publication of any non-confidential material relevant to its determination;
- guidelines to be used by the ACCC on common or likely issues in disputes as a result of its consideration of matters arising in the particular arbitration.

It is expected that this could be achieved without disclosing any confidential material but would nonetheless provide a mechanism for disclosure of key issues likely to be relevant going forward.

A radical alternative would be to introduce a variant on the classic arbitration model and use a final offer arbitration structure to determine the outcome. There is a considerable body of opinion which suggests that this method of arbitration has a higher prospect of a negotiated outcome being achieved than does conventional arbitration[22]. As a commercial methodology it has much to commend

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[22] See Neale, Margaret A. and Max H. Bazerman, Max H. 1983; Grigsby, David and Bigoness, 1982; Notz W.W., and F.A. Starke, 1978.

it. How far it can be utilised in the policy context of access regulation may be more contentious.

3.3 Pricing principles

As this submission recognises elsewhere, there is inherent difficulty in determining what is an appropriate access charge. The Hilmer Review commented on this difficulty and said:

> *Neither the application of economic theory nor general notions of fairness provide a clear answer to the appropriate access fee in all circumstances. Policy judgements are involved as to where to strike the balance between the owner's interest in receiving a high price, including monopoly rents that might otherwise be obtainable, and the user's interest in paying a low price, perhaps limited to the marginal costs associated with providing access...Decisions in this area also need to take account of the impact of prices on the incentives to produce and maintain facilities and the important signalling effect of higher returns in encouraging technical innovation. For example, relatively low access prices might contribute to an efficient allocation of resources in the short term, but in the longer term the reduced profit incentive might impede technical innovation.* (Hilmer Review 1993, p.253)

The Council considers that the pricing principles that are currently applied in the context of arbitrations for declared services are too vague to provide guidance to the parties involved in access issues. S.44X(1) merely sets out a range of factors, some difficult to interpret (for example, the direct costs factor), without any indication of the weight to be put on each factor or of the basis on which they are to be combined.

This has far-reaching effects:

- it makes it difficult, in the context of declaration decisions, to determine the consequences of declaration, as so much latitude exists as to the terms and conditions of access;

- it likely reduces the willingness of the parties to achieve commercial settlement, as they have little basis for determining the likely outcomes of arbitration; and

- it hinders the task of arbitrators and encourages appeals from arbitral decisions.

In considering ways of addressing this issue, it seems reasonable to start from the presumption that regulated prices should be set on the basis of the revenues an efficient operator would require to provide the service over the long term ("the efficient cost standard"). It is important that this presumption be implemented in a manner that

takes account of the risks – notably in terms of asset stranding – that the use of such an efficient cost standard creates. But so long as this risk is properly factored in to the arbitral decision, the efficient cost standard should prove acceptable in most instances.

As a result, it may be that the current criteria could be replaced by a presumption in favour of efficient costs. This presumption could be rebutted by showing that in the particular circumstances, the use of that cost standard would be inconsistent with the promotion of economic efficiency over the longer term. Unless that rebuttal could be made out, the arbiter should be required to apply an efficient cost standard.

3.4 Review of access arrangements within Part IIIA

Part IIIA is relatively new, and many of the access arrangements approved under this regime have only very recently come into effect. Yet it is clear that the periodic review of these arrangements will be an increasingly important function of the regime in the years to come. More specifically, it is essential that the regime acts to ensure that arrangements do not remain in place when the conditions that called for them in the first place no longer pertain. Additionally, now that a number of arrangements are in effect, it is appropriate to consider the scope to inject greater consistency in their terms and nature as and when they come up for review – for example, by placing competition tests on a more uniform footing across different jurisdictions.

The National Gas Access Regime provides an indication of the importance of including a review role. As it currently stands, the Gas Regime requires coverage of a pipeline where it is uneconomical to develop another pipeline to provide the service. This may not be appropriate in instances where the competitive constraint comes from other transportation technologies or energy sources.

Part IIIA includes a review role through requiring that state regimes be certified for a period of time, with reassessment before re-certification and by requiring that undertakings be accepted for a defined time period.

It would seem desirable for a review process akin to certification to be brought to bear on Commonwealth regimes that have been established outside of the Part IIIA framework: for example, the telecommunications provisions in Part XIC of the TPA, the postal services access regime and the arrangements with respect to airports set out in the *Airports Act 1996* and the PSA.

It is apparent that Parliament, in establishing these regimes outside of Part IIIA, intended them to differ from the economy-wide access

arrangements. However, the community ought to have the opportunity to review these regimes in the light of the principles that the Commonwealth has viewed as required of the access regimes set out by other jurisdictions. More specifically, the Commonwealth should accept that even where they cannot achieve certification, the mere fact of periodic review of these regimes will clarify the scope and possible net benefits of moving to more uniform access arrangements nation-wide.

3.5 Assessing infrastructure significance

Clause 6(3) of the CPA requires that services subject to State and Territory regimes be provided by means of significant infrastructure facilities. The facilities are not required to be nationally significant and there are no qualifications on how significance is to be assessed. This test provides a more appropriate model than the current s.44G(2)(c) which requires that infrastructure be nationally significant as assessed against particular criteria.[23]

A materiality test should be designed to ensure that access regulation is not imposed on infrastructure services where there is likely to be little gain from doing so. While this matter is also taken into account in a consideration of the public interest, an explicit requirement provides additional emphasis to the importance of ensuring the gains will be delivered.

If the 'national' limitation has any meaning, then theoretically there are infrastructure services that may be significant, but not nationally significant. These significant infrastructure services would then be outside the national regime even if they met the other criteria of s.44G(2). This could lead to a differential application of access regulation across infrastructure services.

The Council considers that s.44G(2) should be amended to reflect the same test as provided in the clause 6 principles. It provides for an appropriate test of materiality that ensures consistent application of access regulation for significant facilities.

3.6 Timeliness of process

Part IIIA contains few restrictions on the time in which applications for declaration and certification must be finalised. Under declaration, the Minister must make a decision within 60 days. Also, applications for review to the Tribunal must be lodged within 21 days of a decision

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[23] s.44G(2)c is discussed further in Section 3.

being made. Otherwise, the Council, the Minister and the Tribunal have no defined time limits.

In comparison, the National Gas Regime provides defined time limits for regulatory processes, with some flexibility to extend when necessary. The Council's experience is that this has worked well and provides an appropriate model for the declaration and certification processes.

It is important that any time limits achieve a balance between having an application dealt with as quickly as possible, and allowing sufficient time to consider the matter, taking into account the views of all interested parties.

Declaration

The Council's experience in declaration matters suggests that a limit of four months on the Council's process, from the time of application to forwarding the recommendation to the Minister, would be appropriate. A similar time limit should apply for the Tribunal if a decision is to be reviewed. However, it would be desirable to incorporate a mechanism allowing these periods to be extended, should this be necessary due to the complexity of the application.

The Council considers that the current sixty-day limit for the Minister to make a decision on declaration is appropriate.

Certification

The TPA does not require the Council to make a certification recommendation within a specified time. Nor are time limits prescribed for the Minister or any review by the Tribunal.

The Council deals with certification applications as expeditiously as the proper consideration of all relevant issues allows. The certification process often reveals that an access regime requires amendments to satisfy the CPA principles. These amendments can take time to be drafted and implemented, especially where parliamentary processes are involved. At the same time, the Council is unable to convey a recommendation to the Minister that an access regime is effective until any required amendments have been implemented.

The Council is concerned that the absence of time limits can create uncertainty for both access seekers and infrastructure owners. The introduction of time limits would create a discipline on governments to initiate any necessary amendments within a reasonable time, or failing this, to withdraw an application and resubmit at a later time when the principal issues have been addressed. In addition, the imposition of time limits would provide some discipline on the processes of the Council, the Minister and the Tribunal.

The Council's experience with certification applications suggests that a limit of six months on the Council's processes – from the time of application to forwarding a recommendation to the Minister – would be appropriate.

A limit of four months could be placed on the Tribunal process, if a decision is to be reviewed. It is not necessary to allow time within the Tribunal's processes for jurisdictions to amend legislation. It is also likely that the issues before the Tribunal would not involve an examination of a regime against all the clause 6 principles; only against those principles in contention.

It would be desirable to include a mechanism allowing these periods to be extended, should this be necessary due to the complexity of the application.

The Council considers it appropriate that a sixty-day limit apply to the Minister in making a decision.

3.7 Exemptions from declaration

Exemptions in the definition of a Part IIIA service in relation to the supply of goods and production processes appear to have been intended to ensure that the application of Part IIIA was restricted to where 'access to certain facilities with natural monopoly characteristics, such as electricity grids or gas pipelines, is needed to encourage competition in related markets, such as electricity generation or gas production'.[24] With five years experience in the operation and interpretation of the declaration criteria, there is a question about whether these restriction were needed and whether they serve any purpose.

The continued need for these exemptions should be examined.

[24] Second reading speech, p.7

4 Addressing the problem of bottleneck infrastructure

Access regulation, in one form or another, is present in most modern economies. It is widely recognised that an economy has 'bottleneck' services, access to which is essential for competition in related upstream and downstream markets. Historically in Australia, such bottlenecks typically have been government owned vertically integrated utilities, including those operating in the electricity, telecommunications, water, rail, aviation, and gas sectors. However, microeconomic reforms in the last two decades have meant that privately owned and operated firms now often provide these services.

This section outlines the problems that access regulation is designed to address, and considers overseas and Australian responses, focussing on the framework in Part IIIA. The Council goes on to discuss the principles of efficient regulation and considers how effectively Part IIIA addresses these principles.

4.1 The natural monopoly problem

Part IIIA was introduced in response to the recommendations of the Hilmer Review for the establishment of a new legal regime 'under which firms could in certain circumstances be given a right of access to specified "essential facilities" on fair and reasonable terms'. (Hilmer Review 1993, p.xxxii) The Review noted:

> *In some markets the introduction of effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics, and hence cannot be duplicated economically. For example, effective competition in electricity generation and telecommunications services requires access to transmission grids and local telephone exchange networks respectively. Facilities of this kind are referred to as 'essential facilities'.* (Hilmer Review 1993, p.239)

Thus, the focus of the Hilmer Review was on infrastructure services where it is economically efficient to have only one producer and which constitute a 'bottleneck' to competition in dependent markets. The Hilmer Review noted that while it was difficult to define the term 'natural monopoly' precisely, electricity transmission grids, telecommunications networks, rail tracks, major pipelines, ports and airports were often cited as examples (Hilmer Review 1993, p.240).

As the Hilmer Committee emphasised, a vertically integrated infrastructure service provider has a real incentive to deny access to firms with whom it competes in related markets, leaving open the possibility that there will be an absence of competition in these related markets. (Hilmer Review 1993, p.240-242)

However, as discussed in section 2, there are significant problems for competition even where the bottleneck facility owner is not integrated into related markets. In such a situation, the facility owner can harm competition even if it does not supply to such markets. The phenomenon has been summarised by Stephen King in the following way:

> *If an upstream monopoly (whether integrated or not) does sell the input product to downstream firms, then it will want to price the input in a way that:*
>
> - *maintains overall monopoly production and profits downstream; and*
>
> - *enables the upstream firm to seize as much of the monopoly profits as possible.*
>
> *In either case, sale of the essential input will not promote efficient downstream pricing, although it creates the appearance of downstream competition. The real problem in these circumstances is the lack of upstream competition.*
>
> *... access to an essential input is only a cause for specific regulatory intervention if it is either highly unlikely that competition will develop in the upstream market in the longer term or if such competition is itself undesirable. In general, this means that the upstream production process involves a natural monopoly technology* (King 2000, p 66).

The concept of natural monopoly first arose in the 1970s in the work of Zajac, Faulhaber, Baumol, Panzar, Willig and Bailey[25]. The definition of a natural monopoly, now widely accepted in the literature, is a market where at the existing level of demand, the cost function is subadditive. This means that at the level of output corresponding to demand, the least cost means of providing the

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[25] See Baumol, W.J. 1977; Baumol, W.J., Bailey, E.E. and Willig, R.D. 1977; Faulhaber, G.R. 1972, 1975; Panzar, J.C. 1977; and Zajac, E.E. 1972.

service is through a single unified production process.[26] While the concept is simple to state, and indeed intuitive, it is exceptionally complex mathematically to define the general circumstances for which cost functions can be subadditive (Sharkey 1992, p.83).

If the theoretical conditions necessary for subadditivity are complex, testing for the existence of subadditivity is even more so. As Stephen King notes, what constitutes a natural monopoly can vary over time, and with technological change:

> *The existence of a natural monopoly technology is an empirical question, although such technologies are most likely to arise where production involves fixed costs that are large when compared with marginal costs. Further, the existence of a natural monopoly technology depends on the extent of demand. As demand for a product grows, it may become economically desirable to divide the increased production between different producers* (King, 2000, p 67).

What does all this mean in practice? It means that although the natural monopoly concept itself is well-defined, it is more difficult in practice to establish whether a particular market falls neatly into the definition of a natural monopoly. Thus the implementation of a 'natural monopoly' test and the standard of proof required can create substantial costs. For instance, it would require the estimation of econometric cost functions to determine the existence of subadditivity of costs which is one of the defining characteristics of natural monopoly.

Consequently, much of the debate surrounding access regulation involves the notion of bottleneck infrastructure, rather than natural monopoly, for two reasons:

- firstly, identification and analysis of bottleneck infrastructure is less problematic, both in practical terms and in terms of the evidence necessary for the conduct of administrative processes within an access regime; and

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[26] As the definition suggests, under conditions of natural monopoly, technical or productive efficiency can only be obtained with one producer in the industry. However, while it may be technically or productively efficient to have one provider of natural monopoly infrastructure services, the resultant lack of competition can lower overall efficiency, and in particular, consumer welfare.

- secondly, natural monopolies which do not constitute a bottleneck to competition in dependent markets are not a problem from the point of view of the objectives of access regulation.

However, the concept of natural monopoly remains fundamentally important to the identification of relevant infrastructure in the context of the design and coverage of access regulation.

4.2 Overseas experience and the essential facilities doctrine

As early as the 19th century, there was legal recognition in the United States and in Europe of the problems associated with access to services provided by natural monopolies. In the United States, this led to the development of the essential facilities doctrine.

The earliest case to deal with this doctrine was *United States v. Terminal R.R. Ass'n, 224 U.S. 383 (1912),* where the Supreme Court approved an order requiring a group of railroads, which jointly controlled access and terminal facilities permitting traffic across the Mississippi River, to allow other railroads to join the combination or to use the facilities in a non-discriminatory manner. However, the doctrine was most fully enunciated *MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, (7th Cir. 1982),*[27] in which the following tests were set out:

- there had to be control of the essential facility by a monopolist;
- the competitor was unable, practically or reasonably, to duplicate the essential facility;
- there had to be a denial of the use of the facility to a competitor (including a constructive denial through prohibitively high access prices); and
- the access seeker had to demonstrate the feasibility of providing access to the facility.

The doctrine has been used in the United States to facilitate access to railway bridges, a nation-wide telecommunications network, a local electricity transmission network, a sports stadium and a multi-day ski-pass scheme.

The European Court of Justice has an essential facilities doctrine, the boundaries of which are still being determined.

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27 The seminal US cases are discussed in Lipsky, A. and Sidak, J.

New Zealand relies upon s.36 of the *Commerce Act 1986*, the rough equivalent of s.46 of the TPA.

4.3 Australian solutions

4.3.1 Section 46 of the Trade Practices Act

Following from the recommendations of the Hilmer Review, Australia developed its own, unique answer to the problem of access to natural monopoly services. Policy makers developed an entirely new legislative system in preference to relying on the common law, the existing competition rules in s.46 of the TPA, or upon previous systems of regulation of government-owned utilities.

The Hilmer Review considered that s. 46 was an inadequate response to access issues because:

- Australian courts had rejected the notion that s. 46 embodied the United States doctrine of essential facilities;
- it was very difficult to prove that an access refusal has been made for a proscribed 'purpose' under s.46;
- the courts were reluctant to decide appropriate terms and conditions of access; and
- litigation was costly and time-consuming.

The Hilmer Review considered that simply incorporating pricing principles into s.46 was an inadequate response to the problem. The Review also considered that this approach would still draw the courts into considering pricing issues and making pricing orders – a task that was better suited to specialised regulators or competition authorities.

It was envisaged that a legislated access regime would operate in a non-prescriptive manner, seeking to facilitate agreement between the parties on terms and conditions of access, and providing an arbitration process when agreement could not be reached.

4.3.2 The Hilmer Review and recommendations for access reform

The Hilmer Review was concerned about the problems that could arise when owners of essential facilities operated in downstream or upstream markets. Such owners were thought to have an incentive to deny access, either absolutely, or constructively through the imposition of prohibitively high access prices.

The Hilmer Review considered there was little danger that owners of essential facilities that did not compete in upstream or downstream markets would seek to deny access. It was thought that they would have little incentive to do so, although they might seek to exploit their market power though the imposition of monopoly prices for access. In such a case, direct price regulation could be relied upon to prevent monopoly pricing.

The Review proposed, as a 'first best' solution to the problem of vertically integrated monopolies, structural separation of the natural monopoly activities of the firm from the potentially contestable activities.

However, it recognised that vertical separation was not costless, and could involve loss of efficiencies. Consequently, it recognised that access regulation would be particularly important where structural separation was not desirable, or had not occurred.[28] The Review did not, however, argue for access regulation to be limited solely to vertically integrated facilities. Indeed, as further research has evolved in this area of regulation, it has become apparent that access can be just as substantial a problem for structurally separated essential facilities, as for those that are vertically integrated. This is largely because an essential facility owner will always face incentives to seek any rents available in upstream and downstream markets, and vertical integration is not the only means by which the facility owner may be able to capture these rents. For example, contractual arrangements can be used to achieve the same outcomes as vertical integration.[29]

The Hilmer Review made a number of recommendations about the appropriate institutional design of the proposed regime. It expressed a strong preference for a national regulator, rather than a series of industry-specific regulators. In addition, the Review emphasised the need to confine the application of access regimes to instances of clear public interest, and suggested that access should be available only in the case of essential facilities that were of national significance.

The Hilmer Review also recommended that the access regime be predicated upon a negotiate/arbitrate model.

4.4 The objectives of Part IIIA

The TPA does not set out specific objectives for Part IIIA.

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[28] For example, because of the slow pace of structural reform initiated by State and Territory governments.

[29] These issues are elaborated on in section 2.3.1.

However, s.2 of the TPA, inserted at the same time as Part IIIA, states that:

> *The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection.*

Part IIIA is one of the regulatory tools included in the TPA to achieve this overall objective, through its capacity to "unlock" natural monopoly infrastructure and in so doing, promote competition and consumer benefits in related markets

Access can promote the efficient use of natural monopoly infrastructure in a number of ways:

- in the short term, the entry, or threat of entry, of new firms in the downstream market will encourage lower cost of production of services such as the supply of electricity to households (promotion of productive or technical efficiency);

- in the longer term, competitive pressures should encourage greater innovation to reduce costs and develop new products (promotion of dynamic efficiency);

- provided the terms and conditions of access are appropriate, all customers who value the service more than its cost of supply will be serviced (promotion of allocative efficiency) (IC 1995, p 12).

4.5 Principles of effective access regulation

The Commonwealth Office of Regulation Review (ORR) has outlined general principles of effective regulation. According to the ORR, effective regulation:

- must yield a net benefit to the community, not just to a particular group or sector;

- must be set to the minimum level necessary to achieve its objectives and to avoid unnecessary restrictions. It should be targeted at the problem;

- should be integrated and consistent with other laws, agreements and international obligations. Any restrictions on competition should only be retained if they provide a net benefit to the community and if government objectives cannot be achieved by other means;

- should not be unduly prescriptive and, preferably, specified in terms of performance or outcomes. It should be flexible enough to allow businesses some freedom to find the best way to comply and so adapt to changed circumstances;

- should be accessible, transparent and accountable. Not only should the public be able to readily find out what regulations they must comply with, but the regulations must also be reasonably easy to understand; they should also be fairly and consistently administered and enforced;

- must be clear and concise and communicated effectively;

- should be mindful of the compliance burden imposed in relation to the problem being addressed, and set at a level that minimises compliance costs while still achieving the set objective; and

- should be enforceable and embody the minimum incentives needed for reasonable compliance (Coghlan 2000, p 44).

The Council considers that these general principles of effective regulation provide an appropriate framework for the examination of Part IIIA and the clause 6 criteria.

Consistent with these general principles, effective access regulation has a number of specific elements. A well-designed access regime should offer a workable framework to address key problems in the market, while minimising the regulatory cost of doing so. In particular, it should:

- provide for an appropriate level of flexibility in terms of the ability of owners and operators to negotiate terms and conditions as market opportunities change;

- be transparent and administered independently; and

- reflect the institutional structure and arrangements governing the management and operation of the market (PC 2000, p 165).

Additionally, it is important that:

- regulatory authorities are given clear guidance about the objectives of regulation, with economic efficiency as the primary objective;

- facilities that are not 'essential' are not declared for access regulation;

- there is no unnecessary duplication and overlap of regulatory functions between bodies within jurisdictions and nationally;

- the regulatory framework provides timely results with a degree of certainty and predictability; and

- processes for undertaking regulation are open to public scrutiny (IC 1995, pp 13-14).

The Council considers that, in essence, Part IIIA substantially meets these requirements. In particular, Part IIIA incorporates the following principles of good regulatory practice: a process for ensuring that coverage is limited to appropriate infrastructure services;

- flexible mechanisms capable of adaptation to a range of circumstances, while adhering to some common principles;

- sound regulatory processes, in particular through minimum standards of transparency and independence of processes;

- an economy-wide community welfare, or efficiency, objective for access regulation;

- a general, industry-wide focus to increase the effectiveness and minimise the direct costs of access regulation;

- timeliness in regulation and regulatory processes; and

- effective review mechanisms to test the efficacy of regulatory processes and the exercise of discretion by regulatory institutions.

The Council notes, however, that some minor modifications to Part IIIA could enhance its effectiveness in some of these areas. These were discussed in section 3.

4.5.1 Appropriate coverage

A regime for the regulation of natural monopolies should provide a clear, consistent and objective process for the identification of infrastructure where regulation may be appropriate – that is, an appropriate declaration-type coverage process. It is essential that the regime be confined to instances in which there is demonstrable market failure in the form of natural monopoly, and that the regime does not regulate contestable services.

