COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Reference: Trade Practices Amendment (National Access Regime) Bill 2005

THURSDAY, 11 AUGUST 2005

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SENATE

ECONOMICS LEGISLATION COMMITTEE

Thursday, 11 August 2005

Members: Senator Brandis *(Chair)* Senator Stephens *(Deputy Chair)*, Senators Chapman, Murray, Watson and Webber

Participating members: Senators Abetz, Adams, Bartlett, Boswell, Brown, George Campbell, Carr, Colbeck, Conroy, Coonan, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Fielding, Fifield, Forshaw, Hogg, Kirk, Lightfoot, Ludwig, Lundy, Marshall, Mason, McGauran, Murray, O'Brien, Payne, Robert Ray, Sherry, Stott Despoja and Wong

Senators in attendance: Senators Brandis, Chapman, Murray, Stephens, Watson and Webber

Terms of reference for the inquiry:

Trade Practices Amendment (National Access Regime) Bill 2005.

WITNESSES

Committee met at 4.01 pm

CHAIR (Senator Brandis)—I call to order this public hearing of the Senate Economics Legislation Committee, which is convened in order to take evidence on the provisions of the Trade Practices Amendment (National Access Regime) Bill 2005. On 15 June 2005, the Senate referred the provisions of the bill to the committee for inquiry and report by 5 September 2005. The bill implements the government's response to the Productivity Commission's inquiry on the review of the national access regime. The bill makes amendments to the Trade Practices Act that aim to clarify the regime's objectives and scope, encourage efficient investment in new infrastructure, strengthen incentives for commercial negotiation, and improve the certainty, transparency and accountability of regulatory processes.

Before we begin to take evidence, I remind you that witnesses appearing before the committee are protected by parliamentary privilege. Parliamentary privilege refers to the rights and immunities necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which may operate to the disadvantage of a witness on account of evidence given by that witness before this committee may be a breach of privilege. I also remind witnesses and committee members that witnesses have the right to request to have part or all of their evidence heard in private, and they may also object to answering a question in circumstances that are consistent with the Senate's privilege rules, copies of which are available in the hearing room for those who wish to consult them.

I also remind witnesses that giving false or misleading evidence to the committee may constitute a contempt of the Senate. A program has been circulated and is available in the hearing room. Could I indicate that we have decided to foreshorten the program somewhat by disposing of the dinner break and sitting through, with a view to finishing the hearing no later than 7.30 pm. I have arranged for the secretariat to contact those affected by that change in the arrangements. I also indicate to witnesses, as a matter of courtesy, that for about an hour, from 5 pm, it will be necessary at various times for some of us to absent ourselves from the hearing in order to attend maiden speeches being given in the chamber by our colleagues. I will not be adjourning the hearing, and no discourtesy is intended to witnesses by the withdrawal at various times after 5 pm of senators from various parties represented on the committee.

[4.04 pm]

FIELD, Mr Chris, Member, Economic Regulation Authority

PULLELLA, Mr Robert, Acting Executive Director, Economic Regulation Authority

ROWE, Mr Lyndon, Chairman, Economic Regulation Authority

CHAIR—Welcome. The committee prefers all evidence to be given in public, but should you at any stage wish to give any part of your evidence in private the committee will consider that request. Before you begin, I remind you and members of the committee that, under the Senate's procedural rules, officers of departments—which I assume includes state departments and agencies—may not be asked to give opinions on matters of policy and are to be given a reasonable opportunity to refer any such matters to a superior officer or to their minister. Would you care to make a brief opening statement before we proceed to questions?

Mr Rowe—Thank you for the opportunity to appear before the committee. We appreciate the opportunity to provide a written submission and also to be here today to make a verbal presentation and perhaps to answer some questions.

CHAIR—I am sorry. I should have said in the opening that the committee has before it your written submission, received on 29 July and numbered submission No. 4.

Mr Rowe—You will be pleased to know I do not intend to recite that to you.

CHAIR—I did not expect you would. That is entirely unnecessary, but you are very welcome to speak to it.

Mr Rowe—The Economic Regulation Authority in Western Australia is responsible for regulation of monopoly infrastructure in the areas of gas, electricity and rail. We also have a licensing and monitoring function in those same areas as well as water. ERA also has an inquiry function, which is not a regulatory role, whereby the state government can refer to the Economic Regulation Authority issues it would like to inquire into. It is a public process, a little akin to what the Productivity Commission does but at a state level.

Our interest in this matter is consistent with the aim of the ERA. We are interested in achieving efficient infrastructure investment at an efficient price to encourage investment, both upstream and downstream. So I guess our sole interest in appearing before the committee today comes to that issue of making sure that we have a legislative framework that enables us to achieve that as we regulate the infrastructure. That is the purpose of appearing before you today. Obviously, our role continues regardless of what the legislation looks like, but we have an interest in contributing to the debate in ways which will achieve legislation that makes it easier for us to achieve an efficient outcome.

Consistent with that, we have strong support for the overriding objective of this legislation with its focus on economic efficiency. Indeed, we support the proposed changes into the gas code with a similar overriding objective from the Productivity Commission. Our own electricity access arrangement in Western Australia has a similar overriding objective, so we welcome that focus on economic efficiency. The area where we have some concern goes to the issue of pricing principles. It goes to the issue more generally of the debate about

regulation in Australia and whether or not economic regulation is either succeeding or failing. I need to state that I am not talking about regulation generally; I am talking specifically about economic regulation and, in the case of the ERA, economic regulation and monopoly infrastructure.

We do not get involved in the retail area. We are talking about the regulation of electricity wires, pipelines, rail lines and so on. Our concern is that there has been considerable criticism of economic regulation, where a number of issues have been raised of concern. That has led to some extent to the suggestion that there should be some allowance for regulatory risk in the pricing principles. The question that we are asking is: where is that regulatory risk?

There are usually three issues raised with regard to economic regulation. One is the consistency of the decisions and the predictability, if you like, of regulators. In our submission, we have given you some evidence that we put together about the consistency of decisions made by regulators across Australia. We do not believe that there is an inconsistency in the approach they take. The only piece of independent research I have seen on that was done by the Australian Centre of Regulatory Economics here at the ANU. Again, they came to a similar conclusion, and we can provide you with copies of that if that is useful.

The second issue relates to the criticism about the time delays that regulators take. Again, I think that needs to be put into perspective. We certainly support in this legislation the idea of targeted timelines, but I think the delays that have happened in the past need to be seen in three contexts. Firstly, it is not just the regulators that are the cause of delays; there are sometimes incentives for providers to delay the processes as well. Secondly, this is a system that is maturing. We have been through a first round of regulatory decisions, and I think you will see a significant speeding up in the process as both regulators and providers learn from that process. Thirdly, there has been an element, in the first round at least, of ambit claims, which have not assisted regulators in the process. Regulators are often faced with proposals both from providers and from users, who may be at the extremes of what is possible, and that makes that process longer again.

The last issue about which concern has been expressed is whether or not we are providing rates of return that are commercial. I have to say that, in my view—and I have gone looking for the evidence of this—I cannot find evidence which suggests that the rates of return that regulators are providing are non-commercial. We regularly have people, such as financiers, banks, investment funds, share analysts, come to see us and there is no shortage of investment funds looking for investment in regulated monopoly infrastructure. I have a great deal of difficulty seeing why the issue of concern is about the rate of return.

I am aware that these are introductory comments. I will make one other quick comment and will then leave further comments until questions if people want to follow anything up. A lot of this debate seems to be driven out of Dalrymple Bay. Our own reading of Dalrymple Bay is that that has much more to do with the failure of commercial intelligence than it has to do with the failure of regulation. It is an understandable failure. Nobody predicted the demand. I am happy to explore that if people would like to.

I conclude by saying that our view is that the system is maturing, is starting to settle and is starting to be understood by people. That has been our experience in Western Australia. In the

last three weeks, we brought down two decisions. One was on a gas transmission line and the other was yesterday on a gas distribution network, where we have been able to approve the final access arrangements submitted by the providers following our final decision. They have made the adjustments or otherwise dealt with issues of concern that we had and they have been able to be approved. No significant issues have come out of that. In the sorts of informal discussions that I have—whether it be with owners, users, investors, financiers or share analysts—there is a large degree of understanding starting to develop about how economic regulation works. I stress again that I am talking about economic regulation, not the wider regulation issue.

The concern of all is that, if I am right and the system is settling and these problems that people are saying are there are not there, that is not an environment into which you want to introduce change. By definition, if you change the regulatory process, you are introducing a new degree of regulatory risk. It will take time for the system to settle down and for people to get used to the new system and you actually add to regulatory risk, not detract from it.

Senator BRANDIS—Is that right? I can understand why there is a transition risk, but that is not regulatory risk in the same sense. If you transition from regulatory regime A to regulatory regime B, if regulatory regime B is more efficient, you may actually reduce the regulatory risk but at the cost of perhaps incurring in the short term what you might call a transition risk.

Mr Rowe—You are quite right. It is an introduction of short-term uncertainty. If the new regime is better, then you may well get a better result. I also suggest to you, though, that to take that risk you would want to be convinced that the current system is failing. Regarding the short-term risk, there is a debatable question about how long 'short term' is. There is not just the regulatory process but the appeals process afterwards. There will be a significant period of time, in my view, for that to settle down and for people to understand the new rules and how they work.

CHAIR—That is a constant of all law reform.

Mr Rowe—I come back to where I started: our interest in this is an interest in promoting efficient investment. We would be the first to be concerned if the current system were chilling out what would otherwise be efficient investment, but we have not seen evidence of that. Our argument is: you would want to know that the evidence was there that the system was failing before you would take the short-term risk.

CHAIR—I understand that.

Mr Rowe—The test for any regulation is that market failure on its own is obviously not enough; regulation has a cost. If you are going to regulate then you have to be confident that the result of the regulation will be better than if the market were left on its own. I suggest to you that the same test ought to apply to changes to the regulatory system.

CHAIR—Thank you very much.

Senator STEPHENS—Thank you, gentlemen, for your submission. In reading your submission, I can see that there is a general agreement with the thrust of the legislation, but

you do raise concerns about the pricing principles and then basically say that you are in support of the legislation. What is the benefit of not having the pricing principles in the bill?

Mr Rowe—Our concern is with the pricing principles themselves, whether they are in the bill or not. There is nothing wrong with having pricing principles, if they are good pricing principles. The concern we have with the particular one I highlighted is that there seems to be a view that you need to make some additional allowance for regulatory risk. Implicit in that is that the current rate of return is not commercial and is not sufficient to encourage the investment that is needed. We are disputing that. Not only is there an argument which says that the allowance for regulatory risk is unnecessary—I do not think the risk is great; in fact, a lot of super funds are now looking at investment in monopoly infrastructure almost as debt investment: it is long-term, with secure returns and it is very low-risk investment—but also what does 'an allowance for regulatory risk' mean? It again introduces a degree of uncertainty about what a reasonable degree of risk is into the process—a process which, if I am right, is maturing and settling down. That will go through a series of appeal processes and so on.

Senator STEPHENS—We have seen an argument in some submissions which you highlight as being perhaps vested interest arguments. Are you saying to us that in Western Australia there is no level of underinvestment in monopoly infrastructure?

Mr Rowe—No, what I am saying to you is that there is no shortage of funds for what would be efficient monopoly investment. There are plenty of organisations out there at the moment establishing investment funds just for that purpose. If there is a shortage of investment, maybe it is because people are failing to see the opportunity, or else it is not economic. But it is not being driven by whether or not regulators are providing a commercial rates return.

Senator STEPHENS—In your experience, has the delay between the Productivity Commission's report and the government's response to it created any uncertainty for investors in Western Australia?

Mr Rowe—No, I do not think so. I think the system is settling down and maturing, so I am not arguing that there is a need for significant change. Again, my criticism of the Productivity Commission report—and I have been critical in other places—is that it makes a theoretical argument that there may be underinvestment, but it does not provide the substantive support for that argument. I go back to where I started in my earlier comments: we would be the first to be concerned if we thought we were stalling efficient investment, but I have looked for the evidence and I cannot find it. It is not in the Productivity Commission report, other than the fact that the theoretical case can be made that it might be happening.

CHAIR—That tells you about the state of the Western Australian economy.

Mr Rowe—I generalise my comments to Australia.

Senator CHAPMAN—In relation to the issues of concern that you have raised, do you have any specific amendments that you want to propose to the legislation?

Mr Rowe—Perhaps surprisingly, our view, on balance, would be that it would be better if the pricing principles were in the legislation, if they were good pricing principles.

Senator CHAPMAN—So the only issue really is the pricing principles?

Mr Rowe—In part, our concern about this is that a whole range of reviews are going on at the moment, including, through the Ministerial Council on Energy, the review of the gas code. The debate that has been had in here will have an impact on the debate there and vice versa. We saw this as an opportunity to put some alternative views on the table for people to consider.

Senator CHAPMAN—That is really the only issue you have about the legislation?

Mr Rowe—In our submission there is another issue, apart from the pricing principles, which has gone from my mind at the moment. Generally, we support the legislation and, in particular, we support the focus on economic efficiency—that is the overriding objective.

Mr Field—Of course our principal issue is economic efficiency, which goes across these debates on a couple of levels. Underinvestment is certainly undesirable and it is not in the national long-term interest—but, of course, overinvestment is not either. It is not efficient and it is not in the long-term national interest. Similarly, it is equally arguable that with a premium for regulatory risk, for example, what we might undesirably create is effectively a monopoly rent, which is once again clearly not in the long-term national interests of consumers and not an efficient use of resources.

CHAIR—This is quite congruent with the broad philosophy in part IIIA of the act, isn't it?

Mr Field—Yes.

Senator MURRAY—It is nice to see you again, Mr Rowe.

Mr Rowe—You too, Senator.

Senator MURRAY—It seems to me the main concern of many people—particularly in power, where essentially you need reserves of power, because of the nature of the beast—has been that there is sufficient money available for investment. That, to me, has three components: firstly, is there a commercial rate of return—in other words, is a reasonable profit being generated; secondly, is the entity able to borrow as they see fit and, thirdly, are they being required to give up an unreasonable amount of profit as dividends? It seems to me that in Western Australia, at least with regard to some of the utilities—not the duopoly suppliers—the debt-raising and dividend-paying areas have been more problematic than the pricing area. By that I mean, firstly, if an entity is state owned, it comes within the overall judgment of state debt and, therefore, raising debt for expensive infrastructure can potentially affect the credit rating and, secondly, if you are required by ministerial obstruction to cough up too much of your dividends, which otherwise you would have used for capital investment, there is an issue. In my mind, one of the freedoms that could be introduced through legislation from a regulatory point of view would be the empowerment of boards to make those decisions on their own judgment—in other words, to be free to pay such dividends as they see fit and to be free to raise such moneys as are relevant to infrastructure. I would like you to respond to those propositions.

Mr Rowe—You will probably understand that I cannot. You are now talking about a policy area that is outside the role of the ERA.

Senator MURRAY—But they are legitimate questions, aren't they?

