GOVERNMENT OF WESTERN AUSTRALIA

Submission to the

Productivity Commission Inquiry into Part IIIA of the *Trade Practices Act 1974* and Clause 6 of the Competition Principles Agreement

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SUPPLEMENTARY SUBMISSION TO THE PRODUCTIVITY COMMISSION REVIEW OF THE NATIONAL ACCESS REGIME

This is a supplementary submission of the Western Australian Government (hereafter Western Australia) to the Productivity Commission review of the National Access Regime.

Western Australia wishes to clarify aspects of its initial submission and respond to certain proposals outlined in the Productivity Commission's position paper.

COMMENTS ON SELECTED PROPOSALS

Design of the National Access Regime

The Productivity Commission has presented a number of related proposals that, when taken together, would fundamentally alter the design of the national access regime and its associated checks and balances. These include:

- Introducing an objects clause that suggests (an amended) Part IIIA would become the framework with which both Commonwealth and State industry-specific access regimes would need to comply (proposal 5.1);

- Moving the principles used to assess effectiveness of access regimes into Part IIIA from Clause 6 (proposals 7.3 and 7.4);

- An end to Ministerial decision-making under Part IIIA with decisions to be made by a designated regulatory body with a fallback option of harmonising statutory timeframes and requiring reasons for decisions to be published if Ministerial decision-making roles are retained (proposals 9.1, 9.3 and 9.8); and

- That a single regulator should be assigned responsibility for regulating all aspects of Part IIIA, subject to relevant appeals processes. The ACCC is favoured to assume this role (proposal 9.2). There is also a proposal to remove the ability for service providers (as opposed to users) to appeal against declaration decisions (proposal 9.5).

Western Australia is concerned that these proposals depart from the Competition Principles Agreement and would result in a considerable shift in powers from the States and Territories to the Commonwealth in respect of access regulation.

There are numerous avenues available to achieve an appropriate degree of consistency in access regulation if this is considered a real and practical issue. It has not been demonstrated that a 'one-size-fits all' model such as under Part IIIA is the best in all circumstances. The existence of alternative industry-specific regimes (i.e. the existing national access regimes for gas) suggests that the generic option is not always 'fit for purpose'.

Western Australia does not agree with the Productivity Commission's finding (finding 4.2) that Part IIIA itself should provide a binding framework for industry-specific access regimes.

The Productivity Commission's position paper addresses Part IIIA more thoroughly than Clause 6. Clause 6 has largely been considered only in a residual sense, in terms of how any 'live elements' might be incorporated within Part IIIA, and in terms of its future once this occurs. The Productivity Commission finds that Clause 6 could either become operationally redundant or could be renegotiated to fit its preferred model for Part IIIA.

In this context, Western Australia wishes to outline its views on the role that Clause 6 has played and should continue to play as the cornerstone of the national access regime. Clause 6 is the basis upon which jurisdictions agreed they would enact access regimes for essential facilities. Western Australia contends that there are good reasons for affording Clause 6 appropriate status and keeping its content outside of any jurisdiction's legislation.

Retaining the key design elements within an inter-governmental agreement rather than transferring them to a piece of Commonwealth legislation would preserve the means by which the States and Territories can influence the design of the regime. This was a specific feature of the Inter-governmental Agreements that jurisdictions agreed which provided comfort to the States and Territories as to their continuing role in this area.

In this context, Part IIIA may properly be viewed as an embodiment of the Commonwealth's Clause 6 commitment to introduce a default (i.e. last resort) access regime that could be applied in the absence of other arrangements.

While the 'States-rights' line has been used on numerous occasions since Federation, the label does not do justice to the underlying concerns. It is necessary to consider more deeply the division of Constitutional responsibilities between the States and Territories and the Commonwealth, and the consequences that stem from the design of sharing such powers.

