WMC Limited

Submission to the Productivity Commission on the "Review of the National Access Regime – Position Paper"

Background

WMC Limited (WMC) makes this submission to the Productivity Commission on the Commission's Report on the "Review of the National Access Regime – Position Paper" dated March 2001.

WMC is one of Australia's major resource companies with extensive interests in copper, uranium, nickel, gold and fertilisers, in three Australian States and in overseas countries. As such, WMC is a major user of infrastructure in these locations, especially in relation to electricity, gas and rail, and a major consumer of electricity and gas in its various operations.

WMC has also been, and is currently, a developer of infrastructure in its own right, where this has and is necessary to support mining and processing operations. For example, WMC was the major participant in the development of the 1380km Goldfields Gas Transmission pipeline system in Western Australia, and its associated power stations and transmission lines, and owns and operates a 275kV transmission line from Port Augusta to Olympic Dam in South Australia.

WMC participated in the round of discussions held by the Productivity Commission and put forward its views on the subject matter in general terms. This submission provided the company comments on the Position Paper subsequently published by the Commission.

General Comment

WMC is generally supportive of the proposals arising from the Position Paper, and believes that the Commission has reached a reasonable balance between the interests of infrastructure owners and those of infrastructure users.

WMC is thus generally in agreement with the Commissions Tier 1 and Tier 2 proposals.

Our comments are intended to draw attention to those matters that are especially of concern to WMC and to elaborate on some aspects of the Commission's Position Paper, which should be helpful to the Commission in reaching a final position.

Balance of Interests

In several places in the Position Paper, the Commission expresses the view that "there is a strong, in principle case to 'err' on the side of investors".[1] While sympathetic to this view, WMC wishes to caution the Commission on taking this line of argument too far. Indeed we note that the Position Paper brings forth no evidence to support this point of view.

WMC notes that the ACCC and others state that the returns provided by the present regime compare very favourably with average returns on equity and are higher than return for comparable regulated utilities in overseas countries. This is also the experience of WMC, and we are aware of several studies which have compared the returns actually being achieved by infrastructure owners in Australia with those able to be achieved by listed companies operating in the same Australian economy over the same periods of time. Typically a variety of financial indicators need to be compared to understand the comparative positions. In all such studies of which we are aware, returns earned by infrastructure owners were verging on the excessive, compared to those able to be earned by "normal" companies. This conclusion is particularly strong in the case of the Government-owned electricity network-owning companies.

WMC is aware that a contributing factor to the bias towards the high returns able to be earned by infrastructure owners has been the attitude of Governments, who have been prepared to allow and to seek to maintain, high asset valuations and high values of WACC to maintain either healthy flow of dividends and tax-equivalent payments to Treasuries, or else to attract high purchase prices in those situations where privatisation was thought to be possible. To a great extent, the regulatory agencies have had the unenviable task to reducing the inflated expectations, which built up during this period.

Rather than rely on previous studies, WMC suggests that the Commission should conduct such a comparison as part of the present review. There is sufficient information available on the public record from corporations whose sole activities are governed by the outcome of access regulation – especially the

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1 *Page 71 of the Position Paper, for example.*

Government-owned electricity and gas infrastructure-owning corporations – for such a comparison to be meaningful.

WMC is sure that, were the Commission to conduct such a comparison, the inevitable finding will be that there is certainly no need for the existing regime to be biased more towards the interests of infrastructure owners, but more that the current regime deserves further moderation of the price impacts to reduce the allowable returns to infrastructure owners. Indeed continuing excessive returns risk unnecessary and inefficient over-investment – "gold-plating" is a term sometimes used in such circumstances.
WMC is also firmly against the view put forward by some that access regulation is detrimental to new investment in infrastructure. We can see no evidence that this is the case, and the rush of new prospective investments in gas pipelines from Timor Sea, PNG, and Western Victoria provides tangible evidence of this fact.

The Need for a Declaration Process

WMC believes that the process of declaration needs to be retained and agrees with the Commission that the discretionary role of the State Ministers and Premiers needs to be removed.

