SA GOVERNMENT SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO CLAUSE 6 OF THE COMPETITION PRINCIPLES AGREEMENT AND PART IIIA OF THE TRADE PRACTICES ACT 1974

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SA Government Submission to the Productivity Commission Inquiry Into Clause 6 of the Competition Principles Agreement and Part IIIA of the Trade Practices Act 1974

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1. INTRODUCTION

The Productivity Commission ("the Commission") has invited the South Australian Government ("the Government") to make a written submission to the Commission's Inquiry into Clause 6 of the Competition Principles Agreement (CPA) and Part IIIA of the Trade Practices Act 1974 (TPA).

As part of National Competition Policy, the Commonwealth and States and Territories agreed to review the national access regime for 'nationally significant' infrastructure facilities after five years.

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 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 TPA discharges the Commonwealth's obligations under Clause 6.

The South Australian 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".

This submission provides information on the South Australian Government's experience in implementing access regimes for gas and rail including the Tarcoola to Darwin railway link.

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

Dr Rosemary Ince
Director, Economic Reform Branch
Department of the Premier and Cabinet
GPO Box 2343
ADELAIDE SA 5001
Ph: (08) 8226 0902
Fax (08) 8226 1111

2. GAS PIPELINES ACCESS

2.1 Background

In accordance with the Council of Australian Governments (CoAG) commitments made in February 1994 to competition reform, which included "free and fair" trade in natural gas, Australian governments sought to develop an industry specific but nationally consistent approach to gas pipeline access.

The Gas Reform Implementation Group under the auspices of CoAG developed a uniform national regulatory framework and the National Third Party Access Code for Natural Gas Pipeline Systems (the Code) to regulate third party access to natural gas transmission and distribution pipelines throughout Australia. Each jurisdiction signed the CoAG Natural Gas Pipelines Access Agreement (the Agreement) on 7 November 1997. The Agreement sets out the obligations of jurisdictions to give legislative effect to the Code and related legislation which together comprised the Gas Pipelines Access Law (GPAL) within a specific timeframe and other actions to implement and maintain the integrity of the Code. This Agreement represents a major step in competition reform.

The GPAL is contained in the *Gas Pipelines Access (South Australia) Act 1997* which is the lead legislation. The Code is set out as Schedule 2 to the Act. The Code is designed to provide a degree of certainty as to the terms and conditions of access to the services of specific gas infrastructure facilities, as well as to preserve the role of commercial negotiation. Owing to the national legislative scheme, the *Gas Pipelines Access (SA) Act 1997* commenced upon the *Gas Pipelines Access (Commonwealth) Act 1998* receiving Royal assent on 30 July 1998.

Through legislation, the Code applies to many of the existing natural gas transmission and distribution pipelines and will apply to new pipelines that satisfy the Code's coverage criteria. A schedule to the Code details the transmission and distribution pipelines that were 'covered' by the Code at its commencement. Guidelines concerning the form and content of coverage applications are available from the National Competition Council. Applications should be made in accordance with those guidelines.

Legislation giving effect to the national access Code has now been assented to in each of the States and Territories that have reticulated natural gas.

2.2 Policy considerations

During the development of the Code, it was considered that the more general regime under Part IIIA of the TPA would not provide sufficient regulatory certainty for current and prospective gas pipelines. It was also considered that having all parts of the gas industry including large consumers actively involved in the development of the Code would enable the industry to have some "ownership" of the regime.

One of the fundamental policy intentions behind the development of the Code was coverage of the whole industry under a single regulatory regime. A further aim of

National Competition Policy has been the creation, where possible, of a "level playing field" for all pipelines that meet the coverage criteria in the Code.

The current gas pipeline access regime under the Code is more prescriptive than the general approach used in Part IIIA. This is due to the revenue control exercised through the Reference Tariff mechanism, instead of the "negotiate and arbitrate" approach in Part IIIA. The aim of the reference tariff approach is to both limit monopoly rents and facilitate the ability of shippers to negotiate from a basis of public tariffs. It is considered that this approach lowers transaction costs and speeds up the ability of shippers to gain fair and reasonable access to pipeline services.

2.3 The present situation

The intention of jurisdictions to cover the whole industry under a single regulatory regime has not in fact been achieved. The option of a Service Provider to file an Access Undertaking under Part IIIA remains. This option is most likely to be exercised in the case of new (greenfield) pipelines. It is not likely that a Service Provider whose pipeline was already covered by the Code would wish to also lodge an Access Undertaking.

There is also, after an Access Undertaking under Part IIIA with respect to a pipeline has been filed, no legal impediment to an application for coverage under the Code. In such a case, if the application were successful, "double regulation" could apply.