In its first submission to this inquiry, Western Australia argued on page 3 that:

> *"Legislated, industry-specific access regimes are considered to be superior to other means of establishing access; and Part IIIA should be constructed so that these are the required regulatory route wherever there is currently any prospect of forum shopping or procedural overlap."*

And further, on page 4 that:

> *"Greater recognition should be given to state-based (ie. industry-specific) regimes that generally comply with the Clause 6 principles of effectiveness."*

Clause 6(2) itself lends weight to this view by stating that the Commonwealth (Part IIIA) regime is not generally intended to replace industry-specific regimes. Further weight derives from the design of the certification process and declaration criteria relating to effectiveness of existing access regimes. To make Part IIIA a model for all access would be insensitive to States' and Territories' legitimate interests in regulation and has the potential to introduce unwelcome uncertainty as to the status of existing industry-specific regimes.

Rather, Western Australia would see any "framework" changes that affect industry-specific regimes (as opposed to the administrative processes pertaining to the Part IIIA backup for access) to be matters for further negotiation between jurisdictions under a revised Competition Principles Agreement. Western Australia would remain open to considering and negotiating any changes that the Productivity Commission recommends to Clause 6 as the cornerstone of the national access regime.

Single National Regulator

Consistent with its contention that industry-specific regimes play the central role in the national access regime, in its first submission Western Australia also noted the importance of the opportunity (or threat) of gaining access under Part IIIA. Declaration is an important discipline on the way in which industry-specific access regimes are designed. Hence industry-specific regimes and the administrative path to access under Part IIIA should continue to co-exist.

Western Australia's view, expressed on page 4 that there was:

> *"…an argument for having a single regulatory body for Part IIIA",*

was presented on the premise that there would continue to be State based regulators for those services that fall under State's regulatory responsibilities. That is, the view was that a single advisory and regulatory body for Commonwealth matters might be a possibility.

That said, the role of the NCC is considered to be an important one in supporting both Commonwealth and State Ministers in their decision-making responsibilities. A single regulatory body may not be compatible with Western Australia's preference for retaining Ministerial decision-making, which is strongly supported.

In response to the issue of whether there were too many access regulators, Western Australia also contended on page 20 that:

> *"…principles of national consistency are not undermined by the involvement of different regulators covering the different jurisdictions."*

With the diverse mixture of public and private ownership of utilities among jurisdictions, and the Constitutional difficulties associated with centralising regulation (and where States and Territories wish to preserve their legitimate interests), the most practical solution is likely to entail multiple regulators implementing arrangements according to a consistent theme.

In this context, Western Australia's vision of the appropriate degree of consistency entails a single economic regulator in each state to deal with state-based access matters; and participation in national fora to promote consistency and best-practice in regulatory outcomes.

Where integration of regimes becomes an issue due to the importance of relevant inter-state services, this can be managed by co-operation among jurisdictions (eg. the National Gas Code) or alternative arrangements such as access undertakings (eg. the emerging inter-state rail services model).

Modified Criteria for Declaration

The Productivity Commission has proposed two options for changing the criteria for declaration under sections 44G and 44H.

The first proposed option (proposal 6.1) involves introducing the concept of materiality to the criterion under paragraph 44G(2)(a) that requires access to **lead to** an increase in competition in at least one market, other than the market for the service.

If adopted, it may be necessary to introduce the notion of likelihood to this criterion, otherwise there may be scope for a service provider to seek revocation on the basis that new entry has not **in fact** occurred within a reasonable time. Such a revocation would be an unfortunate outcome since the potential gains from increased contestability (ie. the threat of new entry) would be lost. For this reason, Western Australia is not attracted to the proposal as currently worded.

The second option (proposal 6.2) entails a more substantial re-write of the declaration criteria under sections 44G and 44H. While generally supporting this approach, Western Australia submits that proposed new criterion c) causes some conceptual difficulties.

An increase in competition in downstream markets could reduce the countervailing market power of each downstream user of a service such that the relative market power of the service provider is increased by new entry. Additionally, the degree of competition in upstream markets may also be a relevant consideration in influencing

the ability of a (transmission or transportation) service provider to engage in exclusionary behaviour or to price monopolistically.