WMC has had particular experience with the need for this option in relation to access to the electricity transmission and distribution systems in Western Australia. There, the previous State Government sought to maintain Western Power Corporation as a vertically-integrated entity – arguable contrary to their obligations under the Competition Principles Agreement – and instead to graft on an "open access regime". This has always been unsatisfactory, and despite many representations to the Government and its various committees set up to oversight the open access regime – all of which were dominated or controlled by the Government and Western Power Corporation – no satisfactory regime has emerged after more than four years of frustrating effort.

Compounding this is the fact that, while in 1997, the Government stated that it intended to submit the regime for "certification" as an effective access regime, this action was never taken, and thus the unsatisfactory regime has never been subjected to the independent assessments contained in the Competition Principles Agreement. WMC has been supporting of, and understands, the reasons why Normandy Mining has recently sought "declaration" of the regime, as noted in the Commission's report.

We note however, that Western Power Corporation has recently instituted legal action to seek to prevent the NCC from

proceeding with the assessment of the declaration application, and WMC generally deplores this action. Furthermore, were the NCC to recommend declaration, the recommendation would be subject to the effective veto of the same State Government who had established the regime and previously refused to submit the regime for certification. This is not satisfactory.

In the event, the Government has recently changed, and WMC remains optimistic that such problems may be a thing of the past – but the experience illustrates the need for a continuation of a process like that of the "declaration" process contained in the existing access regulation arrangement.

Comments on Asset Valuation Methodologies

WMC welcomes the comments made by the Commission in relation to asset valuation methodologies in Chapter. We especially welcome the doubt, which the Commission throws on the pre-occupation with the DORC methodology by Governments and regulators in Australia and "its virtual hegemony as a regulatory tool for valuing assets within access regimes" in Australia.

The Commission rightly points out the many problems with the DORC valuation methodology, including the scope for a wide range of outcomes depending on the assumptions made, and the generally inadequate and ineffective optimisation step.

WMC, along with most users of infrastructure in the country, would prefer to see the use of asset valuations based on the DAC methodology, rather than DORC. However, we are also of the view that even the "building block" approach can only provide a broad starting point to determine suitable annual revenue requirements, and that testing of the final outcome against a basket of financial indicators, to see that the returns and levels of profitability which result are not excessive, is also required. We commend this approach to the Commission.

However we do see a problem in the Commissions assertion that "cost bases should be already established for most essential infrastructure services in Australia".[2]

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2 *Page 214 of the Position Paper*

As noted above, WMC is aware that a contributing factor to the bias towards the high returns able to be earned by infrastructure owners has been the attitude of Governments, who have been prepared to allow and to seek to maintain, high asset valuations and high values of WACC to maintain either healthy flow of dividends and tax-equivalent payments to Treasuries, or else to attract high purchase prices in those situations where privatisation was thought to be possible. This factor has been aggravate by the tendency of the same Governments to restrict the ability for regulators to revisit the initial asset valuations at the first regulatory review, meaning that the regulators do not get a chance to correct mistakes and over estimates of asset valuations for as long a ten years. All State Governments have adopted this approach – usually by way of derogations from the relevant industry codes.

We respectfully argue therefore, that the Commission is not justified in assuming that cost bases have be already established for most essential infrastructure services in Australia – or at least that such cost bases are satisfactory and not excessive.

Rationalisation of Industry Regulators

WMC is generally of the view that there are too many regulatory and quasi- regulatory agencies in Australia, especially in the electricity and gas areas.

The Commission is proposing that the ACCC become a single regulator for the purposes of Part IIIA of the Trade Practices Act. While WMC supports this rationalisation of the role of the ACCC and the NCC in relation to access regimes generally, WMC remains of the view that a single, national regulator is required for the wholesale energy industries in Australia, and that existing state regulators for electricity and gas, dealing with the distribution aspects, need to be similarly rationalised to have a single competent regulator dealing with both electricity and gas.

It is very doubtful that the ACCC has the necessary expertise of these industries for it to take on the role of the single regulator, but it should be possible to link such a regulator into the ACCC structure – for example, but having an ACCC Commissioner as a member of the specialist regulator and

having certain critical matters subject to ACCC approval – under the "authorisation" provisions or similar.

We also note that the Commission's proposals in this area are listed as being in the second Tier. WMC suggests that this is one recommendation that deserves of being elevated to first Tier status.

WMC suggests that the Commission look again at its proposals in this area before finalising its position.

