APA Group: coverage criteria in the National Gas Law

OPINION

1. We have been asked to consider a number of questions relating to the coverage criteria in the National Gas Law and to provide APA Group with an opinion on those questions.

Introduction and background

2. In response to recent reviews conducted by the Australian Competition and Consumer Commission\(^1\) (ACCC) and the Australian Energy Market Commission\(^2\) (AEMC), the COAG Energy Council is examining whether a new test for determining if a gas transportation pipeline should be subject to economic regulation is needed.\(^3\) To this end, on 4 October 2016, the COAG Energy Council published a consultation paper by Dr Michael Vertigan AC concerning the current test for the regulation of gas pipelines (Consultation Paper).

3. The ACCC’s report, Inquiry into the East Coast Gas Market (ACCC Inquiry Report) recommended that the COAG Energy Council agree to replace the current test for the regulation of gas pipelines in the National Gas Law (NGL) with a new test.\(^4\) The new coverage test proposed by the ACCC would be that pipelines would be covered where the relevant Minister is satisfied that:

   a. the pipeline has substantial market power;

   b. it is likely that the pipeline will continue to have substantial market power in the medium term; and

   c. coverage will or is likely to contribute to the achievement of the national gas objective (ACCC Proposed Test).\(^5\)

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\(^1\) ACCC, Inquiry into the East Coast Gas Market, April 2016 (ACCC Inquiry Report).


\(^3\) Michael Vertigan, Examination of the Current Test for the Regulation of Gas Pipelines, 4 October 2016 (Consultation Paper).

\(^4\) ACCC Inquiry Report, 11.

\(^5\) ACCC Inquiry Report, 11. The national gas objective is set out in section 23 of the National Gas Law and provides: “The objective of this Law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas”.

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4. The current test for the regulation of gas pipelines is embodied in the pipeline coverage criteria in section 15 of the NGL, which are as follows:

a. that access (or increased access) to pipeline services provided by means of the pipeline would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the pipeline services provided by means of the pipeline (criterion (a));

b. that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline (criterion (b));

c. that access (or increased access) to the pipeline services provided by means of the pipeline can be provided without undue risk to human health or safety (criterion (c));

d. that access (or increased access) to the pipeline services provided by means of the pipeline would not be contrary to the public interest (criterion (d)).

5. The coverage criteria in the NGL essentially mirror the "declaration" criteria in the national access regime set out in Part IIIA of the Competition and Consumer Act 2010 (Cth) (CCA). The declaration criteria are the matters about which the relevant Minister must be satisfied before declaring a service. Relevant for the purposes of this advice is criterion (a) which provides:

that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;

6. The Productivity Commission in its 2013 inquiry report\(^6\) on the national access regime recommended that criterion (a) be amended so that it becomes a comparison of competition without and without access on reasonable terms and conditions through declaration.\(^7\) The recent competition policy review chaired by Professor Ian Harper (Harper Review) agreed with the Productivity Commission's recommendation to re-focus criterion (a) on the specific effect of declaration.\(^8\)

7. The Australian Government has supported the Productivity Commission's recommendation to amend criterion (a) and recently released an exposure draft of the relevant amending legislation (Exposure Draft).\(^9\) The exposure draft criterion (a) is as follows:

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that access (or increased access) to the service, on reasonable terms and conditions, following a
declaration of the service would promote a material increase in competition in at least one market
(whether or not in Australia), other than the market for the service;

8. In light of the above context we have been asked to provide advice on criterion (a), including the
prevailing judicial interpretation of criterion (a) and the application of the current and exposure
draft versions of criterion (a) in particular contexts. Our advice on the questions we have been
asked is set out below.

Consider the alternative judicial interpretations of criterion (a) including the formulation of the
‘with and without access’ test and the ‘with and without declaration’ test and provide an
opinion on the prevailing judicial interpretation of criterion (a)

9. As a preliminary matter, we note that the phrase “with and without declaration” might connote
different things to different people. We understand the phrase to be a shorthand reference to
the formulation of criterion (a) in the Exposure Draft, which essentially directs consideration to
whether access (or increased access) on reasonable terms and conditions following declaration
would promote a material increase in competition.

