SA GOVERNMENT RESPONSE TO THE PRODUCTIVITY COMMISSION'S POSITION PAPER ON THE REVIEW OF THE NATIONAL ACCESS REGIME

AUGUST 2001

1. INTRODUCTION

This submission by the South Australian Government is in addition to our submission of January 2001 to the Productivity Commission's review of the National Access Regime.

The purpose of this submission is to raise concerns with, or comment on, specific proposals in the Productivity Commission's Position Paper.

The Commission is to examine and report on current arrangements established by Clause 6 and Part IIIA for regulation of access to significant infrastructure facilities, and ways of improving them. Clause 6 of the Competition Principles Agreement (CPA) requires the Commonwealth to establish a national access regime, explains when that regime will apply, and details the principles with which an effective State or Territory access regime must comply. Part IIIA of the Trade Practices Act (TPA) discharges the Commonwealth's obligations under Clause 6.

The Government notes that there is no intention that the inquiry will lead to "reconsideration of existing or pending certifications, declarations or undertakings agreed or accepted under Part IIIA".

The first point of contact for discussion of any issues contained in this supplementary submission should be:

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2 COMMENTS ON SPECIFIC PROPOSALS

2.2 Proposal 5.1 Inclusion of an Objects Clause

The inclusion of an objects clause in Part IIIA is supported in principle.

The SA Government considers that the need to promote efficient long term investment in essential infrastructure services should be emphasised more strongly by being a separate point in the objects clause.

In the area of gas, the National Gas Pipelines Advisory Committee proposes to develop Code changes for consideration by Ministers to deal specifically with investment in new infrastructure.

2.3 Proposal 6.2 Declaration Criteria

The report acknowledges (p 147) that the proposed hurdles for a service to be declared under Part IIIA are significantly higher than in the current regime. Although there is a case for raising the hurdles, the declaration criteria proposed, as worded, and taken together, could be so narrow that almost nothing could be declared. This might be even narrower than intended.

Clarification of the intention underlying the proposed hurdles is required.

2.4 Proposal 6.3 Provision of Information

The Gas Access Code and Sections 28 & 29 of the *Railways (Operations and Access) Act 1997 (SA)* already mandate that access seekers should be provided with good information.

However, there does not appear to be any obligation on the access seeker to provide good quality information about the service that is sought. When coupled with other proposals to force arbitration within a limited time frame, this provides an easy avenue for the access seeker to mischievously distort the process.

2.5 Proposal 6.4 Arbitration to Commence within 30 days.

The conditions that trigger arbitration should be well thought out, and not subject to such harsh and inflexible criteria. There may be many reasons why a negotiated result may not be practical in such a time frame, for example, the need to clarify the nature of required access, consult affected parties, or discuss infrastructure enhancements. In the *Railways (Operations & Access) Act 1997 (SA)*, there is provision for the regulator to refuse arbitration if, in its opinion, the access seeker has not acted in good faith.

2.6 Proposal 6.5 Aims of Arbitration

This proposal will need to be integrated and consistent with other proposals, particularly the objects clause and provisions in the legislation concerning pricing.

2.7 Proposal 6.8 Arbitration of Disputes and Requirement to permit Interconnection-Removal of Power to require Extension of Facilities

This proposal is not aligned with provisions of the National Third Party Access Code for Natural Gas Pipeline Systems (the Gas Access Code). The definition of "Service" in section 10.8 of the Gas Access Code includes the right to interconnect with the Covered Pipeline. Section 6.22 of the Gas Access Code gives the arbitrator power, in defined circumstances, to require a Service Provider to develop capacity.

2.8 Proposals 7.5, 7.6, and Finding 7.1 Dual Access Requirements

The SA Government reiterates the concern it expressed in its submission of January 2001 about the possibility that a Service Provider could be subject to both an Access Undertaking under Part IIIA and the Gas Code.

Since the decision of the Australian Competition Tribunal (ACT) on 4 May 2001 on the coverage of the Eastern (Longford to Sydney) Gas Pipeline, the probability that pipelines (particularly major transmission pipelines) would not meet the criteria for declaration under either Part IIIA or the Code has increased.

There remains the possibility, at least theoretically, that some pipelines could be subject to regulation by both the Code and Part IIIA, some to regulation by either the Code or Part IIIA and some (probably an increasing number) to regulation by neither.

It would be extremely difficult, as is suggested in the Position Paper, to simply align the requirements of the relevant industry regime with those of Part IIIA. It would be difficult to develop "generic" price and other regulations to deal in detail with industries as diverse as, for example, gas, electricity, telecommunications and rail.

There is considerable complexity in industry specific regimes. For example, the Gas Pipelines Access legislation is considerably more complex than Part IIIA. It is doubtful whether there are sufficient people, with a detailed understanding of all of the diverse regimes, who could extract meaningful and coherent generic principles for application in all of them.

2.9 Proposal 8.1 Access Pricing Principles in Part IIIA

While agreeing with the Commission that pricing principles should be specified, the SA Government has some concerns with the principles proposed in the Position Paper.

