EXECUTIVE OFFICE

Australian Competition & Consumer Commission

23 Marcus Clarke Street
Canberra ACT 2601

GPO Box 3131
Canberra ACT 2601

tel: (02) 6243 1111
fax: (02) 6243 1199

www.accc.gov.au

15 August 2016

The Hon. Ken Travers MLC
Deputy Chair
Standing Committee on Legislation
Parliament House
GPO Box A11
PERTH WA 6837

By email: lclc@parliament.wa.gov.au

Dear Mr Travers

Pilbara Port Assets (Disposal) Bill 2015

Thank you for your letter dated 23 June 2016 inviting the Australian Competition and Consumer Commission (**ACCC**) to comment on the proposed regulatory regime surrounding the *Pilbara Port Assets (Disposal) Bill 2015* (**the Bill**) and the disposal of the Utah Point Bulk Handling Facility (**Utah Point BHF**) at Port Hedland in Western Australia (**WA**).

The ACCC is pleased to provide its views to assist the Standing Committee on Legislation's (**the Committee's**) inquiry on this matter. As you would likely be aware, the ACCC has been advocating directly to governments and publicly for competition and regulatory issues to be appropriately considered and addressed upfront during the process of privatising government assets. Doing so provides both the potential owner and users of the asset a level of certainty regarding the transaction and how the asset will be regulated into the future and drives efficient outcomes for the long-term interests of Australians.

The attached document sets out the ACCC's views on market structure and regulatory regimes for facilitating pro-competitive arrangements in such asset sales, which the ACCC considers are relevant to the Utah Point BHF. These views have been developed based on the information attached to your letter as well as submissions and other documentation published on the Committee's website.

If you would like to discuss this letter or any issues contained in the attached document, please contact Matthew Schroder, General Manager Infrastructure & Transport - Access & Pricing Branch on (03) 9290 6924 or at matthew.schroder@accc.gov.au.

Yours sincerely

Rod Sims
Chairman

ACCC comments on market structure and regulatory regime that are relevant for the Utah Point BHF

The ACCC considers that the privatisation of government owned assets, if implemented appropriately, can be an effective way to promote efficient outcomes in the interests of users and the wider community.

The economic efficiency benefits will, however, only be realised where there is strong potential for competition or where, in the absence of competition due to monopoly or near monopoly characteristics, there are appropriate structural reforms and/or sufficient regulatory oversight put in place as part of the privatisation process.

In the ACCC's experience, three particular problems can arise where competition and regulatory issues are not properly considered and addressed as part of the privatisation process:

a) worsening or entrenching a market structure that is not sufficiently competitive, or could yield considerable benefits if it was made more competitive;

b) selling a monopoly or near monopoly asset to a bidder with existing or potential upstream or downstream interests, without ensuring that appropriate access arrangements will exist; and

c) selling monopoly or near monopoly assets without sufficient controls on pricing.

Regarding the proposed regulatory arrangements for the Utah Point BHF, the ACCC supports the implementation of a negotiate-arbitrate model regarding non-price terms of access. However, the ACCC considers that to be a more effective regulatory regime, recourse to independent and binding arbitration should be extended to include pricing as price is a key term of access. The ACCC would also prefer for the potential for vertical integration (both at the time of the sale and in the future) to be addressed upfront.

The following sections set out the ACCC's more detailed views on key competition and regulatory issues relevant to the proposed sale of the Utah Point BHF, namely:

- market structure; and
- economic regulation of monopoly or near monopoly infrastructure.

In forming these views the ACCC notes it has reviewed the WA Department of Treasury's submission to the Committee (dated 26 April 2016), which sets out details on what is likely to be included in the Regulations for the Utah Point BHF. However, it should also be noted that the majority of the details on the proposed access and pricing arrangements for this privatisation are to be set out in Regulations, which the ACCC has not seen.

Accordingly, the views in this document should not be taken as a complete and final view on the adequacy of the proposed regime. The ACCC would certainly be happy to engage with the WA government on the specific details of the Regulations when they become available.

Market structure

As privatisation will often drive future market structures, the ACCC considers that privatisation almost always provides an opportunity to maintain or create a competitive market structure for the future. Even if a purchaser of a privatised asset has no upstream or downstream interests at the time of sale, the sale may provide them with incentives to vertically integrate into related markets at a later time.