10. The relevant authority on the interpretation of criterion (a) is the Full Federal Court decision in
Sydney Airport Corporation Ltd v Australian Competition Tribunal (2006) 155 FCR 124 (Sydney
Airport). The Court concluded in that case that the relevant comparison is between “access
and no access and limited access and increased access”.

We disagree with this approach whereby “access” becomes “declaration under Part IIIA”.
Whilst Part IIIA is entitled “Access to Services”, the two stage approach, if engaged, does not
necessarily lead to access or increased access to the service for anyone...But “access” is an
ordinary English word. Taking into account the context and background, we think that in this
part of s 44H, the word “access” is being used in its ordinary English sense. Virgin is correct
in its submission that all s 44H(4)(a) requires is a comparison of the future state of competition
in the dependent market with a right or ability to use the service and the future state of
competition in the dependent market without any right or ability or with a restricted right or
ability to use the service.

We do not accept the Tribunal’s basis for rejecting the submission that it would be unrealistic
to undertake a counterfactual analysis which discounts the fact that Virgin has access. That,
with respect, is not the point. The terms of s 44H(4)(a) do not incorporate the requirement for
comparison with what is factually the current position in any given circumstances.

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10 Sydney Airport Corporation Ltd v Australian Competition Tribunal (2006) 155 FCR 124, 146 (French, Finn and Allsop JJ)
(Sydney Airport).

11 Sydney Airport, 147 [83]–[84].
11. The Court in *Sydney Airport* did not consider that its approach to the counterfactual being “with and without access” had the consequence that facts about access to the service being provided and the terms and conditions on which access was being provided were irrelevant. The Court considered that the behaviour of the service provider and the impact of that behaviour on the market could be relevant to whether a declaration should be made.\textsuperscript{12} This is an apparent reference to the Court’s finding that even if all of the criteria are satisfied, there is a residual discretion not to declare the service. The Court stated that after the criteria have been dealt with, the decision whether or not to declare a service “may be affected by a wide range of considerations of a commercial, economic or other character not squarely raised by, nor falling within, the necessary preconditions”.\textsuperscript{13}

12. However, the High Court in case of *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 246 CLR 379 (*Pilbara HC*) held that there is no residual discretion to be exercised if the declaration criteria are satisfied.\textsuperscript{14}

If the Minister is satisfied of all of the six criteria, including in particular that access (or increased access) to the service would not be contrary to the public interest, no satisfactory criterion or criteria could be devised which would guide the exercise of some residual discretion...That is, if the Minister, having considered the matter, is satisfied of all of the six criteria, the Minister must declare the relevant service.

13. In *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136 (*Fortescue Metals*), the Tribunal applied the approach of the Court in *Sydney Airport* noting that “access” in criterion (a) means “access simpliciter”, being the right or ability to use the service as opposed to the right or ability to use the service under Part IIIA.\textsuperscript{15} However, in connection with its consideration of criterion (f) (that access or increased access is not contrary to the public interest), the Tribunal concluded that while the approach in *Sydney Airport* does not permit a detailed consideration of the likely terms of access that might be imposed under Part IIIA, it does allow for the assumption that access will be on reasonable terms.\textsuperscript{16} The Tribunal’s approach to criterion (f) was to make some broad assumptions about the nature of access on reasonable terms and conditions, and also consider issues of substitutability and the effect of access being taken up.\textsuperscript{17} The Tribunal noted that this approach could have the following consequence:\textsuperscript{18}

\textsuperscript{12} *Sydney Airport*, 147 [85].
\textsuperscript{13} *Sydney Airport*, 137 [39].
\textsuperscript{14} *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 246 CLR 379, 423 [116] (French CJ, Gummow, Hayne, Crennan, Kiefel, Bell J, Heydon J agreeing, 452 [193]).
\textsuperscript{15} *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136, 310 [1059].
\textsuperscript{17} *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136, 329 [1166].
\textsuperscript{18} *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136, 330 [1167].
There may be a finding that access simpliciter is in the public interest (or, more correctly, that access is not contrary to the public interest), but taking into account the effects of both a declaration and access under Pt IIIA, a different conclusion might be reached.

