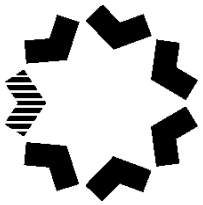

National Competition Council

# Annual Review of Regulatory Burdens on Business: *Primary Sector*

## Response to the Productivity Commission's Draft Research Report

## October 2007

# Introduction

The Draft Research Report of the Productivity Commission (Commission) concerning the Annual Review of Regulatory Burdens on Business: *Primary Sector* contains a section on the mining, oil and gas sector that includes specific comment on the operation of Part IIIA of the *Trade Practices Act 1974* (Cth) (TPA).

The National Competition Council (Council) is responsible for advising decision making Ministers on applications for third party access under Part IIIA. The purpose of this submission is to provide the Commission with some additional background to the operation of Part IIIA based on the Council's experience, and to comment more directly on the specific issues discussed and conclusions and recommendations reached in the Commission's Draft Report.

The relevant conclusions and recommendations in the Draft Report include, that:

- some of the issues raised by participants in the review (in particular the effectiveness of Part IIIA given delays in decision processes) could be expected to be addressed by the recent amendments to Part IIIA;

- further proposed changes to Part IIIA are also expected to be beneficial in ensuring that the "entry bar" for Part IIIA is not lowered;

- the matters raised by participants in the Commission's review and the appropriateness of Part IIIA as an access regime can be more appropriately dealt with in the next review of Part IIIA scheduled for 2011; and

- Part IIIA decision makers should ensure that their decisions are transparent by publishing the reasons and considerations for decisions.

Appropriate third party access to "bottleneck infrastructure" is a significant issue. Invariably it involves significant infrastructure facilities and substantial financial interests for both asset owners and access seekers. Part IIIA seeks to strike a balance between competing private interests in order to reach a result that serves the long term economic interests of the Australian economy.

The Part IIIA regime, and similar regulatory approaches adopted in most developed market economies, try to identify a middle ground between allowing owners of bottleneck infrastructure significant power over markets which are dependent on access to their infrastructure and imposing third party access rights that undermine returns on desirable infrastructure investment.

It is important that consideration of the operation of these regimes, including Part IIIA in the Australian context, recognise the inherent tensions between owners of bottleneck infrastructure on the one hand and parties seeking to

compete in markets where competition is dependent on access to that infrastructure – and also between the desire for infrastructure investment and development, and competition in dependent markets. It is likely that any solution to the bottleneck monopoly problem will have some effect on the "rights" of bottleneck infrastructure owners. Any such solution will also affect the rights of access seekers to participate and compete in dependent markets. Ultimately, and perhaps most importantly, the rights of consumers will be affected by both these factors. Most obviously consumers will benefit from opportunities to enhance competition in dependent markets, but importantly consumers will also be affected by changes in incentives for, and levels of, investment in infrastructure.

The issues raised before the Commission in respect of Part IIIA reflect the concerns of access seekers that determinations under Part IIIA take an excessively long period of time and the value of any access that might finally be mandated is significantly reduced by such delay. Concerns are also expressed in relation to at least one recent court decision that may significantly change the basis on which access may be required.

In relation to these areas of concern the Council agrees with the Commission's conclusions that these matters should be addressed by relatively recent legislative amendments and other changes to Part IIIA foreshadowed by the Australian Government. While the effectiveness of these changes should be kept under review, the Council considers that no additional changes should be contemplated at this time.

Other issues raised with the Commission reflect infrastructure providers, not unexpectedly, seeking to protect their positions. That infrastructure owners that are, or consider they may be, subject to access under Part IIIA will express concerns of that nature should not be surprising. As noted above, Part IIIA will almost always involve tensions between the competing rights and interests of infrastructure providers and access seekers, but ultimately Part IIIA is concerned with a wider national interest. Focusing on the position of any one party runs the risk of obscuring consideration of the broader objectives of Part IIIA. While it is of course reasonable that bottleneck infrastructure owners represent their interests, these interests, or indeed the particular interests of access seekers, do not equate to Australia's economic interests. A partial and incomplete analysis that focuses on particular interests or issues that arise in the context of considering third party access is inappropriate whether it arises in determination of a particular access application or in a broader policy context.