Introducing the concept of countervailing market power in upstream and downstream markets might be one way of overcoming these difficulties.

Western Australia is also concerned about the proposed nexus between Part IIIA and criteria for coverage under industry-specific regimes. It does not believe that a direct link is appropriate. While it accepts the desire to limit the application of Part IIIA to natural monopolies (and even as far as precluding its application to duopolies), there may be cases in which jurisdictions intend multiple competing facilities to be covered (such as occurs under the gas code).

Inserting Pricing Principles in Part IIIA

The Productivity Commission has proposed (proposal 5.3) that:

> *"Pricing principles should be included in Part IIIA with application to arbitrations for declared services, assessments of undertakings and evaluations of whether existing access regimes are effective."*

Western Australia's has two comments on this proposal. Firstly, it considers that the application of pricing principles to the assessment of effectiveness would more appropriately be achieved through renegotiation of Clause 6 (as per the comments above about the framework of the national regime).

Secondly, Western Australia would be concerned if the above proposal was actually suggesting that ***existing*** regimes (that have already been certified) be subject to a new round of evaluations against the proposed criteria. This would add an unwarranted degree of inconvenience and uncertainty.

Subject to these issues, Western Australia has no particular concerns with the proposed pricing principles (proposal 8.1).

Role of Ministers

Western Australia does not support the proposal to remove the decision-making role of Ministers under Part IIIA (proposal 9.1). It sees merit however, in adopting the alternative set of proposals to strengthen the timeframes and information requirements where Ministerial decisions are required.

Retaining Ministerial decision-making would not preclude other positive adjustments to the framework. For example, the time limits proposed by the NCC appear to be a reasonable addition. Ministers are an important aspect of the governance arrangements surrounding the national access regime, and their role in declaration, certification and coverage decisions (under industry-specific) regimes is supported.

Certification of Commonwealth & State Regimes

Western Australia does not see merit in the proposal that would require Commonwealth industry-specific regimes to be certified (proposal 7.1).

Requiring that the Commonwealth submit all of its existing (and future) regimes for certification would be an onerous and unnecessary requirement. States and Territories are not compelled to do so, and requiring this of the Commonwealth would introduce another form of inconsistency. It also has the potential to cast doubt on the legal standing of these regimes.

However, the Commonwealth may wish to reconsider its approach in generally precluding by legislation the possibility for declaration under Part IIIA where an industry-specific regime is enacted. Leaving the possibility open would allow users to test an industry-specific regimes' effectiveness.

Certification, as it relates to State and Territory regimes is an optional process taken to reduce uncertainty as to whether alternative paths to access remain open.

In this context, it is questionable whether the certification process has added sufficient value to be considered a compulsory step. In Western Australia's case one attempt at certification has succeeded (ie. its enactment of the Gas Code); and one attempt has failed (ie. the rail access regime). On the other hand, the threat of declaration is considered to have added significant value, especially in encouraging States and Territories to enact robust and compliant industry-specific regimes.

The effectiveness of a given regime, now that the features of effectiveness have been reasonably tested, may only need to be considered in the event that an application for declaration is received. Such an application could be forthcoming on the basis that an existing regime is somehow deficient. A legislated regime should not be annulled simply because it does not meet certain design criteria. Instead, the declaration path should be (re)opened where an industry-specific regime is found to be lacking against the effectiveness criteria.

Where an application for certification is successful, Western Australia believes that declaration and undertakings under Part IIIA should be precluded. This matter is given further attention in the following section.

Forum Shopping and Double Jeopardy

Western Australia considers that further work is required to establish a more coherent hierarchy among the alternatives for access regulation.

In this regard, the State's primary concern is that the potential exists for forum shopping or double jeopardy under the gas access regime. The National Gas Code represents the culmination of many years of work and significant cooperation among jurisdictions and industry. Western Australia therefore does not believe that it is inferior in any regard to Part IIIA or the outcomes of a Part IIIA process.