It is important to recognise the scope for competitive infrastructure, and the need to separate natural monopoly and competitive activities; and to continually test for both these things in the light of changing technology. The former Industry Commission stated that:

> *In practice, deciding what constitutes a natural monopoly is a complex analytical task; the answer*

> *may change according to how broadly markets are defined and as new technologies develop. If the boundaries are blurred beyond natural monopoly to include situations in which there are two or more facilities serving a market, the size and difficulty of the regulatory task and its potential cost may increase substantially, without the prospect of further significant efficiency gains* (IC 1995, p.x).

Part IIIA recognises the importance of ensuring appropriate coverage and addresses the issues through a variety of mechanisms.

First, the criteria for coverage under Part IIIA essentially limit the application of access regulation to significant natural monopoly bottleneck infrastructure services. To date, the declaration process has resulted in coverage of particular services at Sydney and Melbourne International Airports, and regimes that have been either certified as effective or accepted as undertakings have covered gas pipelines, electricity networks, rail infrastructure and shipping channels.

Second, coverage of particular infrastructure services must be for a definite period of time and capable of being revoked if the criteria for coverage are no longer met. Clause 6(4)(d) requires state and territory regimes to contain a mechanism to ensure re-testing of the need for access regulation for the infrastructure services covered by the regime. Further, certifications are also for a specified time period. Undertakings are a voluntary arrangement and operate for a definite period of time.

Third, the periodic review of Part IIIA ensures that these coverage mechanisms remain effective over time.

Finally, Part IIIA avoids the potential distortions associated with inconsistent treatment of public and private infrastructure. Natural monopoly is a technological phenomenon, independent of the nature of ownership. For this reason, it is important that any access regime applies generally across all sectors of the economy, public and private.

As such, Part IIIA is a regime of general application – it does not differentiate between privately and publicly owned infrastructure services. Thus, the Council has been required to consider, in declaration and certification applications, issues that have not been appreciably different, in design or application, between publicly and privately owned infrastructure.

4.5.2 Flexibility

An access regime should be flexible enough to cover a wide range of access situations. As the Council notes in section 2, mechanisms

should be provided for resolving both 'one-off' access problems and situations where the provision of access may be central to the business of the service provider.

The Council notes that Part IIIA is flexible enough to accommodate each of these situations, by providing three access pathways. These are:

- access undertakings approved by the ACCC;
- certified access regimes;
- declaration of services.

The access undertaking avenue is suited to access situations in which:

- the provision of access is central to the business of the service provider;
- there are a large number of potential access seekers; and
- it is desirable to have set terms and conditions, for instance where there are significant information asymmetries between parties.

The undertaking option is the basis for the application of the national access regime to the electricity sector. Thus, electricity network service providers have given undertakings to the regulator to provide access to the network in accordance with the National Electricity Code. They must also develop their own pricing structures and tariffs that, once approved by the regulator, form posted prices for all access seekers.

The certification route[30] may also be suitable in access situations where the provision of access is central to the business of the entity and where there are a large number of potential access seekers. Certification is available where access regulation is subject to state or territory legislation.

The legislative nature of arrangements subject to certification allows for a combination of prescription and flexibility in determining the terms and conditions of access. It can also be an effective means of implementing consistent access regimes across different jurisdictions.

The certification option has been used effectively in the National Gas Access Regime. That regime, outlined in section 6.13, allows participating jurisdictions some flexibility in determining the specifics

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[30] This mechanism is discussed in section 6 of the submission.

of their own regime, while ensuring effectiveness and broad national consistency through the application of model legislation and the National Gas Code. Service providers develop access arrangements determining benchmark terms and conditions suitable to their own pipeline or system, but parties are also free to negotiate on tariffs.

The declaration option, because it is based on a pure negotiate/arbitrate model, is best suited to situations where there are likely to be few access seekers, where information asymmetries are relatively small and/or where significant flexibility in determining the terms and conditions of access is desirable. The application of declaration to Sydney Airport is an example of where terms and conditions of access are determined purely by negotiation between the parties, with a dispute mechanism applying when agreement cannot be reached.

A key difference between the three pathways is the different mechanisms for determining the terms and conditions of access. Such mechanisms are an important elements of an access regime — a regime that provided only an obligation to supply could be undermined through the setting of terms that would make access unprofitable or ineffectual.

However, in providing flexible instruments to cater for a range of circumstances, it is important not to lose sight of the presumption that, where possible, an environment for the commercial negotiation of access should be facilitated. This reflects the presumption inherent in economic reasoning that, in the absence of substantial transaction costs and asymmetric information, commercial negotiations are likely to lead to the best outcomes from an efficiency perspective.

It is likely that, over time, parties will move away from the more prescriptive forms of access regulation such as those adopting posted prices – towards forms of regulation that put greater emphasis on commercial negotiation. While more prescriptive regulation may be desirable in certain circumstances, increased experience in dealing with the Part IIIA processes is likely to build parties' confidence in undertaking direct negotiations, given the backing of an effective dispute resolution mechanism. This process is likely to be reinforced by a reduction over time in information asymmetries between parties.

Over time, this is likely to stimulate 'regulatory convergence' across industries towards the Hilmer Review negotiate/arbitrate model, with commercial negotiation of access as the principal mechanism, supported by efficient dispute resolution processes where negotiations fail.

4.5.3 Transparency and independence

Transparency and independence are important mechanisms for ensuring the efficacy of regulatory processes. In turn, this provides some guarantee that regulatory processes will be objective, unbiased, investigate important issues and rigorously consider available evidence. Sound regulatory processes that adhere to these principles help to ensure that:

- regulatory outcomes reflect, as closely as possible, the efficiency objectives of the regulatory regime; and
- parties with an interest in regulatory processes have confidence in those processes.

Transparency and independence of regulatory process are enshrined in Part IIIA and the Clause 6 principles. These features are discussed in sections 5 and 6 of this submission.

4.5.4 Promote economic efficiency

While the TPA does not set out an explicit, dedicated objective for Part IIIA, the Council has drawn on the general objective of s.2 of the TPA and the explanatory memorandum to the enactment of Part IIIA (through the *Competition Policy Reform Act 1995*) to apply a community welfare enhancement, or efficiency, objective for Part IIIA. This is consistent with general economic thinking on the appropriate role of economic regulation such as Part IIIA and the principles of effective regulation outlined in section 4.5.

The Council has approached its roles under Part IIIA by recognising that there are three broad components to the application of an efficiency objective in access regulation:

- first, ensuring the efficient utilisation of natural monopoly infrastructure, especially by denying infrastructure owners the opportunity to derive rents – in either the market for these services or in related markets – through constraining the availability of infrastructure services;
- second, facilitating efficient investment in natural monopoly infrastructure, especially by ensuring that:
  - infrastructure services are maintained and developed appropriately;
  - infrastructure owners (and potential owners) yield sufficient returns to provide incentives for efficient investment; and

– incentives for inefficient development of competitive infrastructure are minimised; and

- third, promoting competition in activities that rely on the use of the infrastructure service where competitive infrastructure services are not economically feasible.

These broad components of the efficiency objective of access regulation are largely compatible.

In practice, however, tensions between these components can and do arise. The clause 6 criteria are designed to explicitly deal with any practical tensions in this area by requiring dispute resolution and regulatory processes to take into account a wide range of matters in making determinations. This is discussed further in section 4.7.1.

4.5.5 Avoiding unnecessary duplication of regulatory processes

The Council considers that regulation and regulatory processes should be efficient. Important issues include:

- the application of general principles to all access regulation in Australia to minimise the transactions costs of regulation;

- the consolidation and co-ordination of institutional arrangements for regulation across relevant industries and across jurisdictions.

One aspect of this debate is whether access regulation should be designed and conducted on an industry-specific basis or through a more general approach. The Council examines this issue in section 2.3.4 and noted that there are costs and benefits associated with both industry-specific and general access regimes. However, most of the benefits associated with industry-specific access regimes can be realised under a general access regime without incurring the higher direct costs of a fragmented regulatory system.

Industry-specific regulation has the advantages of:

- greater scope to engage industry specialists in the regulatory institutions;

- industry-specific regulators have to master and use less information than a general regulator;

- increasing the total amount of available information.

It has also been argued that separate agencies allow for the use of yardstick competition by which to compare the behaviour of different regulators, especially in related industries such as gas and electricity.

Thus, in finding out about how it performs compared to others, each regulator can gain feedback on how well it is regulating.

However, most of these benefits can also be realised in a general regime through the contracting of specialist expertise where required. The Council noted in section 2.3.4 that the benefits of an economy-wide approach include the likelihood of progress on a broad front, reduced risk of distortions in resource allocation, and a lower risk of regulatory capture.

Industry-specific regulators are more easily captured than a general regulator, because it is easier for the regulated industry to devote resources to lobbying the regulator. Because all-purpose regulators mediate the interests of several industries at once, capture by any single industry is likely to be more resource-intensive, and thus much less attractive, than with an industry-specific regulator. Closely related to this point is that former industry regulators are likely to make good employees of the industry they regulate, given their specialised knowledge of the workings of the industry. Therefore, an implicit 'bribe' to employ such regulators upon their retirement is far more likely to be credible than similar implicit bribes directed at general regulators.

An aspect of capture that applies particularly to network infrastructure industries is public interference with agency decision-making. The problem arises out of three characteristics of network infrastructure industries:

- huge, mostly sunk investments;
- services that are regarded as public necessities; and
- customer lists which include most of the community.

If regulators are overly sensitive to populist pressure for post-investment changes in the rules of the game against the interests of private investors, the long-term result will be higher costs of capital and under-investment in network infrastructure industries. Additionally, populist pressures may be a convenient tool for competitors to the regulated incumbents, who are keen to cheap ride on infrastructure that has been subject to regulation. While large national regulators are not immune from this pressure, small industry specific regulators are likely to be particularly susceptible.

Linked to the debate over industry-specific versus generic regulation is the issue of fragmentation of regulatory regimes across State jurisdictions. In Australia, there is a blend of state-based and national regulation, and at each level, there is a blend of industry-based and generic regulation across industries. Australia began with a proliferation of regulatory regimes based around different industries in

each State. Since the Hilmer Review, some of these industry access regimes have been absorbed into generic access regimes, albeit state-based, and over time, more regulatory functions are also being absorbed by the general competition authority at the national level – the ACCC.

The Council considers that for infrastructure services with national characteristics – such as gas and electricity transmission and interstate rail services – a single generic national regulator is likely to deliver the most efficient outcomes, for the reasons set out above and in section 2.3.4.

Conversely, state-based regulation on an industry-by-industry basis is likely to exhibit the type of costs typically associated with regulatory fragmentation, while foregoing the potential benefits of a more centralised approach.

At the same time, a general economic regulator operating at the state level – across several industries – may sometimes be an appropriate framework for dealing with state-specific infrastructure, such as gas and electricity distribution networks, and shipping ports. This framework allows for alternative approaches to be tested, promoting innovation and a yardstick competition between agencies. To ensure that outcomes are efficient, regimes should require formal dialogue between regulators to ensure broad consistency of approach on a national basis.

The Council notes that Part IIIA facilitates both general access regulation applied in particular fact situations and the development of national arrangements. The scope for improved co-ordination and rationalisation of regulatory institutions, especially between Commonwealth, state and territory institutions, is discussed further in section 8 of this submission.

4.5.6 Timeliness

Effective regulation should provide prompt responses to issues as they arise, such as applications for coverage of services and the approval of proposed access arrangements.

The costs of slow processes are substantial. Overly lengthy processes increase uncertainty for businesses and may distort decision-making, including decisions on investment by infrastructure owners and access seekers.

Consequently, timeframes for regulatory decisions should be as short as possible, while being sufficient to address all regulatory tasks and provide affected parties with adequate opportunity to provide input.

The Council has sought to ensure that its processes under Part IIIA provide recommendations in a timely fashion, recognising that many matters raise highly complex issues that are difficult to resolve quickly. Generally, the Council considers that Part IIIA processes have worked in a timely way, particularly for declaration recommendations, recommendations under the Gas Code, and the approval of access regimes as effective that have been designed under intergovernmental processes.

4.5.7 Testing regulatory decisions

Another important dimension of effective access regulation is the availability of effective review mechanisms to test the efficacy of decisions by regulatory institutions. Effective review mechanisms help to ensure that access regulation meets its identified objectives, through, in particular, enforcing process requirements and ensuring appropriate use of regulatory discretion.

Review mechanisms can, however, exacerbate problems associated with undue delays in regulatory processes. An appropriate balance, therefore, needs to be struck between the aims of timely processes which minimise the direct costs of regulation, and the aim of ensuring the efficacy of regulatory processes and decisions, including through the availability of appeal mechanisms.

5 Declaration and arbitration

As discussed in section 2 of this submission, Part IIIA of the TPA provides a general framework for access regulation across a variety of circumstances and industries. This framework is capable of providing a flexible approach within an overarching, consistent set of principles. These principles determine both the type of infrastructure services that should be subject to access regulation and the broad form of that regulation.

The declaration/arbitration process is often regarded as the national access regime in total, with state or industry access regimes, such as those in gas and electricity, seen as 'outside' Part IIIA. This characterisation fails to recognise that all those regimes fall within the Part IIIA umbrella, with the declaration process acting as a discipline on other regimes.

The only regimes outside Part IIIA are those established through separate Commonwealth legislation – these are discussed in section 7 of this submission.

All other regimes – state, territory or private – potentially fall within Part IIIA, even if they have not been certified as effective or submitted as an undertaking. The possibility that the infrastructure services covered by those regimes might be declared provides an incentive for the regimes to be developed consistently with Part IIIA. The certification process (for state and territory regimes) and the undertaking processes (available for state, territory and private infrastructure) provide mechanisms to test this consistency, while declaration provides the ultimate mechanism to ensure the services are regulated in a way consistent with Part IIIA.

Declaration of a service does not entitle any person or organisation access to the services. Rather, it:

> *opens the door, but before an applicant to use the service can become entitled to use the service the applicant must progress to the second stage and either reach an agreement for access with the service provider or, in default of an agreement, have its request for access determined through an arbitration by the Australian Consumer and Competition Commission* (Sydney Airport decision, 40755).

Declaration is an important step within the negotiation/dispute resolution process as it provides for an enforceable right to dispute resolution if negotiation fails. This enforceable right to dispute

resolution is one of the significant departures from a traditional commercial arbitration model, as discussed in section 2.3.3.

This section examines the declaration provisions of Part IIIA and draws upon the Council's experience in assessing applications for declaration. It discusses the Council's approach to the declaration criteria and provides details of each of the applications the Council has considered to date. It makes a number of recommendations for minor change to the declaration criteria and processes. These changes are aimed at improving the timeliness of the declaration processes and to ensure consistency in the application of the declaration criteria across all infrastructure services.

This section also considers the arbitration process within Part IIIA and recommends changes to improve certainty for all parties and to ensure that efficiency is the paramount criterion in resolving disputes for declared services.

5.1 Services, facilities and market

5.1.1 Introduction

The declaration process in Part IIIA of the Act provides for access not to a facility but rather to a service provided by the facility (or, indeed, by part of the facility or by multiple sets of facilities).

The types of services that are declarable are defined in s 44B:

> *"**service**" means a service provided by means of a facility and includes:*
>
> *(a) the use of an infrastructure facility such as a road or railway line;*
>
> *(b) handling or transporting things such as goods or people;*
>
> *(c) a communications service or similar service;*
>
> *but does not include:*
>
> *(d) the supply of goods; or*
>
> *(e) the use of intellectual property; or*
>
> *(f) the use of a production process;*
>
> *except to the extent that it is an integral but subsidiary part of the service.*

5.1.2 Services

There are a number of general observations that can be made about Part IIIA services.

- It is the service provided by a facility and not the facility itself that can be declared. A service is something separate and distinct from a facility. It may consist merely of the use of a facility. Thus, for example, it is the rail track service, and not the rail track itself that could be the subject of a declaration recommendation.[31]

- The same facility may provide a number of different kinds of service. In addition, the same facility may provide a number of instances or occasions of the same kind of service; this is the case irrespective of the identity of service users or the operational ends of the service. (Hamersley Iron decision, 43034).

- A particular service may be provided by a multiple set of facilities so long as there is only one provider in respect of the service. It is important to note, however, that because Part IIIA was designed with access to services provided by natural monopolies in mind, an application for declaration of a service which requires the use of many facilities may not satisfy the other criteria in Part IIIA. S. 44F(4), in particular, requires the Council to consider whether it would be economical for anyone to develop another facility that could provide part of the service.

- Certain types of services are specifically excluded from the definition of service.[32]

Sub-section (d) excludes the service of supplying goods, except to the extent that it is an integral but subsidiary part of a service provided by means of infrastructure. For example, the transmission of gas along a pipeline can involve the supply of additional gas to fuel gas compressors. The supply of gas in this case may be an example of a subsidiary activity involving the supply of a good that is integral to the provision of a gas transmission service.

Sub-section (e) excludes the use of intellectual property, except to the extent that it is an integral but subsidiary part of the service. Thus, a declaration may cover services associated with use of technology without which the provider could not provide the declared service to a third party.

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31 See generally RAC v NSW Mineral Council (1998) 158 ALR 323.

32 Note that the services in the following examples are not necessarily services that would be declared.

Sub-section (f) excludes the use of a production process, except to the extent that it is an integral but subsidiary part of the service. The Federal Court has found that where a provider's use of the rail track facility was an integral and essential (but not subsidiary) part of its production process, the relevant service fell within this exclusion (Hamersley Iron decision, 43038).

The Council (and Hope Downs Management Services Pty Ltd) appealed this decision to the Full Federal Court (see section 5.4.1). Briefly, the Council considered that the Federal Court's decision at first instance was flawed because it failed to distinguish between a production process and something that is an input into that production process. The use of the rail track is a discrete input, in the same way as the use of electricity wires to transport electricity is a discrete input, into the production of iron ore, rather than part of the production process itself. However, the original applicant for declaration, Robe River Iron Associates, withdrew its application just prior to the Full Federal Court's hearing of the appeal. As a consequence, the Court lost jurisdiction to hear the appeal and the substantial issues of the appeal were not addressed.

Other exemptions

The following services are exempt from Part IIIA and therefore ineligible for declaration:

- any service supplied by Australia Post; s.32D *Australian Postal Corporation Act 1989*; and

- the supply of a telecommunications service by a carrier or under a class licence as defined in the *Telecommunications Act 1991;* s.235A.

A service cannot be declared if already the subject of an undertaking accepted by the ACCC: s.44G(1), s.44H(3).

5.1.3 Facility

The term facility is not defined in the Act, although examples including roads and railway lines are cited. The Tribunal stated:

> *The word `facility' is not defined, but the dictionary definitions may be of some help. For example, the Shorter Oxford Dictionary defines `facility' as `equipment or physical means for doing something'; but the Macquarie Dictionary adopts a broader concept, namely, `something that makes possible the easier performance of any action; advantage: transport facilities; to afford someone every facility*

> *for doing something* (Application by Australian Union of Students (1997) ATPR 41-573).

The Tribunal has noted that a key issue in determining the relevant facility is '*the minimum bundle of assets required to provide the relevant services subject to declaration*'. This is relevant because:

> *The more comprehensive the definition of the set of physical assets ... the less likely it is that anyone would find it economical to develop another facility within a meaningful time scale. Conversely, the narrower the definition of facility, the lower the investment hurdle and inhibition on development ...* (Sydney Airport decision, 40791).

The Tribunal considered an application for declaration of:

- the service provided by the use of the freight and passenger aprons and hard stands at Sydney International Airport for the purpose of enabling ramp handlers to load freight into and unload freight from international aircraft; and
- the service provided by the use of an area at the Airport to enable ramp handlers to store equipment and transfer freight to and from trucks.

The Tribunal found that most, if not the whole airport, including all the basic airside infrastructure (runways, taxiways and terminals) and related land side facilities were clearly essential to the services to which access was sought, and therefore constituted the relevant *facility* within the meaning of Part IIIA (Sydney Airport decision, 40792).

5.1.4 Market

S 4E of the TPA provides that:

> *For the purposes of this Act, unless the contrary intention appears, "market" means a market in Australia and, when used in relation to any goods or services, includes a market for those goods or services and other goods or services that are substitutable for, or otherwise competitive with, the first-mentioned goods or services.*[33]

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[33] S 44B expands the definition of markets for the purposes of Part IIIA to include trade or commerce outside Australia.

The Tribunal has defined "market" in the following way:

> *A market is the area of close competition between firms, or putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive* (*Re Queensland Co-operative Milling Association Ltd* (1976) 25 FLR 169 at 190).

This view of market has been accepted by the High Court in the Queensland Wire case (*Queensland Wire Industries Pty Ltd* v *The Broken Hill Proprietary Ltd and Another* (1989) 167 CLR 177) and was adopted by the Tribunal in the Sydney Airport case.

Dimensions of Markets

The relevant dimensions of markets include:

- the product market, that is the types of goods and services in a market. Product markets can be considered separate if their respective products are not substitutable in demand or supply. Products are substitutable in demand (and therefore in the same product market) if consumers will substitute one product for the other following a small but significant change in their relative prices. Substitution in supply occurs when a producer can readily switch its assets from producing one product to another.

- functional market. Functional market definition focuses on the different steps in a production process. In defining functional markets, the Council has had regard to the Tribunal's approach to functional market delineation in the Sydney Airports decision which is consistent with the approach identified by Professor Maureen Brunt (Brunt 1990) and further developed by Professor Henry Ergas, (Ergas 1997, pp. 1 - 3).[34] The Council considers that the two following conditions must be satisfied before markets can be regarded as functionally separate:

  – the layers at issue must be separable from an economic point of view (economically separable). This involves an assessment as to whether the transaction costs in the separate provision of the good or service at the two layers are so large as to prevent such

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[34] See, for example, the test of involvement and test of influence proposed in Smith and Walker, (1998).

separate provision from being feasible. In effect, to be in different markets, vertical integration must not be inevitable; and

– each layer must use assets sufficiently specific and distinct to that layer such that the assets cannot readily produce the output of the other layer (economically distinct). In effect, supply side substitution must not be so readily achievable as to unify the field of rivalry between the two layers.