Market Power Issues

Were the existing access regimes under Part IIIA to be substantially modified, the issue of market power able to be exercised by the inevitably small number of competitors providing infrastructure and supply would become more important.

The Commission makes passing reference to this matter in the Position Paper, but WMC believes that the issue of market power has not been sufficiently addressed in this area, and remains and area of concern.

As the Commission itself points out, much of the underlying philosophy of access regulation in Australia equates the encouragement of competition with the public good, as if one inevitably follows the other. Certainly, where effective competition exists, one can argue that such competition drives prices down and improves performance, and there are clear examples of this process at work in Australia – especially associated with the programmes of structural change and unbundling which took place in the mid-late 1990s.

However, if competition is not "effective" and market power exists, then if there is not an effective regulatory regime in place, then there is no guarantee that the public benefits will in fact be achieved.

WMC has been vocally critical of the lack of attention paid to the market power aspects in the reform of the electricity industry, where the limited extent of competition, coupled with market rules which are easily exploited by the producers, are resulting in wholesale electricity prices which are far from the outcomes expected from a fully competitive market. This has adversely affected WMC in South Australia in particular. Experience in the National Electricity Market in Australia, and also in the similar markets which once operated in the UK and California, have shown that participants with a very small share of the market – sometimes as low as 5-10% can effectively set the price of electricity in a poorly designed

market structure. The obverse of this fact is that a surprisingly large number of competitors will be needed to achieve a level of competition, which allows that competition to be relied upon to give satisfactory outcomes in terms of public benefit.

In addition, there appears to be a growing attitude in Australia that the introduction of just a second gas pipeline serving a major area of population is sufficient evidence of competition for the full access regulation regime not to apply. The recent decision of the Australian Competition Tribunal to overturn the coverage of the Eastern Gas Pipeline because the Sydney area is being serviced by one major pipeline from Moomba and a limited interconnecting pipeline from Victoria, appears to take this line and is a cause for some concern. The a actions of oligopolies can be just as much against the public interest as can those of monopolies, and the need for regulation to protect the public interest should not be lightly abandoned.

The Commission is proposing the inclusion of an "objects" clause in Part IIIA to address and other changes along the same lines, but also proposes that the declaration process be tightened to require that a "substantial increase in competition" be achieved. These two actions appear to contradict each other and fail to give proper attention to the issue of market power and the fact that competition must be effective – and not just nominally present – for public benefits to be forthcoming.

WMC suggests that the Commission might re-examine the issue of market power – especially the mounting evidence of problems in the National Electricity Market – and modify some of its proposals before finalising its report.

State Derogations

WMC has mentioned previously the practice of State Governments derogating from the National Codes for long periods of time, and constraining regulators from reviewing access arrangements.

WMC has a particular concern in this respect in relation to the Gas access regime applying in Queensland. The State Government has derogated all gas pipelines in that State from the application of the National Gas Code for a period of time as long as 23 years.

As a major user of the Carpentaria gas pipeline, WMC finds that the ACCC's ability to review the assess regime applying

to that pipeline has been almost completely eliminated because of the derogations made by the State.

These derogations preserve and protect not only a "bundled" contract – supply of gas as well as transportation services – but also a contract of more than 20 years duration. The effect is to completely negate the spirit and intent of the National Gas Code and indeed of Part IIIA of the TPA, and to protect the pipeline from the initial and regular regulatory examinations aimed at ensuring that each State has put into place access regimes, which would pass the tests of being "effective" under the Competition Principles Agreement.

Rail Access Regimes

WMC also has some specific comments to make on the rail access regimes that apply in Western Australia and Queensland.

As with other items of infrastructure, rail regimes appear to allow excessively generous returns on investment, especially when compared to those able to be earned by other listed companies. Asset valuation methodologies again play a major role in this outcome.

WMC also has concerns over the separation of functions in rail access regimes and the effectiveness of ring fencing provisions and of regulation arrangements. The incumbents have an ability to frustrate access by others to sidings and other facilities, to impose unreasonable requirements for information provision and to delay access by taking long periods of time to process access applications.

WMC sees the independence and powers given to the regulator to be important, both to establish an acceptable initial access regime and to monitor progress to ensure that it is effectively implemented over time.

Signed,

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