It is of concern that Service Providers have the option of either filing an Access Undertaking under section 44ZZA of the TPA (Part IIIA) or an Access Arrangement under the Code. These options leave open opportunities for "forum shopping".

At this stage of the evolution of the gas pipeline access regime, it is noted that:

- Regulatory approval of the access details contained in an Access Arrangement has taken considerably longer than originally envisaged, with all Regulators having to go beyond the 6 months[1] noted as the "maximum" time period in section 2.21 of the Code.
- This elapse of time has inhibited the advent of retail competition, as pipeline access is a pre-requisite for market entry by new retailers. This has meant that the benefits of the reform process have been delayed.
- Owing to the bundled service applying prior to access, it is difficult to determine the likely price impact of access regulation on small volume end users. Previously the access charge and retail margins were combined, with little available information on their components within the distribution and retail sector.

In a scenario in which some pipelines are subject to the Code, and others to undertakings under Part IIIA, with still others subject to both, the regulation of the gas pipeline industry in Australia would become fragmented.

The aims behind the development of the Code, of coverage of the industry by a single regulatory regime which creates a "level playing field" for all pipelines, would be

[1] The time from the Access Arrangement being submitted to the Final Decision.

compromised if different rules, with potentially different economic and other consequences, were to apply to different pipelines. The aims would be more readily achieved if:

- all pipelines that meet the coverage criteria in the Code were covered by a single regulatory regime, and
- all service providers who wish to submit voluntary access proposals are only able to do so within the ambit of the Code.

2.4 Further considerations

It is also important to address some aspects of the economic rationale relevant to the review of Clause 6 of the Competition Principles Agreement (particularly its ambit) and both Part IIIA and the Code.

It is of concern that in recent times, with respect to the Eastern (Longford to Sydney) Pipeline, arguments were presented against coverage by the Code, to the effect that the degree of competition in a market that would result from competition between gas from two different basins would suffice to warrant withdrawal of coverage by the Code. Whilst recognising competition from other fuel sources, this is in effect an argument that duopoly constitutes a competitive market. Duopoly has not been seen as adequate competition in other areas, including in the banking, electricity or telecommunications industries.

If the argument that an access undertaking for one or both of such pipelines in such circumstances was adequate were to be accepted, then the "trigger" for revocation of coverage would become set at a level that would be easy to satisfy, particularly in the case of major transmission pipelines. This could lead to inconsistent results with different pipelines delivering gas to the same market being under different regulatory regimes, or with all of such pipelines (typically a duopoly) being outside of coverage by the Code, which would defeat the purpose of the Code.

The ACCC could, if it accepted undertakings the contents of which were "preferred" by sections of the industry, be perceived to have been "captured" by industry. If, on the other hand, the ACCC were to adopt a broad interpretation of section 44ZZA of the TPA and accept only undertakings, the elements of which were identical or nearly identical to those that would apply under the National Code, there would appear to be little to distinguish an Undertaking from an Access Arrangement.

2.5 Recent developments

The National Gas Pipelines Advisory Committee (NGPAC) is presently considering Code changes that would have the effect that, if an access undertaking has been accepted under section 44ZZA of the TPA in respect of the whole or part of a greenfield pipeline (i.e. a proposed pipeline), the Service would be exempted from the requirement to submit an Access Arrangement under the Code.

This is envisaged as an interim measure. The jurisdictions have indicated strong support for a single regulatory regime. If this is to be achieved, a mechanism will be required for an Access Undertaking under Part IIIA of the TPA to be converted into an Access Arrangement under the Code, subject to the coverage criteria at the time

being met. South Australia considers that the mechanism for such a conversion should be included in the Code.

The jurisdictions recognise the need to make changes to the Code to specifically address the special circumstances of greenfield pipelines, particularly those which will be built with excess capacity which will only be utilised in the longer term.

In order to create a single regulatory regime for natural gas pipelines, it will be necessary for the Commonwealth to amend Part IIIA to remove the option of filing an Access Undertaking in the case of gas pipelines. This should be done in conjunction with, and take effect after, the proposed Code changes.

2.6 Certification

The additional regulatory uncertainty which could arise from the declaration of a pipeline under Part IIIA of the TPA in jurisdictions which have not yet had their access regimes certified by the Commonwealth Minister under section 44N of the TPA also needs to be addressed. This situation could arise, for example, with a new proposed pipeline straddling jurisdictions whose access regimes have, and have not, been certified.

3. THE SOUTH AUSTRALIAN RAIL ACCESS REGIME

3.1 Background

The South Australian Government decided to establish a rail access regime in response to the Commonwealth Government's proposal to sell Australian National (AN) rail freight operations within the State as a vertically integrated operation, including both the track and the trains. The South Australian freight business principally comprises bulk grain, coal, limestone and gypsum traffics.