Markets may be functionally separate even though there is a one for one relationship, that is to say, perfect supply and demand side complementarity. A good example of this is rail track and train operations. However, where complementarity is associated with economies of joint production or consumption such that separate provision or consumption was not economically feasible, the services will not be in functionally separate markets (Sydney Airport decision, 40772 - 40773).

- the geographic dimension of the market. This refers to the area covered by the market such as national, intrastate or regional markets. The reference to "other markets" in criterion (a) includes markets outside Australia.

- the temporal dimension of the market. This refers to whether the size and scope of the market is likely to change over time. The temporal dimension is particularly relevant where production technologies are continually changing. In order to determine the temporal parameters of markets, the Council generally has regard to long-run rather than short-run substitution possibilities.

5.1.5 Provider

When an application for declaration is received, the Council must inform the provider. If the Minister declares the service, it is the provider who may apply for review of the decision by the Tribunal. It is the provider who negotiates access where a service is declared and who may be bound by the Commission's arbitration of access disputes.

The provider is defined as the owner or operator of the facility that is used (or to be used) to provide the service; s.44B. There can only be a single provider in respect of each relevant service. The owner or operator may not necessarily be the person who in fact provides the relevant service (*RAC v NSW Minerals Council* (1998) 158 ALR 323). A partnership or joint venture which consists of two or more corporations can be treated as a single provider; s.44C.

5.2 The assessment criteria

The Act provides that the Council cannot recommend that a service be declared unless the Council is affirmatively satisfied of all of the following matters (Sydney Airport decision, 40755):

(a) that access (or increased access) to the service would promote 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) that access to the service can be provided without undue risk to human health or safety;

(e) that access to the service is not already the subject of an effective access regime; and

(f) that access (or increased access) to the service would not be contrary to the public interest.

The Council must also consider whether it would be economical for anyone to develop another facility that could provide part of the service.

5.2.1 Access would promote competition

Introduction

The purpose of this criterion is to ensure that declaration is only recommended where there will be tangible benefits in markets beyond the market within which access is sought. Those benefits may include reduced prices, improved services or new products.

The principle matters considered by the Council are:

- verification that the relevant upstream or downstream market (the additional market) is different from the market for the service to which access is sought; and

- assessment as to whether competition would be promoted in the additional market.

It is not necessary to precisely define the boundaries of all the possible markets, only to determine whether there are distinct markets.

Promotion of competition

The notion of competition is central to the TPA, including Part IIIA. As has been noted by the Tribunal, competition is a very rich concept, containing within it a number of ideas (QCMA (1976) 25 FLR 169). Competition is valued for serving economic, social and political goals. It is a mechanism for discovery of market information and enforcement of business decisions in light of this information. Competition is a dynamic process, generated by the market pressure from alternative sources of supply and the desire to keep ahead. The basic characteristic of effective competition is that no one seller or group of sellers has undue market power. Competition expresses itself as rivalrous market behaviour. It is a process rather than a situation.

The promotion of competition involves creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration will be better than they would be without declaration (Sydney Airport decision, 40775).

In general, it is fair to say that if barriers to competition are reduced, competition will be promoted (Sydney Airport decision, 40790). Competition will be promoted in upstream or downstream markets if the improved terms and conditions achieved in the market for the access service influence the conditions upon which products or services are available to consumers in the additional markets.

The Council does not look to promotion of competitors but rather the promotion of competition. Such an analysis is not made by reference to any particular applicant seeking to have the service declared (Sydney Airport decision, 40759). Instead, the Council makes an assessment of the impact of access generally on competition in a forward looking way, that is, with or without declaration.

The types of matters the Council considers in analysing the competitive process to assess whether competition will be promoted in an additional market through an access declaration include:

- benefits in the form of reduced prices and non-price terms (such as quality and availability) that affect inputs into or outputs from the relevant additional market;

- the structure of the additional market in which competition is said to be promoted. This provides information about whether benefits flowing from access are likely to be passed on as improved terms and conditions for the products or services in the additional market;

- whether there is an alternative source of competition in the additional market, other than the services provided by the

monopoly infrastructure, such that access would not promote competition in the additional market. If there are other opportunities to provide input to the additional market (for example, use of road instead of rail transport), the Council will closely scrutinise whether competition will be promoted in the additional market (for example, freight forwarding) through declaring access to the service (NCC 1997c); and

- whether the service to which access is sought is a material or insignificant input into the goods or services in the additional market. Where the service is a material input the benefits from access are more likely to promote competition in the additional market.

Access (or increased access) to the service

"Access to the service" in criterion (a) refers to the right provided to access seekers, where a service is declared, to negotiate access to the service. The words "increased access" underscores the emphasis of the declaration process on removing structural impediments or barriers to competition in markets that rely on services provided by monopoly infrastructure.

Existing access to a service is no bar to a consideration of whether a declaration should be made in respect of that service (Sydney Airport decision, 40796). Declaration is available where existing or new users are permitted access to the service, and seek the right to additional access beyond the amount presently permitted. It also provides for situations where only a limited number of users are currently permitted access.

5.2.2 Uneconomical to develop another facility

Introduction

The Council's approach to this criterion is to determine whether it would be uneconomical for anyone to develop another facility to provide competing services. This reflects the Council's view that this criterion is designed to identify where development of competing infrastructure would be inefficient. The intent is that the services of competitive infrastructure (whether in actual or potential terms) should not be declared.

The Tribunal in the Sydney Airports case has supported this approach (Sydney Airport decision, 40793). The Tribunal held that "another" facility must be one capable of providing services competitive with those provided by the relevant facility. Services that are merely complementary to those provided by the relevant facility, should not be regarded as competing services for the purposes of this criterion.

The objectives of the legislative scheme are best met by having regard to the provisions of competing services provided by other existing facilities, rather than limiting consideration to new facilities. Where an existing facility already provides, or could provide with minor modifications or enhancements, services that are competitive, this criterion would not be satisfied.

The notion underlying the national regime is that access to facilities with natural monopoly characteristics is needed to encourage competition in related markets.[35] The Council therefore expects that the application of the national regime will be limited to facilities with natural monopoly characteristics.

Where a natural monopoly exists, the barriers to entry for potential competitors mean that, in the absence of non-market controls (such as access regulation), the incumbent has substantial power over pricing and service provision. This power is usually unencumbered by the threat of entry into the market by a competitor (Sydney Airport decision, 40771).

Access legislation encourages efficient use of natural monopoly infrastructure and promotes competition in markets dependant on services provided by the infrastructure. In this way, access provides opportunities for improved outcomes to consumers and businesses.

An assessment that it would be economical for someone to develop another facility to provide the service has a temporal element. Developments in technology may result in a facility becoming economical to develop in the future.[36] This possibility is dealt with in two ways.

First, a declaration decision must be for a specified period of time, rather than continue indefinitely. Subsequent declarations can only be made following a fresh application and a new determination that the criteria are met.

Second, under s.44J the Council may recommend that a declaration be revoked if it considers the criteria are no longer met.

The importance of revocation mechanisms and re-examination of the need for access regulation for particular services was discussed in section 4 of this submission.

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35 See Second Reading Speech for the Competition Policy Reform Bill.

36 Similarly, the applicability of the other declaration criteria may change over time in relation to a particular service.

"Anyone", "Another Facility" and "Uneconomical"

'Anyone' does not include the existing provider of the existing facility. As the Tribunal has noted:

> *This interpretation is more consistent with the underlying policy of Pt IIIA and economic and commercial commonsense. If "anyone" were to include the provider owning or operating the bottleneck facility in issue, a second facility might be developed without a second competing service being available to prospective users. The bottleneck would persist* (Sydney Airport decision, 40792).

It is not merely another facility that must be uneconomical for anyone to develop, but rather another facility to provide the service the subject of the application (Sydney Airport decision, 40791). As previously noted in the discussion of facility, a key issue will be the minimum bundle of assets required to provide relevant services.

Uneconomical is construed in terms of the associated costs and benefits of development for society as a whole. As noted by the Tribunal, this interpretation is consistent with the underlying intent of Part IIIA (Sydney Airport decision, 40793). It is a broader test than the commercial view of uneconomical, which is focused on questions of profitability. It is likely that in most circumstances, assessing either the commercial costs and benefits or the wider social costs and benefits will lead to the same result. However, the objective of Part IIIA access is not just promoting competition, but realising the benefits of competition, most notably, a more efficient allocation of the country's resources.

Services provided by multiple facilities

The related criterion to s 44G(2)(b) is s 44F(4). It provides that in:

> *"deciding what recommendation to make, the Council must consider whether it would be economical for anyone to develop another facility that could provide part of the service. This subsection does not limit the grounds on which the Council may decide to recommend that the service be declared or not be declared"*

S 44F(4) is a related but distinct consideration to s 44G(2)(b). The Council's view is that this consideration forms part of its residual discretion (NCC 1999a, p.13). That is, where the Council is affirmatively satisfied of all the criteria for declaration, it may still recommend that the service not be declared if it considers that it

would be economical for anyone to develop another facility that could provide part of the service.

In some instances, complementary facilities combine to provide a comprehensive service. If a person cannot use those facilities they cannot access the comprehensive service (Tasman Asia Pacific 1997). In the case of rail, for example, this would encompass facilities such as signalling systems and level crossings. However, there will be instances where it is economical to build new facilities that otherwise appear to be complementary.

It is possible that it would be economical for someone to develop a facility to provide part of the service when either:

- the service is provided by several separate facilities; or
- the service has a number of component parts that could be separated.

5.2.3 National significance

Introduction

This criterion establishes a test of materiality by placing less important facilities outside the scope of Part IIIA. While declaration is concerned with access to services rather than access to facilities, this criterion applies to the facility in question and not the service to which the applicant is seeking access.

Size

The physical dimension of the infrastructure may indicate that a facility is of national significance. Size of a facility will most often refer to its capacity or the throughput of goods and services that use the facility. In cases where the facility involves a computer network, for instance, it may be considered to be nationally significant by reference to the quantity of information stored by the network (Australian Union of Students decision, 43960).

Constitutional trade or commerce

Constitutional trade or commerce means any of: trade or commerce among the States; trade or commerce between Australia and places outside Australia; trade or commerce between a State and a Territory or between two Territories. The importance of the facility to constitutional trade or commerce may be indicated by the monetary value of trade dependent on the infrastructure facility, or the importance of the facility to trade or commerce in related markets.

Importance to the national economy

In assessing the importance of an infrastructure service to the national economy, the focus is on the market or markets in which access would promote competition. National significance is established if the additional market or markets provide substantial annual sales revenue to the participating business or businesses.

5.2.4 Human health or safety

Some facilities may require a degree of spare capacity to provide appropriate safety margins. In addition, access to facilities may need to be governed by conduct codes and operational guidelines. Access must be possible without compromising system and operational integrity and safe scheduling or timetabling must be feasible.

Many of the details that surround the terms of safe access to the service and the number of organisations to whom access should be provided will properly be the subject of negotiation between the various parties, or arbitration by the ACCC, should the service be declared.

While this criterion does not specifically refer to increased access, it is necessary to be satisfied that access can be provided without undue risk to human health and safety. It does not follow that simply because access to the service is currently being provided, that this is occurring without undue risk to human health or safety (Sydney Airport decision, 40794).

5.2.5 Effective access regime

Infrastructure services covered by effective access regimes cannot be declared.

State and Territory regimes

For State and Territory access regimes[37], the criteria for judging effectiveness are set out in clauses 6(2)–(4) of the CPA. These clauses, and the Council's interpretation of them, are discussed in section 6 of this submission.

An assessment of whether a State or Territory regime is effective is made at the time an application for declaration is considered, unless the regime has already been certified effective. The effectiveness of a certified regime may need to be re-examined if, since certification,

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[37] Where States and Territories are parties to the Competition Principles Agreement.

there have been substantial modifications to the access regime or to the relevant CPA principles.

Commonwealth/private regimes

In contrast to State and Territory access regimes, there are no specific criteria to assess the effectiveness of other access regimes.

There is no legislative indication of how to assess the effectiveness of Commonwealth access regimes. In considering the effectiveness of such a regime, the Council will have regard to the outcomes produced by the regime, whether they are economically efficient and any other public interest considerations. The Council will look to the legal enforceability of the regime by all potential access seekers. The Council will be guided by the clause 6 principles.

The requirement for legal enforceability means that it is unlikely that a private regime could be regarded as effective. However, private infrastructure owners have the option of submitting an access undertaking for approval to the ACCC.

5.2.6 Public interest

Introduction

The term public interest is not defined in the TPA, and is difficult to define with any great specificity. This is partly because conceptions of the public interest are likely to change over time as community attitudes change. In addition, public interest considerations for each application will include a range of common and unique factors.

A key consideration in the assessment of the effect of a declaration on public interest is the impact on the welfare of the community as a whole. While economic efficiency is an important consideration that is always considered, other specific public interest factors also need to be considered.

Criterion (f) has been expressed in the negative – "not contrary to the public interest" – rather than the positive – "in the public interest". This reflects the fact that criteria (a) to (e) already address a number of positive elements in the public interest and, as discussed in section 2, is consistent with the approach to public interest/benefit in other sections of the TPA.

Economic Efficiency

A key public interest consideration is the effects of declaration on economic efficiency.

Economic efficiency considerations entail production at least cost (technical efficiency); ensuring that services are provided to those who value them most highly (allocative efficiency); and preserving incentives for innovation and investment (dynamic efficiency).

In considering whether granting access would be economically efficient, it is necessary to assess the benefits and costs of declaration. Potential gains from declaration include reduced prices for the declared service and enhanced competition in related markets, promoting improvements in each aspect of efficiency. Potential costs of declaration include administrative and compliance costs for businesses. They also include the costs of "regulatory failure" caused by the interference in property rights. If applied inappropriately, Part IIIA could undermine price signals, innovative activity or the incentives for investment.

It is important to avoid applying Part IIIA 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.

Other public interest considerations

Some public interest considerations have been outlined in the discussion of the various criteria above. While no attempt to list public interest considerations can be exhaustive, matters which might be considered include the items in clause 1(3) of the CPA, such as:

- ecologically sustainable development;
- social welfare and equity considerations, including the distributive consequences of industry reform strategies and the maintenance of community service obligations;
- transitional issues created by reform programs;
- policies concerning occupational health and safety, industrial relations, access to justice and other government services, and equity in the treatment of different persons;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally, or a class of consumers; and
- the competitiveness of Australian businesses.

Other relevant matters may include impending access regimes or arrangements, national developments and the desirability for consistency across access regimes, relevant historical matters and privacy.

5.3 Declaration process

Declaration provides for a two-stage process for access to a service provided by infrastructure:

- the decision by the designated Minister[38] to declare or not declare a service; and
- negotiation or arbitration of the terms and conditions of access.

Declaration involves:

1. the designated Minister or any other person (e.g., a business) making an application to the Council for declaration of the infrastructure service;
2. the Council assessing the application and making a recommendation to the designated Minister; and
3. the designated Minister either declaring or deciding not to declare the service.

The Minister's decision is reviewable by the Tribunal.

5.4 Applications for declaration

The Council has considered twenty-one applications for declaration since the enactment of Part IIIA. Nine applications were for services provided by rail infrastructure, ten covered ramp and cargo terminal services at Sydney and Melbourne airports, one was for a gas distribution service and another for a payroll deduction service.

A summary of the applications appears at Appendix A. The key issues and processes in each application are outlined below.

5.4.1 Robe River Iron Ore Associates

On 24 September 1998, the Council received an application from Robe River Iron Associates (RRIA) for declaration of the rail line service provided by Hamersley Iron Pty Ltd (Hamersley) in the Pilbara region of Western Australia.

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[38] The State Premier or the Chief Minister of the Territory are the designated Ministers where the provider in question is a State or Territory body and the State or Territory concerned is a party to the Competition Principles Agreement. If it is not a party (and all States and Territories currently are), the designated Minister is the Commonwealth Minister (see s 44D(2)(b)). The Commonwealth Minister is also designated for access to private or Commonwealth infrastructure services.

RRIA sought declaration of the rail line service provided by Hamersley so that it could use its trains to transport iron ore from its proposed West Angelas mine to Hamersley's line and along Hamersley's line to RRIA's overpass in the north of Chichester National Park. From that junction, RRIA would continue on its own rail line to its port at Cape Lambert.

The Council adopted a public consultation process in assessing the application, including: advertising for submissions (5 were received); releasing an Issues Paper; giving additional time to several parties to allow them to adequately prepare their submissions; meeting with RRIA and Hamersley and other interested parties; commissioning a study from Rail Management Services Pty Ltd on certain issues; and retaining Dr Joshua Gans, Associate Professor at the Melbourne Business School, to provide advice.

Recognising that certain issues required further consideration, the Council decided to release a discussion paper seeking views of interested parties before finalising its recommendation. These issues included: the extent of the influence of Pilbara mining activities in the international iron ore market; the manner in which access to the rail line might increase competition in the market for rail haulage services; the nature of upstream markets in which competition might be promoted; the relative costs of expanding the line compared with building a new line; and the impact that declaration might have on investment in iron ore production capacity. At the time that the discussion paper was issued, proceedings were ongoing before the Federal Court.

On 30 October 1998, Hamersley brought an action in the Federal Court against the Council and RRIA. Hope Downs Management Services Pty Ltd was later joined as a respondent. Hope Downs Management Services, a company jointly owned by Hope Downs Iron Ore Pty Ltd (a subsidiary of Hancock Prospecting Pty) and Iscor Australia, was managing the development of a possible new iron ore mine at Hope Downs. Among other things, Hamersley argued that the rail line service was an integral part of its production process that was exempt from the application of Part IIIA. Accordingly, Hamersley argued the Council did not have jurisdiction in relation to the application.

The Federal Court handed down its decision on 28 June 1999 concluding the service to which RRIA was seeking access was an integral (and not subsidiary) part of the production process and therefore not a 'service' within the meaning of Part IIIA.

Hope Downs and the Council lodged appeals against the decision. On the first day of the hearing of the appeals, the Court was informed that RRIA had withdrawn its application for declaration of Hamersley's rail line service. After accepting undertakings from Hamersley, which

mean that neither the Council nor Hope Downs are constrained in the arguments which they may put in matters arising in connection to any future declaration application, the Court then decided the appeals were forever stayed.

5.4.2 Western Australian Rail Services

On 25 July 1997, the Council received five applications from Specialized Container Transport (SCT) for the declaration of certain Western Australian rail services. SCT carries freight on Westrail track between Kalgoorlie and Perth continuing on from the transcontinental railway owned by Australian Rail Track Corporation Ltd (ARTC).

The five applications sought declaration of a number of services provided by Westrail. These included: the Westrail railway network service and associated infrastructure between Kalgoorlie and Perth; particular arriving and departing services at the Forrestfield yard; particular marshalling and shunting services operated on Westrail track; particular Westrail network services and associated infrastructure to enable SCT to undertake its own marshalling and shunting activities; and fuelling services operated on Westrail track.

Key issues raised in the Council's process included:

- existing levels of competition in the freight forwarding market — the Council concluded that air transport was not a substitute for rail, that sea transport was a theoretical but not practical substitute for rail, and that road transport was a possible substitute for rail, particularly in non-bulk freight forwarding services;

- whether access would promote competition in another market — the Council concluded that this was the case for the rail service but not for the freight support services (the arriving/departing services, marshalling/shunting access and services, and fuelling services);

  – the Council considered that access to the freight support services would promote competition in the short term but in the long term could discourage competition as investment in the necessary facilities would be discouraged;

- whether it would be uneconomical to develop another facility to provide the service — the Council considered this to be the case for the rail service but not for the freight support services (in particular, the Council did not accept the applicant's contention that the test includes whether or not the facility could be developed within a specified period of time); and

- whether the facilities were of national significance — the Council concluded this to be the case for the rail service on account of its

size and the value of freight transported on it, but not for the freight support services.

On 21 November 1997, the Council recommended to the Western Australian Premier that the rail service be declared but that the freight support services not be declared.

On 20 January 1998, the Western Australian Premier announced that he had decided not to declare Westrail's rail line service and its freight support services. The Western Australian Premier decided not to declare Westrail's rail line service because he determined that an access regime, drafted by the Department of Transport, was an 'effective access regime' for the purposes of the Part IIIA criteria (Western Australia has recently withdrawn an application for certification of this regime, which it submitted to the Council in February 1999).

On 10 February 1998 SCT made an application for review of the Western Australian Premier's decision to the Australian Competition Tribunal. SCT later withdrew its application for review after reaching an agreement with Westrail.

5.4.3 Hunter Valley Rail Service

On 3 April 1997 the Council received an application from New South Wales Minerals Council Limited (Minerals Council) for declaration of the Hunter Rail Line service provided by the railway line and associated infrastructure facilities controlled by the Rail Access Corporation (RAC). The Minerals Council represents 21 coal producing companies that use the Hunter Rail Line to transport their coal.

In the application, the Minerals Council argued that the Hunter Rail Line has the characteristics of a natural monopoly and is of substantial importance to the Australian economy in that it is a vital conduit between mines and markets. It said that declaration should allow its members to negotiate directly with RAC and freight haulers, imposing competitive pressures on both services. The application also raised some concerns about the effectiveness of the existing New South Wales Rail Access Regime.

A threshold issue in considering this application was the interpretation of s. 78 of the *Competition Policy Reform Act 1995*, which provides that, for a period of 5 years, a government coal-carrying service is not a service for the purposes of Part IIIA. The Minerals Council argued that, in this instance, s. 78 did not apply. The Council sought independent advice on this issue. This advice supported the views put by the Minerals Council and concluded that the Council could consider the application.

Key issues raised in the Council's process included:

- whether access would promote competition in another market — the Council concluded that it would as RAC was the only provider of rail line services in the Hunter region; the markets in which competition would be promoted (rail haulage of Hunter region coal, the Australian coal market) are separate to the market for rail line services; and that access benefits are likely to be retained in the terms and conditions of products in other markets;

- whether it would be uneconomical to develop another facility to provide the service — the Council concluded that this was the case due to the high cost, difficulty in obtaining necessary land, the existence of significant spare capacity on the line and the fact that alternative haulage modes were uneconomic; and

- whether the facilities were nationally significant — the Council concluded that this was so due to the high cost of reproduction and the high value of goods shipped along the line.