In this response to the Draft Report the Council seeks to assist the Commission by discussing the purpose and operation of the regulatory framework for third party access to services provided by natural monopoly infrastructure under Part IIIA. The response then comments on the specific issues raised in the Draft Report including the impact of recent legislative amendments and further scope for reform. In the penultimate section the Council also draws the Commission's attention to a specific area where the effectiveness of Part IIIA might be further enhanced.

# Background - Third party access under Part IIIA

The National Access Regime, introduced in 1995 and given effect through Part IIIA of the TPA, focuses on facilitating access to services provided by nationally significant infrastructure facilities that are essential inputs into other markets but are uneconomic to duplicate. The regime seeks to promote effective competition in markets that depend on using the services of infrastructure that cannot be economically duplicated. The intended outcome is to promote competition in dependent markets and avoid the inefficient duplication of costly facilities, while ensuring that facility owners receive appropriate recompense from access seekers, including a commercial return on investment, but not monopoly profits that might otherwise be available due to a lack of competition in dependent markets.

Importantly, declaration under Part IIIA does not mandate or guarantee access to a third party access seeker. In the words of the Australian Competition Tribunal (Competition Tribunal), declaration serves to "open the door"[1] to access, providing that access seekers have a legally enforceable right to negotiate terms and conditions of access to a declared service with the facility owner and, should negotiations fail, to have access disputes arbitrated by the Australian Competition and Consumer Commission (ACCC).

Declaration of a service is not intended to provide an access seeker with a free ride. Such a free ride could encourage inefficient outcomes and discourage appropriate investment contrary to the purpose of the National Access Regime. In determining the access prices and other terms and conditions of access in any particular case, the ACCC must balance the demands of access seekers with the interests of the providers of the declared service. It would be inconsistent with the objectives of the regime for access prices or other terms and conditions of access to be set so that providers were not compensated for the costs of providing access, including a commercial return on their investment in the infrastructure.

Part IIIA represents narrowly focused and limited intervention.

To be declared under Part IIIA, the service provided by a facility must satisfy criteria directed primarily at establishing that a facility is uneconomic to duplicate (i.e. a natural monopoly), of national significance and that access to the service would promote a material increase in competition in a related market.

1 *Re Review of declaration of freight handling services at Sydney International Airport (2000)* ATPR 41–754.

The Council cannot recommend that a service be declared unless it is satisfied that each and all of criteria (a)-(f), set out in s 44G(2) of the TPA, are satisfied (Box 1). The designated Minister cannot declare the service unless similarly satisfied.

**Box 1: The declaration criteria**

The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:

(a) that access (or increased access) to the service would promote a material increase in 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

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

*Source:* s44G(2) of the *Trade Practices Act 1974* (Cth)

The Council, in making its recommendation, and the designated Minister in making a decision to declare or not to declare the service, must also have regard to the objects of Part IIIA which state:

> *The objects of* [Part IIIA] *are to:*
>
> *(a) promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and*
>
> *(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.*[2]

It is clear from these criteria and requirements, and their application to date, that Part IIIA applies to a small sub-sector of infrastructure in specific circumstances.

While some infrastructure owners rail against the regime and its potential consequences (especially a claimed disincentive to investment) it should be clear that the scope of any such effects is limited. Furthermore the interests

[2] Section 44AA of the TPA.

of infrastructure owners, when these are consistent with a broader national interest, are seemingly well protected by the requirements of Part IIIA.

Even where a service provided by a facility is declared, in arbitrating a subsequent access dispute, the ACCC does not have to require access in a particular case. In determining a dispute brought to it the ACCC is required, amongst other things, to take into account:[3]

- the legitimate business interests of the provider, and the provider's investment in the facility;
- the public interest, including the public interest in having competition in markets;
- the direct costs of providing access to the service;
- the operational and technical requirements necessary for the safe and reliable operation of the facility;
- the economically efficient operation of the facility; and
- the pricing principles specified in s 44ZZCA.