14. Thus, the Tribunal's view that consideration could be given to the likely terms of access that might be imposed under Part IIIA was based on the fact that it had a residual discretion not to declare a service where the statutory criteria are satisfied.\(^{19}\) As noted above, the High Court has held that no residual discretion exists. On appeal, in the case of Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal (2011) 193 FCR 57 (Pilbara FC) the Full Federal Court endorsed the Tribunal's approach in Fortescue Metals to criterion (f), namely that it requires the Tribunal to consider the consequences of access.\(^{20}\) The Full Court expressed its conclusion by saying that in criterion (f) "access" meant "access on reasonable terms and conditions as may be determined in the second stage of the Part IIIA process".\(^{21}\)

15. On this state of authority, it must be acknowledged that the prevailing interpretation of criterion (a) is as set out in Sydney Airport—what is required is a comparison of the future state of competition in the dependent market with a right or ability to use the service, and the future state of competition in the dependent market without any right or ability or with a restricted right of ability to use the service. However, this interpretation was predicated, at least to some extent, upon the existence of a residual discretion. Without that residual discretion, there are some aspects of the prevailing approach that are not entirely convincing. In particular, where the issue is one of "increased access" this phrase in its terms appears to invite an inquiry as to the incremental benefit on the promotion of competition from access on improved terms and conditions, which in turn would logically require some view to be formed as to the existing level and terms of access and what the improved terms and conditions of access might be. In these circumstances it is not self-evident why the current state of access should not be (indeed, cannot be) considered.

16. It is possible that, in light of the High Court's determination that if the criteria are satisfied there is no residual discretion not to declare a service, a different interpretation will be placed on criterion (a). The Tribunal considered this issue in Application by Glencore Coal Pty Ltd [2016] ACompT 6 (Glencore). The Tribunal concluded that it was bound by the decision in Sydney Airport, which it considered made clear that there was no place in criterion (a) for consideration of the current factual position with respect to access to the service.\(^{22}\)


\(^{20}\) Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal (2011) 193 FCR 57, 104 [117].

\(^{21}\) Pilbara, [112]

\(^{22}\) Application by Glencore Coal Pty Ltd [2016] ACompT 6, [92] (Glencore).
possibly criterion (f). Therefore, even if Sydney Airport FC suffered from the residual
discretion error (subsequently identified in Pilbara HC) it does not undermine the comments
made there in relation to criterion (a). The Tribunal’s consideration of the Full Court’s reasons
leave it convinced that the reasoning of the Full Court on the proper consideration and
application of criterion (a) does not permit it to decline to follow Sydney Airport FC concerning
criterion (a).

17. The Tribunal’s decision in Glencore is the subject of a judicial review application by the Port of
Newcastle. In recognition that the Court may be invited to depart from the decision in Sydney
Airport, the application will be before a bench of five. On appeal it is likely that the Federal
Court will need to give careful consideration to the correct approach to be taken to criterion (a).
The Court may be required to re-examine a number of aspects of criterion (a) and to deal with
the apparently conflicting approaches to the term “access” when it is used in criterion (a), as per
Sydney Airport, and where it is used in criterion (f) as per Pilbara FC. In so doing the Court will
also need to consider what approach to the interpretation of “access” is sensible given the
reference to “increased access” in criterion (a). The appeal of the Tribunal’s decision in
Glencore is set down for hearing in late November 2016 and the decision in that case might
significantly change the approach to be taken to criterion (a).

18. The effect of the amendment to criterion (a) in the Exposure Draft is to allow for the assumption
that access will be on reasonable terms following a declaration in considering whether access
(or increased access) will promote a material increase in competition. It embeds the approach
taken by the Federal Court in Pilbara FC with respect to criterion (f) in criterion (a)—that is,
that “access” in criterion (a) is access on such reasonable terms and conditions as may be
determined in the second stage of the Part IIIA process.