On 1 September 1997, the Council recommended to the NSW Premier that the rail service be declared. As the Premier had not made any formal decision on the application by 3 November 1997 the service was deemed not to be declared in accordance with s. 44H(9) of the TPA.

In November 1997, the Minerals Council lodged an application for review with the Tribunal. In November 1999, the New South Wales Rail Access Regime was certified as 'effective'. The Minerals Council then withdrew its application for review, as there was now an 'effective' access regime under Part IIIA for the service.

5.4.4 Sydney to Broken Hill rail services

On 4 February 1997, Specialized Container Transport (SCT) applied to the Council for declaration of the Sydney-Broken Hill rail service provided by the New South Wales Rail Access Corporation (RAC).

SCT provides an interstate rail freight forwarding and distribution service. SCT was seeking to offer its own rail freight forwarding service between Sydney and Perth using RAC track between Sydney and Broken Hill. Specifically, SCT sought declaration of: standard gauge railway lines between Sydney and Broken Hill along the routes Sydney-Lithgow-Parkes-Broken Hill and Sydney-Cootamundra-Parkes-Broken Hill; and services provided by rail infrastructure facilities which are integral to providing access to these lines.

Key issues raised in the Council's process included:

- the nature of the relevant rail freight transport market — the Council concluded that the market is a point-to-point market, and that it is different to the market for access to rail track;

- the extent to which rail transport can be substituted by other transport modes — the Council concluded that road and rail freight are highly substitutable for some freights, particular non-bulk and short distance hauls, but are not highly substitutable for other freight services; and that there is some substitutability between sea and rail freight but little between rail and air freight;

- whether the rail track could be considered separately from the associated infrastructure and facilities under s. 44F — the Council concluded that the facilities are integral to providing the service and are therefore not separable;

- the potential for declaration to preclude the development of a national access regime for interstate track — the Council concluded that this would not occur as declaration would be revoked following certification of such a regime; and

- interface with the NSW rail access regime — the Council concluded that the regime was not an effective regime, and that there was no public interest argument against having certain lines subject to both Part IIIA and the NSW regime.

On 16 June 1997, the Council recommended to the Premier of New South Wales that the service to which SCT sought access be declared. On 18 August 1997, the Premier announced that he had decided not to make a formal decision in relation to the Council's recommendation given work being undertaken between the Council and the New South Wales Government in relation to its application for certification of the New South Wales Rail Access Regime. As a result, the service was deemed not to be declared.

On 27 August 1997, SCT lodged an application for review with the Tribunal. SCT later withdrew its application for review after reaching an agreement with the RAC.

5.4.5 Brisbane to Cairns rail freight services

On 24 December 1996, the Council received an application from Carpentaria Transport Pty Ltd seeking declaration of specified rail freight services on the Brisbane-Cairns corridor. Carpentaria transports and warehouses freight in Queensland.

Carpentaria sought increased access to services provided by Queensland Rail (QR) needed to run dedicated trains along the Brisbane-Cairns line (it already moved freight along the line by dedicated trains operated by QR). It specified a range of facilities –

including narrow gauge track, rolling stock, shunting equipment, lifting equipment and terminals – that it argued were necessary to provide the service.

Key issues raised in the Council's process included:

- whether rail linehaul services and freight forwarding services are in the same market — the Council concluded on several grounds that they are not, including because customers do not consider the service of rail transport to be substitutable for a freight forwarding service;

- whether access would promote competition in the freight forwarding services market — the Council concluded that this was the case, considering and rejecting a number of arguments including contestability between rail and road line-haul services and the fact that Carpentaria already had access;

- whether it would be economical to develop another facility to provide the service — the Council concluded that it would be economical to develop other facilities to provide the 'above rail' elements of the service, including rolling-stock and terminals, but not the track; and

- whether the facilities are nationally significant — the Council concluded that this was the case only for the track, due to its size, the importance of the ports served and the operation of the corridor as the main trunk line of Queensland's rail system.

On 3 June 1997, the Council forwarded its recommendation to the Queensland Premier. It recommended against declaration of the service. On 1 August 1997, the Queensland Premier announced his decision not to declare the service, although his statement of reasons differed in several respects from the Council's.

On 21 August 1997, Carpentaria lodged an application for review of this decision with the Tribunal. Carpentaria subsequently withdraw the application for review.

5.4.6 Sydney and Melbourne airport services

On 6 November 1996, the Council received applications from Australian Cargo Terminal Operators Pty Ltd (ACTO) to declare particular services at the Sydney and Melbourne International Airports. ACTO is a small business which provides cargo terminal services to international airlines.

The airport freight-handling industry consists of cargo terminal operators (CTOs) and ramp handlers. CTOs consolidate outgoing freight and break down incoming freight. Ramp handlers load

consolidated containers of freight on to aircraft. For third parties to compete, they must have access to the freight aprons and hard stands on the airports to load and unload aircraft, and a place to store equipment and transfer freight to trucks.

The applications sought declaration of the following services provided by the Federal Airports Corporation (FAC) respectively:

- the service provided through the use of the freight aprons and hard stands to load and unload international aircraft at Sydney International Airport (S1) and Melbourne International Airport (M1);

- the service provided by the use of an area at the airport to: store equipment used to load/unload international aircraft; and to transfer freight from the loading/unloading equipment to/from trucks at Sydney International Airport (S2) and Melbourne International Airport (M2); and

- the service provided by use of an area to construct a cargo terminal at Sydney International Airport (S3) and Melbourne International Airport (M3).

Key issues raised in the Council's process included:

- whether access would promote competition in another market — the Council concluded that increased access could have positive effects on price, service quality and differentiation, and investment in congestion-relieving facilities in the markets for ramp handling and CTO services;

- whether it would be uneconomical to develop another facility to provide the service — the Council concluded that it would be economical to develop cargo terminals off-airport, but not to develop alternate hard-stands (aircraft parking areas), aprons and space for parking and loading of equipment, as these would require the development of another airport;

- whether the facilities were nationally significant — the Council considered this question in the context of the airport as a whole, and concluded in the affirmative, on the basis of the growing market for air freight, the lack of opportunity to by-pass the services and the possibility they provide of creating new forms of business such as just-in-time inventory controls; and

- whether it was possible to operate an off-airport CTO facility safely in terms of its interface with on-airport ramp handling services — after commissioning a consultancy report, the Council concluded that this was the case provided that new entrants observed existing safety regulations.

On 8 May 1997, the Council forwarded its recommendations to the Federal Treasurer. It recommended that the services specified in the first and second applications should be declared (S1, S2, M1 and M2), but that those specified in the third should not be (S3 and M3). On 14 July 1997, the Treasurer announced his acceptance of the Council's recommendations and the reasons supporting them.

The FAC subsequently lodged an application for review of the Treasurer's decision with the Tribunal in relation to services at Sydney airport (S1 and S2). The Tribunal heard the application in December 1998. The Tribunal handed down its decision on 1 March 2000, affirming the Treasurer's decision to declare the services. The declarations are effective from 1 March 2000 until 28 February 2005.

The Tribunal's decision has clarified many of the contentious issues concerning the interpretation of the criteria for declaration. In particular, the Tribunal endorsed the view that declaration is primarily concerned with the services of natural monopoly infrastructure where access (or increased access) to those services would promote competition in another market. The Tribunal's approach is discussed in greater detail in the context of the declaration criteria earlier in this section.

5.4.7 Western Australian gas distribution services

On 4 September 1996, the Council received an application from Futuris Corporation Limited seeking access to supply natural gas to its gas-fired plants (used to manufacture bricks and related products) located in the Perth metropolitan area. Futuris identified the facility to provide the service as the AlintaGas high-pressure gas distribution system. Under Western Australia's then proposed access arrangements, Futuris claimed it could only negotiate access to supply gas to two brick plants, and was seeking access to deliver gas to all six plants.

Shortly after the Council acknowledged the declaration application, Futuris informed the Council that it was engaged in negotiations with AlintaGas, and requested that no further action be taken on the application until further notice.

On 18 November 1996, Futuris formally advised the Council that it had reached agreement with AlintaGas on particular issues and withdrew its application for declaration.

5.4.8 Certain payroll deduction services

On 24 April 1996, the Council received an application from the Australian Union of Students (AUS) seeking access to a service

described by AUS as the 'Austudy Payroll Deduction Service'. Austudy is a form of financial assistance provided by the Commonwealth Government to approved students.

AUS identified the facility to provide the 'service' as the Commonwealth Department of Employment, Education, Training and Youth Affairs' (DEETYA) computer network. In seeking declaration, AUS requested that the Council require DEETYA to establish a system of payroll deductions to enable AUS to be paid membership fees directly from students' Austudy payments. DEETYA did not already provide a payroll deduction service.

The Council evaluated the application against the declaration criteria in s.44G(2) of the TPA. It concluded that access to the service would promote competition in the market for student representation services. However, it was not satisfied that it would be uneconomical to develop another facility to provide the service, nor that the facility was nationally significant. The Council also concluded that access to the service would be contrary to the public interest.

On 19 June 1996, the Council recommended to the Commonwealth Treasurer that the services sought by AUS not be declared. On 14 August 1996, the Treasurer announced his agreement with the Council's recommendation and reasons.

On 30 August 1996, AUS lodged an application for review of the Treasurer's decision with the Australian Competition Tribunal. On 28 July 1997, the Tribunal affirmed the Treasurer's decision not to declare the service.

6 Effective access regimes - certification and undertakings

Under Part IIIA of the TPA, declaration is not available for infrastructure services already subject to an 'effective' access regime or to an undertaking. This section considers the certification of State or Territory access regimes as effective, drawing on the Council's work in this area. It also briefly considers the access undertaking pathway.

6.1 Effective access regimes

For access regimes developed by a State or Territory government, the criteria for judging effectiveness are set out in clauses 6(2)–(4) of the CPA.

The issue of "effectiveness" arises in two contexts:

- declaration applications (discussed in section 5); and
- certification applications.

6.2 Considering effectiveness in a certification application

The certification process is only available for State and Territory access regimes, where the relevant jurisdiction is a party to the CPA.

For a State or Territory access regime, the question of effectiveness can be pre-determined to provide certainty to interested parties. A Premier or Chief Minister may apply to the Council for a State or Territory access regime to be certified as effective.

The Council's recommendation on the matter is forwarded to the Commonwealth Minister, who must decide whether or not to certify the regime as effective and specify the period for which certification, if granted, will be in force.

The State or Territory Minister can apply to the Tribunal within twenty-one days for a review of the Commonwealth Minister's decision: s.44O. The Tribunal may affirm, vary or reverse the original decision and, once decided, the Tribunal's decision has the same effect as the Commonwealth Minister's decision.

6.2.1 Substantial modifications to a certified regime

A decision by the Commonwealth Minister (or Tribunal) that a regime is effective provides immunity in the event of an application to declare services covered by that regime.

However, an access regime may cease to be effective if it no longer satisfies the CPA principles. This may occur if the regime or the CPA principles themselves are substantially modified; s.44G(4). This would become an issue if there was an application for declaration for services covered by the regime.

6.2.2 Guiding principles

The TPA was amended in 1998 to clarify that there is flexibility available to the Council and the Minister in applying the clause 6 principles. S.44DA of the TPA notes that the clause 6 principles have the status of guidelines rather than binding rules.

While each of the clause 6 principles needs to be reflected in an effective access regime, the Council has avoided a narrow interpretation of the principles. The Council recognises that a range of regulatory arrangements are capable of promoting competitive outcomes and efficient use of infrastructure. In considering whether an access regime is effective in this regard, the Council considers the access regime as a package.

6.2.3 Key requirements

For a number of years the Council approached certifications by considering an access regime against each of the clause 6 criteria in turn. At times this proved to be a cumbersome process and failed to give an overall sense of the structure of a regime. More recently, the Council has adopted an approach of grouping the clause 6 criteria under a number of broad requirements. In essence, the requirements for certification of an access regime are:

- appropriate coverage of services;
- appropriate treatment of interstate issues;
- an effective model to facilitate access and competition, including scope for commercial negotiation underpinned by an independent regulatory framework;
- independent and binding dispute resolution;
- appropriate guidance to the arbitrator and the regulator; and

- terms and conditions of access that deliver competitive outcomes.

These requirements and the underpinning clause 6 principles are summarised in Table 1.

Table 1: Broad Requirements for certification

Requirement	*Relevant principles*
Appropriate coverage of services.	6(3), 6(4)(d).
Appropriate treatment of interstate issues.	6(2), 6(4)(p).
Effective model to facilitate access, with scope for commercial negotiation underpinned by independent regulation.	6(3), 6(4)(a)-(c), (e), (i), (m), (n), (o).
Independent and binding dispute resolution.	6(4)(a)-(c), (g)-(i), (o).
Appropriate guidance to the arbitrator and the regulator.	6(4)(i), (j), (l).
Terms and conditions of access that deliver competitive outcomes.	6(3), 6(4)(a)-(c), (e), (f), (i), (m), (n).

6.3 Coverage of services

Relevant clauses: 6(3), 6(4)(d)

The clause 6 principles set parameters for the kinds of services that can be subject to an effective access regime.[39] They also require that coverage be subject to periodic review.

Clause 6(3) establishes threshold criteria that limit the scope of effective access regimes to services provided by significant infrastructure facilities where:

- duplication of the facility is not economically feasible – clause 6(3)(a)(i);

[39] While a State or Territory access regime may cover services which do not satisfy the clause 6(3) tests, the Council may only recommend certification in regard to those services which satisfy these tests.

- access is necessary to permit effective competition in an upstream or downstream market – clause 6(3)(a)(ii); and

- safe use of the facility by an access seeker is economically feasible and is subject to appropriate regulatory arrangements – clause 6(3)(a)(iii).

In essence, the clause 6 principles refer primarily to significant infrastructure services provided by natural monopolies. The 6(3) tests are intended to limit access regulation to services where tangible benefits are likely to flow to users and the community more generally.

In many ways, the 6(3) criteria are similar to the declaration criteria under s.44G(2) of the TPA. As far as possible, the Council applies each set of criteria in a consistent manner, in the sense that the purpose of certification is to clarify whether State regulation governs otherwise 'declarable' services.

In some cases, an access regime expressly excludes certain services. This might occur if the services are considered economically viable to duplicate, or are subject to different ownership from covered services.

An exclusion may raise certification issues if the omission poses a significant barrier to access. This would be the case, for example, if the excluded service is integral to gaining access to the services covered by the regime.

6.3.1 Proposed services

An effective regime may regulate access to a proposed service that will be available in the future.[40] If the applicant government is not in a position to apply the 6(3) criteria at the time of the certification application, the regime should include a coverage mechanism to ensure that the criteria are applied in an independent and transparent manner at the appropriate time.

The Council has previously approved a coverage mechanism of this kind in the National Gas Regime.[41] The regime has been certified as effective[42] for the services provided by pipelines 'covered' by the

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[40] s 44(M)2 of TPA. Amendment inserted in 1998.

[41] Section 1 of National Gas Access Code.

[42] The National Gas Regime has been certified as effective through its application in South Australia, Western Australia and ACT. Recommendations in respect of New South Wales and Victoria are currently with the Minister. The Council has yet to conclude its process in respect of Qld and NT has not yet applied for certification.

regime. Pipelines outside the regime are not protected by the certification and are subject to declaration.

6.3.2 Review of coverage

An effective access regime should provide for a periodic review of the need for access regulation to apply to a particular service. For example, while a facility might not be economically feasible to duplicate at present (and so might warrant an access regime), market evolution and technological innovation might change this situation over time and remove the need for access regulation in the future.

To ensure that this assessment occurs, appropriate review requirements should be mandated within the regime itself. The process could occur by way of:

- scheduled reviews. The Council has approved this approach in a number of a rail access regimes[43]; or
- revocation provisions allowing parties to apply for a review. The Council has approved this approach in the National Gas Regime (NCC 1997d).

The mandated review process should be independent and transparent.

6.3.3 Pre-existing access contracts

Clause 6(4)(d) notes that a coverage review should not automatically revoke pre-existing contractual rights and obligations. This does not mean that they could not be revoked. Rather, it means that some process, such as a review, would first need to be undertaken before such rights could be revoked.

This principle recognises a legitimate need to maintain commercial certainty for infrastructure operators and users. It also recognises that foundation infrastructure users, whose commitments underpin new infrastructure development, bear greater risks than businesses which decide to make use of it after it has been built. These contexts should be taken into account in any review of existing contractual rights and obligations.

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[43] See, for example, NCC 1999b, p 59-61.

6.4 Interstate issues

Relevant clauses: 6(2), 6(4)(p)

Clause 6 establishes principles for the treatment of:

- facilities with an influence beyond a single jurisdiction; and
- services that are subject to multiple State access regimes.

6.4.1 Interstate influence of facility

Clause 6(2) provides that in some circumstances it is appropriate for access to be regulated by a state or territory access regime unless:

- the facility providing the service has an interstate influence that the access regime is unable to regulate; and/or
- substantial difficulties arise because the facility subject to the regime crosses a State border.

Clause 6(2) issues must be considered in regard to:

- a facility that crosses a State border – for example, a cross-border railway track or gas pipeline. In these cases, State-based regulation could result in conflicting approaches to access on either side of the border, imposing substantial costs on business and inhibiting interstate trade. Another problem is that a piecemeal state-by-state approach could result in unregulated gaps in the network; and
- a facility wholly located within a jurisdiction, but which is part of a wider interstate network – for example, a State rail network that also forms part of an interstate network. In this case, inefficiencies could arise if access to State-based services is determined without consideration of the requirements of interstate demand.

This principle has not been interpreted so as to prevent the development of State or Territory regimes for services that have an interstate aspect. Rather, it has been interpreted to ensure the regimes deal with the issues in an appropriate way.

Three issues that are likely to need co-ordination are:

- terms and conditions of access across borders should be compatible. For example, an access seeker should be able to negotiate the seamless flow of a service across borders (for example, a seamless interstate train path); and safety accreditation requirements between the relevant States should be compatible.

- arbitration processes should be consistent to avoid imposing multiple costs on parties. For example, the WA Rail and NT/SA Rail regimes contain measures to provide for a common arbitrator in disputes involving cross-border services.

- the regulatory framework should take into account regulatory arrangements in other relevant jurisdictions.

In some cases, mechanisms such as those noted above may be sufficient to address interstate issues. In other cases, a common approach to access regulation may be needed to achieve efficient outcomes. This could be achieved, for example, through:

- a co-ordinated inter-governmental process to implement a uniform framework for access. This has occurred in the gas and electricity sectors;[44]

- Commonwealth Government legislation; or

- cross-vesting arrangements between relevant jurisdictions to establish a single process for access to cross-border services.

6.4.2 Multiple access regimes

For a service regulated by more than one State access regime, clause 6(4)(p) requires a single process to seek access, resolve disputes and address enforcement issues. The rationale is to ensure that, in effect, only one set of access provisions applies to the service, promoting timely and efficient outcomes.

Clause 6(4)(p) considerations arise in the context of a service located in more than one jurisdiction – for example a service provided by a cross-border gas pipeline or railway line.

However, clause 6(4)(p) issues would also arise where more than one State access regime applies to a service located within a particular jurisdiction.

To satisfy this clause, the relevant State access regimes could contain provisions to apply a single regime to the entire service. For example:

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[44] The *National Gas Regime* was developed by the Gas Reform Task Force (later reconvened as the Gas Reform Implementation Group), while the *National Access Code* for electricity services was developed by the National Grid Management Council. Each body was established by the Council of Australian Governments (COAG).

- the Northern Territory and South Australia passed identical legislation to establish the NT/SA Rail Regime, including the establishment of a single regulator;

- States and Territories adopted cross-vesting arrangements under the National Gas Regime to ensure that only one jurisdiction's access legislation applies to cross-border pipelines.

6.4.3 The relationship between 6(2) and 6(4)(p)

Clause 6(4)(p) elaborates on one kind of issue that may also arise under clause 6(2) – the issue of multiple access regimes being applied to a single service. But the scope of clause 6(2) is wider than 6(4)(p), as it also encompasses the influence of a particular facility beyond a State border. For example, the influence of a rail service located in a particular State is likely to extend to interconnected rail networks across the border – including those owned by separate providers.

6.5 Facilitating access

Relevant clauses: 6(4)(a)-(c), (e), (f), (g), (h), (m) and (n)

An effective access regime requires a credible framework to facilitate access to services covered by the regime. Essential elements include scope for commercial negotiation supported by binding dispute resolution.

6.5.1 Scope for commercial negotiation

An effective access regime must allow the parties scope to determine the terms and conditions of access through commercial negotiation. This principle – set out in clause 6(4)(a) – includes negotiation on price and other matters such as service standards. For example, access to rail infrastructure would require negotiation of such matters as train path and performance issues.

Commercial negotiation allows parties to try to reach mutually beneficial agreements. But in isolation, it may not always provide efficient access outcomes. Where infrastructure exhibits natural monopoly characteristics, access seekers will typically lack the necessary information and bargaining strength to negotiate competitive terms and conditions. As such, relying on pure commercial negotiation is likely to permit infrastructure operators to maintain monopoly rents at the expense of users – and ultimately, the wider community. For this reason, clauses 6(4)(b) and (c) require commercial negotiation to be underpinned by enforceable rights for access seekers.

The Council considers that a fundamental requirement is for access seekers to have the right to enter into credible negotiations with a facility owner. To achieve this, market power and information asymmetry issues must be addressed.

6.5.2 Role of arbitration

Arbitration can be an appropriate forum to resolve an issue specific to the parties concerned – for example, a dispute over extension of a facility. Arbitration also has the advantage over more regulated approaches in that it is less intrusive upon property rights and less likely to deter new investment.

But it is not always the most effective way of establishing broad parameters of an access regime – such as benchmark prices or appropriate pricing boundaries. One problem is that credible pricing structures may only emerge after a number of lengthy disputes are resolved. Arbitration also fails the needs of access seekers requiring access at short notice or on an infrequent basis.

In addition, submissions to Council certification processes have noted that arbitration is a costly process. Disputes with a relatively small financial outcome pending are unlikely to be pursued through arbitration. In effect, they are likely to remain unchallenged, allowing the service provider to offer inefficient outcomes on these matters.

