

Draft Part IIIA Access Undertaking Guidelines

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Introduction

Aurizon welcomes the opportunity to submit to the Australian Competition and Consumer Commission (ACCC) comments on the draft Part IIIA access undertaking guidelines (**the Draft Guidelines**). Aurizon, through its subsidiary Aurizon Network, has extensive experience in the development of access undertakings under the *Queensland Competition Authority Act 1997 (QCA Act)*. Many of the matters relevant to the approval of an access undertaking under the QCA Act are consistent with those that would be considered by the ACCC in approving an access undertaking under Part IIIA of the *Competition and Consumer Act 2010 (CCA)*.

The development of the Draft Guidelines provides a constructive mechanism in which the ACCC can facilitate and support stakeholder improvement in their understanding of the regulatory process and what may be required to obtain approval of an access undertaking within reasonable timeframes. However, the Draft Guidelines are unable to address all matters that might be relevant to a voluntary access undertaking which will be strongly influenced by the relevant circumstances. The omission of matters from the Draft Guidelines, or the inaccurate categorisation of the requirements of the CCA, may also undermine the objectives of their preparation.

The role or purpose of the Draft Guidelines is unclear without the inclusion of an objectives statement. As the ACCC has not received a genuine 'voluntary' access undertaking under Part IIIA with infrastructure proponents typically seeking contractual based access arrangements directly with state government bodies, there is an opportunity for guidelines to be structured with the objective of increasing the incentives to pursue a voluntary access undertaking as a credible means of reducing regulatory risk.

Aurizon considers the role of Draft Guidelines can be improved through expansion on the matters relevant to the function and purpose the access undertaking and the interaction with the approval process, including:

- a clearer specification of the role and benefits of a voluntary access undertaking;
- an acknowledgement that best practice regulation requires limiting regulatory prescription and intrusion to the extent necessary to achieve the efficiency objectives (avoids regulatory overreach);
- the use and application of fixed principles and the types of matters that the ACCC might consider to be included as a fixed principle;
- the importance of confidentiality and regulatory certainty in the approval of voluntary access undertakings for greenfield infrastructure investment; and
- the interrelationship between the approval of an access undertaking and the restrictions on making an access determination.

Aurizon also submits that aspects of the Draft Guidelines in relation to the content of an access undertaking could be improved in a range of areas including, but not limited to:

- the addition of a summary on the trade-offs between of ex-ante prescription (rules based) and ex-post arbitration and enforcement (principles based);
- the avoidance of arbitrary statements on pricing which may not represent the proper or complete application of the pricing principles; and
- the exclusion of regulator preference to industry structural models without the presentation of considered analysis of the efficiency and public interest benefits of different industry structures.

Access Undertakings

Aurizon notes that there is limited practical evidence of the ACCC being given a voluntary access undertaking. To date, the ACCC's role in access undertakings is where this has been a requirement of a relevant industry code, lease or other binding mechanism on the service provider to prepare and submit an access undertaking. This was acknowledged by the ACCC in its submission to the Productivity Commission's inquiry into the National Access Regime:

It is relevant to note, however, that in each case when an access provider has submitted an access undertaking to the ACCC, there has either been a legislative or contractual requirement to submit the undertaking or an additional sanction for failure to submit. In this sense, no infrastructure owner has voluntarily submitted an access undertaking to the ACCC solely to avoid the risk of declaration under Part IIIA.¹

Declaration is potentially a costly, complex and time-consuming path to access – certainly there is no evidence that infrastructure owners have voluntarily submitted access undertakings to the ACCC as insurance against the risk of declaration under Part IIIA².

While the Draft Guidelines acknowledge the role and purpose of a voluntary access undertaking as immunising the service provider from the risk of declaration, it does not make the argument as to why this may be a preferable alternative to declaration namely: the voluntary access undertaking approach represents an opportunity to promote efficient use of significant infrastructure whilst avoiding the complex and adversarial legal processes associated with reliance on declaration.

The use of a voluntary access undertaking provides an opportunity for service providers, or potential service providers, to obtain longer term certainty as to the terms and conditions it will offer access to its facilities. The voluntary nature of the undertaken is an essential feature, and one not well articulated in the Draft Guidelines, to achieving the objectives of the access regime. The ability to withdraw the voluntary access undertaking prior to its approval provides the effective restraint on the regulator's overreach. The fact that no party has sought to use the voluntary access pathway and, therefore, has presumably been willing to accept the risk of declaration and its associated costs and uncertainty may be reflective of concerns as to the reasonableness of the outcomes that would be obtained by pursuing a voluntary access undertaking pathway.