19. The proposed amendment as set out in the Exposure Draft would essentially change the
framework for the inquiry to be undertaken pursuant to criterion (a) from that expounded by the
Federal Court in Sydney Airport to that which the Full Court in Pilbara applied to access in
criterion (f). Pursuant to Sydney Airport the inquiry is simply whether access (or increased
access) will promote a material increase in competition, in which there is no role for
assumptions to be made about the likely terms and conditions of that access. Under Pilbara,
and in the context of criterion (f), the inquiry is whether access (or increased access) on
reasonable terms and conditions following declaration will promote a material increase in
competition, which allows for some broad assumptions to be made as to those terms and
conditions, but does not require a precise identification of those terms and conditions.

23 Port of Newcastle Operations Pty Ltd ACN 165 332 990 v The Australian Competition Tribunal & Anor, Federal Court File
Number NSD1147/2016.
24 Dowsett, Besanko, Middleton, Foster, Griffiths JJ.
26 Pilbara FC, [112].
20. We do not see the positions between the “with and without access” approach in Sydney Airport and the approach that would be required under the Exposure Draft to be vastly different. The major difference between the two approaches is that the Exposure Draft leaves open the extent to which consideration is given to the present conditions of access in determining whether access on reasonable terms and conditions following declaration will promote a material increase in competition. However, we recognise that this difference might be important in a given case.

In respect of each of the current form of criterion (a) and the formulation of criterion (a) as set out in the Exposure Draft: consider whether the criterion may be satisfied in situations involving services providers that are not vertically integrated and / or monopoly pricing

21. Either the current form of criterion (a) and the formulation of criterion (a) in the Exposure Draft are apt to apply to vertically integrated or non-vertically integrated service providers. The only difference where non-vertically integrated service providers are involved is that relevant inquiry is almost always likely to be one of whether “increased access” would promote a material increase in competition because a non-vertically integrated service provider has an incentive to provide access.

22. The Hilmer Report observed that in situations where the service provider is not vertically integrated it is possible that a lighter form of regulation may be appropriate (such as price monitoring or surveillance) as the provider will usually have little incentive to deny access.\textsuperscript{27} However, the report states that whether the issues arising in relation to a particular facility owned by a non-vertically integrated service provider would be best addressed under the access regime or the prices oversight process “would be considered on a case-by-case basis”.\textsuperscript{28} That is, the Hilmer Report considered that the general access regime both could and should apply to non-vertically integrated service providers.

23. The Productivity Commission, following its 12-month review of the national access regime, did not identify any difficulty associated with the application of that regime to non-vertically integrated service providers.\textsuperscript{29} The Productivity Commission report noted that non-vertically integrated service providers will usually have little incentive to deny access, however such service providers may still have an ability and incentive to charge monopoly prices, which can lead to allocative inefficiency and restrict competition and investment in dependent markets.\textsuperscript{30} The Productivity Commission thus concluded that there were sound reasons for the national access regime to apply to both vertically integrated and separated service providers.\textsuperscript{31}

\textsuperscript{27} Fredrick Hilmer, Mark Rayner, Geoffrey Taperell, National Competition Policy, 25 August 1993, 240–241.
\textsuperscript{28} Fredrick Hilmer, Mark Rayner, Geoffrey Taperell, National Competition Policy, 25 August 1993, 240–241.
24. The Tribunal and the courts have certainly not faced any difficulty in applying criterion (a) to non-vertically integrated service providers. The most recent application being in Glencore, where the Tribunal’s determination notes that the service provider (Port of Newcastle Operations) is not vertically integrated in any dependent market in any material way.\textsuperscript{32} Similarly, in Sydney Airport there was no problem associated with the application of criterion (a).