The pricing principles in s 44ZZCA of the TPA go further to provide that the access prices determined by the ACCC should:

- be set so as to generate expected revenue for service that is at least sufficient to meet the efficient costs of providing access to the regulated service;
- include a return on investment commensurate with the regulatory and commercial risks involved; and
- provide incentives to reduce costs or otherwise improve productivity.

These provisions permit the ACCC to refuse to require access in a particular situation where access to a declared service could be shown to impose costs that outweigh the benefits of third party access.

However where an infrastructure owner is vertically integrated with commercial interests in upstream or downstream markets, or has some similar interest, it has the incentive to deny its competitors access or to impose prices for access that curb a competitor's ability to compete. In such situations consumers and the national economy generally are likely to be denied the benefits of that competition. It is these situations which are the focus of Part IIIA.

[3] Section 44X of the TPA.

# Issues arising in the Commission's Review

## Improved timeliness of decision making processes under Part IIIA

As the Draft Report notes, recent amendments to Part IIIA have introduced new best endeavours timeframes and standard periods for various stages of the declaration process, including:

- four months for the Council to consider and make a recommendation on an application for declaration for a service; and
- six months for the Tribunal to consider an application for review.

In the Council's view, the new best practice timeframes will provide greater certainty to all participants in applications made under Part IIIA. The Council anticipates that these timeframes will prevent a recurrence of the excessively lengthy process that has endured in relation to some declaration matters. As such, the Council anticipates that the new timeframes will improve the effectiveness of Part IIIA as a mechanism for providing access to services for third party access seekers.

## The promotion of competition (criterion (a))

Criterion (a) requires that "access or increased access" to the service will promote a material increase in competition in a dependent market. Historically, the Council and the Competition Tribunal have analysed criterion (a) by considering the factual and the counterfactual – i.e. what would be the effect on competition if the service were declared as compared to the effect on competition if the service were not declared. A recent decision of the Full Federal Court held that the words "access or increased access" are not synonymous with "declaration" and should be given their ordinary meaning. Some commentators have expressed concern at this development, claiming that the ordinary meaning interpretation of "access" in criterion (a) has "lowered the bar" to Part IIIA.

Criterion (a) has been the subject of recent legislative amendment[4] such that the application and effect of the criterion has now been formalised and clarified in the statute to provide that the promotion of competition in a dependent market from access (or increased access) to the service must not be trivial. As is apparent from the Council's recommendations on applications for declaration and from decisions of the Competition Tribunal this legislative amendment has served to formalise the existing approach to applying and interpreting criterion (a).

[4] *Trade Practices Amendment (National Access Regime) Act 2006* (Cth).

The Council notes the intention of the Australian Government to amend Part IIIA to address perceived uncertainty and concern that the "entry bar" to declaration pursuant to Part IIIA has been lowered following the Full Federal Court decision concerning declaration of the domestic airside service at Sydney Airport and the interpretation of criterion (a).[5]

The Council expects that such an amendment will improve certainty and transparency in the interpretation of Part IIIA and believes the proposed amendment should alleviate concern that the bar for application of Part IIIA has been shifted to a lower point than intended by the underlying policy.

## Effects on infrastructure investment

Regulation of infrastructure does involve tradeoffs and considered judgements about the costs and benefits. Access seekers contend that where an existing facility has spare capacity (or is capable of being expanded to provide additional capacity) and all users can be supplied at a lower cost if the facility is shared, then it is neither economical nor efficient to demand investment in high cost new infrastructure. On the other hand, some infrastructure owners argue that the costs of regulated access (including the threat and risks of regulation) outweigh the benefits and impose a significant cost in deterring investment in infrastructure that is incapable of compensation.

Leading participants in the mining industry have been amongst the most vocal critics of Part IIIA, principally in relation to costs and claimed adverse effects on investment. In matters that are still under consideration by the Competition Tribunal and the courts parties have quoted large attention grabbing figures that are claimed to be the cost and loss to the national economy of allowing third parties access to railways in the Pilbara region of Western Australia.

As these matters are still to be considered in the fora provided for under the TPA, it is not appropriate to draw conclusions in relation to the specific matters. However it is apparent that the costs claimed are based on an assumption that, even at a time of record demand and world iron ore prices, third party access would cause an infrastructure owner to delay the investment necessary to increase its capacity and thereby increase and maximise its output and profit.