Mr Rowe—Yes, they are. Can I respond though, in part, in a slightly different way? It is interesting that Western Australia was held up in part of this debate as an example of regulatory failure, particularly in the electricity area, because of some of the power failures we have had in Western Australia. We have not had independent regulation of the power system in Western Australia, so to hold that up as a failure of independent regulation is a bit tough. The issue in Western Australia has been more about the network side. To be frank, I do not think we have a problem going forward in generation. As you see the split up of Western Power in Western Australia, you will see more independent generators coming into the market and the returns will be fine. I do not think you will see a shortage of investment on the generation side. The challenge for us now, as the regulator of the networks, is to make sure the networks are reliable. That is what the serious issue is. There will be an instant debate there about what is an adequate level of reliability—as part of that debate.

Senator MURRAY—Without giving your personal opinion—because I respect the fact that your position makes it difficult for you to do that on the policy matter that I have asked you about—do you think that the Productivity Commission dealt adequately with the issues I have raised about the freedom of boards to raise money in a commercial fashion and to determine the level of dividend they pay out, which therefore affects their ability to reinvest?

Mr Rowe—Probably the answer is no, but I do not think it was part of their remit. In the review they were looking at the gas code, and that is more an issue for parliament and for the shareholders than it is for the regulator.

Senator MURRAY—But it does affect the ability of the entity to reinvest, of course.

Mr Rowe—Yes.

Senator MURRAY—This is the issue we are discussing: the ability to invest in infrastructure.

Mr Rowe—What I can say is that there is a perception in Western Australia at least—I do not know whether it is true or not—that part of the reason that the networks may need greater investment in the near future than they have needed in the past is because of that. I accept that.

Senator MURRAY—Thank you for your responses. I know you enough to suspect what your answers might have been if you had been free, but we will leave that aside. I want to challenge, if I may, the idea that price should be regulated at all. As you know, there are monopolies and duopolies in this country over which there is no price control. Costs may be imposed through special excises, levies or rates. I am referring to things like casinos and airlines, for instance. It seems to me that, where there is a possibility of gouging—or monopoly profits, to use the correct term—it would be better if a regulator were charged with the job of assessing where the monopoly profits are being taken and given the ability to put in some remedial action if that was necessary, rather than trying to set rates in a process of application and appeal which, as you know, has its own inefficiencies, time lags and assessment difficulties.

I wonder, given your long experience in matters of economic policy—I know about your previous history—whether you think it is time that governments accepted that price control of utilities in the way in which it has been applied to date should be done away with?

Mr Rowe—The first thing to establish is whether it is genuinely a monopoly infrastructure. In the ERA's case, that is all we deal with. We do not deal with retail issues; we deal with the wires and the pipelines. I think there is an argument for regulation where there is genuine monopoly infrastructure.

Senator MURRAY—Sorry, if I could interrupt: I did not suggest no regulation; I am just suggesting no control over price.

Mr Rowe—I understand. In part, the question you are asking me is whether there should be what is currently called heavy-handed regulation—what we are currently doing with access arrangements—or light-handed regulation. I think that is a really good question to ask the providers, and I have asked this question a couple of times. I have asked them this on the basis of, 'Would you rather see me once every five years, when we can hammer it out and I will leave you alone, or do you want the ERA watching you on a constant basis?'

I think this view that monitoring can be light handed needs to be questioned. For a regulator to be able to put their hand on their heart and say, 'This organisation is doing the right thing', they will need to be very intrusive into that business. I certainly do not want to micromanage businesses.

Senator MURRAY—I am thinking of the experience I have with other national regulators, such as APRA, ASIC and the ACCC, who all are charged with saying to the industries or the organisations or businesses within their remit, 'Are you doing the right thing with respect to the particular legislation?' They go in—as does the tax office and the customs department—and make sure that that is happening. I have got that model in my mind, which to me is a cautionary power—it is a reserve power. It is a monitoring and regulating power; it is not a price-setting and a market anticipation power. They do not try and say, 'This is how the market's going to be' or try and do the job which you are obliged to do. I know your expertise, but it is always going to be difficult because you are not the particular utility concerned.

Mr Rowe—There are really two reasons you have economic regulation. One is that there is a risk of that monopoly position being exploited in terms of pricing. Secondly, there is a risk that, if the monopolist also has interests either upstream or downstream, access to that monopoly in infrastructure may be an issue. In a sense, what the ERA is on about in its regulation role is making sure that prices are reasonable. That is important, because the infrastructure itself is a means to an end; it is not the end. It is about creating competition upstream and downstream and allowing the development of the economy. From that point of view, price is important. Equally, access issues are important. You will know, coming from Western Australia, the debate we have had over access to Western Power's wires. That is a crucial issue. I think it is slightly different because that is the focus of the economic regulation. I have difficulty seeing how you would implement those two under the system we are using now or, in effect, under a price monitoring system, and my concern about that is that I think it could be very intrusive and probably more expensive than the system we are currently using.

Senator MURRAY—Mr Rowe, just to conclude this line of argument: it is the responsibility of this committee not only to address the legislation at hand but to identify other problems it might suggest that governments should examine as a consequence. It is my

view that it is impossible to resolve the sorts of questions I am putting to you within the scope of this legislation, if there were an alternative view. It just could not happen. My question to you is: given that the Productivity Commission's brief left out a number of areas for consideration, is it your view that further review of this area could be useful and that the principles which are presently running our regulatory concepts need to be further assessed? If your answer is a positive one, in what ways should that happen?

Mr Rowe—I think we can always learn from the process and we can always improve the process. If we are going to have more inquiries, though, I go back to the criticism I made earlier of the Productivity Commission and, indeed, of the infrastructure task force: they need to be factually based reviews and they need to be based on the evidence that is before them. It would need to be an inquiry that looked at what was actually happening, not what theoretically might be happening. I still come back to the fact that, even if they are not saying it publicly, in my private discussions with players—the stakeholders in this market—there is a degree of settling down. Yes, we can always improve, but we want to be confident that, if we are going to change it, it is actually going to make the system better, not simply disrupt it.

Senator MURRAY—You are acquainted with what is known as the BHP Pilbara railway line, which I would consider a monopoly piece of infrastructure. That does not fall under your aegis, does it?

Mr Rowe—No, it is not covered.

Senator MURRAY—The state government's Department of Treasury and Finance put in a submission in October 2004: 'Western Australian Government Submission to the National Competition Council—Response to Preliminary Issues Paper: Fortescue Metals Group declaration application threshold issue'. I put the conclusion of that submission to you:

> The State Government has long recognised the need for an efficient and effective rail access regime for the Pilbara iron ore railways. The inclusion of third party access clauses in State Agreements places an obligation on Agreement companies to carry third party freight, provided it does not unduly prejudice, or interfere with, their operations.

Do you agree with that statement?

Mr Rowe—I am going to disappoint you, Senator. The Economic Regulation Authority is an independent statutory authority and cannot speak for government. I have a view on that, but it is a personal view and not an ERA view and it would not be appropriate for me to answer your question.

Senator MURRAY—I am not surprised but I am disappointed, because I expected you to say that, yes, you do agree with third-party access.

Senator STEPHENS—I want to go back to the pricing principles and our conversation before. First of all, you made the comment that the pricing principles should be incorporated in the legislation if they are the right pricing principles. Is that an accurate reflection of what you said?

Mr Rowe—I certainly would not argue against it. What you need in this environment is certainty, so if you are going to have pricing principles then in my view I do not see why those should not be in the legislation so that people know what they are and that they exist—

and so they are there. I understand, though, that even in what is proposed that will be the effect of what happens in any case. I do not have a strong view one way or the other, but the issue is making sure that we have pricing principles that create certainty, not uncertainty, and that are able to be interpreted by all the parties in a way that is consistent. We need principles that do not allow inconsistent interpretation.

Senator STEPHENS—The government has accepted the Productivity Commission's preferred pricing model and has agreed to include the pricing principles in part A. They are—I will read from the legislation—that the ACCC:

… must have regard to the following principles:

(a) that regulated access prices should:

(i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and

(ii) include a return on investment commensurate with the regulatory and commercial risks involved.

(b) that the access price structures should:

(i) allow multi-part pricing and price discrimination when it aids efficiency; and

(ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.

(c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

Given the question that Senator Chapman asked earlier, is there another pricing principle that you would like included?

Mr Rowe—Just to elaborate on the point about regulatory risk, my understanding is that there may have been some discussion about drafts that take that a little further to focus more specifically on allowance for regulatory risk, and that is part of the concern that comes out of that. That adds to that issue.

Senator STEPHENS—Sorry, are you saying that there is some discussion with the government?

Mr Rowe—I understand there is some discussion within government—

Senator STEPHENS—Within government, yes.

Mr Rowe—which might see that strengthened a little more so that there is an allowance for regulatory risk. Given our views about whether or not that exists, that is of concern. You could argue that 'commensurate with commercial and regulatory risk' is okay. 'Commensurate with commercial risk' I think is fine. You can also run an argument to say that if you have a diversified portfolio there is no specific regulatory risk attached to that asset. There is that debate as well, but I will not go there. The other one we have a little bit of concern with is what is meant by a return 'at least sufficient'. What is the meaning of the words 'at least' and how does that create certainty in the process?

Senator STEPHENS—That is a good point. The legislation proposes that the pricing principles be determined by the Treasurer and specified in regulation. What do you think of that approach?

Mr Rowe—You would be more expert in this than I am, but in my understanding that means that those regulations go through parliament and there will be an opportunity for them to be overturned if they are inappropriate. So they become part of the process, if you like. Providing they are good pricing principles, I guess in some respects it does not matter how you get there.

Senator STEPHENS—There has been an argument put that relegating the pricing principles to a regulation is a significant watering-down of the previous position taken by the government. Do you see it that way?

Mr Rowe—If it were, in some respects I would welcome it. Given my criticism of the pricing principles, if that was because they have listened to our arguments and they are having a rethink, I would be very pleased.

Senator STEPHENS—Some industry sources are suggesting that the Treasury is seeking greater flexibility in setting the principles.

Mr Rowe—I understand the point you are making and I think I would share their concern about the need to make sure that we have certainty in the process. We certainly do not want a set of principles that are constantly changing.

Senator STEPHENS—We could have a discussion about whether or not it is good policy to do it this way, but we will not ask you about policy. That is fair enough. There are just a couple of other issues. Do you have any comments about the new objects clause that has been included in the bill?

Mr Rowe—We support the direction of the objects clause. Consistent with the comments I made at the start about the role of economic regulation being to promote economic efficiency, putting in an overriding objects clause which makes that clear does help interpret the subordinate objectives within various codes. There is a similar clause proposed for the gas code. I agree with most of the providers: that will help clarify the objective of the code and put some certainty into that process. In our own electricity code in Western Australia we have a similar objects clause.

Senator STEPHENS—Do you think the objects clause would be strengthened by mentioning restraint on monopoly behaviour?

Mr Rowe—My understanding of economic efficiency is that it is about the long-term interests of consumers, and that is what the code is about.

Senator WEBBER—I want to go back to the role of the ERA. You described your role before in terms of the monopolies, and we still have some in Western Australia, unlike other states. You are guided by all these things in your act; one of them is to promote competition. In the areas of water and gas, say, how is the regulator going about promoting competition?

Mr Rowe—By having a regulator look after the monopoly infrastructure part of it. We do not regulate water. We license and monitor water but we do not regulate access to water and we do not regulate water prices. The argument is that the gas pipelines, the electricity

networks and the rail—WA more probably than the eastern states—are unlikely to be in a competitive position, because of the limited market and the limited number of pipelines. But you are looking at monopoly infrastructure so you are not going to get competition in that part of it. So the role of the regulator is to try to step in, and I accept that it is a second best way, to ensure that the prices that are charged on that piece of monopoly infrastructure are an adequate reflection of what would be an efficient investment. How are we promoting competition in that way? If we get that right then we are more likely to be promoting competition both upstream and downstream from those pieces of infrastructure. It is upstream and downstream of that infrastructure that our role comes into play.

Senator WEBBER—There is no role for you to take the initiative to encourage alternative providers rather than the monopoly infrastructure?

Mr Rowe—Other than by making sure, for example, in the case of electricity networks that we have—

Senator WEBBER—But that is a new role that has been given to you since the government has taken the policy decision to break up the monopoly.

Mr Rowe—Okay. Even in the gas pipelines area, to make sure that there is fair and open access to the monopoly infrastructure and that the prices being charged—the tariffs on that pipeline—are an accurate reflection of the efficient costs of the pipeline.

Senator WEBBER—I accept the challenges of the WA market and our geography and all the rest of it but, if we continue to have the monopoly provision, how do we determine things like the real price of gas or water in Western Australia? How do we know what the real price is when there is no alternative and no encouragement for alternative provision?

Mr Rowe—In electricity and gas you have competition at the upstream supplier end. You will have competition downstream—although it is debatable how much you will have. You may end up with a duopoly—that is not an issue for me—but you will have competition.

Senator WEBBER—Duopoly is better than monopoly, which is what we have at the moment.

Mr Rowe—The challenge for the regulator is to do exactly what you said: to try to make sure that there is open access to the piece of monopoly infrastructure in between those two, so that anybody who wants to get access to that infrastructure can and so that it is done at price which is a reflection of the efficient costs of running the pipeline.

Senator WEBBER—But what will we do to determine the real price at the moment? Educate me.

Mr Rowe—That is what we do in our access arrangements. We have just completed, for example, Alinta Gas's distribution network in the south-west area. They go through and submit to us an access arrangement. They outlay their capital expenditure plans and their operating expenditure plans for the next five years. We go through a process of using consultants to assess that and to gauge the reasonableness of that. We establish what is an appropriate rate of return and we set that rate of return on their capital base and take all those things into account. We do an assessment of what they think the volume use on that pipeline is

and use all of those factors to arrive at what we think is a reference tariff and appropriate tariff for the pipeline.

Senator WEBBER—I know there are debates about this in New South Wales as well but it seems to me that nobody in Australia actually knows what water is worth as a commodity. There are monopoly providers everywhere and they can do what they want. We do not know what price the market, be it individual consumer or industry, will bear.

Mr Rowe—As you would know, Senator Webber, if you wait for another month we will be able to tell you in Western Australia. For the benefit of other senators, we are currently doing an inquiry into urban water and waste water pricing in Western Australia.

Mr Field—Regulators can give you a second-best idea of what it is worth. The best idea, of course, comes from the competitive market, but in the areas where we do not have it—

Senator WEBBER—That is why I come back to promoting competition.

Mr Field—Exactly, it is the point you are making. Where we do not have competition, we can give you the second-best answer about what it is.

Mr Rowe—We are dealing with natural monopolies, in effect.

Senator WEBBER—Therefore, it is about having the confidence that that second-best idea is as good as we can get. I am not convinced by some of it, I must say. When you are dealing with a market where no-one knows what the real market price will be because there is no—

Mr Rowe—To give you some reassurance, in the area that we deal with there are large forces making sure that we get it as right as we can. In dealing with a monopoly infrastructure not only is the provider obviously extremely concerned but the users are usually not small consumers; they are usually large industry and they have a very strong interest in and make very strong submissions to what we do. So we balance those interests. In the end, as Chris says, we are dealing with second-best solutions. We cannot expect to duplicate a competitive market; we can hope to get to a second-best solution.

Senator MURRAY—On the same point, it is obviously in the economic interests of the users to have a low price, but it may pay for the price to be allowed to rise, because that will encourage other competitors in, as you know. It seems to me that Senator Webber has her finger on the point here—namely, that the system is restricting the ability of the price to rise such that other competitors may come in.