25. As noted by the National Competition Council (NCC) in its recommendation to the Minister on declaration of the services that were the subject of the Sydney Airport decision, the fact that an application for declaration concerns a non-vertically integrated service provider may shift the focus of the inquiry, but does not result in some problem in applying the criteria.\textsuperscript{33}

\ldots{}SACL noted that ‘airport services are not vertically integrated’\ldots{}The Council has taken this to mean that SACL is not vertically integrated in a way that would enable it to engage in strategic behaviour to advantage a vertically related affiliate. The Council is also unaware of any other arrangement SACL may have with a functionally distinct entity, such as an airline, that would cause SACL to leverage its market power to advantage that entity and itself. Accordingly, the Council will focus its enquiry on market power to a consideration of whether SACL has the ability and incentive to impose terms and conditions of access that result in the extraction of monopoly returns, such as by charging monopoly prices for the provision of the Airside Service.

26. It follows from the above that no difficulty arises in applying criterion (a) to monopoly pricing, in either its present form or in the form set out in the Exposure Draft. Indeed, as noted by the NCC, when dealing with an application for declaration in respect of a non-vertically integrated service provider, the inquiry is likely to be directed to whether there is an incentive to charge monopoly prices. Of course, the inquiry under criterion (a), in either form, does not stop there. Not only must there be an ability and incentive to exercise market power (by charging monopoly prices), any use of that market power in that way must be likely to adversely affect competition in a dependent market in order to satisfy the requirement that access (or increased access) would promote a material increase in competition in that dependent market.

Consider whether the correct interpretation of the words ‘promote a material increase in competition’ involves an assessment of the impact on the conditions or environment for improving competition and the process of competition in the dependent market, rather than an assessment limited to the impact on the number of competitors in the dependent market.

27. We consider that the phrase in criterion (a), that access (or increased access) to the service would “promote a material increase in competition”, is directed to a consideration of the conditions or environment for improving competition and the process of competition in relevant

\textsuperscript{32} Glencore, [149].
\textsuperscript{33} National Competition Council, Application by Virgin Blue for Declaration of Airside Services at Sydney Airport: Final Recommendation, November 2003, 62 [6.105].
dependent markets, as opposed to a consideration of the number of competitors in those markets. While the number of competitors in the dependent market might tell you something about the competitiveness of a market, the conditions for competition are also relevant. For example, as noted by the Tribunal in the context of telecommunications access regulation, addressing barriers to entry into a market is likely to affect the level of competition in a market even if entry (or further entry) does not occur:

The Tribunal acknowledges that the competitiveness of a market cannot be measured simply by the number of firms in the market, their market shares and the market concentration. That can only be the starting point of the analysis. A feature that is "equally important"…or simply another factor that must be brought to account, is the ease of market entry…entry conditions are important in assessing competition in a market, first because the number of firms in the market is partially determined by the cost of entry as well as by factors such as economies of scale. Hence entry conditions play a role in determining concentration. Second, entry conditions determine the extent of potential competition. Most courts and economists accept ease of entry by potential competitors is likely to affect the competitiveness of the actual competitors.34

28. It is clear from a number of Tribunal cases that the words 'promote a material increase in competition' involve an assessment of the impact of access on the conditions or environment for improving competition and the process of competition in the dependent market, as opposed to the impact of access on individual competitors. For example in Re Sydney International Airport (2000) 156 FLR 10, the Tribunal observed:35

The Tribunal does not consider that the notion of "promoting" competition in s 44H(4)(a) requires it to be satisfied that there would be an advance in competition in the sense that competition would be increased. Rather, the Tribunal considers that the notion of "promoting" competition in s 44H(4)(a) involves the idea of creating the conditions or environment for improving competition from what it would be otherwise. That is to say, the opportunities and environment for competition given declaration, will be better than they would be without declaration.

We have reached this conclusion having regard, in particular, to the two stage process of the Pt IIIA access regime. The purpose of an access declaration is to unlock a bottleneck so that competition can be promoted in a market other than the market for the service. The emphasis is on "access", which leads us to the view that s 44H(4)(a) is concerned with the fostering of competition, that is to say it is concerned with the removal of barriers to entry which inhibit the opportunity for competition in the relevant downstream market. It is in this sense that the Tribunal considers that the promotion of competition involves a consideration that if the

34 Application by Chime Communications Pty Ltd (No 2) [2009] ACompT 2, [51].
conditions or environment for improving competition are enhanced, then there is a likelihood of increased competition that is not trivial.