The Productivity Commission has dismissed the State's concern and suggests on page 196 that:

> *"to the extent that 'forum shopping' or 'double jeopardy' is a source of uncertainty, modifying industry regimes to bring them into line with Part IIIA would be a preferable solution to closing off the undertaking option within the generic regime."*

Western Australia's view is that Part IIIA itself should close off the undertaking option in certain circumstances (discussed below). It is evident from the preceding discussion that the difference in views on this matter stems from different starting points in terms of what form of access (industry-specific or administrative) is a better model.

For example, the ability of pipeline owners to submit access undertakings needs to be re-considered. Western Australia's gas access regime has been certified as effective and so it should be considered as the appropriate path for access. Under the regime, questions of coverage are determined transparently, and the Independent Regulator conducts public consultation and decides on the appropriateness of any access arrangements that are submitted. Moreover, comparability between decisions is possible and the first round consideration of access arrangements under the Gas Code is already far advanced.

Western Australia suggests that further consideration could be given to Part IIIA removing the option of access undertakings where an industry-specific regime has been certified (and applies or would apply to the service in question) and the question of coverage under that regime has not (yet) been resolved in the negative.

It is not attracted to the option of attempting to amend a certified regime (with more difficult inter-Governmental processes for effecting change) to achieve this.

Western Australia acknowledges that there is a trade-off to be made between leaving open alternative paths of access against the uncertainty this might create for owners and users and the opportunities for forum shopping to get the best deal.

To attempt to bring some closure to this issue, the following hierarchy is proposed, based upon Western Australia's views as expressed in its submissions to this inquiry.

Certified industry-specific regimes should be the cornerstone of the national access regime, precluding any other path to access. Underneath each regime a robust framework for determining coverage and revocation is required (as exists in the National Gas Code). It is conceded that the limits of such regimes are likely to be tested for inter-state services. In such cases, cooperation between relevant jurisdictions to create a seamless regime under a single regulator (for that service or class of services) may be desirable. Alternatively, an access undertaking should be an available option only for a (new) inter-state service or services which are not otherwise covered by the regime. A Service Provider should not generally have the choice of submitting an undertaking where a Parliament has passed a regime encompassing its services (ie. where a service is "covered"). Access regimes such as the gas code are based on the concept of access undertakings in any case but are

generally much more informative on technical matters. Additionally, though the Productivity Commission appeared to agree (page 181) with Western Australia's suggestion that interim certifications be permitted, this does not appear to have been translated into a proposal for reform.

Similarly, **non-certified industry-specific regimes** express the legislated intent of Parliaments and ought not to be overlooked in their significance. Recognising that it is optional for a State or Territory to commence the process of certification, it is also necessary to consider the effectiveness of a regime should a competing access claim (eg. application for declaration or an access undertaking) be received. This would allow declaration (as an alternative to the existing regime) in cases where a regime is deficient. Or it might also allow undertakings to be accepted in the case that this leads to increased effectiveness over an existing regime, for example, by extending seamless access across state borders. Users would be protected from 'deficient' regimes by being able to seek declaration so that the question of effectiveness can still be addressed.

The advantage of **Part IIIA access undertakings and industry codes** over the declaration framework is the collective nature (ie. accommodating many users) and the integrated nature that can be applied to network pricing problems (as opposed to point-to-point) price determination. Western Australia sees merit in proposal 7.5 of the Productivity Commission's position paper to permit access undertakings to be accepted following declaration of a service. Undertakings should not be able to be accepted where an industry-specific regime exists and has been certified, or is otherwise found to be effective.

Western Australia considers that the place of **declaration** within the national access regime is simultaneously as a last resort for gaining access, and a critical feature for testing the effectiveness of non-certified industry-specific regimes. It is unclear whether declaration would provide a durable or cost-effective solution to generally providing access to all prospective users in multi-point to multi-point situations.

RESPONSE TO SELECTED REQUESTS FOR FURTHER INFORMATION

Costs of Regulation

The Western Australian Office of Gas Access Regulation (OffGAR) advises that its regulatory costs amount to approximately $260,000 per Access Arrangement assessed. This translates to less than 0.6 cents per GJ of throughput of regulated pipelines. Further information is contained is available in the Western Australian Independent Gas Pipelines Access Regulator's 1999/2000 Annual Report.