In this context, a contributing factor in the reluctance to submit a voluntary access undertaking may be the concerns of perceived bias towards the interests of access seekers resulting in the truncation of investment returns. The significance of the regulator's determination on the likelihood of earning the return on investment that aligned with the service provider's initial investment expectations is considerable in the context that the regulator is unable to underwrite the service provider's losses from regulatory error. In this regard the then Productivity Commission Chairman, Gary Banks noted at the ACCC 2012 Regulatory Conference that:

But the very fact of exposure to price regulation – and the uncertainties this creates – can in itself deter investment. This is the flipside of the 'hold-up' rationale for regulation, with the regulator rather than the monopolist posing the threat to investment. Moreover, 'errors' in the balance of regulated prices are unavoidable.³

¹ ACCC (2013) Submission to the Productivity Commission's Review of the National Access Regime, February, p.32 <http://www.pc.gov.au/inquiries/completed/access-regime/submissions/submissions-test/submission-counter/sub016-access-regime.pdf>

² Ibid, p. 2

³ Banks, G (2012) Presentation to the ACCC Regulatory Conference 2012, Brisbane, 26 July, p. 14

Best Practice Regulation

The general presumption of a voluntary access undertaking is that the social-welfare function would be improved in a state with access relative to a state without access. This also suggests that the role of regulation in the context of a voluntary access undertaking should be limited to that of achieving the objectives of access rather than solving for the optimal value of the social welfare function once open, or third party access, has been committed to through the voluntary access undertaking.

In this regard Aurizon notes that the Government's statement of expectation regarding the exercise of the ACCC's functions⁴ states that:

The Government expects that the ACCC will act in accordance with regulatory best practice in its decision-making, policies, processes and communication practices to maximise effectiveness, efficiency and transparency, and minimise compliance costs. The ACCC should regularly review its policies and procedures to achieve these goals.

*The Government's preference is for **principles-based regulation** that identifies the desired outcomes, rather than prescribing how to achieve them. An outcomes-based approach is more likely to accommodate change within the economy, allow for innovation and enterprise and reduce compliance costs by allowing regulated entities to determine the best way of meeting regulatory objectives. [emphasis added]*

Aurizon recommends that the Draft Guidelines include an overarching policy statement regarding the preference for principles based regulation and a commitment that the ACCC will assess an undertaking to promote the Competition Principles Agreement intent of promoting negotiated outcomes in the first instance⁵.

In preparing and responding to proposed access undertakings Aurizon has observed a reliance on stakeholders to propose excess levels of prescription as a preference to reducing their own costs of negotiating and avoiding the need to rely on dispute resolution. This is contrary to the intention of the negotiate-arbitrate framework where the costs associated with seeking arbitration serve to both:

- provide the countervailing market power; and
- ensure only those matters which have sufficiently material effects are addressed through regulatory prescription.

The access undertaking approval process provides an effective means to avoid these costs and results in matters that are otherwise immaterial being prescribed in the access undertaking. The demand for excess levels of prescription in access undertakings can be tempered through stronger regulatory commitments to promote principles based regulation.

Regulatory Compact and Fixed Principles

The Draft Guidelines do not contain a reference to, or guidance on, the use and application of fixed principles in an access undertaking. The explanatory memorandum for the *Trade Practices Amendment (Infrastructure Access) Bill 2009* which introduced fixed principles into section 44ZZA summarised the role of these principles as:

⁴ http://www.accc.gov.au/system/files/ACCC_Statement_of_expectations.pdf

⁵ See clause 6(e)(1) and reaffirmed in clause 2.2 of the Competition and Infrastructure Reform Agreement.

Regulatory risk for infrastructure investors would be reduced if access undertakings were allowed to contain fixed principles, which apply to subsequent access undertakings for that infrastructure service. When important variables are fixed, service providers and access seekers can more easily extrapolate the terms and conditions for access under future access arrangements and have more certainty in their investment and business planning.

The CCA also requires that the ACCC may reject an access undertaking (whether it contains a fixed principle or not) if it considers one or more terms in the undertaking should be fixed if they are to operate appropriately.

Given the relevance and importance of fixed principles to both investment decisions and the approval of an access undertaking, it would be highly desirable that the Draft Guidelines include an appropriate discussion on:

- the role and purpose of fixed principles;
- the nature and terms the ACCC consider suited towards being a fixed principle; and
- examples of where the ACCC has applied, or accepted, fixed principles such as those in the NBN special undertaking.