AN's customers were greatly concerned that a new owner who had a monopoly might attempt to extract monopoly prices. There was also concern that prospective purchasers for AN might base their bids on expectations of monopoly profits.

Furthermore, some existing rail operators had experienced difficulty in reaching satisfactory resolution of access disputes. They were concerned that there was no mechanism to assist in resolving disputes, apart from taking legal action.

These concerns were shared by the State. Reliance on Part IIIA of TPA was considered undesirable. SA railways would need to pass the 'national significance' test for the TPA to apply, which was doubtful for most lines. Also experience suggested that applications for declaration under the TPA involved time consuming and expensive processes that could still frustrate competition.

State access regime legislation was therefore drafted and the Bill was provided to bidders for AN in mid 1997. The *SA Railways (Operations and Access) Act 1997* came into operation on 11 September 1997.

The SA Act has been designed to provide a 'light handed', flexible approach that encourages commercial negotiation of access, minimises regulatory imposition and

administration, and provides certainty and efficiency in resolution of access disputes. The TPA requirements for an access regime to be considered 'effective' were taken into account in the drafting of the SA Act.

To date, there has been no need to invoke dispute resolution provisions and the State has not sought certification by the National Competition Council as an 'effective' regime. The need for certification will be kept under review.

The SA rail access regime takes effect by proclamation of the infrastructure and services to be covered. The State decided to proclaim only that infrastructure and those associated services considered to present significant barriers to competition. Coverage can be varied by further proclamation, if needed.

The access regime was proclaimed on 7 May 1998.

In general terms, rail track (except private sidings), signalling and train control have been covered. The principal exceptions are the inter-state mainline tracks, which are managed for open access by the Australian Rail Track Corporation, and the BHP and Optima Energy owned tracks, where the prime customer is in control of the track. Private sidings are excluded because their operation is linked exclusively to the (non-transport) business conducted at the site. Competitive access is therefore not likely to be required.

Railway stations have also been covered, due to the difficulty and expense in establishing new stations for what are usually fairly low frequency passenger train operations. Freight terminals have been excluded because there are competing terminal operators and it is considered possible to develop a new terminal if required.

3.2 Investment in infrastructure

The SA government will monitor the possibility that open access could present a threat to the long term viability of the capital asset, by reducing the returns to the track owners. Already, in most areas of SA, returns do not cover the full economic cost of capital employed, and there is a real risk of infrastructure decline. Competition from road is strong, even for bulk commodities such as grain, and prices are already below an economic level in the long term.

3.3 Cherry picking of profitable services

In most networks, there are services that are inherently more viable than others, and infrastructure providers inevitably cross-subsidise their operations by acceptance of the different profitability of different services. The SA Government will also monitor the possibility of third parties 'cherry picking' as this could threaten the ability of infrastructure owners to generate enough revenue to maintain the complete network, or maintain it at a given standard.

3.4 Access to terminals

The SA Government intends to closely monitor the need for the access regime to cover freight terminals. The availability of adequate terminal capacity under fair access conditions is crucial for competition. Any tendency by existing owner operators to inhibit competition by pricing access at a prohibitive level needs to be swiftly countered.

4. TARCOOLA TO DARWIN RAILWAY

4.1 No change to the access regime

The Tarcoola to Darwin Railway project has been difficult to establish because it is a risky, greenfields project. In agreeing to accept risk, and invest substantial amounts of funds on the project, parties are relying on the existence of the certified access regime.

Because of this, the certification should be preserved notwithstanding the amendment of Part IIIA of the TPA, if this is what ultimately occurs. Any amending legislation should contain a provision which continues in operation certifications in existence at the commencement of the amendments.

4.2 Access arrangements for facilities not yet built

A State access regime had to be developed for the planned Tarcoola to Darwin railway because only an infrastructure owner can provide an access undertaking. It would be desirable to have the option of an access undertaking, binding on a future owner, in circumstances where a facility is not yet in place.

4.3 Exempting risky greenfield projects

The need to amend the TPA in order to exempt a facility, for a period, from the Part IIIA provisions is cumbersome, and politically difficult. However, exemption should be an option for risky, greenfields projects such as the Tarcoola to Darwin railway. (Note that this was granted for the Channel Tunnel in Europe).

4.4 Relationship between the ACCC and NCC

The fact that a different body, the ACCC, deals with an access undertaking is also an issue, especially in matters to do with the interface of different regimes. For example, the ARTC is negotiating an access undertaking for a significant part of the interstate network at present.

Consistency then relies on the NCC and ACCC working cooperatively, and agreeing on the handling of the critical issues, which can not be guaranteed.

4.5 Access disputes

Furthermore, where an access dispute involves two regimes, there is a need for a mechanism to ensure that each regime contains the necessary provisions to ensure the requirements of the other regime are taken into account, there are mechanisms to appoint a common arbitrator, etc.