The cost of regulation under the Western Australian Rail Access Regime is not yet available given its recent commencement.

Price Monitoring and its Relationship with Access Regulation

The Productivity Commission has sought further views on the merits of providing scope to use price monitoring as an alternative, or complement, to declaration of services under Part IIIA and the most appropriate institutional arrangements to give effect to such monitoring. The following preliminary thoughts on the matter are provided.

Western Australia sees significant synergies between price monitoring and the various ways of dealing with potentially anti-competitive situations, of which access is one. Price monitoring could be a relatively un-intrusive form of regulation that creates incentives for providers of 'at risk' services to price transparently. However, it should not extend to services for which reference tariffs are approved by Regulators and where independent arbitration mechanisms already exist. In general, it should not extend to regimes that are certified as effective (consistent with the removal of a declaration threat where a certified regime exists).

In terms of institutional arrangements to support price monitoring, Western Australia sees merit in retaining something similar to the current arrangements where the responsible Minister must decide upon the scope of goods or services to be monitored. This is consistent with the views expressed earlier that there is a need to retain a degree of Ministerial decision making in access regulation.

It could be open to the Regulator to make a case to the Minister where 'declaration' of a service for price monitoring may be warranted. Decisions of this nature ought to be able to be made with a degree of expediency against relatively simple criteria; without the need for broad consultation; and should give effect to a suite of information gathering powers for the Regulator. A price monitoring declaration could potentially be designed as a "show cause" notice where the affected party has limited period of time to prove that monitoring is unwarranted or unduly harsh.

The onus should be on the affected party to deliver information in a prescribed form while commercially sensitive information is protected from misuse.

Access Holidays & Null Undertakings

The Productivity Commission has requested further information on ways in which the practical difficulties of targeting those projects/services that should be granted an access holiday within Part IIIA might be overcome. A related concept is that of the null undertaking.

It is suggested that these concepts are complex and can usefully be drawn out into at least three component parts:

- Firstly, there is the concept of coverage and the reverse concept of exemption from coverage;
- Secondly, there is a question of the appropriate terms and conditions of access where a facility or service is covered. The suggestion that a null undertaking has merit appears to be based on an assumption that there is some inability to reflect the riskiness of new ventures;
- Thirdly, there is a question of what residual aspects of access (ie. other than price) might usefully be retained in the event that the price of access was unregulated.

Western Australia is of the view that the coverage/exemption question could be addressed with reference to the public interest. If the risk of declaration is considered to be too high for a prospective project, it appears reasonable for a project developer to be able to mitigate that risk by excluding the possibility of regulated access should the overall public interest be met by doing so.

In such cases, there may be some merit in a public process of similar nature to that employed for Authorisation of anti-competitive conduct under Part VII of the Trade Practices Act. That is, the merits of an exemption (permitting what may otherwise be anti-competitive behaviour, noting that authorisations are not currently available in respect of s.46) could be addressed openly and an exemption, and the term of that exemption, granted only if it were found to serve the overall public interest.

It is noted that Authorisations under Part VII are limited in duration and that such an arrangement would allow reversion to the 'normal' situation, where the threat of declaration or coverage prevails.

Where the question of coverage is determined in the positive, Western Australia would argue that it would be appropriate to continue to focus on price as a critical term and condition of access. Price can be as much of an issue as outright exclusion. Commercially negotiated outcomes should be favoured. However, it should be a matter for the regulator or arbitrating body to ensure that any determined price balances the interests of parties, including to ensure that it reflects an appropriate risk-adjusted return on investment.

The risks of mis-specifying the appropriate terms and conditions can be mitigated by the appropriate tariff determination methodology incorporating economic life of assets rather than technical life and allowing greater flexibility in determining throughput forecasts. Other suggestions such as contracts of longer duration than standard

industry practice; and access arrangements longer than a five year period are further considerations.

Western Australia
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