6.5.3 Regulatory design

The regulatory framework needs to address the potential abuse of market power that can arise in monopoly markets. In particular, an access regime should provide the following structural underpinnings:

- require the setting of ring fencing standards when appropriate by an independent body;
- require facility owners to use all reasonable endeavours to accommodate the requirements of access seekers; and
- prohibit conduct for the purpose of hindering access.

Further regulatory intervention may be necessary to establish prices and other terms and conditions. In regimes considered by the Council, this intervention has typically taken the form of regulatory guidance on indicative tariffs or reasonable price boundaries, and the release of appropriate information in this regard to the market.

The aim of this intervention is to equip access seekers with enough reliable knowledge to enter purposeful negotiations with a facility owner. It also gives owners and users greater certainty about their rights and obligations, reducing the range of issues likely to cause

disagreement and limiting the need for dispute resolution. The extent and nature of regulatory intervention will determine whether it augments the negotiation process or supplants it.

The Council considers that the most practical way to address regulatory issues is to equip an independent regulator with the necessary discretion and enforcement powers. This has been the approach adopted in most access regimes certified to date. In some cases, jurisdictions have conferred regulatory responsibilities across a number of industries on a generic economic regulator – such as the ACCC or the Independent Pricing and Regulatory Tribunal of NSW (IPART). In other examples, an industry specific regulator – such as the WA Office of Gas Access Regulation – has been established. In one regime considered to date – the NSW Rail Regime – an economic regulator was not established as part of the regime. Instead, a number of specific regulatory tasks were conferred on IPART.

Independent and transparent regulation

It is necessary for market participants to perceive regulatory processes as credible. Two essential elements of this credibility are independence and transparency.

Independence can be achieved through vesting regulatory powers in a single independent body, or through a suite of independent processes. In the access regimes considered to date, the approach most often used has been to establish a single independent body – a regulator – vested with the appropriate powers.

The essential criteria for independence is an arms length separation from facility owners, current users, access seekers, governments and other stakeholders. Regulatory bodies should enjoy a separate legal mandate, with freedom from day-to-day ministerial control in exercising regulatory functions. This degree of independence is needed to avoid the reality – or market perceptions – of conflicts of interest.

Another aspect of independence is for regulatory bodies to be allocated sufficient resources to undertake their duties effectively. Appropriate funding also engenders confidence in regulatory processes.

Transparency is equally critical in engendering market confidence in regulatory processes. Public consultation with high levels of disclosure is an appropriate way of making regulatory approval processes transparent. For example:

- the National Gas Regime requires the regulator to conduct open and transparent public processes on a proposed access undertaking, including benchmarking terms and conditions of access.

- the WA Rail Regime requires the regulator to conduct open and transparent public processes on a range of cost and pricing parameters, ring fencing arrangements, and other terms and conditions of access.

Ring fencing and competitive neutrality

Under clause 6(4)(n), an effective regime must impose appropriate accounting requirements on service providers. In particular, financial information must be made available that focuses exclusively on the elements of a business subject to the regime.

The availability of relevant accounting information is necessary for access seekers and regulatory bodies – including dispute resolution bodies – to make an assessment of the terms and conditions of access.

To satisfy clause 6(4)(n), an effective access regime should include provisions that require a facility owner to:

- maintain a separate set of accounts in respect of each service that is the subject of an access regime;

- maintain a separate consolidated set of accounts in respect of all of the activities undertaken by the facility owner; and

- allocate any costs appropriately that are shared across multiple services.

Vertical integration issues

More rigorous 'ring fencing' arrangements may be required in some industries to ensure that the necessary accounting information is transparently objective. The issue takes on critical significance in industries with high levels of vertical integration, where a facility owner operates or has interests in the same markets as third party access seekers. Vertical integration creates opportunities for transfer pricing and preferential treatment of affiliate businesses over third parties.

One option to address these issues is structural separation.[45] Alternatively, if a vertically integrated structure is retained, more extensive 'ring fencing' arrangements than those listed above may be required to ensure that objective financial information can be generated. These provisions should include measures to:

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[45] Clause 4 of the CPA specifies certain circumstances where structural separation must be considered. The relevant circumstances are where a public monopoly is to be privatised or where the market it supplies is to be exposed to competition.

- segregate access related functions from other functions;

- protect confidential information disclosed by an access seeker to the facility owner from improper use and disclosure to affiliated bodies; and

- establish appropriate staffing arrangements between the facility owner and affiliated bodies to avoid conflict of interest.

Competitive neutrality issues

Where vertical integration issues arise, ring-fencing provisions may not be sufficient to assure market participants that they will not be discriminated against by the service provider. Competitive neutrality provisions may also be required.[46] For example, the regime may need to prohibit anti-competitive price discrimination between affiliated users and third party access seekers operating in the same market.

In addition, vertical integration is likely to require especially rigorous provisions on transparency and regulatory oversight across the regime more generally (for example, in regard to pricing).

Accommodating the needs of access seekers

Clause 6(4)(e) requires that a facility owner use all reasonable endeavours to accommodate the requirements of access seekers. In access regimes considered to date, this principle has been underpinned in various ways, including regulations requiring a facility owner to:

- provide access seekers with written information on spare capacity[47] and indicative access terms and conditions, including sufficient

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[46] In some markets, resource allocation distortions can arise because certain participants enjoy advantages over others for reasons not related to competitive behaviour. Competitive neutrality refers to policies aimed at removing these distortions. In the context of access, competitive neutrality typically refers to neutralising competitive advantages enjoyed by a particular infrastructure user – over other users – because it is affiliated with the infrastructure owner. This can be distinguished, for example, from the competitive neutrality principles set out in clause 3 of the CPA, which relate to competitive advantages arising out of public ownership of significant businesses.

[47] The National Gas Access Code also requires that information be provided on developable capacity. This refers to capacity that may be created through investment in compressors or pipeline expansion within the existing geographical range of a pipeline.

information for access seekers to understand the derivation of tariffs;[48]

- use all reasonable endeavours to accommodate a person's request for access to spare capacity;

- respond to access requests and negotiate on terms and conditions within a reasonable timeframe; and

- provide a written explanation as to why a particular request for access cannot be accommodated, including likely prospects for future access.

Hindering

Clause 6(4)(m) requires that an effective access regime prohibit conduct for the purpose of hindering access.

This principle applies both to existing users – to reduce the risk of problems such as hoarding – as well as facility owners.

Guidance on terms and conditions

An effective access regime should address market power and information asymmetry issues so that meaningful negotiations between service providers and access seekers are feasible. While the dispute resolution process can provide this, as discussed in section 2 and earlier in this part, there are circumstances when relying solely on dispute resolution will not be appropriate. In these circumstances, a regulatory process within the regime may provide for a more efficient outcome.

The regulatory process could:

- verify that terms and conditions of access reflect efficient principles. These processes should relate to access pricing principles[49], as well as other relevant terms and conditions of access,[50] and should be undertaken in a transparent manner; and

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[48] Given the nature of information asymmetry between monopoly service providers and access seekers, the appropriate level of information disclosure should be sufficient to facilitate robust market assessments, but should not be used as a device to unduly harm the service provider's competitive position in the market.

[49] The pricing and cost parameters over which the regulator should exercise discretion will depend on the access pricing model used. For example, the *National Gas Regime* equips the regulator with approval powers over reference tariffs (benchmark tariffs) that an access seeker is entitled to receive, and which become binding in arbitration. Conversely, the *WA Rail Regime* equips

- make available sufficient information – including financial information – that has been independently verified to enable access seekers to enter credible negotiations with a facility owner.

The relevant regulatory mechanisms should be exercised independently and have appropriate powers to obtain information and documents necessary to perform these tasks.

Enforcement provisions

Under clause 6(4)(c), an effective access regime must have credible enforcement mechanisms. It may be appropriate for some provisions to be enforceable through arbitration or through the regulator.

For serious breaches, such as hindering, obstructing the regulator, or a ring fencing breach, enforcement might include:

- a robust penalty regime. For example, penalties in the National Gas and WA Rail Regimes are in the order of $100,000.

- the regulator and/or an aggrieved party able to seek an injunction to stop the breach.

Other remedies – such as criminal sanctions and civil damages – should be considered where appropriate.

Appeal rights

Regulatory processes can have a significant bearing on property rights. While independent and transparent processes provide important checks and balances to protect the rights of affected parties, other mechanisms may also be appropriate – for example, merit and judicial review mechanisms.

It should also be noted that under clause 6(4)(h), existing avenues of appeal should not be diminished. For example, a regime should not

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the regulator with powers to approve certain costs (including the WACC), underlying costing principles and floor and ceiling prices that set the boundaries for negotiation. In this regime, the regulator does not set actual tariffs, but actual prices must fall within the boundaries set by the regulator. The regulator will also inform an access seeker whether the price offered is consistent with the price charged by the facility owner to affiliated bodies.

[50] Other parameters requiring independent assessment will vary depending on the nature of the service. In the case of *rail* services, for example, relevant matters might include train path and network management policies, capacity transfer policies and operating standards. In *gas*, relevant matters might include capacity management policies, trading policies, queuing policies and extensions/expansions policies.

constrain parties from seeking judicial review on account of breaches of natural justice or bias.

The need for a merits-based appeal mechanism may depend on the circumstances. For example, the National Gas Regime introduced a limited merit review against certain decisions of the regulator, in response to concerns raised in public submissions. The mechanism adopted was designed to balance the risks of gaming behaviour and delays in access against the aim of protecting the rights of affected parties.[51]

6.6 Dispute resolution

Relevant clauses: 6(4)(a), (c), (g), (h), (k), (o)

6.6.1 Levels of dispute resolution

An access regime should provide appropriate mechanisms to resolve issues of contention between a service provider and access seekers. For example, the NT/SA Regime includes a three-tiered approach to dispute resolution:

- direction from the independent regulator during the negotiation phase;
- conciliation by the regulator, subject to agreement of the parties; and
- appointment of an arbitrator by the regulator.

An efficient way to resolve matters affecting all access seekers – such as guidance on pricing – may be through independent regulatory processes. But some disputes raise issues that are specific to the parties involved. Sometimes informal processes, such as conciliation, may resolve matters. In other cases, formal arbitration may be necessary.

The arbitration framework should be sufficiently robust to promote confidence among the parties. In particular:

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[51] The *National Gas Regime* includes a limited merits-based appeals mechanism on a regulator's decision to impose an access arrangement. The Council found this to be in accord with principles of natural justice, due process and accountability. The Council took into account the potential for the regulator's decisions to influence a service provider's property rights and financial position. It also made note of the relatively early stage of regulatory reform in the gas industry. See, NCC 1997d, p. 25-27.

- the dispute resolution body should be independent of all parties and have access to sufficient resources and expertise to fulfil its duties;

- the arbitration framework should be designed in such a way that outcomes can be expected to be reasonably consistent; and

- arbitration outcomes should be enforceable.

These matters are considered below.

6.6.2 Appointment of arbitrator

An effective access regime should permit the parties to a dispute to agree upon an independent body to resolve it. Accordingly, disputes may arise and be resolved as part of the commercial negotiation process – without recourse to the arbitration processes in the regime itself.

However, an effective regime must also address the circumstances where the parties cannot even agree upon how to resolve a dispute – including the identity of the dispute resolution body. To deal with this situation, an effective regime must contain a mechanism to ensure that an independent body is appointed to resolve a dispute.

One way of doing this would be for the regime to specify an independent body that could resolve disputes. Under the NSW Rail Regime, for example, IPART is designated as the dispute resolution body.

An alternative approach is for the access regime to provide for an independent person to appoint an independent arbitrator (perhaps from a panel of arbitrators). In the WA Rail Regime, for example, the arbitrator is appointed by the independent regulator from a panel pre-selected by the regulator in conjunction with the Chairman of the WA Chapter of the Australian Institute of Arbitrators.

6.6.3 Funding arrangements

Clause 6(4)(g) provides that an effective access regime should require the parties to a dispute to fund some or all of the costs of arbitration.

At the same time, the Council is mindful that the costs of arbitration should not become a deterrent to seeking access. An access regime will be more effective if it includes low cost approaches to dispute resolution (such as regulatory direction and conciliation) as well as full arbitration.

6.6.4 Independence of dispute resolution

An independent dispute resolution framework is necessary to engender confidence in the process. The Council adopts similar standards of independence with respect to arbitration as it does in regard to regulatory bodies. In essence, the arbitrator should be independent of service providers, users, access seekers and governments. Another consideration is independence from related regulatory bodies (see below).

An alternative is for an independent arbitrator or arbitrators to be selected by an independent person (perhaps from a panel of arbitrators). This model was adopted under the WA and NT/SA Rail regimes.

The Council considers that the process of dispute resolution includes all of the mechanisms available for resolving disputes, including arbitration and appeals processes. The Council regards this set of mechanisms as a package, with different elements capable of satisfying the need for independence.

While judicial review may provide another mechanism to address issues of arbitrator independence, the Council is aware that affected parties may find this avenue costly and time consuming.

6.6.5 Independence of the arbitrator from the regulator

The Council's work in certification has raised issues as to whether an arbitrator's independence is compromised if that body also fills the role of regulator of an access regime. The view has been put that such arrangements may create conflict or tension. For example, the body involved may be called on to make determinations on disputes about access prices which it has previously approved in its role as a price regulator.

While the Council is not opposed in principle to the roles of regulator and arbitrator being vested in the same body, it is concerned that appropriate safeguards exist to ensure independence where a party raises concerns in this regard. For example, a combination of some or all of the following mechanisms would be appropriate:

1. ring fencing of the body's arbitration functions from regulatory functions;

2. practice and procedure notes to provide for the body's arbitration functions to be carried out independently of regulatory functions;

3. a mechanism enabling any party to a dispute to require the regulator to appoint as arbitrator a person who has not been

substantially involved in regulatory decision making on the service in question.

4. an independent (administrative) appeals process to address questions of arbitrator bias or independence.

6.6.6 Quality of process

The arbitration framework should be sufficiently robust to promote confidence among the parties. While independence is an important element here, the arbitration framework should also be designed in such a way that outcomes are credible and reasonably consistent.

Credible outcomes are more likely if the arbitrator has sufficient resources and expertise to resolve complex disputes. The Council notes here the potential complexity of disputes in areas such as access pricing. In resolving a pricing dispute, the arbitrator must be capable of addressing the clause 6(4)(i) criterion, which include having regard to the "economically efficient operation of the facility" and the "benefit to the public of having competitive markets."

One way to achieve consistency is for a single arbitrator to hear all disputes. But if dispute resolution responsibilities are spread across a number of different arbitrators, additional measures may be needed.

To ensure that arbitration outcomes are credible and consistent, a combination of some or all of the following mechanisms may be necessary:

- ensuring that the arbitrator has sufficient resources and expertise to fulfil duties.

- vesting the arbitrator with appropriate information gathering powers. This is a specific requirement of CPA clause 6(4)(o).

- binding the arbitrator to observe determinations previously made by the regulator – thereby ensuring consistency, and shifting important layers of skill requirements from the arbitrator to the independent regulator.

- allowing the arbitrator to seek independent expert advice from the regulator, to provide for information flows and a consistent approach across different arbitrations.

- vesting the arbitrator with the power to determine process, including confidentiality and timeframe matters.

6.6.7 Determinations are binding

An effective access regime must have credible enforcement arrangements to ensure an arbitrator's decision is binding. To achieve this, the regime must require that an arbitrator's decision be reflected in a contract between the parties within a specified timeframe.

However, it is appropriate to allow an access seeker a limited period to decide not to be bound by the arbitrator's ruling. Otherwise, an access seeker might be compelled to accept terms that would not have been agreed to as a negotiated outcome – and may not be financially viable for the operator concerned. "Opt out" provisions of this kind appear, for example, in the National Gas, WA Rail and NT/SA Rail Regimes.

The enforcement process should be given effect through legislative provisions, with appropriate sanctions and remedies for non-compliance.[52]

6.6.8 Material change of circumstances

Clause 6(4)(k) refers to situations where a material change of circumstances occurs following the conclusion of an arbitration process. While this clause clearly applies to a change of circumstances following arbitrations, it probably derives from a suggestion in the Hilmer Review that a "declaration could be revocable on the showing of a material change of circumstances." (Hilmer 1993, p.253)

The Council has been reluctant to interpret this clause in a way that would compromise the certainty of contractual arrangements. Once a contract is signed – whether through commercial negotiation, or following arbitration – this should govern the relationship between the parties. The contract should make provision for all relevant matters including price and other terms and conditions of access. It would be appropriate for the parties to identify in a contract any factors that would constitute a material change of circumstances that would result in a contract being reopened.

This approach recognises that different infrastructure users have different risk exposures, necessitating provisions tailored to their individual needs. In such a situation, the parties would define for themselves what is the threshold for a "material change in circumstances". Indeed, parties to a contract may explicitly seek to provide very limited grounds upon which contracts may be reopened.

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[52] Should an access regime incorporate appeal provisions against an arbitrator's decision, the decision of the appeal body must bind the parties

For example, they may limit the grounds to those available normally for commercial contracts under the common law. At the same time, an access regime should not preclude the application of common law principles (for example, the doctrine of frustration) to matters of this nature.

An access regime could make provision for parties to refer disputes concerning what constitutes a material change in circumstances to the arbitrator. This would provide for circumstances where commercial negotiations fail to bring agreement on this matter.

6.7 Guidance for the arbitrator and the regulator

Relevant clauses: 6(4)(i),(j), (l)

The clause 6 principles require that an access regime provides appropriate guidance to the arbitrator in resolving disputes. Guidance may also need to be provided to regulatory bodies.

6.7.1 The 6(4)(i) principles

To ensure that arbitration outcomes reflect the clause 6 principles, the arbitrator must observe all of the matters set out in clause 6(4)(i). This requires the arbitrator to take into account a range of factors, including the legitimate interests of all parties, safety requirements and the public benefits of economic efficiency and competitive markets.

The Council notes that the clause 6 principles are written from the perspective of a negotiate/arbitrate regime with minimal regulatory intervention. As such, the principles state that an effective regime must provide guidance to the arbitrator, and make no mention of a regulator.

Some access regimes, however, empower a regulator to determine terms and conditions of access. Where this is the case, the application of clause 6(4)(i) is effectively transferred – at least in part – from the arbitrator to the regulator. In these circumstances, it is important that the clause 6(4)(i) principles are also used to guide regulatory decisions. This ensures that that the objectives underlying the certification principles are observed consistently across the regime. The National Gas Regime, WA Rail and NT/SA Rail Regimes are among the regimes to have adopted this framework.[53]

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[53] See, for example, s 2.24 and 6.15 of the National Gas Access Code.

6.7.2 New investment issues

In some situations, the needs of an access seeker can only be met by:

- extending the geographical range of a facility; or
- expanding the capacity of a facility.

These are matters that, in the first instance, should be subject to negotiations between the parties. But clause 6(4)(j) requires that where agreement cannot be reached, the arbitrator[54] must be empowered to require an extension, provided certain conditions are met.

Clause 6(4)(j) elaborates on these conditions, covering:

- technical and economic feasibility, and safety considerations;
- the owner's legitimate business interests; and
- adjustments to access tariffs to reflect the costs and benefits of the extension to the parties.

The Council considers that geographical extensions should not necessarily be the responsibility of a facility owner. It may be appropriate for a business seeking geographic extensions to undertake the necessary construction work itself and gain access to an existing facility through interconnection. For this to be feasible, an access regime would need to empower the arbitrator to require interconnection, provided the 6(4)(j) conditions are met. This approach was adopted in the National Gas Regime.

While the wording of 6(4)(j) refers only to extensions, a more efficient way to address a capacity issue is sometimes through expansion of capacity. For this reason, it would be appropriate to apply the 6(4)(j) principles to expansions. The National Gas Regime, WA Rail and NT/SA Rail Regimes adopted this framework.[55]

6.7.3 Impeding an existing right

Clause 6(4)(l) requires that a dispute resolution body may only impede the existing right of a person to use a facility where compensation issues have been considered, and where appropriate, addressed. This clause does not stop access regimes from preventing dispute

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[54] Depending on the design of the access regime, it may sometimes be appropriate to vest this power with the regulator.

[55] See, for example, s 6.22-6.23 of the National Gas Access Code.

resolution bodies impeding the existing rights of a person to use the facility. However, where a dispute resolution body can do this, it must also be empowered to consider and, if appropriate, determine compensation.[56]

6.8 Access pricing

Relevant clauses: 6(3), 6(4)(a)-(c), (f), (i), (n)

6.8.1 General principles

Clause 6(4)(i) lists a range of matters that should be taken into account when determining access tariffs.[57] The 6(4)(i) principles note, among other things, the importance of cost-related pricing, the efficient use of infrastructure, and the public benefits arising from competitive markets.

Clause 6(4)(i) is implicitly supported by clause 6(3). One of the purposes of access regulation – as set out in clause 6(3) – is to promote competition in related markets. This aim can only be achieved if an access regime delivers efficient pricing outcomes.

With these principles in mind, the Council considers that access tariffs and underlying cost structures should allow infrastructure owners to recover efficient costs but not allow for gold plating, inefficient operating practices or monopoly profits.

The extent to which the Council scrutinises access pricing issues depends on the design of the regime. In general, the Council considers the vetting of price and cost quantums to be a matter for regulatory or dispute resolution processes – assuming these processes are independent.[58] Rather, the Council will focus on:

- whether the underpinning price and costing principles reflect well-accepted methodologies for generating efficient outcomes;
- whether price and costing principles are determined in an independent and transparent manner; and

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[56] See, for example, s 6.18 of the National Gas Access Code.

[57] Clause 6(4)(i) is written from the perspective of a negotiate/arbitrate model. The Council considers 6(4)(i) to have equal relevance in access regimes where pricing is determined through regulatory processes.

[58] The Council would be obliged to examine any price and cost quantums that have been inserted in an access regime without an independent and transparent assessment.

- whether appropriate mechanisms are in place to ensure that actual costs and prices reflect the underpinning principles.

6.8.2 Measuring costs

Costs (including rates of return and valuation, depreciation and optimisation of assets) used to generate access tariffs should reflect:

- efficiency considerations; and
- accepted regulatory methodologies.