Importantly, if the privatised owner is or becomes vertically integrated, it will have an incentive to discriminate in favour of its own related entities. In the ACCC's view, behavioural arrangements, such as ring-fencing obligations, to address vertical integration concerns cannot replace full structural separation. This is because the privatised owner and its related entity may seek to circumvent the obligations in order to maximise their combined profit by, for example, allocating shared costs and revenues in ways that advantages its competitive services even within the constraints of an accounting separation regime. Further, compliance with information sharing restrictions and equivalent access obligations can be difficult to monitor and enforce because, in the absence of sufficient transparency about the services the privatised owner provides its related entity, a regulator or competitor may not be able to determine whether equivalent access is being provided.

While the ACCC cautions against imposing unnecessary restrictions on firms' ability to participate in markets, where the sale of an asset is likely to confer enduring market power, the ACCC sees benefit in legislative restrictions on vertical integration. This may involve the exclusion of certain parties who operate up and/or downstream from bidding for the asset during the privatisation process, and the imposition of limits on the vertical integration interests the lessee may have in the future.

In the case of the Utah Point BHF, the ACCC notes that the result of such restrictions would be consistent with the current market structure as the Pilbara Ports Authority does not compete in the upstream (mining) or downstream (export) markets. In this regard the ACCC notes the Victorian Government's decision to restrict stevedores from bidding for the long-term lease of the Port of Melbourne.

Economic regulation

The Utah Point BHF provides an important service for miners and exporters in the Pilbara region. Without sufficient regulatory arrangements being put in place during the privatisation process, the privatised owner will have the incentive and ability to use its market power to raise prices above efficient levels and/or reduce service quality.

The ACCC notes that the appropriate form of economic regulation and the mechanism used to implement the arrangements is not a 'one size fits all' exercise and depends on the type of market and the nature of the competition concerns relevant to the circumstances.

There is a range of possible regulatory tools, including:

- monitoring and information gathering which, although not price regulation, can be a useful tool to provide information to governments, regulators and the wider community about the transitional impact of deregulation and other reforms on price levels in particular industries;
- negotiation and arbitration in relation to price and non-price terms, such as where access is required to a monopoly service in order to compete in an upstream or downstream market; and
- ex-ante (upfront) determination of terms and conditions including price, such as where access is required to a monopoly service, or case-by-case negotiation is impractical.

The ACCC has previously expressed its preference for access and pricing arrangements around monopoly infrastructure to, at a minimum, be based on a publish-negotiate-arbitrate framework.[1] The key features of an effective publish-negotiate-arbitrate regime are:

---

[1] ACCC, *How did the light handed regulation of monopolies become no regulation?*, Speech by ACCC Chairman Rod Sims, 29 October 2015, http://www.accc.gov.au/speech/how-did-the-light-handed-regulation-of-monopolies-become-no-regulation.

- a requirement that the access provider publish its standard terms and conditions (including price) for regulated services;
- a robust negotiation framework to facilitate negotiations between access providers and access seekers over the standard terms, conditions and prices; and
- recourse to arbitration by an independent economic regulator in the event that negotiations fail.

Importantly, such a framework allows for commercial negotiations to take place. In doing so the framework also provides access seekers with a degree of leverage when dealing with the monopoly infrastructure owner/operator through the threat of referring a dispute over prices or other terms of access to binding independent dispute resolution.

Access

The ACCC notes that there are proposed to be overarching obligations on the privatised owner of the Utah Point BHF to negotiate in good faith, to not unreasonably discriminate between users and to not hinder access. The ACCC considers that such obligations are a good starting point and support the general aims of an effective access regime. As previously noted, however, it would be important that these obligations were sufficiently strong in the event that the privatised owner is, or is able to become vertically integrated into upstream or downstream markets.

In relation to the more specific access arrangements for the Utah Point BHF, the ACCC notes the proposal for a publish-negotiate-arbitrate framework, which includes:

- publication obligations requiring the terminal operator to publish and comply with an access policy, capacity management policy as well as a capacity resumption policy to ensure that capacity does not go unutilised; and
- the ability for users to enter into commercial negotiations for access, with recourse to independent and binding arbitration on non-price terms if negotiations fail.