In considering and preparing its recommendation on Fortescue Metals Group Ltd's application for access to a service provided by BHP's Mt Newman railway line — which was considered to have the potential to lead to one additional train running daily (at most an increase in demand of 4 per cent on BHP's then current use) — the Council considered the assumptions behind

[5] *Sydney Airport Corporation Ltd v Australian Competition Tribunal (2006) 155 FCR 124.*

BHP's claims and arguments in this regard. The Council acknowledged the issues underlying BHP's concerns but found that:

> … *any deterrent of declaration on efficient investment would be mitigated by negotiated or arbitrated outcomes that account for the costs of access (including diseconomies of shared use) and which provide certainty to the parties on the allocation of costs of future capacity and technology investment.*
>
> … *they* [BHP and Rio Tinto] *have asked the Council to assume that the mere fact of declaration or the use of the Mt Newman line would be sufficient for BHPBIO to decide to delay the implementation of a significant capacity expansion project in a period of unprecedented global demand for Australian iron ore—that is, to act irrationally.*[6]

The Council found that there would be benefits from declaration including the promotion of competition in the Pilbara rail haulage and tenements markets and economic and environmental benefits from avoiding the unnecessary duplication of rail infrastructure. While acknowledging there were mixed views on whether the shared use of railways or the development of multiple railways would better support growth in iron ore exports, the Council was not persuaded that declaration under Part IIIA would have a negative impact on the industry's performance such as to justify foregoing the benefits from additional competition associated with access. Nor was the Council persuaded that the historical preference for vertically integrated operations in the iron ore industry, in itself, established a model that is invariably more efficient than one that involves the shared use of facilities. The matter is now before the Competition Tribunal, which will reconsider whether third parties should be allowed the opportunity to use the BHP Mt Newman railway line.

The Council considers, based on its experience to date, that the Part IIIA declaration process allows for appropriate consideration of the costs and benefits of declaration. The declaration criteria and objects necessitate that the Council and the decision maker identify and balance all costs and benefits and test this analysis through a public process. Declaration decisions are also subject to merits review.

The existence of potential costs (such as adverse effects on investment incentives) is an argument for ensuring that costs (and benefits) are properly considered in deciding whether or not to declare a service. It is not a reason to eschew beneficial regulation. Furthermore, the Council considers that there is no evidence that the terms of any access arrangement cannot recognise the ongoing and future needs for timely investment and development of the infrastructure servicing the particular industry.

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[6] National Competition Council 2006, *Final recommendation: Fortescue Metals Group Ltd's application for declaration of a service provided by the Mt Newman railway line under section 44F(1) of the Trade Practices Act 1974*, Melbourne, paragraphs 11.40 and 11.44.

## An "efficiency override"

One suggestion from some infrastructure owners is that there should be an override capacity within the National Access Regime to refuse access per se on the ground that it would be contrary to the national interest. In the Council's view this suggestion does not take sufficient account of the already comprehensive nature of the declaration criteria and in particular criterion (f), which requires that various parties in the decision making process be satisfied that access is not contrary to the public interest.

It is important, in the Council's view, to distinguish between arguments for a general override and arguments that may be made in a particular case that declaration would be contrary to the national interest, especially when the arguments presented in a specific case have been considered and not accepted.

The declaration criteria (refer Box 1) are comprehensive. All of these criteria must be satisfied before declaration occurs. Where this is so it is difficult to conceive why access would not be in the national interest and accord with the objectives and policy underlying Part IIIA and the TPA. If any one of the criteria are not satisfied then declaration would not satisfy the objectives and policy of Part IIIA and the TPA and would not be required.

Once it can be shown that declaration of a service will promote a material increase in competition in a dependent market, that the subject facility is both uneconomic to duplicate and of national significance, that there is no existing effective access regime and access can be provided safely (i.e. if criteria (a) to (e) are shown to be satisfied), then the intention of the legislation is that there is a presumption that declaration of a service is, amongst other things, economically efficient and in the national interest. For this presumption to be overturned it needs to be shown that there are other factors that demonstrate that declaration would be contrary to the public interest (i.e. what is necessitated by criterion (f)). If this is demonstrated then all of the requisite declaration criteria are not satisfied and the Council's recommendation would be that the service not be declared.