6.8.3 Approaches to pricing

Competitive markets oblige firms to offer prices that reflect efficient costs. In natural monopoly markets, competition is not available to drive costs down to this level. Under the Part IIIA framework, an access regime provides an alternative way of generating efficient prices in natural monopoly infrastructure markets. To fill this role, access regimes require mechanisms that can replicate efficient outcomes – including pricing outcomes.

Natural monopoly infrastructure is typically characterised by a high volume of capacity relative to initial demand – suppliers often operate with significant spare capacity in their early years of operations. High capital costs and long asset life – characteristics of such infrastructure – commonly mean that access providers face declining unit costs as demand rises. Setting prices to average costs in the early stages may therefore result in prices that discourage access – in turn, forcing up unit costs as demand weakens. However, setting prices to marginal costs may result in prices that are too low to secure the viability of the access provider.

Pricing approaches for natural monopoly services generally recognise these conditions. At a total revenue level, they commonly aim to recover no more than the long term efficient costs attributable to the services demanded. At an individual pricing level, they aim to recover all those costs directly attributable to the consumer, as well as a proportion of common costs. To preserve economic efficiency, the proportion of common costs charged to each consumer needs to cause little change in the demand of that consumer – that is, it should correctly estimate the consumer's "ability to pay".

Estimating this margin above direct costs can create a secondary problem for revenues – it can allow total revenues to exceed the efficient costs of supply. A group of customers may face prices that include too large a proportion of common costs. Their combined revenues may then exceed the long term efficient cost benchmark. The access provider would then make monopoly profits and the demand for

services would be suppressed inappropriately. To prevent this outcome, a total revenue constraint should apply.

With these contexts in mind, a number of alternative approaches to pricing may satisfy the CPA principles. To some extent, the appropriate framework may depend on characteristics of the particular industry and infrastructure. For example, posted (or fixed) tariffs are common in the electricity industry, reflecting the premium placed by market players on certainty of outcomes.[59] Conversely, a greater deal of flexibility in pricing occurs in rail, reflecting the fact that efficient outcomes can be achieved by recognising that capacity to pay varies widely across different categories of rail freight.

Three approaches to pricing that have been approved by the Council are:

- published reference tariffs (benchmark prices) approved by an independent regulator. This approach, adopted in the National Gas Regime, requires that reference tariffs be derived from efficient cost principles set out in the National Gas Code for nominated reference services. Once approved, reference tariffs form a basis for commercial negotiation for both reference and non-reference services (i.e. prices can vary from the reference tariff through negotiation), but an access seeker has a right to acquire access to spare capacity in the reference service at the reference tariff. The reference tariff for the reference service cannot be varied in arbitration. An advantage of this framework is that it provides considerable guidance to access seekers and certainty to all parties.[60]

- commercial negotiation of prices within a band approved by an independent regulator. In this approach, adopted by the WA Rail Regime, the regulator-approved floor price measures the costs the facility owner would avoid in the short term if access was not provided. The ceiling price – the upper constraint on pricing – represents stand alone costs of providing access, and covers forward looking efficient costs. The regulator-approved floor and ceiling prices form a basis for negotiation. While access seekers may negotiate prices within the band, the regime requires non-discriminatory pricing for users in the same market.[61] An access

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[59] At the same time, posted tariffs may raise issues under clause 6(4)(a).

[60] The Regime's pricing principles are set out in section 8 of the National Gas Access Code. Certification issues are noted in the Council's report on the regime. See, NCC 1997d.

[61] This provision is a response to vertical integration issues.

seeker has the right to arbitration if a dispute arises over price. An advantage of this framework is that it allows for considerable flexibility within an efficient pricing band.[62]

- A similar approach exists in the NT/SA Rail Regime, but with additional guidance on price for services where road freight provides competitive discipline on access prices. In effect, the rail access price for rail haulage of general freight currently transported by road is set with reference to the road freight rate.

  This approach was adopted on the assumption that investment in rail infrastructure in this instance was a marginal proposition vis-à-vis road transport.

6.8.4 Regulatory framework

Given the complexity of access pricing, and the likelihood of information asymmetry between facility owners and access seekers, an effective access regime should establish independent and transparent processes to verify that access prices are derived from efficient costs. In addition, an effective regime must provide industry participants with sufficient information about access pricing and underlying costs to enter the negotiation process with confidence that outcomes will be fair and reasonable. The Council considers these to be appropriate functions for an independent regulator.

6.8.5 Competitive tendering and access tariffs

An alternative approach to regulated access pricing – for infrastructure yet to be built – is to determine access tariffs as part of a competitive tender process to select the infrastructure operator. This approach is offered as a pricing alternative in the National Gas Access Regime.[63]

The Council considers a robust tendering process to be a sound mechanism for generating efficient pricing. The very purpose of access regulation is to replicate competitive outcomes where a competitive market is missing. As such, the adoption of a soundly-based market process to achieve this end would reduce the need for other forms of market guidance, such as regulator-assessed reference tariffs. However, the effectiveness of this approach requires the tendering process to be a genuinely competitive one. For this reason, *ex ante* oversight of the tendering process is essential. This may also

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[62] The WA Rail Regime's pricing principles are set out in Schedule 4 of the *Railways (Access) Code*. See also Part 5 of the *Railways (Access) Code*.

[63] s 3.21- 3.36 of the Code.

require a degree of *ex post* vetting to ensure that tendering outcomes are consistent with the approved process.

Oversight arrangements should be conducted through independent and transparent processes. For example, the National Gas Regime vests these powers with the independent regulator.

6.8.6 Constraining the arbitrator on access pricing

There has been considerable debate as to whether an arbitrator should have the power to vary pricing and cost parameters pre-determined by an independent regulator. The Council has previously considered alternative responses to this question.

Under the NSW Gas Regime (interim), an arbitrator had the discretion to depart from reference tariffs previously approved by an independent regulator. The Council accepted that this approach provided scope for commercial negotiation around the reference tariffs, which facilitates more literal consistency with clause 6(4)(a). It also allows the arbitrator the flexibility to consider the particular circumstances of a dispute. Finally, it permits an arbitrator to address any deficiencies in the initial regulatory process.

However, in considering the National Gas Regime, the Council was guided by the views expressed by industry participants – both on the demand and supply side – that the arbitrator should adhere to the reference tariffs approved by the regulator. It was argued that this would create a higher level of certainty and reduce the risk of gaming, delays and costly arbitration. It was further argued that this would avoid the need to duplicate the thorough processes of the regulator and promote a more stable environment for investment.

In the WA Rail Regime, the applicant responded to concerns over the skills and resourcing of the arbitrator by binding the arbitrator to determinations previously made by the independent regulator – on matters such as cost parameters. This approach effectively shifted important skill requirements from the arbitrator to the regulator. It also responded to the market's concern over inconsistent outcomes, due to the potentially large number of arbitrators involved in the regime.

The effectiveness of 'binding' the arbitrator requires that any 'fixed' parameters have been vetted through an independent regulatory process and have been found to be reasonable. As such, the

independence and appropriate resourcing of regulatory processes is crucial.[64]

6.8.7 Access pricing in secondary markets

While regulatory intervention is an appropriate response to market power and information asymmetry in primary markets for access, the argument is less convincing in secondary markets.[65]

In a secondary market, a facility user sells capacity to other businesses which want to use the service (as opposed to the sale of access to them by the facility operator itself, as occurs in the primary market). So, in a secondary market, businesses wanting to use infrastructure services can directly approach an existing user which is not utilising all of its existing entitlement, and seek to buy a portion of that user's entitlement.

Promoting secondary markets can bring three types of benefits:

- it can facilitate better utilisation of existing infrastructure, so the need to expand capacity could be deferred or avoided altogether;
- existing users gain flexibility to better manage risk if, for example, they are unable to use all the capacity they have contracted to purchase from the facility owner; and
- secondary markets can generate useful price signals, which might promote better informed commercial negotiation in primary markets.

Some secondary market arrangements seek to overcome the natural monopoly problem by creating competition between discreet bundles of capacity in the one set of infrastructure. These arrangements include capacity auctions where capacity is sold to a number of users or other mechanisms to vest capacity rights in favour of more than one party. The vesting of property rights to water in some river systems under the CoAG water reform agreements works in a similar way: in effect, water users are sold rights to bundles of capacity in a dam. Under the CoAG agreements, these water rights are tradeable,

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[64] See, for example, NCC 1997d, pp 28-29 and NCC 1997a, , p. 24-25. The relevant provision in the *National Gas Regime* appears at s 6.13 of the Code. The relevant provision in the *WA Rail Regime* appears at Part 3 of the Railways (Access) Code.

[65] The nature of the technology and the economic characteristics of an infrastructure facility will influence the manner in which secondary markets would be developed for a particular service.

generating competition in the supply of water even where a river system relies on only one storage facility.

For these reasons, access regimes should not impose unreasonable barriers to capacity trading in secondary markets unless there is strong evidence that this is inappropriate.

6.9 Other terms and conditions of access

Relevant clauses: 6(3), 6(4)(a), (b), (c), (e), (i), (m)

Negotiation of access is not limited to pricing issues. Other elements of an access agreement that might require negotiation include:

- safety requirements;
- the allocation of capacity between competing users;
- interoperability issues; and
- service quality issues.

In some cases, these matters may be as important to access seekers as price.

6.9.1 Safety requirements

While it is appropriate for a state government to determine whether, and how, to regulate the safe provision of an infrastructure service, it would not be appropriate for it to regulate safety in a manner which poses unnecessary barriers to access and competition.[66]

Nor is it appropriate for an access provider to impose additional safety requirements that impose an unreasonable barrier to access – for example, requirements that duplicate matters covered by government regulation.

The issue of safety requirements acting as a barrier to access has been raised with the Council in the context of a number of rail access regimes.[67]

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[66] In assessing whether a safety restriction poses unnecessary barriers to access and competition, the Council would consider, among other things, whether the restriction has been found to confer a net public benefit (and whether alternative approaches to achieve the objective have been considered) in a review under clause 5 of the CPA.

[67] See, for example, NCC 1999b , pp 52-55.

6.9.2 Allocation of capacity between competing users

A critical matter in negotiating access to infrastructure services is to resolve capacity issues.

In rail, for example, capacity issues are closely linked to train path allocation and network management principles. Issues for access seekers include negotiation of a suitable train path, day to day network management and mechanisms for reallocating unused train paths.

Independent and transparent approaches are needed to assure market participants that capacity issues are managed in a manner that promotes competitive outcomes. This is especially important if the access provider also operates above-rail services. Train path principles should facilitate efficient utilisation and be competitively neutral to all market participants.

In the National Gas Regime, capacity issues are addressed through queuing and expansion policies, and through capacity trading mechanisms – all subject to approval by the regulator. In addition, arbitration provisions allow an arbitrator to require a geographical extension or an expansion of capacity to meet the needs of access seekers. Capacity issues in the Victorian application of the regime are also managed through wholesale trading arrangements in the primary market.

6.9.3 Interoperability issues

Interoperability issues may arise because of potential problems associated with:

- the interconnection of discrete geographic networks; and
- the relationship between the provision of an infrastructure service and the use of that service.

Both sets of potential problems may need to be addressed, or at least recognised, by the regulation of monopoly infrastructure.

Clauses 6(2) and 6(4)(p) specifically address interstate interconnection issues and are discussed in section 6.5 above.

Issues regarding the interconnection of discrete geographic networks can also arise entirely within a particular jurisdiction. Negotiations between access seekers and infrastructure owners may involve:

- interconnection of infrastructure;
- common or compatible operating procedures; and

- terms and conditions for joint use.

Interoperability issues can also arise in the relationship between infrastructure and the use of the infrastructure. Different uses of the same infrastructure service can involve different operating requirements and different costs for the infrastructure. For example, some train rolling stock configurations involve greater track wear than others. These issues need to be recognised in access negotiations.

6.9.4 Quality of service issues

Price and service quality are seen as interdependent in negotiating access to certain infrastructure services. The issue arises in rail, in particular, where quality of service can vary considerably. An effective rail access regime should ensure that contracts set performance indicators to establish the service provider's accountability – covering matters such as entry and exit times, track quality and speed restrictions.

6.10 Duration of certification

When the Council recommends that a State or Territory access regime be certified as effective, it is also required to recommend the period for which certification should remain in force: s.44M(5).

In general, the Council is aware that infrastructure owners/operators and users have a need for stability and certainty in the regulatory environment, especially in the development of new infrastructure. At the same time, the Council will take into account:

- the stage of regulatory reform in an industry. For example, the Council would take into account whether a regime is proposed as a transitional measure, or developed in the early stages of industry reform – where there is limited guidance on the likely operation and effectiveness of the regime in practice.

- related regulatory developments in the industry. For example, in considering the duration of certification for a 'stand alone' State or Territory access regime, the Council would examine whether arrangements are also advanced in the development of a national access regime for the relevant service.[68]

For example, the Council recommended a relatively brief certification period for the NSW Rail Regime, given that related regulatory developments were occurring with regard to interstate rail access. At

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[68] See, for example, NCC 1997a, , pp. 50-52; and NCC 1997b, , p. 27-28.

the time of the Council's recommendation, the likely future interface between the NSW Rail Regime and the proposed national regime was unclear.

By contrast, the Council recommended a relatively long certification period (30 years) for the NT/SA Rail Regime. The regime covers, in part, an entrepreneurial greenfields project with considerable risk attached.

6.11 Applications for certification

The Council has received a total of thirteen applications for certification since the enactment of Part IIIA (see Appendix A). A summary of the applications, by industry, and the Council's processes is outlined in the following sections.

6.12 Gas

In February 1994, CoAG agreed to remove impediments to free and fair trade in natural gas. The underlying objective was to develop a nationally integrated and competitive industry in which consumers can contract directly with the gas producer of their choice for the supply of gas, and separately with a pipeline operator for gas haulage.

A central element of the reform process has been the development of a National Gas Access Regime (the Gas Regime) which applies to natural gas transmission and distribution pipeline services

The Gas Regime comprises: the Gas Pipelines Access Law (GPAL), which provides the legal framework for the regime; supporting state and territory legislation and regulations; and the National Third Party Access Code for National Gas Pipeline Systems (the Code).

South Australia is the lead legislator, with all other jurisdictions enacting the Gas Regime through an application of the South Australian law.[69] Each government agreed to seek certification of the Gas Regime as effective under Part IIIA (CoAG 1997, p.6).

Following extensive public consultation in 1997, the Council found that, subject to a number of amendments – subsequently incorporated – the broad framework of the National Gas Regime satisfied the CPA principles for an effective access regime. However, because of a number of jurisdictional variations in the Gas Regime, the Council has

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[69] Except for Western Australia who enacted essentially the same legislation as South Australia.

also been required to examine each of the applications for certification to test the effectiveness of that jurisdiction's regime.

Under the Gas Regime, the ACCC is the regulator for all transmission pipelines, except for pipelines in Western Australia, with each jurisdiction having a local regulator for distribution pipelines.

The Gas Regime works by applying the Code to all covered pipelines. The Code establishes the mechanisms and principles under which pipeline operators will offer access. The Code has a number of core elements:

- coverage criteria;
- access arrangements;
- ring fencing;
- dispute resolution; and
- appeals

6.12.1 Coverage

Pipelines listed in Schedule A to the Code were covered from its commencement. The Code provides three mechanisms by which other pipelines may become covered.

- Any person may make an application for coverage of the pipeline to the Coverage Advisory body (the Council). The Council then makes a recommendation on the matter to the relevant Minister, with reference to coverage criteria specified in the Code (which closely reflect clause 6(3) of the CPA). The relevant Minister then decides whether the pipeline should be covered.
- A service provider may request coverage of a pipeline by proposing an access arrangement to the Regulator for approval.
- A pipeline is automatically covered if it is subject to a competitive tendering process approved by the Regulator.

The Code also includes a process for any person to apply to the Council for revocation of coverage of a pipeline. On receipt of an application, the Council assesses whether the coverage criteria continue to apply to the relevant pipeline. It then makes a recommendation to the relevant Minister, who decides the matter.

To date, the Council has received one application for coverage and seventeen applications for revocation of coverage (three of these related to the Moomba to Sydney pipeline system).

In respect of the coverage application the Council recommended and the Minister decided in favour of coverage of the pipeline (the Eastern Gas Pipeline). In respect of the revocation applications the Council recommended and the Ministers decided to revoke coverage for twelve of the pipelines.

6.12.2 Access arrangements

Access arrangements are similar in many respects to undertakings under Part IIIA, and are designed to allow the owner or operator of the pipeline to develop its own tariffs and other terms and conditions under which access will be made available, subject to the requirements of the Code. The regulator must accept this access arrangement.

An access arrangement must include a policy on services offered, reference tariffs (benchmark prices for standard services), a policy on the rights of network users to trade rights to services, and a policy on allocating spare and developable pipeline capacity (a queuing policy). The Code contains specific provisions regarding pricing principles.

Third parties may negotiate access on the basis of information contained in the access arrangement and an information package (which must be supplied by service providers to access seekers on request).

Elements of the access arrangement, including the reference tariffs, may be developed through an approved competitive tendering process.

6.12.3 Dispute resolution and appeals

An arbitration process is available where commercial negotiation is unable to resolve disputes. The Regime identifies factors the arbitrator must take into account when resolving a dispute. The arbitrator is bound to apply the reference tariffs in disputes over the pricing of reference services.

Due to the possible implications for the service provider and potential users, the Gas Regime also provides mechanisms for the administrative and/or judicial review of decisions.[70] Decisions which may be appealed include those by the relevant Minister concerning pipeline coverage (administrative and judicial), certain decisions by the relevant regulator concerning the imposition of an access arrangement (administrative and judicial), and an arbitrator's determination (judicial only, except in Tasmania).

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[70] Administrative review relates to issues of merit, while judicial review is limited to questions of law.

6.12.4 Ring fencing

The Code contains ring-fencing provisions, which require a pipeline owner to establish arrangements to segregate its business of providing pipeline services from other activities (notably the production, sale or purchase of gas). These arrangements must include the legal separation of the different businesses, unless a waiver is obtained from the regulator.

6.13 Gas: Applications by individual jurisdictions

As discussed above, each jurisdiction had a number of variations to the Gas Regime that the Council considered on an individual basis when each application for certification was received. For most jurisdictions, these variations related to the identity of the local regulator and the time period within which full retail contestability was being introduced. However, a number of jurisdictions have significant derogations from the Gas Regime that have caused the Council some concern.

6.13.1 South Australian Gas Access Regime

On 22 June 1998, the Council received an application from the South Australian Premier to certify the effectiveness of the South Australian Gas Access Regime. The Council assessed the local regulator, the South Australian Independent Pricing and Access Regulator (SAIPAR), as being independent and appropriately resourced and structured. The regime provides for full retail contestability by 1 July 2001, which the Council considered an appropriate transitional period.

The Council recommended certification of the Regime, and the Minister for Financial Services and Regulation certified it on 8 December 1998 for a period of 15 years.

6.13.2 Western Australian Gas Access Regime

The Council received the Western Australian Government's application for certification of its Gas Access Regime in March 1999.

The Western Australian regime included a local regulator, the Office of Gas Regulation, for both distribution and transmission pipelines and had a number of significant differences from the Gas Regime, including:

- the timetable for phasing in competition;
- variations in the ring-fencing arrangements;

- transitional arrangements providing for reduced ring-fencing requirements for AlintaGas; and

- AlintaGas's ten-year exclusive franchise in Kalgoolie/Boulder.

The Council concluded that these arrangements were reasonable and complied with the certification provisions.

As a significant number of pipelines were not covered by the Regime until 1 January 2000, the Council considered it was appropriate not to recommend certification of the Regime until after 1 January 2000. The Council recommended certification of the Regime on 4 February 2000. The Minister for Financial Services and Regulation certified the Regime effective on 31 May 2000 for a period of 15 years.

6.13.3 ACT Gas Access Regime

The Council received the ACT Government's application for certification of its gas access regime in January 1999. Under the regime the local regulator is the Independent Pricing and Access Commission (IPARC). Full retail contestability is to be introduced by 1 July 2001.

The Council was satisfied that most aspects of the Regime complied with the certification principles, but raised with the ACT Government the issue of potential conflict of interest in the merged role of the regulator/arbitrator under the Regime. The ACT subsequently made changes to these arrangements which the Council considered adequately dealt with these concerns.

The Council forwarded its recommendation to the Commonwealth Minister for Financial Services and Regulation on 19 July 2000. The Minister certified the Regime as effective on 25 September 2000 for a period of 15 years.

6.13.4 New South Wales Gas Access Regime

The Council received the New South Wales Government's application for certification of its gas access Regime in October 1998. This regime replaced an earlier regime for natural gas distribution pipeline systems that had been operating in NSW. This earlier regime had been certified as effective in August 1997.

The Council sent its recommendation to the Commonwealth Minister for Financial Services and Regulation in March 1999. The Minister's decision has been delayed pending resolution of cross-vesting issues arising from the High Court decision in *Re Wakim: ex parte McNally*.

6.13.5 Queensland Gas Access Regime

The Council received Queensland's application for certification of its gas access regime in September 1998. While the Queensland regime was submitted to the Council as an application of the National Gas Regime, it incorporates a number of significant derogations from the National Regime. The derogations cover matters such as access prices and information flows to access seekers.

The Council initially considered whether the Queensland regime remained broadly consistent with the National Gas Regime. If it did, the Council could draw upon its earlier assessment that the National Gas Regime was effective. The Council sought the advice of the ACCC on whether the regulatory processes, including tariff outcomes, for the derogated pipelines were broadly consistent with the National Code and to the extent to which differences are significant.

The ACCC completed a substantial report in April 2000. It reported that the derogations significantly alter a number of regulatory processes, tariff and other outcomes from those in the National Code. The Council considers the variations to be sufficiently material that it cannot regard the Queensland regime as a consistent application of the National Code.

As such, the Council has been obliged to consider the regime on a stand alone basis. Following consideration of public submissions, consultancy work done for the Council by the ACCC, and its own deliberations, the Council considers that the Queensland regime does not currently satisfy the certification principles. Fundamental concerns include the impact of the derogations on regulatory and dispute resolution processes, information flows to access seekers and review arrangements. The Council is unlikely to recommend that the regime be certified as effective in its current state.

The Council notes that the Queensland Regime was enacted in May 2000. While not certified, the provisions of the Regime – including obligations on pipeline owners – now apply.