Confidentiality and Greenfield Infrastructure Investment

It is a reasonable expectation that the most likely candidate for a voluntary access undertaking under Part IIIA is a greenfield infrastructure investment of state or national significance. In response to the Competition Policy Review in 2014 Aurizon noted⁶:

There are no effective mechanisms presently in the national competition policy framework that allow governments to determine and set access arrangements as part of project approval.

Part IIIA currently contains two options for infrastructure providers and governments seeking to put a multi-user or access framework in place ahead of a greenfield project:

- first, ineligibility rulings, also known as 'access holidays'; in effect a period of time *in which an asset will be ineligible for regulation; and,*
- second, a government requiring a project proponent to lodge of a voluntary undertaking with the ACCC or a state competition regulator as a condition of project approval.

Neither option is particularly well suited to the task of promoting infrastructure development.

Both of these approaches potentially require the proponent of significant infrastructure investment to disclose commercially sensitive material which may have implications for its financing arrangements.

In relation to the voluntary access undertaking pathway Aurizon notes that the ACCC may invite public submissions on a proposed access undertaking if it considers it appropriate and practical do so. While the Draft Guidelines acknowledge that an access undertaking application may be given by a person who expects to be a provider of the service (i.e. the service will be provided by a facility to be built) there is no

⁶ Aurizon (2014) Promoting efficiency, productivity and new investment in the Australian rail freight market and export infrastructure sectors, Submission to the Competition Policy Review, June, p. 70

explicit recognition in the Draft Guidelines that the ACCC is not compelled to consult on the proposed access undertaking.

The Draft Guidelines could further assist proponents of significant infrastructure investments by outlining the matters the ACCC considers relevant to why, and when, it would invite submissions on a proposed access undertaking. For example, it may be preferable to not invite submissions until a period of time after the ACCC has made a draft decision, or on a subsequent application. This would allow the proponent to preserve the confidentiality of its project and to evaluate whether it would continue along the voluntary undertaking pathway, withdraw and submit another voluntary access undertaking, or to accept the risk of declaration.

The current preference for proponents of significant infrastructure investment to develop contractual based access frameworks with relevant government bodies highlights the importance proponents place on the ability to protect the confidentiality of a market-led proposal. Greater clarity from the ACCC as to how it would preserve and protect the proponent's interests in greenfield infrastructure investment would reduce the incentives to pursue access models which retain a residual level of declaration risk.

Inter-relationship with Access Determinations

Aurizon observes that the Draft Guidelines include a reference to the restrictions on making an access determination which would require the access provider to bear the costs of investing and maintaining an expansion. However, this is the only reference to the relationship between an access undertaking and the making of an access determination for a service which has been declared.

Aurizon believes it would be appropriate for the discussion on the legislative background in the Draft Guidelines to include a reference to, and commentary on, the restrictions on making an access determination. Having regard to the broader objects of Part IIIA, it would be reasonable to conclude that the ACCC could not require a matter to be addressed in an access undertaking if it was otherwise unable to make the same outcome in an access determination due to a relevant restriction. This would especially be the case for a voluntary access undertaking where the proponent would not expect to obtain less favourable outcomes than a declared service.

Contents of an Access Undertaking

In reviewing the Draft Guidelines, Aurizon has focussed primarily on the relevant context of the requirements for the suggested component of an undertaking and not on the reasonableness or merits of the examples chosen.

Aurizon recognises that preparing guidelines on the likely content of an undertaking is an inherently difficult task given the diversity of services, industry structures, incentives and market power that could need to be addressed in preparing an access undertaking. The content of an access undertaking will necessarily be bespoke to take into account differences in these factors but will need to include a degree of commonality in order to reduce regulatory risk and achieve the Council of Australian Government's objectives of simpler and nationally consistent approaches to regulation and avoid more intrusive regulation where it is not warranted as set out in the Competition and Infrastructure Reform Agreement⁷.

The Draft Guidelines provide an appropriate high level summary without unnecessarily addressing matters which might be relevant to all access undertakings that might be given to the ACCC. Therefore, Aurizon's comments in this section are limited to addressing matters raised in the Draft Guidelines which are unclear or potentially inconsistent with stated policy objectives. There are also some matters which the Draft Guidelines do not address but potentially should.

Scope of Services

The specification of the scope of services is unduly restricted to the explicit requirements of the CCA that an access undertaking given under Part IIIA must relate to a service or services provided by means of a facility.