Determinations of this kind are best made on a case by case basis as provided for through the application of the declaration criteria. If in a particular case a party can show that there are reasons why declaration of a service would be contrary to the public interest, such as substantial costs and real losses to the national economy, the service would then not be declared.

It was submitted to the Commission that there should be an "efficiency override" inserted into Part IIIA that provides the decision maker with the capacity to exempt certain facilities (identified as vertically integrated export facilities) from the operation of Part IIIA on national interest grounds. While it is unclear what such an "efficiency override" might offer that is not already appropriately considered within the existing declaration criteria, in the Council's view, it is clear that overtaking objective consideration of applications for declaration by applying some broad, poorly specified and subjective "override" would be a retrograde step.

Furthermore, if by an "efficiency override" some parties are suggesting that impacts on the commercial operations of infrastructure owners should be attributed additional weight or be subject to lower standards of substantiation than other elements that must be considered in the declaration process, the Council considers that such a proposal should be rejected.

## Provision of reasons, Deemed decisions

The Commission proposes to recommend that s 44H(9) of the TPA be amended to require the designated Minister to publish reasons as to why the service has not been declared following the expiry of the 60 day time limit. The Commission also notes that the Minister, the Council and the ACCC should fulfil all requirements to make more transparent and publish their considerations in reaching decisions, thus providing greater clarity to Part IIIA participants.

It has been a longstanding practice of the Council to provide comprehensive reasons in its recommendations to decision makers which are made public at the time the decision is promulgated. Prior to this the Council's process includes seeking public comment on a draft recommendation. Similarly, on most occasions decision makers provide a document outlining their reasons for decisions and in particular to explain any areas where they depart from the reasoning in the recommendation. This is consistent with best regulatory practice and proper administrative decision making.

Bodies and individuals making regulatory and similar decisions should be accountable for those decisions and those decisions should be subject to appropriate review or appeal mechanisms. A critical element for accountability and review is the availability of reasons for decisions. The Council agrees that reasons must be made available in respect of all decisions made under Part IIIA to ensure the transparency of the process, to educate and inform and to facilitate any subsequent stages of the access regime, such as review by the Competition Tribunal and notes that this occurs in most situations.

The situation in which a decision (of a type) can emerge without supporting reasons is where the designated Minister does not make a decision to declare or not to declare a service within the prescribed statutory 60 day period. In these cases the designated Minister is deemed to have decided not to declare the service (s 44H(9) TPA). In such an instance of deemed refusal, the decision is not accompanied by reasons it simply results from the bare application of the law. To overcome this concern, and address a range of other problems that arise in these circumstances, the Council has proposed that where a decision making Minister does not make a decision within the prescribed time period the deemed decision should follow the Council's recommendation (rather than being an automatic refusal in all cases). This would mean that the Council's recommendation could then serve as the reasons for the decision. This would avoid situations arising where there exist decisions without reasons. This would assist all parties in understanding the

reason for the decision and may also assist any subsequent review of the deemed decision by the Tribunal.

## Review of Part IIIA

As the Draft Report states there are several matters presently before the courts in respect of Part IIIA. There is also one matter before the Competition Tribunal. Irrespective of the outcomes of these proceedings they will provide greater elaboration of the law relating to the application and operation of Part IIIA.

The Council notes the review of the National Access Regime scheduled for 2011. The previous review conducted in 2001 provided a useful scrutiny and critique of the regime with results that have both clarified and strengthened the legislative framework. It is anticipated that any future reviews will have similar outcomes. The 2011 review will of course be informed by the amendments to the TPA and the additional experience in the operation of Part IIIA in the period since the last review was conducted.

The Council agrees with the Commission's conclusions that issues relating to Part IIIA that are not already subject to government action should be addressed in the 2011 review. The Council consider that this is likely to minimise the potential for partial and incomplete consideration of the important policy issues that arise in Part IIIA.