6.13.6 Victorian Gas Access Regime

The Council received Victoria's certification application in July 1999. The National Regime allows for a pipeline owner to submit an access arrangement for either a contract carriage pipeline or a market carriage pipeline. This provision was a late amendment to the Regime to allow for the Victorian market carriage model to be accommodated. At the time of its assessment of the National Regime, the Council indicated it would more closely examine the market carriage system in considering a state regime that applied it. The Victorian Regime required its existing pipelines, at the time state-owned, to adopt the market carriage model in developing their access arrangements.

The Council forwarded its recommendation to the Minister for Financial Services and Regulation in April 2000.

6.14 Rail

Unlike other areas of network infrastructure, the NCP agreements did not include a specific reform program for the rail industry. As a result, while each State and Territory may establish access arrangements under Part IIIA, no mechanism was provided for seekers of access to interstate rail services to avoid dealing with multiple regimes. This has led to significant uncertainty and difficulty for rail access seekers.

In November 1997, State and Commonwealth Transport Ministers agreed to a series of reforms to apply to track that joined the State capitals and their ports, with connecting lines to the major regional ports of Whyalla, Port Kembla, Newcastle and Westernport. These reforms aimed to reduce the costs of transporting freight by rail by increasing train speeds and tonnages, as well as standardising practices, technologies and access conditions.

The Ministers also agreed to establish the Australian Rail Track Corporation (ARTC) to provide a 'one-stop-shop' for national rail operators. This would avoid the need for rail operators to seek separate access in each State.

The States agreed to enter into negotiations with ARTC to achieve arrangements over state track that would allow it to operate as a 'one-stop-shop' over a national network. While leasing of the interstate lines was the preferred approach, this has not proved possible for the entire track. ARTC owns the interstate track in South Australia and as far west as Kalgoolie and has a long-term lease over the interstate track in Victoria. It was intended that the ARTC would enter wholesale agreements with the other track owners and then develop an access undertaking on terms and conditions of access for the interstate network. To date, the ARTC has reached a wholesale agreement with Western Australia.

It is now clear that it is not possible for the ARTC to submit an undertaking on its own that would cover the entire interstate rail track network. While ARTC would be considered the service provider under Part IIIA for the interstate rail network in Victoria, South Australia and as far west as Kalgoolie, they are not the service providers in New South Wales or on the other parts of the interstate network in Western Australia and Queensland. An undertaking, or undertakings that could cover the entire interstate network would need to involve all service providers.

Because of the slow pace of reform, parties have been relying on the general provisions of Part IIIA to gain access to rail infrastructure. As a result, the Council's work in access in recent years has been dominated by applications regarding rail infrastructure. As discussed in section 5, there have been five applications to declare rail network services (New South Wales, Queensland and Western Australia). There have also been four applications for certification of state-based access regimes (New South Wales, Western Australia, Queensland and South Australia/NT).

The uncertainty in the interstate access arrangements has made it difficult for the Council to be sure that State and Territory access regimes on their own deal appropriately with the interstate issues. This has resulted in some regimes covering interstate rail infrastructure services being certified for only a short period of time or not at all.

6.14.1 Northern Territory/South Australian rail

On 18 March 1999, the Council received an application from the Northern Territory and South Australian Governments to recommend certification of a regime for access to rail services provided by existing track between Tarcoola and Alice Springs and to be provided by new track between Alice Springs and Darwin (the NT/SA Regime).

The Regime requires an independent regulator to develop guidelines, assist in dispute resolution and monitor the effectiveness of the Regime. All prices for access are to be struck within a floor/ceiling band, set in accordance with efficient forward-looking costs. For interstate rail operators, the Regime allows for a single arbitrator to deal with disputes under the NT/SA Regime and regimes in other jurisdictions. It also allows for the ARTC to negotiate access to on-sell to interstate operators.

The Council took into account the particular circumstances of the existing and proposed infrastructure, including the ex ante risks facing the investor, when considering certification of this regime. The projected revenues from this infrastructure were considered marginal, leaving the private consortium at considerable risk, in spite of substantial Government contributions. The Council considered that the regime should strike a balance between encouraging efficient long term investment while ensuring competition in related markets.

The regime as originally submitted provided certainty for the supplier over a long period of time but included a number of provisions that could deter access. For instance, prices could include monopoly components, while dispute resolution, competitive neutrality and ring-fencing arrangements were weak.

The regime as certified included considerable changes, including provisions that strengthen these dispute resolution, competitive neutrality and ring-fencing arrangements and ensure prices take account of efficient costs. All prices, including those set under an adapted efficient component price approach based on the prices of effective substitutes[71], are set within a floor/ceiling band, defined by efficient forward looking costs established under the guidance of the Regulator[72].

The regime accommodates interstate rail operators by allowing them to either negotiate with the supplier or to allow the Australian Rail Track Corporation (ARTC) to negotiate on their behalf. The Regulator must take account of interstate issues where applicable and the regime allows for the appointment of a single arbitrator for disputes that arise under more than one access regime.

After considering the Council's recommendation, the Commonwealth Minister recommended in February 2000 that the NT/SA Rail Access Regime be certified as effective until 31 December 2030.

6.14.2 Western Australian Rail Access Regime

The Western Australian Government applied for certification of the Western Australian Rail Access Regime in February 1999. The Western Australian Regime sought to establish a framework for access negotiation covering Westrail's responsibilities to negotiate in good faith, provide specified information to access seekers and observe timeframes and other parameters set out in the Regime.

The Council's public submission processes, consultancy work and its own consideration identified a number of issues that caused considerable concern, including:

- the lack of an independent regulator;
- reliance on commercial arbitration to resolve all areas of disputation;
- no requirement that costs be efficient costs;

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[71] Where competition from non rail freight is sufficient to discipline rail operators to minimise their costs and prices, the Regime's "sustainable competitive" approach uses the price of the competitive non rail freight as the starting point for calculating the rail access price between the floor/ceiling band. Tests conducted by the Council, in conjunction with interested parties, indicated that this was a practical approach.

[72] When developing capital cost guidelines, the Regulator must take into account the government contributed assets and cash subsidies.

- concerns about the asset valuation methodologies;
- uncertainty about the pricing and cost information provided by the infrastructure owner;
- uncertainty about how the regime would interface with the rest of the interstate network; and
- vertical integration of the service provider.

The Western Australian Government made considerable changes to the regime to address these concerns. The most significant of these included creating an independent regulator with powers to verify costing information and to determine the floor and ceiling prices within which negotiation can occur. Changes were also made to the pricing principles to ensure that only efficient costs were allowed and that asset valuation included optimisation. A number of changes were also made to strengthen the competitive neutrality provisions and give the regulator power over ring fencing guidelines.

While the Council was satisfied that the Regime substantially met the CPA principles, the interface between the Regime and interstate rail access remained a concern for the Council.

The Council proposed that the Regime require the infrastructure owner to submit an undertaking to the ACCC on interstate rail access. It had become clear during the certification process, that the ARTC would not be able to submit an undertaking for national rail access without the co-operation of the infrastructure owners in Western Australia, New South Wales and Queensland. The Council was concerned that if it recommended certification of the Western Australian Regime without any provisions to ensure this co-operation, the Western Australian track service would be protected from declaration and there would be no other discipline on the track owner to participate in the national process.

The Western Australian Government was not prepared to include such a requirement in the Regime and subsequently withdrew the application for certification in November 2000.

6.14.3 Queensland rail

On 19 June 1998, the Council received an application from the Queensland Government to certify as effective a regime for third party access to certain rail services in Queensland. The regime established the conditions applying to access to rail transport infrastructure managed and operated by Queensland Rail (QR), excluding the standard gauge interstate rail infrastructure in Queensland.

On 11 February 1999, the Queensland Government withdrew its application for certification after the Council raised concerns that the regime, as it then stood, did not provide enough information for the Council to be satisfied of its effectiveness against the CPA principles.

The regime required QR to submit an access arrangement to the Queensland Competition Authority (QCA) for its approval, with this access arrangement determining the terms and conditions of access for third parties. The Council expects that many of the issues raised by the CPA principles will be dealt with in the access arrangement and the assessment of the effectiveness of the regime will be able to be conducted once the access arrangement is in place.

The Queensland government has indicated to the Council that it will reapply after QR's access arrangement has been finalised by the QCA.

6.14.4 New South Wales rail

On 12 June 1997, the Council received an application from the New South Wales Government to certify as effective a regime for access to New South Wales rail services.

The regime adopts a negotiate/arbitrate model with negotiations on price to be no lower than avoidable costs and no higher than stand-alone costs. As originally submitted to the Council, while the regime provided for an independent arbitrator, IPART, there was no provision for IPART to be involved in the initial determination of price and revenue parameters. This was done by the infrastructure owner.

The Council was concerned that the price and revenue parameters had not been reviewed to assure the market they took account of efficient costs. For instance, specific arrangements for coal freight included apparent monopoly components. Firstly, a high rate of return was allowed on high asset values. Secondly, a separate premium, unrelated to costs, was imposed on selected coal freights.

NSW agreed to phase out the separate premiums[73] and amend the Code to allow IPART's recommendations from reviews of cost elements to determine current price and revenue settings. The results of these reviews, among other things, significantly decreased the rate of return[74] applied to asset values and indications are that a significant

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[73] Ceased at 30 June 2000.

[74] Reduced rate of return and changed the terms of its specification from 14% (nominal, post tax) to 8% (real pre tax) – see IPART 1999.

reduction in asset values could be necessary[75]. However, NSW did not amend the Code to require IPART to ensure their findings were put into effect or to periodically repeat these exercises to update price and revenue parameters.

The Council had concerns over a number of issues subject to reviews not concluded at the time it made its recommendation. These covered accreditation charges, accreditation practices[76] and the trading of timepaths.[77] Additionally, it was not clear that the Code could harmonise with the national arrangements for rail. As a result the Council recommended a relatively short certification with an expiry date of 31 December 2000.

After considering the Council's recommendation, the Minister concluded that he would need to also consider the outcomes from several reviews on safety and timepath matters then being conducted by the New South Wales Government before he could conclude that the regime is effective. After considering the outcomes of these reviews, the Minister concluded in November 1999 that the regime should be certified as effective until 31 December 2000.

6.15 Ports

To date, the Council has considered only one regime that relates to port infrastructure.

6.15.1 Victorian commercial shipping channels

On 24 December 1996, the Premier of Victoria applied to the Council to consider the effectiveness of the Victorian Access Regime for Commercial Shipping Channels. The regime applies to Victorian commercial shipping channels covering the ports of Melbourne, Geelong, Hastings and Portland.

The regime requires a channel operator to provide access to prescribed channels on fair and reasonable terms and conditions. Further, it

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[75] IPART is currently conducting a valuation exercise, focused on the coal lines of the Hunter Valley. Preliminary estimates indicate that values may ultimately be significantly reduced.

[76] IPART undertook a review of charges for accreditation services while the NSW Government undertook a review of practices to ensure that costs were not being increased by each state requiring separate accreditation procedures. For IPART's recommendations on charges See IPART, Review of Rail Safety Accreditation Costs, Final Report, 99-3, March 1999.

[77] NSW developed a Capacity Transfer Policy in consultation with interested parties. This policy was implemented in mid 1999.

states that a channel operator must: use all reasonable endeavours to meet the requirements of a person seeking access to prescribed channels; and make a formal proposal of terms and conditions for access within 30 business days of receiving a request, or within such reasonable lesser period as is determined by the Office of the Regulator-General.

The terms and conditions of access may vary according to the actual and opportunity costs to the channel operator. The regime states that a channel operator, or any person having access to a prescribed channel, must not engage in any conduct that will hinder access to the channel.

The regime also provides that, if a channel operator and a person seeking access cannot agree on the terms and conditions on which access is to be provided, the channel operator or the person seeking access may apply in writing to the Office of the Regulator-General for the making of a determination in accordance with the *Office of the Regulator-General Act 1994*.

Key issues considered during the application process were the adequacy of the arrangements for negotiating access and the independence of the dispute resolution processes.

On 12 May 1997 the Council recommended to the Commonwealth Treasurer that the Victorian regime be certified as effective for a period of five years. On 18 August the Treasurer announced his acceptance of the Council's recommendation and the reasons supporting it.

6.16 Electricity

In the early 1990s, governments embarked on a program of reform for the electricity sector. These reforms had as their centrepiece the creation of a fully competitive National Electricity Market (NEM), featuring a national wholesale electricity market and an interconnected national electricity grid. Following significant structural reform by participating jurisdictions, the NEM became operational in December 1998. Jurisdictions currently participating in the NEM are New South Wales, Victoria, Queensland, South Australia and the ACT.

The access regime in the National Electricity Code (the Code) has been given effect under the undertaking provisions in Part IIIA of the TPA, which provide that the ACCC may accept an industry-wide code of conduct (an access code) prepared by an industry body. Consistent with these provisions, the ACCC authorised the National Electricity Code, with some amendments, in September 1998.

The access regime in the Code governs the means by which third parties can gain access to the electricity and distribution networks.

There are detailed rules for network connection and disconnection, network extensions and interconnection, system security and metering. The regime also provides a framework for the regulation of access prices and for the capping of revenue on some networks.

To participate in the market, the provider of a transmission or distribution service must register with the market operator. The service provider is then required to give an undertaking to the regulator to provide access to its network in accordance with the Code. It is also bound by the Code to develop its own pricing structures and tariffs, which it must submit to the appropriate regulator for approval.

As all NEM jurisdictions have access regimes that have been accepted as undertakings under Part IIIA, only the Northern Territory and Western Australian electricity network services are still open to declaration. Both of these jurisdictions have predominantly government-owned, vertically integrated electricity sectors.

The Council is currently considering an application for certification of the Northern Territory electricity access regime and a declaration application for a substantial part of the Western Australian network.

6.16.1 Northern Territory Electricity Access Regime

On 1 December 1999, the Council received an application from the Northern Territory Government to certify as 'effective' a regime for access to Northern Territory electricity distribution networks owned by the Power and Water Authority (PAWA).

The Regime covers electricity network services provided by PAWA Networks, one of the range of related businesses delivering electricity and water services owned by the Northern Territory Government. The main components include:

- obligations and processes for third-party access;
- obligations regarding the technical terms and conditions to be met by network users;
- procedures in the event of an access dispute;
- broad pricing principles;
- the approach to determining the network provider's annual network revenue cap and the level of individual network tariffs; and
- regulatory oversight for capital contributions and out-of-balance energy prices.

The Council's public process and consultancy work identified aspects of the regime that it considered did not comply with clause 6 of the CPA.

The Northern Territory has agreed to make a number of changes to address some of the concerns raised. These include increasing information flows to the access seeker, more stringent ring-fencing arrangements and the introduction of competitive neutrality provisions. Prices and revenues, including those related to new investment and excess network charges, now take account of efficient costs. The Regulator sets price and revenue parameters, allowing public scrutiny and input into its deliberations.

Outstanding issues include the penalty approach taken when setting out-of-balance energy prices and the lack of full contestability. The current contestability program precludes the majority of NT electricity consumers from benefiting from the regime. Its limitations reduce the scale economies available to new entrants, placing them at a disadvantage to PAWA's competing upstream and downstream businesses. Exacerbating this disadvantage are the community service obligation payments made only to PAWA businesses for selected consumers.

The Council is continuing to explore approaches that will overcome these outstanding issues with NT.

7 Access regimes partially or completely outside Part IIIA

7.1 Introduction

As discussed in section 5 of this submission, the only access regimes that can be said to be outside Part IIIA are those established by separate Commonwealth legislation or those established by States or Territories for services not within the definition of services in Part IIIA. It would be possible, for example, for a State or Territory to establish an access regime for a service that might be considered a production process under Part IIIA. However, no government has done this.

There are a number of access regimes that have been developed by the Commonwealth that fall completely or partially outside Part IIIA.

The two regimes completely outside Part IIIA are the telecommunications access regime, which is given effect under Part XIC of the TPA, and the postal services access regime, which is currently given effect under the *Australian Postal Corporation Act 1989*. These regimes contain provisions limiting or excluding the operation of Part IIIA.

Two other regimes can be seen as falling, at least partially, outside Part IIIA. The *Airports Act 1996* provides for certain airport services to be automatically declared for third party access. Once declared, these services are subject to the arbitration provisions of Part IIIA. However, the determination of what services are declared is made by the ACCC under criteria under the *Airports Act*. These criteria are different from the declaration criteria in s. 44G. Unlike the telecommunication and postal regimes, the *Airports Act* does not explicitly exclude or limit the operation of Part IIIA.

There is also an access arrangement associated with the financial payments clearing system that is unrelated to Part IIIA.

Section 3 of this submission proposes that all Commonwealth access regimes should be assessed against clause 6 of the CPA to ensure they are consistent with the Part IIIA model and meet best regulatory practice.

7.2 Telecommunications

Telecommunications services are the subject of industry-specific access arrangements under Part XIC of the TPA. Part XIC formed part of a package of legislation passed in the first half of 1997. This legislation created a new regulatory regime to govern

telecommunications from 1 July 1997 with the partial privatisation of Telstra.

The telecommunications access regime outlined in Part XIC provides that the ACCC, as regulator, may declare telecommunications carriage services. Providers of declared services are required to comply with standard access obligations in relation to those services, which include providing access, permitting interconnection and supplying billing information.

The terms and conditions on which standard access obligations are supplied are subject to agreement. If agreement cannot be reached, but the service provider has given an access undertaking, then the terms and conditions are those set out in the undertaking. If not, the terms and conditions are determined by the ACCC as arbitrator. The ACCC's determination may not be inconsistent with the standard access obligations.

Part XIC also provides that the ACCC may approve a telecommunications access code. Such a code must set out model terms and conditions relating to compliance with the standard access obligations and that are capable of being adopted by access undertakings. Such a code may be submitted by the Telecommunications Access Forum (an industry body) or, under certain conditions, by the ACCC itself. The ACCC approved a Telecommunications Access Forum Access Code in January 1998.

Individual service providers may submit access undertakings to the ACCC that are based on the model terms and conditions outlined in a telecommunications access code. The ACCC may also approve access undertakings from service providers that are not based on model terms and conditions, with some provisos.

Where services are declared under Part XIC the operation of Part IIIA is significantly curtailed. A party may not notify a dispute in relation to a service declared under Part IIIA where that service is also declared under Part XIC, and where the other party to the dispute is a service provider as defined in the *Telecommunications Act 1997*. The ACCC must not accept an undertaking under Part IIIA in relation to a service declared under Part XIC if the undertaking relates to the provision of access to one or more service providers. A pre-existing undertaking under Part IIIA ceases to operate where a service becomes a declared service to the extent it sets out terms and conditions relating to the provision of access to one or more service providers.

7.3 Australia Post

The services of Australia Post are regulated under the *Australian Postal Corporation Act 1989* (APC Act). Under the legislation Australia Post has a monopoly over the delivery of standard-sized letters. The operation of Part IIIA has been excluded by the APC Act.

The APC Act provides for users to gain access to Australia Post's network by the delivery of pre-sorted bulk mail to designated mail centres. Australia Post provides discounts for bulk mail users wishing to interconnect with its network in this manner.

S. 32B of the ACP Act provides that the ACCC may inquire into a dispute between Australia Post and an access seeker over the terms and conditions or price of access. The ACCC does not itself have power to resolve such a dispute. It may, however, make a recommendation to the Minister, who has power to direct Australia Post to act in accordance with the recommendation of the ACCC.

Australia Post offers two types of access provisions and associated discounts: bulk discounts and interconnect discounts. These access provisions entitle users to discounts on their postage in exchange for performing some elements of the postal delivery work normally performed by Australia Post. The access provisions apply in respect of the letter service, but have different discounts for small, medium, large and extra large letters.

The Council considered issues associated with this access regime in its 1998 *Review of the Australian Postal Corporation Act* (NCC 1998). The Council recommended that: a compulsory access undertaking, to be approved by the ACCC, be developed by Australia Post for CSO and post office box services; and that if Australia Post does not submit an acceptable undertaking, the ACCC should determine the terms and conditions for access. The Council also recommended that Australia Post's exemption from Part IIIA be repealed.

In response to the review, the Government agreed to put in place an access regime, with details to be determined. Legislation implementing this new regime was introduced into the Parliament in the Autumn session 2000, but has not yet been passed. The legislation contains proposed amendments to the TPA to insert a new Part XID, which would incorporate the postal services access regime.

The access regime proposed by the Commonwealth is modeled on the regime operating in telecommunications. The regime provides first for commercial negotiation between Australia Post and its competitors over the terms of access to network services, such as sorting, delivery and post office boxes. Australia Post may make an undertaking to the ACCC setting out the terms and conditions under which it will provide a service, or it can also apply to have a commercial agreement

registered with the ACCC. If there is not an undertaking in effect, the ACCC has the power to declare a service. The ACCC may choose to conduct a public inquiry before it declares a service.

At the outset of the regime, the Minister will automatically declare Australia Post's bulk mail and post office boxes. The ACCC will only be asked to arbitrate the terms of access to bulk mail and post office boxes if negotiations between Australia Post and those seeking access to the network services fail.

7.4 Airports

During 1997-98 the Commonwealth Government privatised management of all Commonwealth owned airports except Sydney and Essendon Airports. At the same time the Government established a regulatory framework to apply to the privatised airports, including an airport-specific access regime under Part 13 of the *Airports Act 1996*.

The access regime contained in the Airports Act provides that an airport service will be a declared service for the purposes of Part IIIA, unless an access undertaking is given within 12 months after responsibility for the airport is transferred to the private sector. Once airport services are declared they are regulated under the declaration provisions of Part IIIA.

An airport service is defined under the Act as a service: necessary for the purposes of operating and/or maintaining civil aviation services at the airport; or provided by means of significant facilities at the airport, being facilities that cannot be economically duplicated.

At present, services at the following airports have been declared for the purposes of access under the abbreviated declaration process set out in s. 192 of the Airports Act: Adelaide, Alice Springs, Brisbane, Canberra, Coolangatta, Darwin, Hobart, Launceston, Melbourne, Perth and Townsville Airports.

The arbitration provisions of Part IIIA apply to the declared services. If a third party access seeker is unable to negotiate suitable terms and conditions of access with an airport operator they can inform the ACCC of a dispute and have it arbitrated by the ACCC.

