Australian Government

The Treasury

Submission to Productivity Commission Inquiry

National Access Regime

February 2013

This document provides Treasury's response to written questions from the Productivity Commission (PC). The PC's questions are included in the boxes below. Treasury's response follows each question.

High Court decision

On 14 September 2012, the High Court delivered its judgment into the Pilbara rail access dispute between the Pilbara Infrastructure Pty Ltd and Rio Tinto. The High Court decided that:

- criterion (b) of section 44H of the *Competition and Consumer Act 2010* should be a private profitability test — that is, that a service should not be declared if it is privately profitable for anyone to duplicate the infrastructure to provide the service;
- the Australian Competition Tribunal should not lightly depart from the Minister's decision on whether access would be in the public interest; and
- there is no residual discretion — if the criteria for declaration are met, the Minister has no reason not to declare the service.

Q What are the implications of the High Court decision for the Australian Government?

Treasury is concerned that a privately profitable test for criterion (b) does not appropriately take into account whole of economy costs. We look forward to the PC's analysis of this issue during the course of this inquiry.

The High Court's decisions on the Tribunal's consideration of public interest and on 'residual discretion' do not raise any issues for the Treasury. If necessary, the residual discretion matter could be clarified were legislative amendments pursued in future.

The Commission's 2001 recommendations

The Commission is seeking information, if available, on the implementation of its 2001 recommendations, including in relation to the objects clause and certification. This information will assist the Commission as it develops recommendations for the current inquiry into the National Access Regime.

Objects clause — recommendation 6.1 proposed that the following objects be incorporated in Part IIIA of the [then] Trade Practices Act:

'The object of this Part is to: (a) promote economically efficient use of, and investment in, essential infrastructure services; and (b) provide a framework and guiding principles to discourage unwarranted divergence in industry-specific access regimes'.

The Government inserted an object clause in 2006 that was different to the Commission's recommended wording. The object clause is written as follows: (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.

Q Is information available to the Commission on the rationale for wording the object clause in this way?

The differences in the wording of the objects clause were not intended as a departure from the PC's recommendation. The term 'infrastructure by which services are provided' is consistent with other provisions in the Act and the Competition Principles Agreement. The term 'essential' is not an element of the provisions that govern declaration and is often taken to refer to the US 'essential facilities' doctrine.

The term 'discourage unwarranted divergence in industry-specific access regimes' was changed to 'encourage a consistent approach to access regulation in each industry' to improve the readability of the clause.

Although after the 2006 Act that inserted the new objects clause into Part IIIA, we note that the 2007 amendments to the COAG Competition Principles Agreement state:

> *A State, Territory or Commonwealth access regime … should incorporate the following principles: (a) Objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.*[1]

The PC may wish to note that objects clauses can assist in interpreting provisions when they are ambiguous but cannot be used to change provisions that are otherwise clear or add further requirements that are not reflected in criteria or other operative clauses.

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[1] Clause 6(5), *COAG Competition Principles Agreement*, 11 April 1995 (as amended to 13 April 2007).

Matters considered by COAG

The following three questions relate to COAG consideration of PC recommendations. Detailed Part IIIA matters are usually considered at a lower level than COAG. Prior to the 2010 amendments, Minister Bowen wrote to the State Premiers and Chief Ministers to circulate a consultation paper on the package of reforms. He also consulted with members of the COAG Infrastructure Working Group and the Business Regulation and Competition Working Group.

Certification – recommendation 9.3 sought investigation by parties to the Competition Principles Agreement and the National Competition Council on how best to provide for 'interim' and 'conditional' certifications.

Q Was this matter considered by COAG?

'Interim' and 'conditional' certification was not formally provided as it was considered that the certification arrangements provided enough flexibility.

The National Competition Council (NCC) can recommend that the Minister certify regimes for a short period of time which has the same effect as an interim certification (the PC noted this in the 2001 report).[2] For example, in 2011 the Western Australian Rail Access Regime was certified for a period of five years.

In addition, in practice the NCC discusses certification with the relevant parties, particularly where changes might need to be made in order to achieve certification.

For example, in considering the South Australian Rail Access Regime, the NCC released a draft recommendation stating that because the regime did not have legislated periodic review, they would recommend certification for five years only. If the regime was amended to include periodic reviews by the state, the NCC would be willing to recommend certification for 10 years. The South Australian Government advised that Cabinet had agreed to amend the access regime to include periodic reviews and that legislation was being prepared. On that basis, the NCC's final recommendation was for certification for 10 years.