One issue is the rigid application by some Regulators of the principle that prices should reflect the cost of providing the service. Such an approach can more readily be applied to an existing facility than to a new or a proposed facility. Such an approach leads to a short-term focus, which has the potential to discourage new investment.

The SA Government considers that, any pricing principles should explicitly highlight the need for a rate of return that is commensurate with the pricing risks, particularly for new facilities, by making it a separate pricing principle.

The SA Government is also concerned that without this change the proposed pricing principles do not adequately address the issue of providing incentives for infrastructure developers to undertake efficient investment and build for more than the immediate level of demand. The level of economies of scale in the provision of certain infrastructure like gas pipelines and electricity transmission lines suggest that it may be optimal to take account of future demand growth when expanding or building infrastructure, and marginal capacity is cheap.

It appears that the access regime may in certain instances penalise developers for building for future capacity requirements. The operation of the access regime should encourage infrastructure developers to minimise long run costs. This may involve developing capacity for anticipated market growth. Such an approach could be also required if providing an adequate supply security margin is deemed to be part of market requirements.

The option of price monitoring, which is discussed in the Position Paper, warrants serious consideration as a complement to declaration, particularly in circumstances where there are only two or three providers of a service. Price monitoring could help to determine whether there appears to be collusion on pricing, and thereby also act as a deterrent to it.

2.10 Proposal 8.2 Productivity Based Approaches

In circumstances when Regulators propose to apply the CPI-X formula, they should be required to explain the basis of the envisaged productivity increase. For example, from Research and Development (R&D) funding which has been provided for in the access arrangement or in expected managerial efficiencies.

If Regulators are assuming that Service Providers will be able to apply overseas R&D without cost, they should state this explicitly.

2.11 Proposal 9.1 Ending the Decision Making Role of Ministers

The SA Government considers that the role of Ministers should be retained in any decision making on policy changes, but that such a role is not essential for administrative changes.

Much of the discussion in the Position Paper is based on the ease of administration of the decision making process itself, without sufficient regard to the question as to who should ultimately make the decisions.

No convincing argument has been presented as to why decision making powers (particularly with respect to policy changes) should be removed from elected Ministers and given to unelected officials. It is extraordinary that a reason presented for this proposal is that of “making Ministers more accountable for their decisions” (p 226). Ministers are ultimately accountable to the electorate for their decisions.

The SA Government supports the removal of the decision-making role of Ministers only with respect to administrative changes, subject to criteria for distinguishing policy and administrative changes being developed and agreed by jurisdictions.

If it *is* seriously proposed to reduce the number of participants in the decision making process, then consideration should be given to removing the role of the NCC in making a recommendation to Ministers. While it is preferable to retain it, it is not clear that this step in the overall decision making chain is essential.

2.12 Proposal 9.2 Single Regulator-ACCC

The SA Government is strongly opposed to this proposal.. It considers that the existing role of State Regulators should be retained, as is provided, for example, in the Gas Pipelines Access Law. This provides for the regulation of transmission gas pipelines by the ACCC and distribution networks by local State based regulators.

Local Regulators are better able to understand, and constructively respond to, the unique features of each distribution network.

It is likely that there would be greater creativity and flexibility with several State based Regulators operating under a uniform set of rules than with a single Regulator.

The argument presented in the Position Paper, that the ACCC should play an expanded role in administering Part IIIA and continue its role in the administration of industry specific regimes because of the expertise that it has acquired, applies also to existing State based Regulators. Existing State based Regulators have acquired considerable expertise in applying the Gas Access legislation, and can take account of the circumstances prevailing within their jurisdictions whilst operating under a uniform national regime.

Having the ACCC as the sole regulator would further sharpen the conflicts of interest to which it is already subject, in particular between being a "consumer watchdog" on the one hand and an industry regulator on the other.

This issue cannot be fully considered from the perspective of administrative convenience alone.

In the area of natural gas, the Report does not explore in detail the legislative changes that would be required in order to implement the proposal. It is not clear whether it is proposed that the single Regulator would operate under the existing Uniform State and Territory legislation (reinforced by Commonwealth legislation) or Commonwealth legislation alone.

The existing Uniform State and Territory legislation is well entrenched, and would be difficult to amend. Under clause 6.1 of the Council of Australian Governments (COAG) Natural Gas Pipelines Access Agreement:

> ***A Party must not amend its Access Legislation (either directly or by making other legislation that would alter its effect, scope or operation) unless the amendment has been approved in writing by all the Ministers.***

Even if the relevant Ministers were to agree to such an exclusive conferral of power on a Commonwealth body (the ACCC) the conferral might could well face

Constitutional difficulties, especially in the light of the decisions of the High Court in *Re Wakim* and *The Queen v Hughes*.

The replacement of the existing Uniform State and Territory legislation by Commonwealth legislation alone would be a fundamental change in the administration of the scheme, and would almost certainly require the approval of COAG. Any such Commonwealth legislation would also face the risk of a Constitutional challenge to aspects of the Access Regime by Service Providers (particularly price regulation), in view of the absence of any express Commonwealth power to control prices (such power was rejected by referendum in 1948).