Mr Rowe—Let me assure you that, in our approach to this, our interest is economic efficiency. Economic efficiency is about the long-term interests of the consumers, not the short-term interests. Setting prices in the short term, which may benefit consumers but lead to an underinvestment in infrastructure, is not in the long-term interests of consumers.

Mr Field—I think that is an absolutely critical point. Consumer advocates might sit before you and say that they are interested in short-term price decreases, but that is not necessarily an efficient outcome and it is certainly not necessarily in the long-term interests of consumers. Speaking for the ERA, we focus quite singularly on their long-term interests and the economic efficiency that leads to that.

Senator WEBBER—I might leave that issue for a moment. In terms of dealing with a monopoly infrastructure—again, in gas, water or whatever—what processes does the ERA have in place to ensure that you remain simply an economic regulator and that you do not become a de facto environmental, safety and any other regulator that the community is after at the moment? How do you ensure that you stick to the economic facts?

Mr Rowe—The state government has given us a piece of legislation which is quite specific about our role, so we stick to our role.

Senator WEBBER—So, no matter who comes to you, be they politicians or whatever, talking about social impact or—

Mr Rowe—We have roles. For example, in our licensing role, we have a role in looking at issues such as the public interest. In looking at those issues, we will not second-guess what other government authorities are doing; we will seek their advice on those issues and be guided by it. For example, in electricity safety—which is not an area we regulate; there is a separate safety regulator—the safety regulator of Western Australia will provide us with that advice and we will accept it, although to be fair we also have the opportunity to seek independent advice, should we wish. But we are not going to go outside our area of expertise either.

Senator WEBBER—So, in your role as a regulator with a monopoly infrastructure, there is no policy development or anything?

Mr Rowe—Our role is to interpret the legislation.

Senator WEBBER—You purely stick to regulating case by case as the submissions come to you?

Mr Rowe—Correct.

CHAIR—Senator Watson, do you have any questions?

Senator WATSON—In the submission by AusCID, they urge the committee to adopt the provisions contained in the bill, with one exception. That exception is that we:

... replace the determination of pricing principles by the Minister contained in Division 6A, with the statutory principles accepted by the Government in its response to the Review of National Access Regime undertaken by the Productivity Commission.

What is your view?

Mr Rowe—We have some concern about the pricing principles as spelled out by the Productivity Commission. Our concern goes to the issue of regulatory risk and whether that really needs to be taken into account. I will give the same answer that I gave to an earlier question: we do not have a strong view one way or the other about whether the pricing principles should be in the legislation or through regulation. Probably on balance we would say that, for certainty's sake, it makes more sense for them to be in the legislation, but the more important thing is that they be the right pricing principles. We have some concern with the current proposals.

Senator WATSON—I read in your submission that there were differences between what the minister's regime required and the principles which the government accepted in response to the review of the national access regime undertaken by the Productivity Commission.

Mr Rowe—I suspect that is a question you should ask them.

Senator WATSON—These issues on pricing do affect you in another area, and I wanted to test the waters. I will certainly take the question up with Treasury. Basically you have conveyed to me that you are happy with the regime as it stands.

Mr Rowe—Correct. To make those changes, you need to be confident that you are going to get a better result.

CHAIR—Thank you very much.

[4.52 pm]

MUNDY, Dr Warren, Advisor, Australian Council for Infrastructure Development (AusCID)

O'NEILL, Mr Dennis, Chief Executive Officer, Australian Council for Infrastructure Development (AusCID)

CHAIR—Welcome. The committee has before it your submission, No. 2. I invite you to make a brief opening statement before we proceed to questions.

Mr O'Neill—I do not have a very detailed one, other than to say that the thrust of our submission, which is substantially in support of the bill, is that good regulation has to be about ensuring adequate forward investment in new infrastructure capacity while also ensuring reasonable pricing outcomes for consumers and that this bill therefore represents a very satisfactory and responsible evolution of the Trade Practices Act in that direction. Representing, as AusCID does, infrastructure investors, from both an equity and a debt perspective, we think that regulation needs to be about reducing risk and increasing certainty and there can be a trade-off on the risk-reward paradigm in that respect. This bill is certainly contributing to good public policy in that area.

Senator STEPHENS—Thank you for your submission. You raise some important issues as an industry organisation that is representing significant companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment. You make a strong recommendation in your submission:

... the Bill be amended to replace the determination of pricing principles by the Minister contained in Division 6A, with the statutory principles accepted by the Government in its response to the Review of National Access Regime ...

Would you like to elaborate on your arguments?

Dr Mundy—Yes. One of the difficulties we have—and one I think many people have who have submitted to the committee—is that the government, in receiving the recommendations from the Productivity Commission and responding to them formally, as the government is required to do under the Productivity Commission Act, accepted the principles that the commission put forward. Yet when the bill came to the parliament, those principles, which are enunciated in our submission, were not to be found in the bill and there was no explanation in the explanatory memorandum or the second reading speech to explain why the government had changed the position which it had accepted. I think it is important to remember that the government had accepted the Productivity Commission's recommendation in the first instance. Maybe officers of the Treasury, who are appearing later on today, may be able to enlighten the committee and others as to why that has happened.

CHAIR—Would you prefer that the pricing principles were specified in a statute?

Dr Mundy—Yes. We support the pricing principles as recommended by the Productivity Commission. It is a strong preference that they be included within the act.

CHAIR—What do you say to the view expressed against that—that, particularly in the early period of the operation of the pricing principles, there is a need for flexibility? In the

event that there needs to be some adjustment to them, is it more efficient to do that by regulation?

Dr Mundy—Part IIIA of the act has been with us since 1995. I reflect on the comment made earlier about changes in transition. People are not used to the pricing principles contained in part IIIA because the ACCC has never undertaken an arbitration under part IIIA. It is not as if there is a set of precedents now that someone may be departing from. However, as far as general pricing principles are concerned, economic regulators such as the ERA, the essential services commissions of Victoria and South Australia, IPART, the Queensland Competition Authority and the ACCC have been undertaking pricing decisions of one type or another for a long time, and there is significant academic literature on this. It is important I think for people to understand up front that, at the end of the day, the difference between the pricing principles being contained in the act and being made under some sort of subordinated legislation seems to me to be ultimately a question of parliamentary procedure. If the principles are made out in regulation and they need to be changed, the regulations will be altered. They will be laid before both houses of the parliament and both houses of the parliament will go through their procedures. If they are found to be functioning well and they are contained in the statute, then presumably the government will also bring forward necessary amending legislation—accepting that it is a bit easier to get on the draughtsman's program for regulations than for primary statutes.

CHAIR—I think it is a lot easier, and that is part of a problem.

Dr Mundy—That may well be the government's reasoning and it would be helpful for them to tell us that. I think that would clarify issues. The real point is certainty, and it needs to be understood that the investments we are talking about for which certainty is required have asset lives best understood in decades. People are investing today in assets that may last 50 or 100 years, so they need to understand very much what the policy principles are that are going to govern activities. Regulators are always going to have to make decisions, no matter how these words are set out or where they are set out. In regard to the issue about where they sit, in our view it is preferable that they are contained within the primary statute. If not, then a regulatory framework is better, and it is significantly better than the situation that exists today whereby, as the act currently stands, the commission may basically, subject to review by the tribunal, form any view it likes on pricing outcome, because it has no guidance in the act and at the moment it does not even have guidance with respect to objects of part IIIA.

I would like to comment on the notion of regulatory risk, because I think it is wrong to assume that when the Productivity Commission thought about the notion of regulatory risk, all it was thinking about was regulatory error. I think it is important to understand that the notion of regulatory risk can encompass issues such as the life which a pricing decision may have—five years is the standard, although there are other time frames that have been used—and the ability for the infrastructure provider to go back to the regulator and say, 'Circumstances have now changed.' A very good example of this would be in the case of airports where they are faced with changing costs associated with aviation security. So the notion of regulatory risk is much broader than simply that the regulator has got the cost of capital wrong.

Senator MURRAY—And time lags.

Dr Mundy—And time lags. I think it is better to understand the notion of regulatory risk. It does encompass error but it also encompasses the regulatory framework in which things sit.

CHAIR—Sorry, Senator Stephens. We were on a bit of an excursus into your time. You have the call.

Senator STEPHENS—That is okay. It was an interesting discussion. Going back to your submission, you also make the recommendation that the government bring forward further amendments to include price monitoring with the national access regime, either in this bill or as a separate bill, as a matter of urgency. Would you elaborate on that?

Mr O'Neill—The issue that we are very strongly alluding to there is that, when one goes back to the mid-nineties and the regulatory environment that flowed from the application of national competition policy, Australia launched on a pathway initially of quite heavy-handed, intrusive price regulation whereas investors and operators, in response to some of the political messaging of the time, felt that we were going to launch off into a period of lighter-handed regulation, of which price monitoring is an example.

The philosophy that we as representatives of investors have long adopted in this area is that because of the costs, time delays and intrusiveness associated with heavy-handed regulation, we believe that the country, efficiency and outcomes would be better served if, instead of intrusion from day one, there was a hands-off approach with a monitoring regime put in place. If parties stepped outside of reasonable bounds within that monitoring framework then the regulator, based on evidence, would have an excuse to step in and adopt a more heavy-handed regime. So we have put the cart before the horse, in some respects.

There has been a series of legal actions—particularly by gas pipelines—to seek deregulation, some of which have been successful and some of which have been partly successful. They have been very expensive and very protracted. To what benefit? It is very evident from our perspective that, at a macroeconomic level, the sheer expenditure of money has been quite wasteful. Yet the consumer, at the end of the day, has not had any better outcome. So when you look at—and I will pass over to my colleague for more detailed comments, for example, on airports—the sectors where there has been a shift from intrusive regulation to this lighter-handed price monitoring regime, it has been quite interesting to see how investment has lifted off. Perhaps, Dr Mundy, you would care to comment on the airport sector as an example.

Dr Mundy—It is probably appropriate at this point to indicate to the committee that I advise a number of Australian airport companies; let us be clear about that. Part IIIA of the act is predicated primarily on a vertical integration assumption that the provider of the monopoly infrastructure is effectively providing services to one of its competitors. Whilst the act does not require that test to be made out, the real rub in the competition provision in declaration is really about that.

Part IIIA as it stands is not really about regulation of services provided to households; it is really about business to business transactions. In, say, the airport sector, we have highly sophisticated and politically very able customers—Qantas, I guess, is principal amongst them in Australia, but the flag carrier wherever you go in the world—and relatively sophisticated,

largely capitalised companies that provide services. Airports such as Melbourne are worth several billion dollars, so these guys presumably have some capability.

We have found over time that the complexity and the richness of the relationships that they have goes to much more than just the question of price. Looking at how those arrangements have developed forward in a number of cases—such as Melbourne, Brisbane, Adelaide and more recently Cairns—airports and airlines have got together and reached binding commercial agreements about the provision of the services that are provided. It is our very strong feeling that the best form of regulation is contract because everyone knows what they are and people can agree to what the rules are, and they are enforceable.

That has proved to be a much more successful and quicker regime than the regime that was administered by the ACCC after airports were initially privatised in 1997, which, upon examination by the Productivity Commission, the government decided to terminate. It has worked quite effectively. Investment has come forward, quality has improved and the nature of the interaction has got better. We do not say that this is necessarily an appropriate case everywhere. But with regard to the incentive to deny someone access to use of the facility—facilities like airports and seaports, for example, have very large amounts of sunk capital and very large amounts of surplus capacity—the principal way that they are going to grow shareholder value is actually by encouraging access and usage, not by denying it.

The difficulty we have in the act at the moment—and it is, for example, in the case of the airports or also, for example, in the case of ports in South Australia and Victoria, which are subject to monitoring regimes—is that they can be happily complying with the monitoring regimes either constructed under state law or constructed by the Commonwealth under part VIIA of the Trade Practices Act, in concert with part 7 of the Airports Act and they can be happily doing everything that government policy requires of them and then someone can come along and seek for them to be declared under part IIIA of the Trade Practices Act. That, to us, seems like regulatory double jeopardy. You are either complying with the government's policy, and that should be sufficient, or you are not, in which case you should apply part IIIA. At the moment, people are subject to both. Indeed, there was a time when airports were also subject to section 192 of the Airports Act, which did something else as well.

Some of this may become clear when the tribunal finally comes up with a decision on the application that has been made with respect to Sydney airport. It may clarify this question. But, likely as not, it will not. So the Commonwealth could be left in a position where airports which are diligently complying with their policy—Melbourne and Brisbane airports have both won awards from international airline associations for how they have gone about this stuff—may then find themselves subject to application under part IIIA. We think that is just not good public policy. That is why we are advocating essentially a link. It needs a bit more flesh on the bone, obviously, but where in the case of airports people are subject to part VIIA of the act, they should not then also be subject to application of part IIIA, unless the government has formed a view they are actually not doing what they asked them to.

Senator STEPHENS—I was going to pursue some questions in relation to the modelling that you provided in your submission. Did anyone want to pursue this issue any further before we move off the topic?

Senator MURRAY—I have some general questions about pricing and access. I am happy to wait.

Senator STEPHENS—Go for it.

Senator MURRAY—Mr O'Neill, it is good to see you before us again. I have been concerned that our pricing regulation across the range of infrastructure available has resulted in two things: firstly, under-investment and, secondly, delayed investment. It is my view that pricing needs to be freed up, and that government should cease being afraid of price rises—particularly for water, power and so on. In due course, if the price and the return rise sufficiently, you will get additional competition—that is basically the theory. Where you have a monopoly or duopoly and profit capable of being made which might equate to price gouging then you should have an approach of price monitoring with perhaps a punishment regime, rather than an approach of price setting with an application regime. How do you feel about that philosophy and view?

Mr O'Neill—Certainly, the latter part of your point—the notion of price monitoring with an after-the-event, punitive, to use your word, price-setting regime to follow—would hopefully apply the checks and balances that the infrastructure owner required to toe the line, so to speak. But I think there is an important prior condition that one needs to observe here. In a number of sectors and jurisdictions, it is not the regulator who necessarily establishes the price limit. It is governments who do that. So I think we need to distinguish between the role of the regulator and the regulatory process in establishing, for example, access prices or transmission prices in a system. We also need to understand the role of the government of the day in seeking to cap prices flowing through at the retail level.

Senator MURRAY—I am not sure if you were in the room before when this was raised. I am very cognisant of that because not only can it be direct; it can be indirect. For instance, in WA, the process by which government insists on the dividend it wants and the way in which debt is restrained because of its effect on the overall state debt rating both have chilling effects on investment potential, possibilities and decisions.

Mr O'Neill—Absolutely, and I was in the room when I heard the remark about allowing prices to rise to a level where a range of other technologies and a range of other competitive players could enter the market, because the pricing is at a level where a wider range of opportunities could play in that market. So by keeping prices down you are often favouring the—often government-owned—existing monopoly in the supply of those services.

Senator WEBBER—To protect the monopoly?

Mr O'Neill—Correct.

Senator MURRAY—I raise these questions deliberately, because my impression is that the debate and the thinking which has gone on at the formal appraisal level—such as in the Productivity Commission review—have not addressed this fundamental question adequately. It is my view that an inquiry such as this, whilst we cannot address it within this legislation, could certainly be used to prompt the government to open up that debate and to consider these issues. I put that proposition to the previous witnesses but, of course, being who they are, and being employed by who they are, they quite properly said it would be improper for them to

give a clear response. You do not have any such constraints, so how do you feel about that proposition?

