OFFICE OF
REGULATION REVIEW
INDUSTRY COMMISSION

First Assistant Secretary
Structural Policy Division
Treasury
Parkes Place
PARKES ACT 2600

Attention: Mr Michael Warlters

National Competition Policy: Draft Legislative Package

The Office of Regulation Review (ORR) offers the following comments on two aspects of the National Competition Policy Draft Legislative Package — the policy goals of the proposed new institutions, and the process whereby access declarations would be made and administered. The purpose in making these comments is to try and identify more cost-effective avenues for implementing the framework agreed at the Darwin meeting of the Council of Australian Governments (COAG).

Policy goals

The proposed new institutions — the National Competition Council (NCC) and the Australian Competition Commission (ACC) — should be given clear and transparent policy goals. While the draft package sets down that the NCC must have regard to certain specified factors when considering access declarations, its overall goals regarding access and the rest of its work program are not specified.

The provisions of the draft bill dealing with the proposed access regime do direct the NCC to promote competition and the public interest, but there are a number of caveats that safeguard the position of the owners of the essential facility regarding both usage and rates of return. It may be difficult to administer these provisions in a way that does not entrench the monopoly rents of incumbent firms.

The requirement in the draft bill's access regime that the NCC promote competition may be counter-productive. The most fundamental mistake in antitrust law enforcement

Benjamin Offices, Chan Street,
Belconnen ACT 2616
PO Box 80, Belconnen ACT 2616
Telephone: 06 264 2705
Facsimile: 06 264 3257

in a number of countries was initially to regard the goal of such laws as the promotion of competition. But what emerged was a bias against mergers and vertical integration, and against strong price competition, regardless of any net economic benefits to the community. Thus, it was not competition that was promoted, but rather the welfare of existing competitors. "Competition" was protected at the expense of superior efficiency, innovation and economic growth.

If its mandate is simply to promote competition, the proposed regime may grant access to an essential facility without regard to whether its final outcome is lower prices to consumers. This contrasts with the modern conception of antitrust law that the objective is to promote community welfare. Competition is seen as a means to this end because it delivers lower prices and new products to consumers.

It is therefore important that the NCC should have the goals of promoting consumer welfare and economy-wide efficiency specified with greater clarity both in regard to the access regime and to its general work program. Useful models are provided by the Prices Surveillance Authority (PSA), the Trade Practices Commission (TPC) and the Industry Commission (IC) which must have regard to certain statutory factors when performing some or all of their respective functions. For example, the PSA must balance the restraint of market power with maintaining profitability, investment and employment. The TPC must take ten specific factors into account when considering applications for authorisations of mergers, and then weigh the implications for competition against the public benefit. The IC has policy guidelines in its Act that directs the Commission to encourage the development and growth of efficient, self-reliant and internationally competitive industries, and to reduce unnecessary regulation. In framing its recommendations, the IC is required to consider the interests of the community as a whole — in addition to the interests of those most immediately and directly affected by the recommendations.

Such statutory policy guidance in the Acts of the PSA, TPC and IC increases transparency and provides a clear public signal about each agency's priorities. It provides notice to the community as to what factors will be taken into account and how they will be assessed in decision making. Statutory guidance about policy goals facilitates the development, over time, of a consistent and sensible approach. Most of all, it places the broader interests of the community at the forefront of each agency's priorities.

Access Declarations

The following comments touch on three aspects of access declarations: the setting of time limits, establishing principles for access pricing, and the use of "final offer arbitration".

Time limits

The proposed regime whereby access declarations are made and administered appears to have no time limits for each stage of the process. Tight time limits on responses by regulators to complex proposals are not unknown. For example, the TPC has 30 days to respond to applications for merger authorisations.

However, most access disputes will have many stakeholders in addition to the negotiating parties, and all stakeholders will want an opportunity to consult with relevant parties, obtain considered economic and legal advice, and state their views. The experience of the Industry Commission with public inquiries involving possible natural monopoly characteristics is that its takes many months and extensive public consultations before considered opinions can be formed. An open-ended public inquiry process for access declarations may have the undesirable effect of increasing investor uncertainty and be used by the incumbent to delay entry of potential competitors.

For these reasons, specific time limits on establishing access would be helpful.

Establishing principles for access pricing

The draft access regime does not provide for access principles to be specified with a declaration. The ORR suggests that the access regime process could be more cost-effective if an early task of the NCC is to set out some general principles for inter-connection pricing. A statement of such principles would provide a solid basis to private negotiations as all parties would have a better idea of what would guide any later arbitration. As a general rule, parties to disputes "settle out of court" if there is a defined body of principles and precedents that makes it clear who is likely to win or lose in any later adjudication.

Use of final offer arbitration

A more cost effective regime might also result through use of final offer arbitration. This is an approach to dispute resolution that limits the arbitrator to adopting in full the final offer of one of the two parties to the dispute. Final offer arbitration encourages parties to converge to a reasonable offer. As the arbitrator can only pick between the two final offers, each negotiating party would put itself at a considerable disadvantage if its final offer is unreasonable. In consequence, each party has an extra incentive to make a last offer that is reasonable and which discloses sufficient information for the arbitrator to make an informed evaluation.

In contrast, conventional arbitration systems are information intensive. The requirement for an unbiased hearing requires the arbitrator to start "with a blank sheet of paper" and to undertake time consuming inquiries and hearings. The parties in dispute can continue to make ambit claims and engage in other forms of strategic

behaviour. The parties to a dispute in a conventional arbitration system usually have an information advantage over the arbitrator. In a final offer arbitration system, it is difficult for the disputing parties to avoid disclosing considerable inside information when making a final offer that is credible in the eyes of an arbitrator.

Final offer arbitration also has the virtue of administrative simplicity. It reduces the amount of information that must be organised, evaluated and communicated. This reduces both uncertainty and the frequency of disputes. In conjunction with a general statement by the NCC on inter-connection pricing principles, the reduced discretion inherent in final offer arbitration makes inconsistent and unpredictable decisions less likely. The ACC (or the body nominated as arbitrator) would not have to delve into all the particulars of an industry before it comes to a decision. The arbitrator would only have to understand each final offer and determine which is more reasonable given the general inter-connection pricing principles and any statutory requirement to promote community welfare, efficiency and an adequate return on investments.

Moreover, as each party to an access dispute knows that their final offer needs to be reasonable, there is an incentive to settle earlier than otherwise to avoid unnecessary costs. The overseas experience with final offer arbitration of industrial disputes suggests that settlement occurs at an earlier date than under more conventional arbitration systems.

The contact officer on these matters is Mr Jim Rose on 264-3245.

Paul Coghlan
Assistant Commissioner
Office of Regulation Review
1 December 1994