Section 44ZZN of the TPA provides for compensation if a determination would result in an "acquisition of property", which is expressed to have the same meaning as in section 51(xxxi) of the Constitution. It is probable that the use of this section would increase if the ACCC were the sole Regulator. It is also noteworthy that section 51(xxxi) of the Constitution provides that the Commonwealth can only acquire property on just terms for any purpose in respect of which the Parliament has the power to make laws.

The Government also considers that licensing and technical supervision functions should remain with State based Regulators, and should not be performed by the access Regulator.

2.13 Proposal 9.4 Full Merits Review by Australian Competition Tribunal

This recommendation requires some detail as to who is to be granted the right of appeal. Section 39(1)(d) of Schedule 1 of the *Gas Pipelines Access (South Australia) Act 1997* could be considered as a model. This grants the right to persons who made submissions to the relevant Regulator on an access arrangement and whose interests are adversely affected by the decision.

2.14 Proposal 9.5 Abolition of Appeal against Decision to Declare Services

The SA Government does not support the reduction of such rights.

2.15 Proposal 9.6 Provision for Public Comment

The SA Government supports this proposal in principle. The circumstances when it is deemed to be inappropriate to provide for public comment should be clearly identified, and very limited.

2.16 Proposal 9.8 Publication of Reasons by Ministers

This proposal is supported. It should be noted that Ministers are already required to publish reasons for their decisions on the effectiveness of an access regime under section 44N(4) of the TPA.

3 OTHER MATTERS

3.1 The Rate of Return and Risk

In Box 8.6 the Position Paper discusses the operation of the capital asset pricing model (CAPM) and its treatment of non-diversifiable risks. It notes that there is uncertainty about how project specific risks should be treated in the cash flows and the weighted average cost of capital (WACC). In the absence of any consensus on this issue regulators should be required to explain their treatment of risk in any decisions. In particular, Regulators should be required to provide an explanation of how future augmentation of existing assets can be catered for in WACC determinations.

In the discussion of the relative merits of the depreciated optimised replacement cost (DORC) and depreciated actual cost (DAC) methodologies and the selection of DORC by Regulators, it should be noted that in the gas area the Access Arrangements required to be submitted by Service Providers under the Gas Access Code have been based on the DORC methodology. Regulators have, after careful consideration, endorsed this choice.

3.2 Access Holidays

In response to the Commission's request for further information or views as to how the practical difficulties of targeting those projects/services that should be granted an access holiday might be overcome (p194 and 205), it is suggested that provision should be made for such a holiday within, rather than outside, the relevant industry specific regime. Such a holiday could be limited to the pricing aspects of regulation, whilst other provisions on access itself could continue to apply.

This issue is closely linked with the need to allow for a rate of return commensurate with the risks for new facilities, rather than requiring the application of cost pricing to them.

3.3 Revocation Arrangements and Duration of Part IIIA Determinations

The SA Government supports in principle proposals to fast-track the extension of certification arrangements. Consideration should also be given to extension by mutual agreement, with a requirement to publish reasons for the extension.

With respect to the length of time that an Access Arrangement under the Gas Access Code can operate, it should be noted that section 3.18 of the Code provides that an Access Arrangement may be of any length, but attaches some specific requirements if its length is to exceed five years.

3.4 Freight Australia's Statements to the Productivity Commission

Freight Australia Limited (FAL) in the public hearing held in Melbourne on 28 May 2001 made a number of statements about the South Australian rail access regime, established under the *SA Railways (Operations and Access) Act* 1997, which the Government wishes to comment on.

Freight Australia (FAL) has claimed that the Information Brochure provided by Australia Southern Railroad (ASR) was seriously deficient. The SA Railways (Operations and Access) Act 1997, and the associated Information Kit produced by the regulator, requires that an Information Brochure contain:

- Terms and conditions on which an operator provides above rail services.
- Terms and conditions on which an operator is prepared to make its infrastructure available to others.
- Demonstration of how this information relates to the pricing principles developed by the regulator.

ASR's Information Brochure satisfies these requirements.

FAL also stated that the South Australian rail access regulator declined to take the application to arbitration despite acknowledging that FAL had a case for arbitration. In fact, the South Australian rail access regulator has consistently advised FAL that the preconditions for arbitration had not been met, always giving the reasons for that position. These preconditions include a requirement to have engaged in good faith negotiations.

One of the reasons for lack of progress was the refusal of FAL to provide service specification information. FAL argument was that they only required 'ad hoc' services, and that they could not provide any specifications.

4. CONCLUDING REMARKS

In summary, the SA Government considers that:

- while mandating pricing principles is a good idea, care needs to be taken to ensure flexibility is retained and efficient new investment is encouraged
- the role of Ministers should be retained in any decision making on policy changes, but that such a role is not essential for administrative changes
- the existing role of State Regulators should be retained.