Mr O'Neill—I am pleased to confirm your point—that I do not have those constraints. Certainly, our organisation has long been on the public record, including in various submission processes, as identifying the inappropriate pricing of basic infrastructure services as the a priori issue which governments—collectively and in a coordinated manner—need to address before we can see adequate long-term investment in a range of infrastructure services in this country.

Senator MURRAY—With your long experience you would recognise that I am leading the witness, but would you encourage the committee to address this issue in their report and ask that government review this matter?

Mr O'Neill—I do not think the committee needs a lot more encouragement, to be quite honest!

Dr Mundy—Senator, the point you make about delay is particularly true in the case of a particular matter that came up in your state with respect to the enhancement of the Bunbury-Dampier pipeline. The then gas regulator, who I understand is about to become a vice-regal person in Western Australia, essentially dragged it through just about every court in the land to ultimately come up with a decision which was barely adequate to allow the pipeline to be expanded. It is very much after the time it should have been expanded, and, if it had been expanded, in all likelihood difficulties that were experienced with electricity supply last summer in Perth would have been avoided.

Senator MURRAY—That is exactly what is in my mind.

Dr Mundy—I do not think it is true to say that there have been no examples of regulator induced infrastructure delay in this country.

Senator MURRAY—Might I put it to you that regulatory risk is a prospective thing, but in fact in that case regulatory risk was realised.

Dr Mundy—One of the great problems with risk is that it exists. The mere fact that we cannot point to it turning up and ultimately being manifested does not mean that it does not exist. Risks are mitigated. We never know what a risk is. We have seen other regulatory examples of capital inefficiency. It was the case that, when the ACCC administered airport price controls, a highly labour intensive checked bag screening arrangement was put in place in Melbourne rather than a relatively high-tech one simply because of the view that the ACCC took on the words 'necessary cost'.

Senator MURRAY—Let me briefly deal with the other issue I want to raise, and that is the issue of access. I want to draw your attention to submission No. 10, which is a submission to us by the Fortescue Metals Group Ltd. Would you be good enough to have a look at that and to come back to the committee with a view about the proposition they make. I doubt that you have had the opportunity to look at it.

Dr Mundy—We have not looked at it but we are happy to.

Senator MURRAY—The reason I ask this is that, to me, the other function of a regulator, apart from monitoring monopolistic or duopolistic price performance, is looking at access

issues. To me, that is the other key thing. That submission suggests an amendment to the act. It seems to me that, on the face of it, the amendment has some attraction. But I am not sufficiently informed of the alternative arguments to form a view at present. But it does have an implicit attraction. Essentially, that group is arguing that a state government facilitated monopoly infrastructure, which exists for BHP to transport its iron ore, should be available for third-party access, and that is entirely proper in terms of the state government agreement which says:

The inclusion of third party access clauses in State Agreements—

which are automatic—

places an obligation on Agreement companies to carry third party freight, provided it does not unduly prejudice, or interfere with, their operations.

It seems to me that, provided the owner of the infrastructure gets a return and that, if an additional capacity has to be invested, it might be at the cost of the party that is going to access the infrastructure, we should incline ourselves to be supportive of third-party access rather than resistant to it. They say they are being dragged through the courts in a similar way to the way you have described. One of the problems is that the act does not indicate sufficient encouragement of a third-party principle. I am seeking that you give it some consideration and respond to it, apart from such remarks as you make now.

Dr Mundy—We will have a look. We have not had a look at the Fortescue Metals submission, but I will make a couple of observations. A lot of the problems generally with regulation fall into what I call the 'what people thought when they went into this' category of problem. What did they believe was going to be expected of them? These arrangements need to be looked at on a case-by-case basis.

But there is a more general problem about the access investment problem, as opposed to the access competition problem. The access investment problems run something like this: a company comes along and invests significantly in infrastructure for its own purposes, so it creates a market for the provision of this service. It bears all the risk of the failure of the development of that service, and carries that risk ultimately forever. At some subsequent point, perhaps five or 10 years down the track, the market has matured, they have borne all the risk, they are still there, and then someone comes in and effectively has a capacity to cherry pick or have a free ride on the fact that they have carried the risk in the establishment.

That is not necessarily the case in this particular instance, but there is a more generic problem with third-party access in that they will come subsequent to the investment decisions, and the risk will not have been properly shared. How you try and unpick that in some sort of fair return pricing discussion is probably beyond the wisdom of most folk to solve, but there is an issue there in what incentives that creates. It is not part of the bill, but there is some debate in the Productivity Commission's report about the concept of what is called an 'access holiday' for people who invest in new infrastructure and then, for a period of time, may be exempt from application of part IIIA of the Trade Practices Act. Those recommendations ultimately did not get up, but there is a more general issue there. We will have a look at Fortescue Metals and get back to you.

Senator MURRAY—Way back in my memory I recall reading about the early development of common law with respect to private entrepreneurs in the Middle Ages who would build a bridge over a river and extract a toll. Of course, they would exclude some people, and the law developed about who they could or could not exclude and the basis of pricing. It is not a new problem. I would think it is certainly reasonable for BHP to get its pound of flesh, but it is not reasonable for somebody not to have the option of paying that pound of flesh, which does seem to be the issue here.

Dr Mundy—Indeed. The difficulty ultimately, though, is in determining the unit of measure of the flesh that is to be extracted.

Senator MURRAY—In conclusion, though, and without taking a side on that particular issue because I want to hear the counterarguments, the question is whether the act should be amended or whether there is reason for the government to examine the issue with a prospect of amending it at a later date. I would like to hear your reaction to that.

Dr Mundy—The issue of access to railways, obviously, is a matter that has been to the council. There was a case in relation to Robe, so there is some jurisprudence on this. I think Robe actually went to the tribunal.

Senator MURRAY—Fortescue Metals says in their submission:

Fortescue would recommend that a definition of "*production process*" be introduced as an amendment in the *Trade Practices Amendment (National Access Regime) Bill 2005.*

That might or might not be possible; it might have to be in some subsequent bill. It continues:

It is respectively suggested this amendment define the "*production process*" to exclude "*railways, ports, roads, power transmission grids or any other facility where the function involves transportation, distribution or reticulation*."

Dr Mundy—It goes to the definition of 'production process'.

Senator MURRAY—We do need your guidance, in my view.

Mr O'Neill—We will look at it. As a last word on that point, as a former mining man, if I may make the point, not necessarily in defence of either BHP Billiton or Rio Tinto, that I have heard it said that their iron ore operations might be better described as excellent logistical operations rather than excellent mining operations, though they are also very low-cost mining operations. In other words, the core of the operational strength of both those businesses is indeed their ability to ship on rail and on the ocean the iron ore to the end markets. That is where the core of their business IP really rests. Your point about excluding rail, road and ports from the description of their operation could be very problematic. I would advise in addition to my colleague's comment that these things have to be looked at on a case-by-case basis.

Senator MURRAY—It is not my point; it is Fortescue's point, but their point is that access is unreasonably denied because it is not a question of asking them to put in more investment or to pay a certain price, it is just that they cannot use it. That seems a different argument.

Mr O'Neill—Certainly we will look at the submission. We will form a view and refer to you on that. Before we finish your earlier question on pricing, if I may offer another brief comment, with your indulgence, to do not just with pricing causing under-investment or delayed investment, as you characterised it, but I would like to make a link between adequate

pricing of infrastructure services and achieving more sustainable outcomes in the concept of particularly environmental and social outcomes in relation to energy and water. Because arguably in this country we have never priced the scarcity of water and we have only priced to consumers the cost of putting in dams, pumps and pipes to deliver water—this came up with the last witnesses—the notion of what is the real price of water has never been fully explored or tested economically or in practice. Consequently you are getting suboptimal outcomes in sustainability objectives because that water has not been priced. Similarly, I would like to put the point that with energy we have real problems because we are not pricing the externalities associated with carbon emissions, for example, that same sort of problem is emerging.

Senator MURRAY—That is right.

Mr O'Neill—And we do not have demand-side measures for the consumer to know when they are making inappropriate choices about increasing their use of energy—for example, turning on an airconditioner. If they had price signals that let them know the cost, they might make different choices, much as we might make different choices about buying smaller vehicles when the price of fuel goes up at the pump. Pricing is a very important and sensitive mechanism, in our view, for ensuring that we get not just good investment outcomes but across the triple bottom line we get good sustainability outcomes.

Senator MURRAY—Yes, and your point is that there is an attempt to include externality costs in the price of certain goods in what are known as the sin industries. Undoubtedly gambling, smoking and alcohol pricing is also influenced by the idea that price does assist in restraining consumption and that is an attempt to price externalities. Without going to hypothecation where you say, 'Look, there are 19,000 deaths from tobacco smoking so we will raise enough money to pay for the cost of it,' that does not happen, but there is certainly an externality component in the pricing of those goods. Those are matters which have been considered by this committee previously.

Mr O'Neill—Indeed, that is why our organisation has concerns and reservations about the use of technology-only solutions to deal with greenhouse impacts of various energy production methods because those members of ours who are providers of debt for new energy generation have assured me that debt is not available for new technology unless the technology has got to a point of such robustness and reliability that it is basically low risk and therefore backed by debt. In the meantime, the expectation is that equity-only will fund the new technology or indeed equity will come along to government looking for a grant or some similar support mechanism. With our current mechanism for dealing with greenhouse impacts through the energy white paper, we possibly have a problem in the making for energy investment going forward in this country.

Senator CHAPMAN—Again from your submission I assume that the only issue you have taken with the legislation is the omission of pricing from the legislation itself.

Mr O'Neill—That is right.

Senator CHAPMAN—Apart from that, you are supportive of the legislation.

Mr O'Neill—We are supportive. As I said in my opening remarks, the legislative change is definitely a solid move forward in the right direction and in the interests of just getting that

extra degree of certainty in place from an investor perspective we would prefer to see the pricing principles hard wired, so to speak.

Senator WEBBER—Senator Stephens has given me her question because she has had to go back to the chamber. On that point, it would also be fair to say, wouldn't it, that if the pricing principles were in the legislation there would be a greater degree of transparency? At the moment we are proposing to pass the legislation and see those principles later in the form of regulations, so we have to take the Treasurer's word on what he is going to do.

Dr Mundy—The Productivity Commission has been inquiring into these sorts of matters generally for the last 2½, maybe three, years. It started with their inquiry into what is now the defunct Prices Surveillance Act and has continued. The pricing principles that they recommended to the government in their report, which the government accepted, are pretty uncontentious in the minds of many, and they are transparent. One of the difficulties that we have had with a large number of regulatory regimes and a number of jurisdictions is that things have been left unsaid. To be fair to regulators—and I am not usually inclined to be fair to them—in a situation where they have not been given guidelines by policy makers, they have had to make them up. They simply could not have lived without them because they needed something to get on and do the business that they were charged to do.

Senator WEBBER—Before I go on to some general issues, I will turn briefly to Senator Stephens's questions about the modelling—table 7 on page 19 of your submission.

Dr Mundy—Do you mean the document prepared by Econtech which was attached to our submission?

Senator WEBBER—Yes.

Dr Mundy—Labelled table 2.

Senator WEBBER—Whatever. It looks at the rates of return and the underinvestment by sector. Senator Stephens wants to know how the desired rate of return necessarily implies an increase in the capital stock. She was wondering whether one could increase the rates of return by reducing the capital stock and whether the modelling has specific marginal efficiencies of capital stock in the sectors as part of its assumptions.

CHAIR—Could I suggest, particularly given that we are running behind time, that you read Senator Stephens's questions onto the record—

Senator WEBBER—That is the only question from her. I have some general questions.

CHAIR—Dr Mundy, if he wants to, could take that on notice.

Dr Mundy—I have a very quick answer to Senator Stephens's questions. It needs to be understood that the rate of return that is listed there is what a private sector investor would need to seek to invest in that industry, given the nature of the risk as we understand it. If you observe those industries where the investment gap is greatest, you will observe that they are industries in which the primary provider, and in some cases almost the exclusive provider, is the state government. I would suggest that it is not a regulatory failure; it is a lack of fiscal will.

Senator WEBBER—Fair enough. On to some more general issues. I think you were here earlier when ERA were giving evidence. Mr Rowe commented that he thought a lot of the current debate about infrastructure was being driven by the issue of Dalrymple Bay. I was wondering if your organisation had any comments about that.

Mr O'Neill—We spent some effort and time on submitting on the Dalrymple Bay issue. From our perspective, frankly, it reduces to a very simple proposition, which is that the privatisation of a coal loader, in setting up a contract between the owner and the operator—the owner being ultimately the Queensland government—unfortunately nominated as an arbitrator the Queensland Competition Authority. Our argument is that, as Dr Mundy indicated earlier, where you have two sophisticated players on either side of the commercial table, as you do with airports, so do you with a coal loader such as Dalrymple. It could well have gone to a commercial arbitrator, had the contract provided for it, which would have resolved the issues far more quickly and capably.

Unfortunately, with statutory regulators you tend to have embedded in the system a much more ponderous red-tape driven process or series of processes. Ultimately, the end result was achieved on Dalrymple through the activities of the Queensland Competition Authority; it just took a damn long time to get there. So it was an example of excessive use of time as a result of embedded process. I do not think it is necessarily a question of blaming anybody. The QCA no doubt acted and behaved as its legislation called upon it to do. What we are trying to argue for—and we did this to the Prime Minister's infrastructure task force—is that the priority question that needs to be asked first is: does the asset need to be regulated in this fashion? If the answer is no, go for price monitoring. And, if the asset does need regulation in some fashion, can a more efficient form of regulation be put in place? In cases where you have sophisticated players, do you need to resort to an independent governmental regulator when in fact you might be able to just point them at a commercial arbitrator to resolve differences?

Senator WEBBER—Speaking of industries that may or may not need regulation, I would like to return to the issue of water. Obviously Mr Rowe and I are going to have a discussion in about a month's time when he tells me what the real price of water is in Western Australia, which I am looking forward to. But, given that it is mainly monopoly protected government infrastructure at the moment, I was wondering whether your organisation was aware of any proposed private sector projects within that sector and whether there were any barriers that you knew of to the private sector actually investing in providing water and helping us determine the real cost.

Mr O'Neill—Do you mean in any jurisdiction in Australia?

Senator WEBBER—Yes.

Mr O'Neill—The most obvious one that would come to mind, and one that has had some publicity, is that of a small company in Sydney that is trying to get access to the Sydney sewer system essentially to undertake what is colloquially known as sewer mining—that is, treating the sewage stream into a solid fraction and a purified water fraction, and the purified water fraction would be of such a quality that it could well become suitable for environmental flows back into the river systems to the west of Sydney. That process has been through all the statutory mechanisms available to it, with both the competition bodies, with the NCC, and I

believe the New South Wales government, after the statutory period in question, failed to make a decision on the matter so it has now gone to the Competition Tribunal.

Beyond that very specific example, there have been numerous proposals over the years, some of which have borne fruit. There are a number of private sector water operations in South Australia. There was a major outsourcing in South Australia by the government of the day involving Adelaide's water and involving regional water. In Victoria there are a number of regional water supply projects in which the procurement method used was a PPP—a public-private partnership. In Queensland I believe both the potable water, the drinking water, supply for Noosa as well as the waste water treatment at Noosa shire are PPPs and have been in place for over a decade. There are others I could name.