4.6 Inconsistencies between the CPA and Part IIIA

The inconsistencies between the CPA and Part IIIA of the TPA need to be removed to make the policy intent clear, for example CPA clause 6(3)(a)(ii) is expressed in materially different terms to sections 44G(2)(a) and 44H(4)(a) of the TPA.

The concept in section 44G(2)(a) of the TPA (the promotion of competition in another market) is different to the concept in clause 6(3)(a)(ii) of the CPA (access being

necessary in order to permit effective competition in a downstream or upstream market). Clause 6(3)(a)(ii) has a narrower focus than section 44G(2)(a) of the TPA.

There are other inconsistencies between the two provisions. Clause 6(4) of the CPA requires that a number of principles should be incorporated into each State or Territory access regime, for example that access to a service for persons seeking access need not be on exactly the same terms and conditions. The principles contained in clause 6(4) are not contained in an equivalent section in the TPA. Also section 44G(2)(c) includes guidance on when a facility should be considered nationally significant - there is no equivalent section in the CPA.

The inconsistencies between the two provisions should be removed as both provisions are relevant if an application is made to the NCC under Part IIIA of the TPA.

4.7 Role of the NCC

It is South Australia's view that the NCC over-steps its mandate at times. It asks for more than would appear necessary under the TPA, and it would be useful to clarify the extent of the NCC's ability to require changes. Also, the NCC had particular difficulty 'fitting' a long-term, greenfields investment carrying significant risk into the CPA/TPA mould. It would be desirable to give explicit recognition to the special requirements of risky, long term, major, greenfield investments in the CPA/TPA.

Examples are:

- the NCC questioning the economic benefits of a project, where SA argues that it is for the investors to decide what level of risk they are prepared to accept, and for the State to decide the level and nature of any support it may offer, as an equity investor or otherwise;
- the NCC taking a view that the benefits of any State Government support should flow to all users, rather than to the facility owner (whereas providing the specific benefits of Government support to the facility owner is necessary to get the project off the ground);
- the NCC insisting that it should not be possible to negotiate access outside the regime (where SA argued that an agreement that had been freely negotiated between the two parties should be recognised, whether or not it met all the requirements of the regime); and
- the NCC insisting that the regime should require the facility owner to extend the facility to meet an access applicant's needs (and not merely permit such an extension).

4.8 Pricing

In respect to pricing, there is a need to tailor regimes to particular circumstances. This is particularly the case for those areas where there is effective competition. For this railway, road competition effectively 'caps' freight rates for general traffics (but may not for some other traffics). For competitive markets SA argues that there is no need to set a ceiling price or rate of return cap, and only minimum regulation should apply. Also, for risky, greenfields investments it is critical to remove as much (non-market) risk as possible from future revenue streams by providing an acceptable degree of certainty in access pricing. Examples of problems experienced are:

- the NCC insisting on a conventional floor and ceiling approach for competitive markets;
- the NCC seeking to impose a conventional rate of return cap, when the investor needs the future up-side potential to offset losses in the initial phase (a rate of return cap in this situation means the actual return over the project life will inevitably be lower than the cap); and
- lack of any clear guidance as to the appropriate asset valuation methodology, which caused considerable difficulties because the NCC would not accept prescription of SA's preferred method and yet would not offer an alternative, wishing to leave this to a Regulator to decide (increasing future uncertainty).

4.9 Other matters

Other matters worth commenting on concern the ring fencing provisions and arbitration of disputes.

4.9.1 Ring fencing provisions

The ring fencing provisions in the access regime may be inconsistent with the provisions of the Corporations Law, for example reporting and duties of directors. Any such conflict needs to be resolved.

- Reporting arrangements under the Corporations Law require accounts to be prepared in a particular way (in accordance with certain Accounting Standards). The concern is that the ring fencing requirement may require accounts to be prepared in a different way. If nothing else, this may lead to the need to have two sets of accounts.
- Directors of a company are required under Corporations Law to exercise a reasonable degree of care and diligence in the management of the affairs of the company. This includes the requirement to inform themselves about the activities of the company and the matters that fall to be considered by them from time to time in their position of director. It may be difficult to do this in the context of provisions that impose certain ring fencing requirements.

4.9.2 Arbitration

There needs to be an easily activated mechanism for arbitration (Clause 6(4)(g) of the CPA refers to parties to a dispute "*appointing and funding an independent body to resolve the dispute*"). This is too rigid and the better concept is for the access regime to provide a mechanism for the appointment of arbitrators, as appropriate to the particular circumstances. For example the Australasia Railway (Third Party Access) Act 1999 allows the independent regulator to appoint arbitrators from a panel, although this may conflict with Clause 6(4)(g).