7.5 Financial payments clearing systems

There are four general-purpose financial payments clearing systems operating in Australia: cheques and other paper instruments; bulk electronic payments; consumer electronic payments (such as EFTPOS and credit cards); and large-value electronic payments. Each of these systems establishes a framework for settling payments processed by

payment service providers. Payment service providers include banks, building societies, credit unions and Australia Post.

Exchange Settlement (ES) accounts at the Reserve Bank of Australia are the means by which payment service providers settle obligations accrued in the payment clearing process. For example, a financial institution on which a cheque is drawn settles its obligations with the financial institution at which the cheque is deposited through an entry to each of their ES accounts.

In 1999, the Payments System Board announced liberalised access arrangements that allow institutions other than banks, and the Special Service Providers for building societies and credit unions, to apply for ES accounts. The new arrangements are intended to promote competition and efficiency by allowing eligible institutions to settle their own payments without reliance on another institution that may otherwise be a competitor.

Under the new arrangements, all providers of third party (customer) payments services that have a need to settle clearing obligations with other providers are eligible to apply for an ES account. Applicants need to demonstrate that they have the liquidity necessary to meet their settlement obligations under routine, seasonal peak and stress conditions. Institutions authorised and supervised by the Australian Prudential Regulation Authority (APRA), and applicants proposing to operate exclusively on a real-time gross settlement basis, will not be required to lodge collateral. Institutions not supervised by APRA operating in deferred net settlement systems may be required to lodge collateral on an ongoing basis.

In November 1999, the Sydney Futures Exchange Clearing House was the first organisation to be granted an ES account under the new arrangements.

8 Institutional arrangements

8.1 Introduction

This section outlines the institutional arrangements applying under Part IIIA including under the industry-based access regimes accepted as undertakings or certified as effective state regimes. There are a number of bodies that play a role in these access regimes. A body may perform several functions within one regime or perform different functions from one regime to another.

This section describes agencies' responsibilities only insofar as they relate to access, even though they may have broader roles.

As discussed in section 4, it is the Council's submission that it is appropriate for state based general economic regulators to operate alongside a national economic regulator. However, there seems to be little advantage in multiple industry-specific regulators at either a state or national level. Further, to ensure the complementary operation of state and national economic regulation, mechanisms need to be in place to assist in co-ordination of approach, information flows and appropriate consistency.

Currently there is a combination of general economic regulators and industry specific regulators, with most industry specific regulators being at state level. Part IIIA allows governments and private operators, through the certification and undertakings processes, the flexibility to determine what body should perform the role of regulator/arbitrator within their regimes. This flexibility is appropriate. Governments in particular, however, should be mindful of the benefits of moving toward general economic regulators and developing strong co-ordination between the different regulators.

Moves such as the establishment of the Utility Regulators Forum, discussed below, and the inclusion of the state-based gas and electricity regulators[78] onto the ACCC's Energy Committee[79] should be encouraged and supported by governments.

8.2 Declaration

The process for declaration involves:

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[78] Appointed as ex-officio associate commissioners.

[79] The Energy Committee is responsible for the ACCC's decision-making functions in relation to regulatory reforms in the electricity and gas sectors.

- an application for declaration being made to the Council;
- the Council then making a recommendation to the Decision-maker; and
- the Decision-maker determining whether to declare or not.

The decision may be subject to an application for review to the Tribunal by either the service provider (if declared) or the applicant (if not declared).

The identity of the Decision-maker varies depending on the ownership of the infrastructure that is subject to the application. For infrastructure owned by a State or Territory government, the Decision-maker is the Premier or Chief Minister of that State or Territory. For all other applications, the Decision-maker is the designated Commonwealth Minister (currently the relevant Treasury Minister).

If a service is declared, then the ACCC may be required to arbitrate on access disputes relating to that service. Any determination made by the ACCC is subject to review by the Tribunal upon application of any party to the determination. The decision of the Tribunal is subject to appeal to the Federal Court on a question of law.

8.3 Certification

The Premier or Chief Minister of a state or territory may apply to the Council for a recommendation that an access regime is effective.

The Council makes a recommendation to the Decision-maker, the designated Commonwealth Minister (currently the relevant Treasury Minister), who then determines whether the regime is effective or not.

Only the Premier or Chief Minister can apply to the Tribunal for a review of the decision.

8.4 Undertakings

A service provider, or prospective service provider, submits an undertaking to the ACCC for it to approve. There is no provision for a service provider to apply for a review of a decision of the ACCC not to accept an undertaking.

8.5 Regulatory bodies

The access regimes that have been certified as effective or accepted as undertakings create roles for a number of regulatory and dispute resolution bodies. For network services such as gas and electricity, roles have been separated between what might be loosely described as

the regulation of the interstate transmission services and the regulation of the intrastate distribution services.

For both gas and electricity, the ACCC is, or will be, the regulator of transmission services, while state based regulators perform the same role for the distribution networks. These bodies also resolve disputes in relation to access to particular services. To ensure consistency of approach, the state based regulators responsible for gas and electricity are also appointed as Associate Commissioners with the ACCC.

While there are some variations, in general, applications for review of decisions of the ACCC go to the Tribunal, with applications for review of the state regulators' decisions going to state review panels or state courts.

In rail, all regulatory bodies to date are state based, though it is possible that the ARTC undertaking[80] will create an ongoing role for the ACCC in determining disputes under that arrangement.

Other state regimes, such as the Victorian shipping channels regime, use state-based regulators.

To date, New South Wales, Victoria, Queensland and the ACT have created general economic regulatory bodies and vested functions on them under specific regimes. The agencies are:

- the Independent Pricing and Regulatory Tribunal of NSW;
- Victoria's Office of Regulator-General (ORG);
- the Queensland Competition Authority (QCA); and
- in the ACT, the Independent Pricing and Access Commission (IPARC).

Western Australia, South Australia, Tasmania and the Northern Territory have created a number of industry specific regulators under particular regimes. These are:

- the South Australian Independent Pricing and Access Regulator (SAIPAR) – gas industry;
- the South Australian Independent Industry Regulator – electricity, rail and ports;
- Western Australia's Office of Gas Access Regulation;

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[80] See section 6.14 of this submission.

- Western Australia's Office of Water Regulation;
- Western Australia's Office of Rail Regulator;
- Government Prices Oversight Commission of Tasmania – urban water;
- Office of the Tasmanian Electricity Regulator; and
- the Utilities Commission of the Northern Territory – electricity.

8.6 Utility Regulators Forum

The Utility Regulators Forum (the Forum) has been established to ensure an exchange of information between regulators and to create the opportunity for common issues to be discussed and consistent regulatory approaches, where appropriate, be developed.

Its membership includes the ACCC, the NCC, the state based general economic regulators and state based industry specific regulators.

The Forum meets regularly and publishes information on current regulatory issues and the work program of the individual regulators. It also operates through smaller ad hoc working groups, established to more closely examine particular regulatory issues.

Further development of the Forum should be canvassed to further enhance co-operation between regulators, increase regulatory consistency and reduce the transactions costs of regulation.

Alternatively, further development of joint decision-making arrangements (such as the Energy Committee of the ACCC) could be contemplated. Joint decision-making bodies offer more scope for achieving national consistency than consultative arrangements such as the Forum.

8.7 Institutional arrangements under sector-specific access regimes

8.7.1 Gas

Coverage

The National Gas Access Regime includes a coverage mechanism similar to the declaration process. An application for coverage or revocation of coverage is made to the Council. The Council then makes a recommendation to the Decision-maker. The Decision-maker under the National Third Party Access Code for National Gas Pipeline

Systems (the Code) is the 'relevant Minister' as defined by the Gas Pipelines Access Law, and varies with the type of pipeline involved.

Regulator

The ACCC is the relevant regulator for transmission pipelines in all jurisdictions except Western Australia, where the regulator is the Independent Gas Pipelines Access Regulator. The relevant regulator for distribution pipelines is the local independent regulatory agency, except in the Northern Territory where the ACCC is also the regulator of distribution pipelines.

Dispute resolution

The National Regime provides that where a prospective user and service provider cannot agree on access to a pipeline service, either party may refer the dispute to the relevant regulator. If the relevant regulator agrees that there is a dispute, it must arbitrate on the matter. The arbitrator under the Code is therefore the relevant regulator.

Appeals

Decisions concerning the coverage of a pipeline are subject to both administrative and judicial review. For transmission pipelines, the Australian Competition Tribunal (the Tribunal) is the administrative appeal body in all jurisdictions except South Australia and Western Australia (where the relevant bodies are the SA Gas Review Board and WA Gas Review Board respectively). The Federal Court is the judicial review body in all jurisdictions except Western Australia, where the Supreme Court is the judicial review body. For distribution pipelines, the Tribunal is the administrative appeal body in all jurisdictions except Queensland (Qld Gas Appeals Tribunal), South Australia (SA Gas Review Board) and Western Australia (WA Gas Review Board). The Federal Court is the judicial review body in all jurisdictions except Queensland (Supreme Court) and Western Australia (Supreme Court). Arrangements in Tasmania are yet to be determined.

Decisions by the regulator concerning the imposition of an access arrangement for transmission pipelines are subject to administrative review by the Tribunal and judicial review by the Federal Court in all jurisdictions except Western Australia (where the WA Gas Review Board is the administrative appeal body and the Supreme Court is the judicial review body). For distribution pipelines, the Tribunal is the administrative appeals body for all jurisdictions except Victoria (ORG Appeal Panel), Queensland (Qld Gas Appeals Tribunal), South Australia (SA Gas Review Board) and Western Australia (WA Gas Review Board). The Federal Court is the judicial review body for all jurisdictions except Queensland (Supreme Court) and Western Australia (Supreme Court).

Applications for judicial review of an arbitrator's determination would be made to the Federal Court in all jurisdictions except Western Australia, where applications would be made to the Supreme Court, and South Australia in the case of distribution pipelines (Supreme Court). Tasmania is the only jurisdiction that provides for review of an arbitrator's determination (for transmission pipelines only); the Tribunal would be the appeals body.

Other bodies

Several other bodies have been set up under the national regime to facilitate its operation.

- The National Gas Pipelines Advisory Committee (NGPAC) comprises a panel of government and interested parties. Its responsibilities include reviewing the operation of the Code, advising Ministers on the interpretation of the Code, and making recommendations to Ministers on possible Code changes.

- The Code Registrar maintains the Code, keeps a public register describing each pipeline covered by the Code, and holds documents provided to it by participants in the regime.

8.7.2 Electricity

Code Administrator

The body responsible for administering the National Electricity Code (the Code) is the National Electricity Code Administrator (NECA). NECA's responsibilities include enforcing the Code, monitoring its adequacy, establishing procedures for dispute resolution, and managing Code changes.

Market Operator

The body responsible for operating and administering the National Electricity Market (NEM) is the National Electricity Market Management Company (NEMMCO). NEMMCO's responsibilities include operating the market in accordance with rules outlined in the Code, maintaining system security, co-ordinating power system planning, and registering Code participants.

Regulator

The ACCC is national regulator for electricity transmission and transmission network pricing under the Code (responsibility for regulating transmission services is being progressively transferred from the jurisdictional regulators).

Jurisdictional regulators (the State-based regulators) are responsible for regulating distribution matters under the Code and under some state-based legislation. The jurisdictional regulators also regulate retail trading (including licensing).

Appeals bodies

The appeals body with respect to reviewable decisions by NECA and NEMMCO is the National Electricity Tribunal. The Tribunal also has a role in the enforcement of Code provisions. The appeals body on questions of law is the Supreme Court.

Other bodies

Several other bodies have been set up to support the operation of the NEM:

- The Inter-regional Planning Committee has been established under the Code to investigate and report on planning of the transmission networks between regions.

- The Code provides for NECA to establish panels to deal with issues arising from the Code. These include the Dispute Resolution Panel, the Code Change Panel and the Reliability Panel. The Reliability Panel's responsibilities include determining the power system security and reliability standards.

8.7.3 Rail

Rail infrastructure in some states and territories is covered under State and Territory-based access regimes while other states and territories have yet to enact regimes. At this stage, rail track access regimes have been certified in respect of NSW rail track services and Darwin to Tarcoola rail track services. Regimes that have yet to receive certification are operating in Queensland and soon to be in Western Australia.[81]

The ARTC is intending to submit an undertaking to the ACCC in respect of its rail track services.

Regulator

The NSW access regime has no regulator. IPART undertook reviews of various pricing matters to set regulatory parameters for the NSW regime.

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[81] These access regimes are valid and enforceable under State law. However, until such regimes are certified, it is open to a party to apply for declaration of the infrastructure services covered by the access regimes.

Under the Darwin to Tarcoola rail services access regime, the regulator is the SA Independent Industry Regulator (SAIIR). The SAIIR is responsible for regulating prices, licensing conditions, monitoring service and performance standards, and educating the public about its rights.

The Western Australian regime establishes an Office of Rail Regulator.

The QCA is regulator under the Queensland rail regime.

Arbitrator

IPART is the arbitrator for disputes under the NSW rail regime.

In respect of the Darwin to Tarcoola access regime, SAIIR is responsible for appointing an arbitrator to hear a dispute. Similarly in Western Australia, the regulator is responsible for appointing an arbitrator.

Under the draft undertaking submitted by QR, QCA is the arbitrator for disputes unless the parties otherwise agree on an alternative expert.

Appeal Bodies

Appeal rights are relatively limited in respect of the Western Australian, NSW and Darwin to Tarcoola access regimes. Each regime provides a right to appeal to the relevant Supreme Court on questions of law from a decision of an arbitrator.

Appendix A

Summary of applications for declaration dealt with by the Council

Application	Service	Council recommendation	Minister's decision	Outcome
Australian Union Students (April 1996)	Payroll deduction service provided by DEETYA	Not to declare (June 1996)	Not to declare (August 1996)	AUS applied to the Tribunal for review of the Minister's decision. Tribunal determined not to declare (July 1997).
Futuris Corporation (August 1996)	WA gas distribution service			Application withdrawn (November 1996)
Australian Cargo Terminal Operators (November 1996)	Qantas ramp and cargo terminal services at Melbourne and Sydney international airports (2 applications)			Application withdrawn
Australian Cargo Terminal Operators (November 1996)	Ansett ramp and cargo terminal services at Melbourne and Sydney international airports 2 applications)			Application withdrawn
Australian Cargo Terminal Operators (November 1996)	Particular airport services at Sydney International airport (3 applications)	To declare (May 1997)	To declare (July 1997)	FAC applied to the Tribunal for review of the Minister's decision. Tribunal determined to declare the services for a period of five years from 1 March 2000.

Application	Service	Council recommendation	Minister's decision	Outcome
Australian Cargo Terminal Operators (November 1996)	Particular airport services at Melbourne International airport (3 applications)	To declare (May 1997)	To declare for a period of 12 months (July 1997)	Services declared from August 1997 until 9 June 1998. Thereafter subject to access provisions of *Airports Act 1996* (Commonwealth).
Carpenteria Transport (December 1996)	Qld rail services, including above rail services	Not to declare (June 1997)	Not to declare (August 1997)	Carpenteria applied to Tribunal for review of Minister's decision. Application for review was subsequently withdrawn .
Standardised Container Transport (February 1997)	New South Wales rail track services (Sydney to Broken Hill)	To declare (June 1997)	Deemed to be not declared due to expiry of 60 day time limit (August 1997)	SCT applied to Tribunal for review of Minister's decision. Application for review was subsequently withdrawn following successful access negotiations.
New South Wales Minerals Council (April 1997)	New South Wales rail track services in Hunter Valley	To declare (September 1997)	Deemed not to declare due to lapse of time (November 1997)	NSW Minerals Council applied to Tribunal for review of Minister's decision. Application for review was withdrawn following the certification as 'effective' of the NSW Rail Access Regime.

Application	Service	Council recommendation	Minister's decision	Outcome
Standardised Container Transport (July 1997)	(1) WA rail track services; (2) arriving/ departing services; (3) marshalling/shunting service; (4) marshalling/ shunting access; (5) fuelling service (5 applications)	To declare (1) rail service; not to declare other services (November 1997)	Not to declare any of the 5 services (January 1998)	SCT applied to the Tribunal for a review of the Minister's decision. Application for review was subsequently withdrawn following successful access negotiations.
Robe River (August 1998)	Hamersley rail track services			Federal Court decision that service not within Part IIIA (June 1999). Federal Court decision appealed. Application for declaration withdrawn by Robe prior to Full Federal Court hearing. Appeal stayed.

Summary of certification applications dealt with by the Council

Application	Service	Council recommendation	Minister's decision	Outcome
New South Wales Gas Distribution Networks Regime (October 1996)	Access to services of relevant gas pipelines	To certify (May 1997)	To certify (August 1997)	Certified; only intended as interim regime
Victorian commercial shipping channels (December 1996)	Access to commercial shipping channels leading into Melbourne Port	To certify (May 1997)	To certify (August 1997)	Certified
New South Wales Rail (June 1997)	Access to rail track services	To certify (April 1999)	To certify (November 1999)	Certified
South Australian Gas Access Regime (June 1998)	Access to services of relevant gas pipelines	To certify (September 1998)	To certify (December 1998)	Certified
Queensland Rail (June 1998)	Access to rail track services			Application withdrawn (February 1999)
Queensland Gas Access Regime (September 1998)	Access to services of relevant gas pipelines	Under consideration by Council		
New South Wales Gas Access Regime (October 1998)	Access to services of relevant gas pipelines	Sent to Minister, but not publicly available (March 1999)	Postponed	Certification of Regime postponed pending resolution of cross-vesting issues

Application	Service	Council recommendation	Minister's decision	Outcome
Australian Capital Territory Gas Access Regime (January 1999)	Access to services of relevant gas pipelines	To certify (July 2000)	To certify	Certified
Western Australian Gas Access Regime (March 1999)	Access to services of relevant gas pipelines	To certify (February 2000)	To certify (May 2000)	Certified
Western Australian Rail (February 1999)	Access to rail track services			Application withdrawn by WA government
Northern Territory / South Australian Rail (March 1999)	Access to rail track services	To certify (February 2000)	To certify (March 2000)	Certified
Victorian Gas Access Regime (July 1999)	Access to services of covered pipelines	Sent to Minister, but not publicly available (April 2000)	Under consideration by Minister	
Northern Territory Electricity Access Regime (December 1999)	Access to services of electricity distribution networks	Under consideration by Council		

Summary of applications for coverage and revocation of coverage of pipelines under National Gas Code

Applicant	Pipeline	Decision sought	Council Recommendation	Minister's Decision
Southern Cross Pipelines (March 1999)	GGTP to Mt Keith Power Station (WA)	Revocation	To revoke coverage (June 1999)	To revoke coverage (July 1999)
Southern Cross Pipelines (March 1999)	GGTP to Leinster Power Station (WA)	Revocation	To revoke coverage (June 1999)	To revoke coverage (July 1999)
Southern Cross Pipelines (March 1999)	Kalgoorlie to Kambalda (WA)	Revocation	Not to revoke coverage (June 1999)	Not to revoke coverage (July 1999)
Southern Cross Pipelines (March 1999)	GGTP to Kalgoorlie Power Station (WA)	Revocation	To revoke coverage (June 1999)	To revoke coverage (July 1999)
SAGASCO South East (May 1999)	Tubridgi Pipeline (WA)	Revocation	Not to revoke coverage (July 1999)	Not to revoke coverage (August 1999)
Boral Energy Resources (May 1999)	Beharra Springs Pipeline (WA)	Revocation	To revoke coverage (July 1999)	To revoke coverage (August 1999)
Robe River Mining Company (June 1999)	Karratha to Cape Lambert Pipeline (WA)	Revocation	To revoke coverage (Sept 1999)	To revoke coverage (Sept 1999)
Epic Energy SA (December 1999)	South East Pipeline System (SA)	Revocation	To revoke coverage (March 2000)	To revoke coverage (April 2000)
AGL Energy Sales and Marketing (January 2000)	Eastern Gas Pipeline (Longford to Sydney)	Coverage	To cover (June 2000)	To cover (October 2000)

Applicant	Pipeline	Decision sought	Council Recommendation	Minister's Decision
East Australian Pipeline Ltd (now Australian Pipeline Trust) (April 2000)	Moomba to Sydney Pipeline System (main trunk line from Moomba to Wilton)	Revocation	To retain coverage (September 2000)	Not to revoke coverage (October 2000)
East Australian Pipeline Ltd (now Australian Pipeline Trust) (April 2000)	Young to Culcairn lateral (NSW)	Revocation	To retain coverage (September 2000)	Not to revoke coverage (October 2000)
East Australian Pipeline Ltd (now Australian Pipeline Trust) (April 2000)	Dalton to Canberra lateral (NSW and ACT)	Revocation	To retain coverage (September 2000)	Not to revoke coverage (October 2000)
Envestra (April 2000)	Palm Valley to Alice Springs pipeline (NT)	Revocation	To revoke coverage (July 2000)	To revoke coverage (July 2000)
Envestra (April 2000)	Alice Springs distribution system (NT)	Revocation	To revoke coverage (July 2000)	To revoke coverage (July 2000)
Dalby Town Council	Dalby distribution network	Revocation	Recommendation to revoke coverage (October 2000)	To revoke coverage (November 2000)

Applicant	Pipeline	Decision sought	Council Recommendation	Minister's Decision
Peabody Moura Mining Pty Ltd	Peabody – Mitsui Gas pipeline (Qld)	Revocation	Recommendation to revoke coverage (October 2000)	To revoke coverage (November 2000)
Oil Company of Australia	Kincora to Wallumbilla pipeline (Qld)	Revocation	Recommendation to revoke coverage (October 2000)	To revoke coverage (November 2000)
Oil Company of Australia	Dawson Valley pipeline (Qld)	Revocation	Recommendation to revoke coverage (October 2000)	To revoke coverage (November 2000)

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National Competition Council Recommendations on Part IIIA matters: principal references

For a list of all Part IIIA matters considered by the Coucil, refer to Appendix A.

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— 1997b, *Application for Certification of Victorian Shipping Channels Regime, Recommendation*, May.

— 1997c, *Application for Declaration of Certain Rail Freight Services: Brisbane-Cairns Rail Corridor, Recommendation*, 3 June.

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