But in terms of getting contestable access to the large urban water systems in Australia, from Western Australia through to Brisbane in Queensland, let me assure you there is a massive degree of protectionism under way by state jurisdictions. We made a very strong case in our submission to the Productivity Commission's review of national competition reforms that the next big tree that needed shaking was the water sector to ensure that there could be contestable access to both drinking water systems and sewerage systems or waste water streams in urban areas of Australia, because not only did we need to move in the direction of so-called drought proofing the supply side of water but in the interests of sustainable outcomes we needed to see a tremendous acceleration of the moves towards recycling, reuse, capturing of stormwater and the imposition of sensible demand management regimes as well as the introduction of innovative technology.

Senator WEBBER—And one of the best ways of having a sensible demand management regime is to determine the real price and what people are prepared to pay.

Dr Mundy—Part of the problem we have at the moment is that we are, for example, using potable water to cool the stacks in the Latrobe Valley power industry. If we do not allow the market to find its own price for water we are not going to allow the market to find different prices for different types of water. It is beyond the wit of regulators to be able to say the price of potable water to drink is $X a kilolitre and the price of tertiary treated sewerage entirely suitable for horticultural purposes is $Y per kilolitre. Regulators will simply not be able to do that because ultimately the price of water in a classical economic sense is a rent. It is a product of land like minerals and other things.

The reality is, I suspect—and there are legitimate social justice issues here—that the price will almost certainly be higher than the price it is today. That is obviously an issue that would be of concern to everyone, but the solution to that problem is appropriate social policy, not regulatory policy. The Productivity Commission made one very wise observation: whatever regulators do they should not be in the business of distributional outcomes. That is what parliaments are for, not what regulators are for. While ever we hold prices down—and there are similar problems with energy in some jurisdictions—regulators are de facto undertaking distributional decisions.

In regional Victoria there are clearly social justice issues associated with the distribution prices of electricity. The government of Victoria gets out the chequebook and writes a cheque and that is passed directly through to consumers. The price is allowed to find its natural place

and then the welfare issues are dealt with through a distributional mechanism. That is precisely the challenge that will be found in the water industry. It is going to be very difficult and I suspect Treasury officers—having been one—are going to find it a very great challenge.

CHAIR—Thank you very much.

[5.43 pm]

BIENCZYCKA, Ms Diane, Network Policy Officer, Energy Networks Association

CRAWFORD, Mr Garth, National Director, Government and Regulatory Affairs, Energy Networks Association

CHAIR—Welcome. Would either of you like to make an opening statement in relation to your submission, which we have numbered 3?

Mr Crawford—We appreciate this opportunity to speak on behalf of the Energy Networks Association to the inquiry into the provisions of the Trade Practices Amendment (National Access Regime) Bill 2005. The ENA is the national representative body for gas and electricity distribution businesses. Energy network businesses deliver electricity and gas to around 12.5 million household connections across Australia and are valued at around $35 billion. Energy network businesses undertake capital investment of more than $5 billion every year in network reinforcement, expansions and greenfields extensions.

The ENA strongly supports the four major aims of the bill, the overwhelming majority of its provisions and the implementation of the pricing principles. We do have some serious concerns, however, that some of the aims of the bill may not be met if the bill is not amended to include the Australian government's agreed pricing principles directly within the text of the bill. The principles should provide improved guidance on how the broad objectives of the regime are to be applied to the detailed terms and conditions of access pricing.

The purpose of these principles demonstrates the interlinkages of the aims of the bill with the principles. If subsequently, for example, the principles were changed via ministerial decree and the aims and the objectives of the bill were not changed, this could lead to a potential discrepancy between the aims of the bill and the actual pricing principles in force under the bill. The absence of statutory pricing principles from the bill, which instead are being proposed to be determined by the Commonwealth minister within the ministerial determination, might unintentionally undermine the substantive consultation process undertaken and the outcomes achieved in the Productivity Commission's original review of part IIIA.

The ENA and our members were actually significant participants in that consultation and some of the subsequent Productivity Commission reviews into the industry specific access regimes. The current formulation of the principles which were contained in the Australian government's agreed response to the Productivity Commission review were the product of around 120 different public submissions by dozens of parties. Following the consultation period surrounding the Productivity Commission review, the Commonwealth, state and territory governments collectively developed their agreed government response and stated explicitly that the principle should be inserted into part IIIA of the Trade Practices Act.

The agreed government response did not consider the arguments of not including the agreed principles within part IIIA to be persuasive. Just in light of this, the ENA is rather surprised to find that one of the former bodies appearing before you—the WA Economic Regulation Authority—in its submission to this committee claimed that the pricing principles

proposed by the Commonwealth government might be inappropriate. We consider this view is incorrect and inconsistent with the Productivity Commission's report and its process, the consultation and conclusions of Australian governments, be they state, territory or Commonwealth. We also consider this a rather peculiar stage—this stage of legislative implementation of the bill—to be promoting a fundamental rethink about the actual written contents of those pricing provisions. Perhaps their view might be explained by the fact that the WA Economic Regulation Authority did not actually contribute a public submission to that Productivity Commission review of part IIIA.

I would also point out that all of the views held by the WA Economic Regulation Authority on the Australian government's pricing principles are not necessarily consistent with the views of other regulatory bodies. For example, we are aware that the ICRC, the state-territory based regulator here in the ACT, has put in a submission to the committee which holds some different views from the WA Economic Regulation Authority on these issues of pricing principles. To the ENA, this inconsistency between just two regulatory bodies who put in submissions to the committee highlights precisely the importance of getting clear and binding national guidance on third-party access pricing issues, given that in a number of sectors our businesses and businesses subject to part IIIA are subject to regulation by up to a dozen different state, territory and federal based regulators.

I will finish there but I will make one point about the justification which has been given for putting these pricing principles in a ministerial determination rather than in the actual legislation. We recognise that justification has been made but in our view—

CHAIR—Where is it made, by the way?

Mr Crawford—It has been made to us by Treasury directly.

CHAIR—I see, because I do not see it in the second reading speech and I do not see it in the EM either.

Mr Crawford—We have been engaged in a process of dialogue with Treasury and other parties about exploring why this particular approach was taken. In our view, we just need to remember that one of the fundamental aims of part IIIA is to seek to facilitate sufficient investment in long-lived infrastructure assets. In the case of these assets, we do not consider the benefits of the flexibility of being able to change it from year to year are outweighed by the substantial uncertainty that could be introduced by this capacity. We think this uncertainty actually has the potential to deter investment that would otherwise go to support ongoing national productivity.

The final point I make, reinforcing the point on certainty, is that the ENA strongly supports the Australian government's response to the review of part IIIA, which has led to this bill. We have been assured repeatedly that the actual pricing principles which will be put into the public arena via ministerial determination will be the same pricing principles which were contained in that Australian government response, but we note that the ICRC submission refers to potentially new versions of the pricing principles—and this was discussed a bit earlier today—being circulated within governments being different from the Australian government's response. To us, this is an early sign of the type of unhelpful uncertainty which is created once important principles are not spelt out clearly in legislation for the benefit of

potential investors and for the third-party access seekers. Thanks very much again for your time. I am happy to take any questions from you.

Senator STEPHENS—Mr Crawford, thank you for your submission and for your expansive introductory remarks. They have been helpful in clarifying your position. Can you please tell me—and I am sorry, because I should know—who your organisation represents?

Mr Crawford—We represent electricity and gas distribution businesses. Here in the ACT, for example, ActewAGL provides electricity and gas. In New South Wales, Energy Australia is one of our major members, which delivers electricity to households and businesses. In WA, it is Western Power Corporation, so we principally represent those distribution network businesses which actually take power from power generation to the householder's door.

Senator STEPHENS—Thank you for that. With regard to your submission and the arguments that you have articulated, you had the benefit of having had explained to you why the pricing principles are not here in front of us and why they are not being included in the bill, and we will ask Treasury for those arguments. Can you tell us what you think the benefits of them not being in the bill are?

Mr Crawford—I do not really have a view about what benefits are derived from having the pricing principles in the ministerial determination. I accept that you certainly do have greater flexibility to change a ministerial determination than you do to change statute but, to us, that is actually a disadvantage rather than an advantage.

Senator STEPHENS—With regard to the legislation itself, do you have any comments to make about the new objects clause?

Mr Crawford—Like the WA Economic Regulation Authority, we strongly support the new objects clause and, in the review of the gas access regime that followed the review of part IIIA, we have also strongly supported a very similar objects clause for that, so we do not have any difficulties at all with that objects clause.

Senator STEPHENS—It has been raised, certainly with opposition senators, that it could have been much stronger in terms of having pro competitive language and that there is not any mention of restraint on monopoly power. Do you see that as a concern?

Mr Crawford—In our view, there is a lot that can be read into the objects clause. A previous person who appeared before you made the point that you can read into economic efficiency, for example, that monopoly power should be restrained when that is necessary. We certainly take that view.

CHAIR—Particularly having regard to the fact that these are amendments to the Trade Practices Act. You do not need the new objects clause to do that.

Senator STEPHENS—No, that is right. It has also been suggested to us that perhaps relegating the pricing principles to regulation is a significant watering down of the previous position taken by the government. Is that your view at all?

Mr Crawford—It is certainly a departure from what we understood was the Australian government's intention to put them into statute but, if the actual pricing provisions are ministerially determined subsequent to this act being passed and they have the same pricing principles which the Australian government said it was going to implement, I would not see

that as being in the nature of watering down the actual pricing principles; I would just see it as a different legislative approach that was taken which we did not particularly agree with, but the pricing principles would remain the same. That is our understanding.

Senator STEPHENS—In terms of the level of certainty in the industry, do you think having the pricing principles not included in part IIIA threatens any existing and future infrastructure investment?

Mr Crawford—We think it could potentially have a chilling effect on new infrastructure development because, if you put yourself in the case of being a hypothetical offshore investor about to make a one-off investment in a large capital asset which might be subject to part IIIA, one of the first questions you would ask yourself would be: what rules of the road are going to be applied? If those rules were in statute, you would obviously take a fair degree of comfort in the fact that those rules were not going to be changed arbitrarily without some form of public consultation process and potentially without quite a long lead time. Those same protections may not be available under a ministerial determination, so you may make a different sort of risk-reward assessment investment decision on the basis of whether or not these pricing principles are within ministerial determination or the statute.

Senator STEPHENS—What about the suggestion that removing the pricing principles from IIIA permits greater divergence across industry-specific access regimes, rather than a consistent approach? Would you have concerns about that?

Mr Crawford—I am not sure our concerns are that strong but it is definitely true to say that part IIIA serves as the template for a whole range of industry-specific access arrangements which cover principally gas and electricity in our particular area. So it will be of great benefit to see those pricing principles set out very clearly in legislation so that when we come to reform, renew and modernise some of those other industry-specific arrangements everybody clearly knows what objectives and pricing principles we should be heading towards to ensure nationally consistent regulation.

CHAIR—I suppose, Mr Crawford, it would be impossible to have two tiers of pricing principles, would it not? There could be core principles that would be generic and industry-specific or sectorally-specific pricing principles could be the subject of regulation. What do you think about that?

Mr Crawford—That is one possible approach. The observation I would make is that the pricing principles which were proposed for part IIIA are broad in nature and could apply to a whole range of infrastructure sectors. You are right, often there is that second tier of pricing regulation but those tend to be contained in those industry-specific acts themselves.

Senator STEPHENS—There has now been a major report of the infrastructure and export task force and consideration of the matter by COAG—it has called for a major review of infrastructure regulation by December. Do you think that there are any complications being provided by this legislation coming forward now?

Mr Crawford—No, I do not think so. I see this piece of legislation as a first piece in a puzzle for fixing a lot of infrastructure regulation across Australia. This is a keystone, as it were. Once you have this in place, you can have more sensible debates in the future about how to reform those specific access regimes across ports, airports, electricity, gas and a whole

range of sectors. I do not think this forecloses any options that the Prime Minister's infrastructure task force and COAG may take.

Senator WATSON—Mr Crawford, in your submission to us, you referred, for example, to the URF paper and a number of unsubstantiated generalisations—for example, by the Western Australian Economic Regulation Authority, which I read with interest. To me you appear to concentrate essentially on events, papers and discussions preliminary to the bill, rather than to the bill itself. I may have misunderstood it, but your references to the bill are, in my quick reading of it, not strong. I am wondering whether in a few minutes you could really focus on the issues of the bill. You do support the bill?

Mr Crawford—Yes, we do.

Senator WATSON—What about the pricing processes and procedures?

Mr Crawford—We support very strongly the proposed pricing principles.

Senator WATSON—You are quite happy with the bill, with the pricing procedures, so really there is nothing untoward in the legislation that you are unhappy about?

Mr Crawford—Our submission focuses on the one issue of making sure that, if possible, the pricing principles are contained within the statute itself, not as a ministerial determination made under the statute.

Senator CHAPMAN—So you agree with our previous witnesses on that?

Mr Crawford—Yes.

Senator WATSON—Do you appreciate that in this parliament and in this Senate we have two committees. We also have the Senate Standing Committee for the Scrutiny of Bills, which looks at bills which subsequently become acts of parliament, to protect the position of consumers, so that the bill does not trespass on certain rights.

In addition to that, we have another committee—the oldest committee of the parliament—called the Senate Standing Committee on Regulations and Ordinances, which looks at issues that arise from the bylaws and the ordinances that arise as subsets of the legislation itself. Generally, so long as the framework for the pricing is adequate and contained, there is appropriate room for the regulations to provide for pricing issues, because they can be subject to inflation and all sorts of shortages, and so offer a much more flexible approach. To put them in the bill obviously takes a lot more time to get it through the parliament and takes away some of flexibility but, because of the oversighting by a committee of the parliament, in a sense the consumers are protected as such. I just thought that, with your statement that you really want all pricing decisions within the bill itself, that can act as something of a restraining influence and not necessarily give any greater protection to the people that you might seek to protect. You are not a consumer organisation; you represent the networks. That is why I asked the question. I am pleased you are supporting the bill. Your only concern seems to be whether it should be in the regulations or the legislation. Would you like to comment quickly? I would have preferred a bit more comment directly related to the immediate issue before us rather than the past issues and papers that have led up to the bill.

CHAIR—Mr Crawford, do you understand Senator Watson's concern?

Mr Crawford—I do. We made that supplementary submission to the committee which provided you with some information that responded with our concerns about some utility regulators' forums, the papers for which we provided to you. We certainly did not mean to divert your attention onto these matters, but we felt that we had a number of perspectives on those particular issues which were different to the WA Economic Regulatory Authority and we wanted those views to be put on the table as a balancing exercise. You are right in one sense that what we are principally focusing on today is whether or not the pricing principles should be in a ministerial determination or whether they should be in the statute. I make no apologies for not taking up 40 minutes of your time telling you everything that we love about every single provision of the bill. We are focused on the one provision of the bill which we are slightly unhappy with—that is, that decision to drop down the pricing principles down that level of regulation because—

CHAIR—Mr Crawford, if I may say so, your submission could not be more concise. You support the bill, but you want the pricing principles in the bill. Is that it in one sentence?

Mr Crawford—Precisely.

CHAIR—Would you like to go on?