The recommendation in the 2001 PC report regarding conditional certification was included to address a situation where an interstate issue could potentially impede certification. The West Australian Government had a particular issue at the time relating to its rail access regime. The PC report stated that '… it is unclear whether provision for conditional certifications would require changes to the Clause 6 principles, as distinct from being a matter on which the NCC could exercise the appropriate discretion'.

Further, where a jurisdiction makes significant changes to an access regime after it has been certified, this may lead to the regime no longer being considered 'effective', and would place infrastructure subject to the regime open to the risk of declaration. While not equivalent to a conditional certification, this places some constraints on jurisdictions to ensure that access regimes are not altered significantly after being certified.

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[2] PC *Review of the National Access Regime* 2001, page 256 'As noted, there appears to be scope for interim certifications under the current arrangements'.

Facilitating efficient investment – the Commission recommended (recommendation 11.3) that the Commonwealth Government, through COAG, initiate a process to refine mechanisms to facilitate efficient investment within the Part IIIA regime and access regimes generally. These mechanisms were to include a consideration of 'fixed-term access holidays' and provision for a 'truncation' premium to be added to the cost of capital. The Commission recommended that this process be completed in sufficient time to enable legislative implementation within Part IIIA no later than 2003.

The Australian Government's response to the inquiry indicated that the practicality of this recommendation would be considered in the context of industry-specific regimes, for example, in the Commission's 2004 Review of the Gas Access Regime. The Government noted that 'such considerations will inform a decision on whether to pursue the adoption of this requirement in the Regime or in other access codes'.

Q Has there been any further consideration of this recommendation by COAG?

The 2010 Act amended the regime to allow a person with a material interest in a proposed new infrastructure facility to apply for the service to be ineligible for declaration. The ineligibility decision would apply for at least 20 years. The relevant test for ineligibility is that one or more of the declaration criteria must not be satisfied.

Access holidays were considered by Treasury, however, they were not supported for two reasons. First, Treasury considered that concerns about discouraging infrastructure investment could be managed through the design of the access regime. Second, there was concern that access holidays may allow an integrated infrastructure service provider to establish over time an overwhelming advantage in markets dependent upon their services.

The Government's response to recommendation 11.3 noted that 'the Government proposes to consider the practicality of this recommendation in the context of industry-specific regimes, for example, in the PC's Review of the Gas Access Regime …'. The PC decided not to recommend the adoption of truncation premiums in its Gas Access Regime report.[3]

We do not know of any consideration of a truncation premium in any industry-specific regimes. The NCC has advised that generally regulators are sceptical about the extent of any truncation premium. If, as matter of fact, such a premium can be established and given a value, there is unlikely to be a barrier to recognising it in a regulatory decision.

[3] PC *Review of the Gas Access Regime* 2004, page 411.

Pricing principles – recommendation 12.2 was for COAG to develop productivity measurement and benchmarking techniques to assist in setting access prices.

The Australian Government noted that it preferred that these measures be considered in the context of industry-specific regimes (as per the response to recommendation 11.3 above).

Q Was this matter considered by COAG?

The Competition and Infrastructure Reform Agreement (CIRA) contained high level principles for regulated access prices. It has then been up to the individual regulators to further develop this recommendation.

The ACCC has provided the following advice:

> *While the ACCC has considered productivity measures and benchmarking techniques in relation to specific access undertakings under Part IIIA, the ACCC hasn't released any formal guidelines on this specific to Part IIIA.*
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> *The ACCC's 2006 arbitration guidelines state that when considering the economically efficient operation of infrastructure (a relevant matter under Part IIIA), the ACCC may consider general industry efficiency (and benchmarks) in applying this criterion.*[4] *The ACCC would generally consider each dispute or access undertaking on a case by case basis, having regard to the relevant facts.*
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> *For example, the ACCC may use benchmark estimates to calculate the Weighted Average Cost of Capital (WACC) in order to determine an appropriate rate of return for a regulated business. This was done in the case of Australian Rail Track Corporation's (ARTC) Interstate Access Undertaking, and was also considered for the Hunter Valley (although, in that case, the ACCC eventually accepted a rate of return that was negotiated and agreed to between ARTC and industry).*
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> *The ACCC has done some work on productivity measures and benchmarking techniques in several industry-specific regimes and has published guidelines outlining its basic approach and methodology. Although these guidelines do not specifically relate to access regimes operating under Part IIIA, the ACCC aims to ensure a consistent approach across industries where it is possible and appropriate to do so.*
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> *Some examples are detailed below.*
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> ***Water**: The ACCC issued Pricing principles for price approvals and determinations under the Water Charge (Infrastructure) Rules 2010 in June 2011 – these contain an overview of how the WACC is determined and in particular how determining particular parameters rely on appropriate benchmarks.*[5]
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> ***Communications**: The ACCC conducted a Review of Telstra's price control arrangements which included a productivity assessment of Telstra's fixed line business in 2004 to support the ACCC's recommendation as to the level at which Telstra's retail price caps should be set.*

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4 These guidelines are available on the ACCC's website at: http://www.accc.gov.au/content/index.phtml/itemId/731775.