The ACCC welcomes these arrangements. The ACCC also notes that the proposed regulatory regime allows for reviews of the access arrangements by the Regulator and for the relevant Minister to amend the arrangements on access.

The ACCC notes, however, that price is a key term of access. Accordingly, the ACCC is of the view that to be more effective the proposed negotiate-arbitrate model should include recourse to binding independent dispute resolution for both price and non-price terms. In the case of the currently proposed access arrangements for the Utah Point BHF, this would simply mean an extension of the existing proposal to also allow for independent and binding dispute resolution in relation to prices.

Prices

The ACCC notes that the proposed pricing regime for the Utah Point BHF is price monitoring against a specified benchmark (such as the Consumer Price (CPI) Index). The ACCC notes that the proposal also includes scope for reviews by the Regulator and subsequent amendment to the pricing regime by the relevant Minister.

As a general observation, the ACCC notes that appropriate starting price levels are an important consideration in any such benchmarking exercise, particularly the extent to which starting prices reflect efficient costs. A further point of note is that even where starting prices are set at efficient levels, increasing prices in line with a benchmark such as the CPI does not necessarily mean that prices will continue to reflect efficient costs over time. For example, increasing volumes could mean that the average cost of providing services may actually decrease over time while, at the same time, revenues increase due to both higher volumes and prices. This could essentially result in an increasing gap between costs and revenues and (potentially) monopoly rents.

For the above reasons as well as a general lack of strict enforcement, the ACCC has previously expressed strong concerns regarding the effectiveness of price monitoring to constrain monopoly pricing. While price monitoring is used in some industries to provide additional transparency, without the credible threat of regulatory intervention and/or independent binding arbitration, monitoring alone is unlikely to be an effective deterrent against monopoly pricing.

That is not to say that the ACCC considers that price monitoring as proposed for the Utah Point BHF would not be useful. The ACCC recognises that the proposed price monitoring arrangements, together with the ability for reviews and amendments to the pricing regime, may provide some constraint on pricing and would, at the very least, increase transparency around pricing practices. However, the extent of the constraint would ultimately depend on the timeliness and propensity for change to the regime if concerns are raised, as well as the ongoing appropriateness of the pricing benchmarks. The ACCC also notes that allowing for change of the pricing regime may create a level of uncertainly around the extent and nature of price regulation for both the private owner and the users.

As discussed above, the ACCC's view is that extending the existing proposal for recourse to independent and binding arbitration to include prices would provide a credible constraint on monopoly pricing while still allowing users to commercially negotiate access terms. Indeed, the price monitoring as proposed for the Utah Point BHF would provide a useful starting point for such negotiations.

In the ACCC's view, a negotiate-arbitrate model would provide an effective incentive to deter monopoly pricing. This is also consistent with the ACCC's preference for negotiate-arbitrate models in the absence of a comprehensive ex-ante pricing regime.

Enforcement of regulatory arrangements

Appropriate compliance monitoring and enforcement tools need to be available in relation to the regulatory arrangements, including for both price and non-price aspects.

The ACCC notes that the proposed enforcement tools for the Utah Point BHF will be a combination of oversight by the Regulator, self-regulation and the State through the lease agreement. As a general principle, the ACCC is of the view that access and pricing arrangements, including enforcement options by the Regulator, should be included upfront either in legislation or regulations, which provides transparency around the arrangements.

The ACCC considers that, in the absence of recourse to independent and binding dispute resolution for access seekers, private contractual arrangements between the lessor and lessee of an asset are not an effective way of regulating price or access. This is because any such regulation by contract would require the lessor to be prepared to dedicate sufficient resources to ensure the objectives of the arrangements are met. Further, a contract can be varied at any time with the consent of the parties, and any breaches of the contract may be waived or insufficiently enforced.

As noted above, the ACCC's view is that there should be available recourse to independent and binding arbitration in relation to both price and non-price terms of access. Such an arbitration mechanism would strengthen the discipline on pricing, while the proposed price monitoring arrangements and suite of enforcement tools would provide additional pricing oversight.