Mr Crawford—The reason we want that is to make the bill have the best chance of achieving its aims. It is not simply a regulatory technical legislative instrument type question; it is a question of whether the bill effectively achieves its aims by having the principles in the right place.

Senator WEBBER—I have one simple question—I am hoping it is simple after that. I think you were here for our previous witnesses. They were discussing airports at the time and the issues that confront entities that comply with government policy yet, in complying with all sorts of other government legislation, they can still actually get caught up in part IIIA. They described it as basically regulatory double jeopardy. Would you have similar concerns? I presume this issue applies to energy and not just to airports?

Mr Crawford—There have been moves to try to address that risk in electricity and gas. In particular, the Productivity Commission's review of the gas access regime, which followed the review of part IIIA, tried to make recommendations for changes which would address that issue of regulatory double jeopardy. We supported that very strongly. In electricity, it does not arise because of their particular legal mechanisms by which those access regimes are set up but we support the elimination of that type of regulatory double jeopardy.

CHAIR—Thank you very much.

[6.05 pm]

BERRY, Mr Luke Drummond, Member, Regulatory Affairs Committee, Australian Pipeline Industry Association

CARTWRIGHT, Ms Cheryl, Chief Executive, Australian Pipeline Industry Association

CHAIR—Welcome. The committee has before it your submission No. 1. Would you care to make a brief opening statement?

Ms Cartwright—Thank you for the opportunity to present our concerns regarding this legislation. APIA's main concern—as is ENA's—is the pricing principles not being included in the legislation. This might have been covered by previous speakers—we have not been here for the whole process. The private sector needs certainty when operating within a regulatory regime and pricing principles are an important part of that certainty. The Productivity Commission report *Review of the National Access Regime* found that there is a need for the regime but also found that the regime has a tendency to deter investment. The improvements which the Productivity Commission recommended covered two main areas: the need to improve procedures and the need to create more certainty for industry. The clear, unambiguous and fair pricing principles were one of the recommendations to improve certainty, transparency and accountability.

In its response to the Productivity Commission report, the government supported this recommendation. In fact, it was a key element of the government's response. Omission of the pricing principles raises concerns about whether the principles already agreed by the government will be introduced at all. There is no time frame indicated for the principles and there is no indication that the principles to be eventually introduced will be the ones that the government has already agreed to. There is also no indication that industry would be consulted should those principles differ from what the government has already agreed to.

CHAIR—Agreed to with whom?

Ms Cartwright—The government's response to the Productivity Commission report on the national access regime agreed to the pricing principles.

CHAIR—I see. When you say 'agreed to', what you really mean is announced?

Senator WATSON—That is the alternative.

CHAIR—I am sorry: when you said 'agreed to', I was a little surprised. 'The principles the government has announced,' may be what you mean.

Ms Cartwright—Okay, I mean the principles the government has—

CHAIR—It is not as though there has been an agreement with industry participants.

Ms Cartwright—No.

CHAIR—The government has announced—

Ms Cartwright—No, sorry. The Productivity Commission report had a response from the government and in the government's response it had agreed pricing principles.

Mr Berry—Yes. They were very similar to the ones recommended by the Productivity Commission.

Ms Cartwright—They had minor amendments. I am not suggesting that it was a deal done with industry; it is government's pricing principles.

CHAIR—Thank you.

Ms Cartwright—It is not clear why all the government's agreed amendments are included in this bill except the pricing principles. It can send the wrong message to industry, a message that certainty for industry is not a priority, and it could send a message that the government is prepared to ignore previous commitments. The Trade Practices Act sets a framework for industry-specific regimes. So something as important as pricing principles should be part of the legislation. It is part of the process to help industry make long-term investment plans and leaving out pricing principles would mean that the government would be missing an opportunity to actually improve the current regulatory environment for industry. Industry needs certainty in order to make long-term investment decisions. The Prime Minister's infrastructure task force also called for more certainty in regulatory regimes and, importantly, the Productivity Commission report *Review of the Gas Access Regime*, given the previous papers on this issue, actually assumes the certainty of pricing principles.

The Australian Pipeline Industry Association urges senators to amend the legislation to include pricing principles and to take an important step towards improving the regulatory environment for industry. An improved regulatory environment will encourage efficient investment by the private sector. From the pipeline industry's perspective, while transmission pipelines are generally unseen, they are essential infrastructure. Increasing investment in this infrastructure, as in other infrastructure, is surely good for the nation. My colleague, Mr Berry, and I would be happy to take questions.

CHAIR—Thank you very much, Ms Cartwright. The previous witness Mr Crawford mentioned that his association had had discussions with Treasury in relation to the pricing principles. Has yours?

Ms Cartwright—No, I have not and I do not think the committee has.

Mr Berry—No, we have not directly had those discussions.

Senator STEPHENS—Thank you for your submission. You raise some other interesting issues and confirm the concerns of previous witnesses. That is an important message for us as well. The issue of the pricing principles is the first one. We had discussion earlier—perhaps you did not hear the witnesses talking about regulatory risk and their concern that that was part of the principles, as well as the concern about the principles not being in the legislation. Do you think that it would improve the legislation to include the principles in the legislation?

Ms Cartwright—Absolutely. We need the pricing principles in the legislation to provide guidance to the other access regimes, in our case the gas access regime.

Mr Berry—The legislation forms a bedrock, the yardstick for the development of industry-specific regimes and there is an interaction through the certification process. As a result, it provides guidance for the development of the other regimes.

CHAIR—The Productivity Commission report to which this is responsive points out that, for example, in the electricity code and in the gas code detailed pricing principles are set out. Perhaps—and I am anticipating here—it may be said that pricing principles are best dealt with by industry codes rather than by statutes. What do you say to that?

Ms Cartwright—The codes need the guidance of the main legislation.

CHAIR—But there is an objects clause inserted. I suppose you could say that by putting in an objects clause, that is the guidance and then the code based pricing principles are the specific application of that in a flexible way to particular industries.

Mr Berry—Yes. I do not think there is necessarily any conflict between having some specific principles in the industry codes and that governments and regulators in their wisdom can consider those matters. But the national access regime really forms the catch-all for the situations where the industry codes do not apply. As a result, it also provides a basic intellectual platform for the development of the codes and for informing what sorts of principles should be in there. Also, when there are reviews such as the Productivity Commission review, they will look to those principles in the legislation in order to consider whether or not those electricity and gas code principles are appropriate. There is certainly a review of transmission pricing under the electricity code due to commence shortly. They will have reference to the sorts of objectives that governments and parliaments are enacting through this sort of legislation.

CHAIR—And what do you say to the suggestion I put to a previous witness? That perhaps one way of compromising, as it were, would be to have a two-tier pricing principle so that core principles of generic application could be legislated for and more industry-specific principles, which arguably need to be more flexible, could be left outside the act, either by being included in regulations or, as is currently the case, in industry codes. What do you say about that?

Ms Cartwright—The government's pricing principles that have been excluded from this legislation are a general guidance for the other regimes. That is why it is inherently important that they actually go in this legislation—for exactly the reason you are saying.

CHAIR—I understand. Thank you very much. Do other senators want to pursue pricing principles question now?

Senator MURRAY—I have only one question, Chair. The question of whether there should be pricing principles is broadly supported. So then there is the question of where they should reside. The chair has an interesting proposition that he has been putting.

CHAIR—I think my proposition has been persuasively blown out of the water by Ms Cartwright, Senator Murray.

Senator MURRAY—Nevertheless, it has been an interesting proposition that you have been putting. The only other question is the question you have raised—that is, the time frame by which pricing principles should be established. My view is that you have to get on with this. This is not a nice-to-do bill; this is must-do bill because infrastructure is an issue of concern.

CHAIR—Particularly, if I might say Senator Murray, since it is responsive to a September 2001 report!

Senator MURRAY—Yes. You have said that there is no time frame in which the minister must determine pricing principles and to my mind one of the good contributions this committee could make is to recommend that a time frame be established in the bill. I do not like open-ended bills; I do not like open-ended process because things can drag out. Is that a practical, reasonable proposition? Are the issues so complex that the minister needs an open-ended discretion or should the commission be saying, 'Within six months of assent' or whatever 'we want the pricing principles determined and published'?

Ms Cartwright—If the Senate was not going to change the bill and include the pricing principles, there would definitely need to be some assurances that the principles that were to be introduced reflected what the government had already agreed to; that if they were going to change, industry would be consulted. It would be difficult to explain why the government would need to change its mind about them because they have obviously thought about it.

Senator MURRAY—Except the legislation requires the minister to determine. That is a precise process, as you would know from your background. The Senate might or might not decide to go in a particular direction but there is still the question by which period or by which time the pricing principles should be established. My question to you is: do you have a time frame in mind which would be a reasonable time to give the minister to make a publication? I do not know what else might be in the minister's or the department's mind which could delay publication.

Ms Cartwright—My colleague might speak about the timing but initially I would like to say that, if the Senate does not alter the legislation, we would ask the Senate to stipulate a time frame and to stipulate that the pricing principles reflect the government's already published view, already agreed pricing principles, and also stipulate that if they are changed, industry be consulted. Mr Berry might have a comment on the time frame.

Mr Berry—In some senses, we would like a shorter time frame rather than a longer one, given that this process really kicked off with a review in 2000. In a sense, where you have a subordinate instrument and a ministerial decision, it is always a process that can be reopened and the initial time frame might be short but there is always a danger of a reopening and a re-examination of the principles down the track. In a sense, there would never be closure on this issue, to the extent that—

Senator MURRAY—We well understand that, if there is ministerial discretion, they can revise the position they have taken, but the question is that a position has to be taken. The point being made earlier was that the government has announced the position it will take. But that is not yet a question of law, of administrative determination or of statutory determination.

The point you have made is that there is no legislative provision by which that should happen. I cannot conceive of a process which allows for it not to happen, if you understand what I am driving at. So what I want is a straight answer. Does it matter if the committee were to say: we recommend that within six months of assent—at least by then; it could be shorter—the pricing principles be published and determined?

Ms Cartwright—If the legislation is not changed, the shortest time frame possible; yes, it perhaps should be recommended, but we would still be concerned that it would be done by regulation, and industry would not have the same sort of opportunity to comment on what those principles would be.

Mr Berry—It would also stand in contrast to the long gestation for the development of the current pricing principles, which has been a process of consultation and response over a four- or five-year period, so that it is distilled into the principles that we have got here.

Senator WEBBER—I want to touch on two quick areas. I am sorry for this, I guess it is getting a little repetitive, and I do not want to make you repeat yourselves all the time. The chair reminded us that this is in response to a report that came out in September 2001. So we have obviously seen a fair bit of delay in terms of the government's response and now this piece of legislation which has obviously had some change along the way with the removing of the principles. Do you think that delay in response has created any uncertainty in terms of investment?

Ms Cartwright—I think it would be too hard to tell.

Mr Berry—I think that industry is looking for some moderate changes to part IIIA which would improve investor certainty. Certainly when you look at the objectives of the bill, the four objectives that have been identified all relate to improving certainty for all parties involved in the process. The pricing principles are a key element—

Senator WEBBER—To giving that certainty.

Mr Berry—To the extent that there has been a delay and that these are principles that we desire now and would have desired in the past—

Senator WEBBER—So it could well have had an impact on investment.

Mr Berry—It could have. It is just difficult to isolate that factor from every other factor in the investment climate.

CHAIR—Mr Berry, just looking at the pricing principles in recommendation 12.1, they seem pretty anodyne.

Mr Berry—They are very high level, that is right. As for concerns about things like flexibility, they are relatively high level so that there is quite a lot of flexibility within them to develop further approaches.

Ms Cartwright—And that is to cover for the various access regimes that come under this legislation. If I could take Senator Webber's question a little further, with the gas transmission industry—you were asking about what we are concerned about with delays—our main concern is the Productivity Commission review of the gas access regime. That came out in June last year. We are now waiting for there government's response to that, and that seems to be fairly close.

Senator WEBBER—Could we have feedback on when we can expect that?

Ms Cartwright—The Ministerial Council on Energy said that they would provide a draft response in September. It is possible that I am focused on it because I have been working for

the industry for only five months. I am pretty focused on the gas access regime report even more than this one, and that is a very important report to our industry.

Senator WEBBER—Is it a report that your industry agrees with?

Ms Cartwright—Yes—well, it is a compromise. While we do not agree with all the recommendations, we accept the report as a whole, rather than cherry picking, and we are asking that the government and the bureaucracy do the same.

Senator WEBBER—That probably leads me to my second question, and it is a separate issue. Does your association believe that there is a case for further regulatory reform—accepting your support for this piece of legislation and accepting that you say, as does almost everyone except ERA from my home state, that the pricing principle should be in there? I have not discussed this with my colleagues, but I think you have sold me on that argument. Is there need for further regulatory reform in your area?

Ms Cartwright—That is happening. The need for regulatory reform was recognised by the Prime Minister's infrastructure task force. Gas transmission pipelines even got a mention in that. So there is a recognition that we need regulatory reform in the sense that more light-handed and less intrusive regulation, more certainty and a better understanding of business are required. At the same time, business understands that where there is a natural monopoly we still need to have an access regime in place.

CHAIR—Thank you, Ms Cartwright and Mr Berry. You are excused.

[6.25 pm]

TAPP, Mr Julian Robert Paul, Economist, Fortescue Metals Group Ltd

CHAIR—Welcome to the table, Mr Tapp. Thank you for making yourself available a little earlier than you were advised. The committee has before it your submission, No. 10. Would you like to make a brief opening statement speaking to your submission?

Mr Tapp—I work for Fortescue Metals Group, a company that hopes to engage in mining activity in the Pilbara and to build a railway and port system to service that mine. I would like to give some background to my submission by taking you back to the history of the development of the Pilbara. The Pilbara is serviced by two rail networks. One of those railway networks is controlled by BHP Billiton and the other is controlled by Rio Tinto Ltd. These railways were initially established under a state agreement with the state of Western Australia. Under the terms under which land was made available for construction of these railways, it was made clear that there was an obligation within the state agreement for those companies to carry the ore of third parties on their rail systems. They have never allowed unrelated third parties to get access to those railways. Back in the late nineties—I believe it was in 1999—Robe River Iron Associates attempted to use the Trade Practices Act to gain access to one of the railways that was owned by Rio, the Hamersley Iron railway. They were unsuccessful in their attempt to get access to the railway.

CHAIR—This was an application under part IIIA, was it?

Mr Tapp—Yes, it was. In front of the Federal Court, Rio successfully argued that the railway was not infrastructure per se that could be declared under the act. It was part of Hamersley's production process and therefore was exempt under the production process exemption that is to be found in section 44B, I believe.

CHAIR—Was that the Federal Court or the National Competition Council?

Mr Tapp—They took it to the National Competition Council, but before the council could hear the case they were injuncted on the grounds that they did not have the jurisdiction to consider the case.

CHAIR—I see: on the grounds that it was beyond their jurisdiction. I understand.

Mr Tapp—So Robe River lost the case initially. They appealed, but on the morning that the appeal was due to be heard the declaration was withdrawn. Robe then decided to build their own railway, and shortly after that they were taken over by Rio. Rio had claimed that Robe could not possibly be allowed access to their railway because they simply could not accommodate them on their railway, but as soon as they owned them they found it was perfectly possible to accommodate Robe River on their railway system. The mine, which Robe were wishing to access the railway in order to develop, now produces around 20 million tonnes of iron ore a year.