5 These pricing principles are available on the ACCC's website at: http://www.accc.gov.au/content/item.phtml?itemId=967534&nodeId=18b613006035400088ac9602a01b19ba&fn=Water%20charge%20rules%20-%20infrastructure%20-%20pricing%20principles.pdf.

Attachment A (page 118) to the published report specifies the basic approach and methodology in undertaking the analysis.[6]

***Energy**: The Australian Energy Regulator's (AER) submission to the Productivity Commission Inquiry into Electricity Network Regulation contains an overview of the AER's work to date in benchmarking and outlines the AER's plans to enhance its benchmarking capabilities.*[7] *The AER also conducted a review of the WACC parameters for electricity transmission and distribution network service providers in May 2009. This review considers how to determine WACC parameters based on a benchmark efficient network service provider'.*[8]

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6 The review report is available on the ACCC's website at: http://www.accc.gov.au/content/item.phtml?itemId=670116&nodeId=87d2b6e9b5f93ed6ede6c61dd8ad1a3d&fn=Final%20report%E2%80%942004%20review%20of%20Telstra%20price%20control%20arrangements%20(Feb%2005).pdf.

7 The AER's submission is available on the Productivity Commission's website at: http://www.pc.gov.au/__data/assets/pdf_file/0011/116768/sub013-electricity.pdf.

8 See: http://www.aer.gov.au/sites/default/files/Final%20decision%20%281%20May%202009%29.pdf.

The Competition and Infrastructure Reform Agreement

Q Has COAG (or the Australian Government) undertaken or commissioned any work to evaluate the benefits of the CIRA reforms (individually or collectively)?

It is intended that this current PC inquiry would include an evaluation of the benefits of the CIRA reforms. We are not aware of any other evaluation to date.

Certification

Electricity and gas access regimes are required to be submitted for certification under clause 13.3 of the Australian Energy Market Agreement.

The COAG Reform Council (CRC) has indicated that there is some uncertainty as to which state and territory regimes are required to be submitted for certification. In its 2011-12 report on the performance of the *Partnership Agreement to Deliver a Seamless Nation Economy*, the CRC recommended that COAG affirm whether states (and the territories) are required to submit their electricity and gas access regimes for certification.

The Commission understands that the Chair of the Standing Council on Energy and Resources wrote to the COAG Chair to set aside the requirement that each jurisdiction certify its electricity and gas access regimes.

Q Given the uncertainty noted by the CRC, and the letter from the Chair of the Standing Council on Energy and Resources, is further information available to the Commission on the status of the states' and territories' requirement to certify their electricity and gas regimes (where they have not already done so)?

We consider that the requirement to certify electricity and gas regimes still stands and remains desirable. A list of state and territory access regimes and their certification status is regularly published in NCC annual reports (for example, see Table 2-2 on pages 17-19 of the NCC's Annual Report 2011-12). While the 2007 milestone date in clause 13.4 of the Australian Energy Market Agreement (AEMA) lapsed without action, the requirement that the national energy regimes be submitted for certification and that parties take all reasonable measures to ensure that they remain certified (in clause 13.3 of the AEMA) did not lapse.

Clause 2.9 of COAG's 2006 CIRA provides that:

> *The Parties agree that, to advance the objective of a simpler and consistent national approach to regulation, all state and territory access regimes for services provided by means of significant infrastructure facilities will be submitted for certification in accordance with the Trade Practices Act 1974 and the Competition Principles Agreement …*
>
> *b. Third party access regimes existing at the time this agreement commences will be submitted for certification as soon as practicable, or as they are reviewed, provided they are submitted for certification no later than the end of 2010.*

The multi-jurisdictional third party access regimes for gas pipelines and electricity networks apply to services provided by 'significant infrastructure facilities'. The electricity and gas regimes therefore fall under this commitment. Clause 1.3 of the CIRA notes that:

> *The access regimes for electricity and gas which are to be developed and certified in accordance with the Australian Energy Market Agreement … will be taken to satisfy the requirements of clause 2 of this agreement.*

This clause does not remove the electricity and gas regimes from the scope of the general certification commitment in clause 2.9. Rather, it acknowledges that, if COAG's AEMA is complied with, this will make good on the clause 2.9 commitment. However, since the AEMA has not yet been complied with, the CIRA requirement stands.