A key concern of existing and prospective owners of railway infrastructure in the Pilbara region is that the requirement to provide third party access to their facility would impose significantly greater costs through lost efficiency than any benefits that would be realised from the artificial concept of competition in the rail haulage market. The ability to submit a voluntary access undertaking for a fully integrated mine to ship service would provide an alternate means of achieving the objectives of access without interfering with the efficient operation of the supply chain. In this situation, the voluntary access undertaking involves the use of the rail facility whereas the service which is being provided under the access undertaking is not access to the facility. As an example, the Roy Hill State Agreement⁸ includes the option to submit a voluntary access undertaking for the integrated rail haulage service.

The Draft Guidelines would assist stakeholders by including reference to the ability to provide access to a service which is dependent on the use of a facility but does not provide direct access to the facility. While it is acknowledged that ACCC is not providing legal advice in respect of Part IIIA, it should confirm that it is able to accept a voluntary access undertaking under 44ZZA that does not provide for the access seeker's direct use of the facility and therefore, that it is able to accept a voluntary access undertaking for an integrated service.

Standard Terms

It is generally acknowledged that the use of standard terms can reduce the transaction costs associated with negotiating access when there is an expectation that those negotiations might be frequent and

⁷ As per clause 2.1, 2.2 and 2.3 of the 2006 Competition and Infrastructure Reform Agreement.

⁸ The *Railway (Roy Hill Infrastructure Pty Ltd) Agreement Act 2010 (WA)*.

involve a large number of access seekers. There may also be benefit in facilitating non-discrimination between access seekers.

The Draft Guidelines indicate that the ACCC would be very unlikely to accept an access undertaking that did not include a set of standard terms. However, it does not discuss why that would be the case or the implicit trade-offs between prescriptive regulation and promoting a negotiate-arbitrate model.

Aurizon notes that the over-reliance on the prescription of the terms of access can also have perverse and unintended efficiency consequences through the stifling of competition and innovation. The use of prescription of the terms of access should therefore be limited only to the extent necessary to overcome a clearly identified efficiency of competition problem.

It is preferable that access undertaking include measures which seek to overcome the potential imbalance in negotiating positions rather than reduce the scope for negotiated outcomes. Aurizon notes the ACCC's discussion is limited to standard terms as opposed to standard contracts. Nevertheless, it would be preferable that the draft guidelines acknowledged the trade-off between prescription and the implications for the broader productivity, innovation and efficiency objectives as explicitly required by the objects of the CCA to promote the economically efficient operation of, use of and investment in monopoly infrastructure.

Pricing

The Draft Guidelines seek to apply an interpretation of the pricing principles in section 44ZZCA of the CCA which may not be aligned with the explanatory memorandum relevant to those principles through the exclusion of key terms in the discussion. For example, section 4.6 the Draft Guidelines includes the statements:

The methodology for determining the level of prices will need to balance a number of considerations, including:

- *providing access seekers with some assurance that they are not paying more than the efficient costs for the service; and*
- *providing the access provider with some assurance that it will be able to earn an appropriate rate of return on its prudent investments.*

There is no explicit requirement within the CCA that an access seeker will not be required to pay more than the efficient costs for the service. There are a range of potential pricing models under yardstick regulation or contestable market theory which may very well require an efficient price to exceed the costs of providing the service. While it could be argued that this refers to the efficient costs of a relevant benchmark the guidelines go on to state that in relation to the service provider's efficient costs:

The intent of the BBM is to ensure a firm can recover its efficient costs and receive a return on its investment that will compensate it for the risks involved but is not in excess of what it would earn in a fully competitive market (i.e. the circumstance where monopoly pricing is not possible). This is consistent with the pricing principles in Part IIIA that access providers are entitled to recover their efficient costs.

The Draft Guidelines should include the full reference to the pricing principles by noting the prices should provide the access provider with some assurance that it will be able to 'at least' earn an appropriate rate of return on its prudent investments as set out in section 44ZZCA of the CCA.

This would ensure that the Draft Guidelines represent the legislative intention of the pricing principles as expressed in the explanatory memorandum:

*...regulated access prices should be set so as to generate expected revenue across a facility's regulated service or services that is **at least sufficient** to meet the efficient costs of providing access to these services, and include a return on investment commensurate with the regulatory and commercial risks involved. This sets a **revenue floor** without necessarily constraining individual prices⁹. [emphasis added]*

Investment

The Draft Guidelines make reference to the restrictions on the ability of the ACCC to make an access determination which would have the effect of the owner of the facility bearing the costs of the expansion. Aurizon notes that recommendation 8.9 of the Productivity Commission's 2013 Inquiry into the National Access Regime stated:

As soon as practicable, the Australian Competition and Consumer Commission (ACCC) should develop and publish guidelines on how its power to direct facility extensions would be exercised in practice such that it is expected to generate net benefits to the community. The guidelines should be developed by the ACCC using a process that includes the public release of draft guidelines, and is informed by stakeholder consultation¹⁰.