CHAIR—If I understand you correctly, that was not the basis on which the litigation turned. The basis on which the litigation turned was that the rail line was part of the production process, not part of the infrastructure, and therefore it was not within the

jurisdiction of the court or the council to make a determination under part IIIA. That is a different issue.

Mr Tapp—Yes, that is absolutely correct. I am trying to give some colour to a history of cases where basically access has been denied to the infrastructure in order to prevent entry into the downstream market—the market for iron ore. The decision made in the Federal Court not to allow Robe access to the railway because it was part of a production process had two key elements to it. One of them was the judge's view that the way to determine what a production process was was to consider a dictionary definition. We certainly consider that more economic theory should have been involved in the consideration as to what constituted a production process.

CHAIR—Who was the judge? Do you know?

Mr Tapp—It was Justice Kenny. The other reason the judge found in the favour of Hamersley was that she found no evidence that a marketable product existed prior to the use of the transportation system. As I have explained, Fortescue is a company that is seeking to mine and develop its own railway and port system. We have a deposit very close to BHP's railway line—the Mount Newman railway line—and it would make sense for us to get access to that railway using part IIIA of the Trade Practices Act. When we applied to have the railway declared, BHP used the same defence that Hamersley did—namely, that their railway was a production process and therefore could not be considered.

CHAIR—Do you acknowledge that that is a legitimate and proper distinction and merely question its application to the particular case or do you deny that that, in an economic sense, is a proper distinction to make?

Mr Tapp—As I understand it—under the law, because of the Kenny decision—the NCC were in some sense correct in saying they had trouble considering our application because, on a strict interpretation of Kenny, it may be said, 'It's the same as the Hamersley case.' We were able to successfully argue in front of the National Competition Council that BHP's railway was different from Hamersley's. In particular, with regard to the existence of a marketable product prior to transportation, we were able to prove that, under the terms of the joint venture that BHP has with some of its partners, it sells the ore at the mine site and therefore it seems to us difficult for it to argue that there is no marketable product.

CHAIR—Why do we need to know all this? What do you want to tell us about the bill?

Mr Tapp—In the case where a small mining company in the Pilbara wishes to get access to a railway to develop a mine using the Trade Practices Act, it is always going to be frustrated by the argument that the railway is part of a production process and therefore exempt from coverage.

CHAIR—Am I missing something? I do not remember noting that the bill changes or removes that exemption. Does it?

Mr Tapp—No, it does not. I am here to request that the Senate considers amending the bill in order to clarify what the term 'production process' means within the bill.

CHAIR—But the judge clarified that; she just clarified it against your interests. I know Justice Kenny. I am sure she wrote a decision in which the meaning was pellucidly clear. You just disagree with the outcome because it affects your company unfavourably.

Mr Tapp—On a strict interpretation of the Kenny decision, if you put that decision with any vertically integrated producer, that vertically integrated producer can decide to arrange its production to make sure that the production process is deemed not to be finished until after the system of reticulation has been utilised.

CHAIR—You want the committee to recommend to the government and to the Senate that the production process exemption be taken out of part IIIA of the Trade Practices Act?

Mr Tapp—No. I am actually here to ask the committee to clarify what was meant when the production process was initially put into the legislation. It is clear that the intention was to exclude things that were internal to a factory such as a conveyor inside a plant. It was never intended to apply to a railway that runs 400 kilometres across the Pilbara.

CHAIR—That is not what the judge decided. I do not know enough about the facts of the particular case. Can you direct me to the definition of production process in part IIIA?

Mr Tapp—No, that is exactly the problem. There is no definition of the production process.

CHAIR—It is not a defined term. Okay. But the distinction has been acknowledged and defined by the Federal Court.

Mr Tapp—Yes. So I am not saying that you should find in our favour in any way; I am just saying that there is this ambiguity in the Trade Practices Act in that the term 'production process' was never defined.

CHAIR—That is not an ambiguity. There are lots of terms not defined by acts of parliament. That does not mean that it is ambiguous. It seems to me, Mr Tapp—and I hope I am not doing you an injustice—that you are really coming here to try to use this Senate hearing as an avenue of appeal against a decision of the Federal Court that did not go your way.

Mr Tapp—Yes and no. We accept that we are prepared to go to the Federal Court, and we are going to the Federal Court, to argue this case and, whatever happens—

CHAIR—Did you say that you are going?

Mr Tapp—Yes, we are going to the Federal Court.

CHAIR—Okay. If this issue is a live issue which is about to be re-agitated in the appellate jurisdiction of the Federal Court, wouldn't the parliament be wise to await that decision?

Senator CHAPMAN—It is not an appeal; this is a new case.

Mr Tapp—This is a new case.

Senator CHAPMAN—This is a different line.

CHAIR—Even if that is so, wouldn't the parliament be wise to await that decision before deciding whether or not it is necessary to reform the law in that respect?

Mr Tapp—I will put it differently. We accept that we will go to the Federal Court and our court case will be heard under the existing legislation. What we are saying is that, for those who come after us, it does not seem right that you have to spend a huge amount of money and go to the Federal Court in order to get your case even heard by the National Competition Council because the term 'production process' was not defined in the legislation because it was not deemed to be necessary at the time. The legislation makes it quite clear that railways and other substantial infrastructure are supposed to be covered. The production process exemption that comes afterwards was never intended to exempt railways. It is actually written—six lines above it says 'the service provided by infrastructure such as railways'.

CHAIR—Yes, but I think you are sort of begging the question, because obviously what the judge did in the case that you are now revisiting in the new litigation is to say, 'Well, what the act means by that is this.' I understand what you are getting at. Is there anything more you wanted to say?

Mr Tapp—No, that is all.

CHAIR—Senator Webber, do you have any questions?

Senator WEBBER—Only briefly, because I must admit that I have not got my head around the distinctions between the production process exemption and other issues. That is really what you are looking at, and not the general issue of third party access—you are more concerned about this definitional aspect.

Mr Tapp—I am concerned that the definition allows a vertically integrated producer to arrange to make sure that their assets would not be covered under part III of the Trade Practices Act. All you have to do because of the Kenny decision is to make sure that a marketable product does not exist until after you have used the distribution network, and then it automatically becomes a part of your production process. I find it difficult to believe that the Trade Practices Act was meant to allow a producer the flexibility to make sure that their assets were not covered by the legislation. Maybe 'ambiguity' is not the right word, but I do not believe that the production exemption was ever intended to do that.

My reading of the Hilmer report was that there were cases in America, such as where a photographic company was trying to get access to Kodak's research laboratories, and they realised that they should exempt somebody's core production from the legislation. It was never intended to cover railways or pipelines or electricity power grids or anything else where you put the product in one end and it is exactly the same when it comes out the other end—all that has happened is that it has been transported—and yet, because the production process was not sufficiently well defined in the act, somebody can come along and argue that that is part of my production process.

CHAIR—Sorry, but you said that it is not defined at all in the act.

Mr Tapp—Yes, it is not defined at all.

CHAIR—I cannot find a definition. So you are saying as an economist that the distinction between production process and infrastructure is an artificial, or indeed even an irrational, distinction, or at least in this particular case it was. And if you were a lawyer—which I gather you are not—

Mr Tapp—That is right.

CHAIR—You would be saying that the creation of that exception is too narrow a reading of the meaning of infrastructure or service capable of being declared under part 3A.

Mr Tapp—That is correct. The National Competition Council have actually considered this issue as part of our declaration process and at the end—

CHAIR—What is their decision called?

Mr Tapp—They have looked at our application, and the issue of whether it is part of a production process or not was one of the preliminary issues they considered.

CHAIR—Is that a determination by the National Competition Council in your litigation?

Mr Tapp—It was a preliminary issue. They had some preliminary issues that they considered before they would consider the main case.

CHAIR—That is what lawyers call an interlocutory determination on a threshold issue. Do you have a copy of that there?

Mr Tapp—I do have a copy.

CHAIR—Can you furnish copies of that to us, please?

Mr Tapp—Basically the final sections of it, 453-467, argue that there should be an economic interpretation of what a production process is.

CHAIR—That is very interesting.

Senator WEBBER—If we were convinced by that argument and we accepted the argument of the artificial distinction and we deemed it all to be infrastructure, how do you propose that we address an issue that was raised by previous witnesses, which is the problems of third party access and then those parties not bearing any of the cost of the risk of establishing that infrastructure in the first place? How do we share the risk across there? Do we give what people are talking about—an access holiday—or how do we handle it?

Mr Tapp—It is not clear to me that you cannot address the risk in the terms of access. You are asking me about conditions under which—

Senator WEBBER—If I am BHP Billiton or whoever and I have built this train line and I am saying it is part of the production process and if we accept what you are saying and we change that definition and we say it is actually infrastructure and therefore companies like yours will have access to it—noting that BHP Billiton have borne the cost of the risk of establishing that piece of infrastructure—how do you ensure that parties like yours bear your proportion of the cost? The risk is usually fairly early on.

Mr Tapp—Perhaps I did not make it clear enough. In this particular case when BHP or their predecessors, Rio, built the railway, the state agreement under which they built the railway made it clear—there were provisions in there—that they have to give access to third parties. What the provisions actually say is that they have to carry the ore of third parties. In BHP's case by about the mid-eighties when it had become apparent, despite attempts by third parties to get access to their railway, that they had kept them all out, the government of Western Australia negotiated what was called the rail transport agreement. That was

negotiated in 1987 and it made it abundantly clear that they were obliged to carry the ore of third parties even if those third parties were competitors. They were being forced to carry the ore of competitors.

CHAIR—Is that one of those revenue-gouging rail freight statutes that state governments tend to favour so much in this country?

Mr Tapp—It was clearly the case that they said, 'Look, we're going to give you the land to build the railway and we're going to write the terms under which we give you that land. Those terms are that this is a piece of infrastructure that it makes sense to share with others. There are huge economies of scale. We're not going to allow you to sit on this when you have got unutilised surplus capacity and keep people off for the simple reason that you do not want them competing in the downstream market.'

Senator MURRAY—Perhaps I can clarify that the state government actually relieved the mining company from royalties in compensation for building the railway.

CHAIR—I have not read the whole of the Productivity Commission report to which this bill is responsive. Do you know whether this issue is treated by the Productivity Commission?

Mr Tapp—I am sorry, I do not know. If I can finish this point: if they had built this as a private railway and it was their own land they built it on, I might have some sympathy with your argument. What I am saying is that they built it under the knowledge, so the risk was known when they made the investment—that they signed up to letting third parties on. What I am saying is: 'You don't have to carry the ore; I just want access to the railway.' This is like asking to get on a road.

Senator WEBBER—I understand that and I am not arguing about that specific case. I do not recall it as well as Senator Murray, but I am from Western Australia, so I have some understanding. If we are to accept your recommendation and if we are to therefore create this definition or deal with this, there will be other people—

Mr Tapp—Agreed.

Senator WEBBER—So I want to talk to you as an economist, not as a Fortescue—

Mr Tapp—I agree with you that when you are looking at pricing mechanisms for access—

Senator WEBBER—Because that would come up because this amendment would apply across the board.

Mr Tapp—Generically, when you invest in infrastructure, you take a risk when you make the investment. If you are going to come along afterwards and look at the capital cost without factoring in the risk that that person was taking when they did it, then the terms of access will be too cheap. If your question is, 'Should you factor in that risk when you are determining the pricing?' the answer is, 'Absolutely.'

Senator WEBBER—Or should we look at, as I say, a temporary access holiday for these third-party users that do not therefore have to bear the cost and the risk of providing infrastructure in the first place?

Mr Tapp—But all the assets that I am talking about are ones where you get economies of scale. So letting third parties on is going to reduce the average cost of utilising them.

Senator WEBBER—Could we come up with a definition that would deal only with that? This is the definition that would then apply across the board for all the infrastructure. You are confident we could come up with a definition that would deal only with that?

Mr Tapp—Yes. I see no problem coming up with a definition that says: if there are economies of scale, why wouldn't you let people on? The reason is because you are trying to keep them out of the downstream market. They are arguing that they are not going to get rewarded for all their risk—that is, how much they paid for the capital cost associated with that investment. What is a fair return?

Senator WEBBER—The companies concerned do seem to have discovered a loophole in the act and played a bit cute with some definitions.

CHAIR—That is a rather tendentious thing to say, Senator Webber. They just had a good argument.

Senator WEBBER—They may well have had a good argument.

Senator MURRAY—I think this is a case which the government has been concerned about which is to do with export bottlenecks and, frankly, a competitor wishing to have access. The question the chair has put is whether your case is valid in policy and in law. What strikes me is that you are right to come to us about this bill because one of the bill's intentions is to enhance the access regime, but the measures within the bill to enhance the access regime require you to be able access the ACCC, and of course you have not been able to because you have been excluded. So that makes for a problem. I glanced at the second reading speech as you were talking. It says:

> The bill seeks to amend paragraph 44G(2)(a), so that declaration of a service cannot be recommended unless access to the particular service would promote a material increase in at least one market other than the market for the service.

That is what basically economically you are proposing.

Mr Tapp—That is correct.

Senator MURRAY—Further on in the second reading speech it says:

> The bill also clarifies and enhances—

I emphasise 'enhances'—

> the ACCC's existing powers when arbitrating access disputes.

That again, I think, is a useful change but one to which you do not have access. I want to put on record this quote from page 5 of the Western Australian government submission to the National Competition Council of October 2004, which we have as a submission—

CHAIR—Can I just interrupt. That is an annexure to your submission, Mr Tapp. It is not a submission to this committee.

Mr Tapp—That is correct.

Senator MURRAY—That is true. It says:

The State Government has long recognised the need for an efficient and effective rail access regime for the Pilbara iron ore railways. The inclusion of third party access clauses in State Agreements places an obligation on Agreement companies to carry third party freight—

that is very specific—

provided it does not unduly prejudice, or interfere with, their operations.

Can you confirm that the principal argument of BHP Billiton against access is in terms of that qualifying clause?

Mr Tapp—Yes. The reason why they are keen that we cannot access the National Competition Council is that they want to force us back onto the state agreement, to seek access through the state agreement, fully aware that the state agreement has this clause in it that enables them to keep everybody out.

When BHP started production, around 5 to 10 million tonnes a year went down this railway line. They have moved all the way from that level to now nearly 120 million tonnes a year. In that entire time, nobody has ever managed to get access to this railway, despite several attempts, because BHP have always claimed that letting anybody on would unduly interfere with or prejudice their operations.

Senator MURRAY—It is quite plain to me on the face of this bill, the second reading speech and the explanatory memorandum that the intention of the bill is to improve competition, infrastructure development and access to infrastructure. So, essentially, what you are saying is that the existing statute allows a legal stratagem to be used which defies the intention of the bill. Is that right?

Mr Tapp—That is correct. We want to get a hearing in front of the National Competition Council. They may decide against us, but at the moment we cannot even be heard by the National Competition Council because of this production process exemption.

CHAIR—I think it might be fairer to say that you are saying that, as interpreted by the court, the existing statute defines 'infrastructure' too narrowly.

Mr Tapp—Yes.

CHAIR—That is your point, really, isn't it?

Mr Tapp—Yes.

Senator MURRAY—All right. Chair, it seems to me the committee has to make a judgment as to whether there is a case for the government to consider.