Certification of industry specific regimes for significant infrastructure removes the risk of the service being declared under the National Access Regime. The certification mechanism also provides a framework for ensuring significant infrastructure facilities are subject to nationally consistent access regulation. Without certification, both the Commonwealth and the State and Territory access regimes will potentially apply to the same infrastructure. The application of two access regimes to the same infrastructure creates the potential for access seekers to forum shop.

While there appears to be no serious question about whether the energy access regimes are currently capable of being certified against the principles, the apparent reasons for why the jurisdictions have declined to apply for certification are discussed below.

There appear to be concerns about ongoing administrative costs associated with maintaining certification as the rules are changed over time, particularly in relation to the electricity access regime. In response to these concerns we note:

- The effect of section 44H(4)(e)(ii) of the Act is that once a regime is certified, the designated Minister can only declare a service if there has been a substantial modification to that regime. Whilst there is no guidance as to what would be considered a substantial modification, it is clear that minor changes would not qualify, nor would changes that do not impact on the access section of the regime.

- The NCC have noted that they are willing to include in their certification documentation a discussion of the features of the regime that they consider to be particularly important for meeting the certification criteria. This would assist in identifying changes that are likely to put at risk the certification status. In addition, the Australian Energy Market Agreement provides for a Memorandum of Understanding between the Australian Energy Market Commission and the NCC that addresses consultation on rules relevant to certification. These measures should go some way to ameliorating concerns about an ongoing administrative burden to maintain certification.

- In the event that the energy regimes were certified and a subsequent substantial modification was made that led to the effective revocation of certification, the situation would merely revert to the status quo in the absence of further action by the parties. Fear of this contingency is not a logical reason for not certifying.

Parties are also concerned that certification would reduce the clarity around the criteria for rule changes as well as reducing the speed and efficiency by which rules changes are made. Part of the intension of the certification mechanism is to provide some guidance and consistency for bespoke regimes.

Competitive tendering for the supply of government owned infrastructure

- **Q** Has the Australian Government received any feedback on how the competitive tendering arrangements have worked?
- **Q** Is the Australian Government aware of any publicly owned infrastructure that has been constructed (since the introduction of the competitive tender provisions) that provides an infrastructure service as per the definition in Part IIIA? If so, was competitive tendering used? If not, is there information available to the Commission on why this was the case?

The competitive tendering arrangements are a recent addition which was completed by the *Trade Practices Amendment Regulations 2010 (No. 2)*. Treasury has not received any feedback on the arrangements nor, to our knowledge, have the arrangements been used. Given this, it would be useful for the PC to consider the effectiveness of the provisions. Some possible issues are that it may be too difficult to gain approval for tender processes and there may be uncertainty as to the timeframe for which the provision applies once the tender process is approved by the ACCC.

It seems more likely the providers would seek an ineligibility ruling for greenfield investments rather than use the competitive tendering arrangements.

- **Q** The Minister for Finance announced on 13 December 2012 that the design, construction and operation of the Moorebank Intermodal Terminal in Sydney is to be subject to a tender process. How will the terms and conditions of access to the terminal be determined? Will the tender process for the Moorebank terminal use the Part IIIA competitive tender provisions?

The Moorebank Project Office is at the early stage of considering access issues and so they have not yet investigated the competitive tending provisions in Part IIIA in detail. The Office has provided the following response:

> *The Government is committed to a competitive tender process for the construction and operation of the Moorebank Intermodal Terminal (IMT) facility.*
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> *The terms and conditions of access to the IMT facility will be determined by the Moorebank Intermodal Terminal Company (MICL) prior to undertaking the procurement process for the builder and operator of the IMT facility. However, the lease to be agreed between MICL and the Commonwealth in respect of the IMT site will include common user principles with which the operator of the IMT facility must comply. MICL is required to act in accordance with the Company objectives which include, among others, 'to facilitate the operation of a flexible and commercially viable common user facility which shall be available on reasonably comparable terms to all rail operators and other terminal users'.*
>
> *The Moorebank Project Office has conducted initial consultations with the ACCC on competition and open access issues relevant to the IMT facility, including means to alleviate competition concerns should an operator with upstream or downstream interests be appointed by the Government Business Enterprise. It is expected that MICL will also engage with the ACCC in preparation for, and during, the competitive tender process as required. MICL's procurement process for the port shuttle terminal operator will begin from mid-2013.*