Aurizon also notes that the Government supported this recommendation in its response and encouraged the ACCC to implement this recommendation¹¹. While the full detail of these guidelines would increase the length of the Draft Guidelines, it would be beneficial to include a summation of their content and where they can be located. As an interim measure the Draft Guidelines should include a statement that the expansion guidelines are under preparation and the Draft Guidelines will be amended as appropriate once they have been completed.

Vertical Integration

The Draft Guidelines includes the statement:

Behavioural arrangements to address these vertical integration concerns cannot replace full structural separation. Structural separation requires that the monopoly service provider and the competitive upstream and/or downstream operations be completely separate entities with no overlapping economic interests. Full structural separation goes beyond ring-fencing type arrangements and removes the vertical integration altogether. The ACCC encourages parties submitting Part IIIA access undertakings to consider structural solutions to fully address any vertical integration concerns.

While the statement that structural separation will alleviate the requirement for an access undertaking to include certain behavioural arrangements is reasonable, the preference to consider structural solutions without a counterfactual reference to efficiency losses provides a potentially biased perspective of the ACCC's approach to access undertakings given by vertically integrated enterprises.

Aurizon submits that it is important to note that:

⁹ Supplementary explanatory memorandum on Trade Practices Amendment (National Access Regime) Bill 2005.

¹⁰ Productivity Commission (2013) *National Access Regime*, Inquiry Report no. 66, Canberra

¹¹ http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20National%20Access%20Regime/Downloads/PDF/Govt_response_NAR.ashx

- a primary objective of Part IIIA is to apply to vertically integrated interests given the premise that an access undertaking should not be necessary for a business which has a commercial objective to recover its efficient costs of providing the service and a commercial imperative to maximise the demand for its services. That is, the candidate services who would most likely seek to give the ACCC a voluntary access undertaking would be provided by a vertically integrated provider; and
- the objective of the regime is to promote efficiency and in most industries, particularly rail, this will be associated with the provision of an integrated service.

Aurizon therefore submits that the guidelines should acknowledge that these efficiencies may materially exceed the costs associated with administering behavioural arrangements. In this regard, vertical integration with behavioural arrangements may provide an overall superior economic benefit with a consequential increase in community welfare. This will be preferable to relying on structural solutions which subsequently transfer the higher costs associated with loss of efficiency to consumers.

In summary, it is reasonable for the Draft Guidelines to communicate that the provision of services pursuant to an access undertaking provided by a vertically integrated service provider will necessarily involve an increase in regulatory burden and the associated costs. However, it should avoid expressing structural preferences and simply note that the party seeking to give the ACCC a voluntary access should assess whether the efficiency benefits outweigh the costs of administering and enforcing the access undertaking relative to pursuing structural solutions.

Aurizon also suggests that the Draft Guidelines should include a reference to the non-discrimination guidelines prepared by the ACCC under Part XI of the CCA. These guidelines appropriately recognise that not all discrimination is harmful and may be efficiency enhancing, or that the circumstance or matter which results in the discrimination is so immaterial as to be irrelevant to the competitive outcome (i.e. not inconsistent with the CCA's objects clause).

Compliance

The Draft Guidelines includes the matters normally included in an access undertaking regarding compliance and enforcement. However, they do not include a reference to performance or compliance reporting or compliant handling.

An important element of a compliance framework is to allow for a level of industry self-regulation. It is therefore desirable that access undertakings include reporting and complaint mechanisms which allow the users of the service to assess compliance prior to involving the regulator.

The Draft Guidelines should therefore also acknowledge the efficiency trade-offs between ex-ante regulation (restricting the businesses conduct and prescribing terms) and ex-post intervention (addressing business conduct after it occurred but relying on the negotiation to produce the best outcome). Neither option is superior as ex post and ex ante intervention are complimentary forms of regulation, with different benefits, risks and costs. In practice an access undertaking will not fit within one of these descriptions but will lie on the spectrum between the extremes. These trade-offs are essential to the design of an access undertaking and need to be given appropriate consideration to the relative efficiency outcomes associated with the risk and consequence of non-compliance and whether a remedy would be effective.

The issues of ex-ante versus ex-post regulation and its implications for prescription, compliance and enforcement are complex and the Draft Guidelines would be enhanced through a brief consideration of the trade-offs. The ACCC is encouraged to consider these issues and how they might be reflected in the Draft Guidelines.