Senator CHAPMAN—A minute ago, you indicated the extent of the increase in ore being produced at Mount Newman travelling down this line. Do BHP Billiton in fact have a valid argument that the line is being so extensively used to fulfil their transport needs that to introduce a second operator or user of the line would jeopardise the degree of access that they need?

Mr Tapp—At the moment I cannot have that argument with them in front of the National Competition Council because of the production process exception.

Senator MURRAY—They are the regulator.

Senator CHAPMAN—I understand that, but I am just asking—

CHAIR—Mr Tapp, you had that argument in a preliminary sense. In the previous court decision, that argument was had before Justice Kenny on the injunction application, which succeeded. So it is not as if the appropriate decision-making body has been foreclosed from making that determination. When the injunction application was heard, the Federal Court made a determination that was adverse to the interests that you now contend for. You disagree with the outcome, that is fair enough; but you cannot say that no relevant authority has been seized of the question.

Mr Tapp—No.

Senator CHAPMAN—Chair, I am asking a different question. I am not asking about the definition of the production process as against infrastructure. I am asking whether the extent to which BHP now need to use the line because of the volume of their production precludes another user.

Mr Tapp—If I can answer that question directly, it is a difficult technical question to define the capacity of a railway line, because the capacity of the railway line is very often quoted by the amount of ore that can be moved down that railway line using existing locomotives and ore cars. We are not proposing actually to access the railway using BHP's railways, their locomotives and their ore cars, their trains; we are proposing to put our own on the line. The capacity of the railway line depends on how big your trains are going to be and how much ore you put in. If you were to ask me whether I believe there is capacity on the railway line at the moment to take extra trains, the answer is yes.

Senator CHAPMAN—Without interfering with the timing of—

Mr Tapp—Without interfering with the timing.

Senator WEBBER—Knowing the railway line and knowing the local work force up there, there is actually capacity using existing infrastructure. It is not fully utilised at the moment.

Senator CHAPMAN—Do you have any views on this issue of the pricing principles that has been drawn to our attention by other witnesses?

Mr Tapp—No, I have not. Sorry, I am not sufficiently involved to give a good view of that.

CHAIR—Thank you very much, Mr Tapp. You are excused.

[6.55 pm]

ARCHER, Mr Bradford John Henry, Senior Adviser, Competition Policy Framework Unit, Competition and Consumer Policy Division, Markets Group, Department of the Treasury

BENSON, Ms Jane Fiona Mary, Acting Senior Adviser, Competition and Consumer Policy Division, Department of the Treasury

CHAIR—Welcome. It is not my custom to invite officers of the department to make an opening statement, so I think we will proceed directly to questions. I imagine you have been listening to the evidence. With the exception of the last witness, who had an entirely different issue, the focus of the other submissions was the omission from the amendments to part IIIA of the act of the pricing principles. Can you tell us why that is the case?

Mr Archer—Certainly. The decision to provide for the making of a legislative instrument to establish the pricing principles was one simply made to balance the objectives of providing certainty to industry but retaining a degree of flexibility should a future need be identified to amend those pricing principles once we have experience with their operation in practice. The government has made no indication that it intends to implement pricing principles that are different to those principles announced in its final response to the Productivity Commission review. The intention is to implement those principles that were announced but it was felt that it would be appropriate to retain a certain degree of flexibility greater than what would be provided for if the principles were legislated directly by inclusion in part IIIA.

CHAIR—The problem with that response, if I may say so, is the extent to which it involves a balancing exercise between certainty and flexibility. Every industry representative who has appeared before us today says that there is insufficient certainty. You have told us the government has no present intention to alter the announced pricing principles and the government has adopted recommendation 12.1 of the Productivity Commission report. I might read it onto the record so that people can see what we are talking about. It is very generic and anodyne and I am struggling to see why that decision needed to be made. For completeness, I will read it onto the record. The pricing principles which were recommended and the government I understand adopted are these:

The Australian Competition and Consumer Commission, in seeking to reduce access prices that are inefficiently high, must have regard to the following principles:

(a) that regulated access prices should:

(i) be set so as to generate expected revenue across a facility's regulated services that is at least sufficient to meet the efficient long-run costs of providing access to these services;

(ii) include a return on investment commensurate with the regulatory and commercial risks involved; and

(iii) generate revenue from each service that at least covers the directly attributable or incremental costs of providing the service.

(b) that the access price structures should:

(i) allow multi-part pricing and price discrimination when it aids efficiency;

(ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher.

(c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

From a superficial view, none of that strikes me as being other than highly generic and, as I said to an earlier witness, fairly anodyne. Do you want to respond, Mr Archer?

Mr Archer—I really do not have a lot more to add to the explanation than I have already provided.

CHAIR—That is fair enough; I know you have to be circumspect about policy.

Mr Archer—Having read some aspects of the submissions that the committee has received, there does seem to be a misunderstanding among some industry participants about what a 'legislative instrument' actually means.

CHAIR—You don't need to tell us what a legislative instrument means.

Mr Archer—No. Certainly there is a concern there that the government would have the ability to act without any parliamentary scrutiny whatsoever in amending the pricing principles and without necessarily undertaking any consultation. I think it is fair to note that that is not the case and that the legislative instrument would be subject to the Legislative Instruments Act and the requirements of that act.

Senator CHAPMAN—It is a disallowable instrument; that is what you are saying?

Mr Archer—Yes.

CHAIR—Again, do not feel the need to respond, but just to complete the point: I could understand that argument if either these principles were pioneering principles, the applicability of which had to be tested on a trial and error basis, in effect, or if they were so specific that there were doubts about the generality of their application. But these principles, I must say, do not strike me as being either dramatically new or original or lacking the quality of generality.

Mr Archer—I probably do not have anything further to add.

CHAIR—That is fair enough. Finally, let me make this point and then I will invite others to contribute if they wish: in the EM the government announced that it had agreed that statutory pricing principles be established in relation to part IIIA as one of the headline legislative objectives of the act, and when one looks at the other aspects of the bill, they are essentially fine tuning or largely of a procedural character. The pricing principles seem to me to be the whole pith and substance of the proposals, yet we do not see them. I must say that does strike me as being more than strange. You do not need to respond to that. Senator Webber, do you have any gratuitous observations to add to mine?

Senator WEBBER—Perhaps I could say initially that I agree with everything my good friend Senator Brandis has just raised. In pursuing this—and this could be gratuitous as well—if the pricing principles are not to be in the act, and you are saying it is a balance between flexibility and certainty for industry, what is the additional flexibility you are looking for that is not contained in the quote that Senator Brandis read out?

Mr Archer—In a sense the pricing principles are untested, so we can anticipate how they might operate, but we do not know for certain how they will operate. If we find after a couple of years, for example, of administration of the regime with the new principles that they are not working or they are creating more uncertainty than is anticipated, once appropriate amendments are identified, they can be implemented quite readily.

Senator WEBBER—But you can amend an act of parliament, too. I have been on this committee for three years and we seem to do six or seven TLA bills every year.

CHAIR—I was just thinking about that. If you are worried about the generality—

Senator WEBBER—We constantly amend and refine pieces of government legislation as problems are found with them, so why in three years time couldn't you amend this piece of legislation?

Mr Archer—Clearly, you could.

CHAIR—Let us face it: the government has a majority in the Senate and I have not heard that Senator Joyce is agitated about part IIIA of the Trade Practices Act.

Senator MURRAY—It is coming!

Senator WEBBER—It might be coming. His may be the sole vote against it!

CHAIR—That is a fair point that Senator Webber makes. As this evening's hearing has made it pretty clear, this is essentially a technical argument and an argument about legislative method. There does not seem to be any partisan dispute as to the policy wisdom of doing this.

Senator WEBBER—No, there is not.

Mr Archer—That is correct, and we do take some comfort from that but, again, I do not have anything further that I can say.

Senator WEBBER—In that case, is it the intention that the regulations will enforce the principles that the government initially said would be in legislation?

Mr Archer—That is correct.

Senator WEBBER—Are the regulations ready to go? If we pass this piece of legislation next week, are the regulations ready to go and when are we going to see them?

Mr Archer—They are not ready. If you pass the legislation next week, the relevant schedule of the act would not necessarily commence at that point.

CHAIR—But, if it is the case that the government's position is as announced—that is, to adopt recommendation 12.2, which I have just read into the record—all it would require would be to insert somewhere in section 44B, I dare say, that 'in making a determination the commission shall have regard to the following principles'.

Senator WEBBER—If we know what they are going to be—

Mr Archer—The chair's proposition is correct, although I think there would be an additional amendment to ensure that they were taking into account access undertakings and access codes.

Senator WEBBER—Is there a timeline for when we are going to see these regulations? The issue that all of industry has raised is certainty. We are going to give them a technical act and we have not argued about any other section of the act—except a new proposition that we have not considered before has been raised. We are going to give them a technical act that no-one seems to be too interested in. When are we actually going to see the piece that is going to give the certainty?

Mr Archer—For the time being, I think the certainty is provided by the government's final response, which was the announced policy. Clearly it is desirable that the regulations be in place in a timely fashion in conjunction with the commencement of the act, but I cannot give you—

Senator WEBBER—But that has not been set yet.

Mr Archer—I cannot give you a definitive time when that will happen.

CHAIR—But you can give us, and have given us, a definitive position.

Senator WEBBER—And we have had that before.

Mr Archer—Yes.

Senator MURRAY—Would you have any obvious counterpoint or objection to make if the committee were to recommend that, if you retain the approach of announcing these principles through a legislative instrument, we require that that determination be made within a set period? The bill does not say that, so it is possible for the determination never to be made.

Senator WEBBER—That is right.

Senator MURRAY—I think, if you are going to leave it as a legislative instrument, there needs to be some certainty as to when the determination will be made.

Mr Archer—I am not sure who you are asking me to speak on behalf of in answering.

Senator MURRAY—Do you have any objection to that? You might respond: 'Well, it's dependent upon some other activity, and therefore it has to be open-ended.' That is really what I want to know.

Mr Archer—I cannot see any reason for it being open-ended, but I cannot speak for the government.

CHAIR—So there is no functional or mechanical reason, which I think is what you were getting at, Senator Murray.

Senator MURRAY—That is right.

CHAIR—There is no functional, process related or mechanical reason it cannot be done.

Mr Archer—I do not think so; I think that, with the pricing principles themselves having been established, it should be a fairly straightforward matter to make the instrument.

Senator WEBBER—As Senator Brandis alerted us to earlier today, this legislation is in response to the Productivity Commission report from September 2001. Why has it taken so long to get to this point, and yet we still do not know when we are going to get to the crucial point? What has been the delay?

Mr Archer—That is a good question. Certainly, since the government's final response was announced, there has been a fairly substantial reform agenda for the Trade Practices Act, and there has to be a question of priorities being established. Since the government received the Productivity Commission's final report, the government has released an interim response and undertaken quite extensive consultation with states and territories. Those processes, of course, would have taken some time.

CHAIR—This is subject to the COAG agreement regarding getting the state and territory governments on side, isn't it?

Mr Archer—Certainly, part IIIA was introduced into the Trade Practices Act as part of the national competition policy agreements that were agreed by COAG in the 1990s.

CHAIR—That is my point. It is not as though the Commonwealth could have acted unilaterally?

Mr Archer—To the extent that it could amend part IIIA, it can do that unilaterally. There are no formal requirements.

CHAIR—But you would have to have a corresponding or mirroring amendment under the national competition principles, wouldn't you?

Mr Archer—It is desirable that you do have, and the government has announced its intention to pursue that with the states and territories. But that has not happened to date and the government is proceeding with the amendments to part IIIA.

CHAIR—It sounds to me as though it may be the states and territories that are the source of the delay?

Mr Archer—I would not speculate any further than to—

Senator WEBBER—The government could have amended part IIIA and provided some certainty, while wanting to cut—

CHAIR—You cannot do that without doing violence to comity and threaten the spirit—if not the letter—of the COAG agreement.

Senator MURRAY—Very briefly, I was rather attracted to the chair's proposition, which essentially was that you need both certainty and flexibility. What he was referring to was the idea that there should be core principles in the legislation, such as those already determined by the government, but with the ability to vary or make industry-specific additions to those principles on a flexible basis through delegated legislation. That would be very easy to do. You stick the principles in and you say, 'These principles may be varied for industry-specific purposes by a legislative instrument.' Is there anything wrong with that proposal? To use the chair's earlier summation, is there any functional or practical reason why that could not be a useful way of doing it?

Mr Archer—There is nothing that I can think of off the top of my head. There is already scope for that to happen. Once we establish these pricing principles under the national access regime in the sense that, where there are industry-specific access regimes, which are established by state and territory governments—which can be certified under part IIIA of the Trade Practices Act—they could, as part of those access arrangements, adopt pricing

principles which have features specific to the particular industry to which they relate. So, in a sense, that will still be a possibility, once we establish these pricing principles in the national access regime.

Senator MURRAY—What is in my mind and why I was attracted to the chair's proposition is I can see extraterritorial circumstances for some industries, where the pricing principles might need to be adjusted, simply because the other country has a different view or has a different perspective. I am thinking of, for instance, gas running from Papua New Guinea or East Timor waters or land. In those circumstances, that particular infrastructure might need industry-specific determinations. I would think that right up front you would need the flexibility to adjust. I thought the chair's idea was pretty sensible.

Mr Archer—It is difficult to comment on a hypothetical case. It would be interesting to see to what extent the pricing principles that we are establishing would provide flexibility to achieve the outcomes that one desires. But it may be the case that an argument can be made that there does need to be something done differently.

Senator MURRAY—Just to conclude this point, there is nothing obvious or self-evident to you from your consultations or study of this work which makes the chair's proposition difficult?

Mr Archer—Only that we are seeking to encourage the national access regime to provide a consistent framework on which industry access regimes might be modelled.

Senator MURRAY—That proposition does not oppose that?

Mr Archer—No, and, again, I am not precluding that there might be a case for deviation from the pricing principles.

CHAIR—I suppose the more you want to regard the principles as a template, the stronger the argument is for putting them in the act?

Senator MURRAY—That is exactly the point.

Senator CHAPMAN—The last witness we heard from was from Fortescue Metals. Do you have any response to the issues raised by him in the context of this legislation?

Mr Archer—The only observation I would make is that the Productivity Commission looked at the operation of this exemption in its review of the access regime and concluded that it should be retained, noting that there was evolving case law around its interpretation. The government accepted that recommendation of the commission. The commission also recommended that the use of the exemption be monitored and the interpretation of that exemption be continued to be monitored by the National Competition Council out of concern that it might be unnecessarily prohibiting access to infrastructure services. Again, the government accepted that that was the appropriate course of action.

Senator CHAPMAN—Over what time frame should it be monitored to see if any change might be required in a legislative form?

Mr Archer—I will have to check to see whether the commission had any particular time frame around that monitoring. The government agreed to conduct a review of the national access regime within five years of these amendments being implemented and it is to report

annually on the operation of the national access regime. So, again, that could provide an avenue to pick up fairly recent developments on that exemption.

Senator CHAPMAN—Can you give us the reference to the Productivity Commission's recommendation on that issue?

Mr Archer—Recommendation 6.4 of the Productivity Commission's report.

CHAIR—Just for clarification, I think I referred before to recommendation 12.2 of the Productivity Commission report. If I did, that was an error. The relevant recommendation is recommendation 12.1. Thank you, Mr Archer and Ms Benson.

Committee adjourned at 7.17 pm