The Tribunal is concerned with furthering competition in a forward looking way, not furthering a particular type or number of competitors.

Consider the extent to which jurisprudence on criterion (a) indicates that the reference to ‘competition’ in criterion (a) functions as a proxy for economic efficiency

29. We do not think that it is correct to say that the reference to competition in criterion (a) functions as a proxy for economic efficiency. Rather, criterion (a) in Part IIIA is directed at improving the conditions or environment for competition, in order to achieve the objects of Part IIIA which include the promotion of the economically efficient operation of, use of and investment in the infrastructure by which services are provided. That is, competition is not a proxy for economic efficiency, rather economic efficiency is achieved through improved conditions for competition.

30. Criterion (a) directs the decision-maker considering an application for declaration to consider whether access (or increased access) to the service would promote a material increase in competition in at least one market other than the market for the service. In circumstances where this criterion (together with the other criteria) is satisfied, the service will be declared. This is consistent with the object of the CCA, which includes to enhance the welfare of Australians through the promotion of competition.\(^{36}\)

31. Importantly, the promotion of “efficiency” in the provision of infrastructure-based services is not an object to be pursued in and of itself. Rather, as made clear in the objects of Part IIIA,\(^ {37}\) promotion of the economically efficient operation of, use of and investment in the infrastructure by which services are provided is undertaken in order to promote effective competition in upstream and downstream markets. This promotion of competition then links to the broader object of the CCA which, as noted above, is to enhance the welfare of Australians.

32. The same analysis applies to criterion (a) in the NGL, i.e., criterion (a) treats the promotion of competition as the relevant means of achieving the national gas objective.

Consider the extent to which regard must be had to the commercial terms and conditions of access

33. As discussed above, pursuant to the decision of the Full Federal Court in *Sydney Airport*, and as applied by the Tribunal in *Glencore*, the current framework of inquiry under criterion (a) pays no regard to the commercial terms and conditions of access. Under the Exposure Draft

\(^{36}\) CCA, section 2.

\(^{37}\) CCA, section 44AA sets out the objects of Part IIIA which include to “promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets”.

formulation of criterion (a), for the purposes of conducting the analysis of the impact of access (or increased access) following declaration, the precise terms and conditions of access are assumed to be reasonable, which does not require speculation as to what terms and conditions might be determined in any arbitration process.

Consider each of the ACCC Examples and provide an opinion on whether criterion (a) of the current NGL pipeline coverage criteria is likely to be satisfied if changes to criterion (a) are made as set out in the Exposure Draft. Consider whether the position would be different applying the “with and without access” test.

34. As a preliminary observation, the ACCC Examples do not provide a useful illumination of whether the ACCC Proposed Test would bring about better outcomes relative to the current formulation of criterion (a) or the Exposure Draft formulation of criterion (a). This is because many other facts would be relevant and necessary before a determination could be made as to whether coverage of the pipelines in the examples is desirable. The conclusions the ACCC reaches based on the examples amount to no more than unsubstantiated assertions.

Example A: The elimination of monopoly pricing on a pipeline that is used by two retailers to supply gas to a regional area may not give rise to any change in competition in the retail market (for example, because the scale of the market may be too small to attract any other competitors) but could still benefit consumers in the region if the cost savings are passed on

35. Under either formulation of criterion (a), the services provided by the pipeline would likely satisfy criterion (a). Assuming the gas transportation services provided by the pipeline are a necessary input for effective competition in the downstream retail market, access (or increased access) to those services would promote a material increase in competition in (at least) that market. As identified above, it is not necessarily to the point that other competitors may not enter, since improving the conditions for entry itself may promote the environment for competition.

36. It is likely in this scenario that other upstream and downstream markets would be relevant, including gas production markets and the markets in which any users or potential users of the gas participate. To form a better view, more would need to be known about other users and potential users (including the customers the retailers supply to) and the state of competition in these downstream markets.

37. The example concludes that elimination of monopoly pricing could benefit consumers in the region if cost savings are passed on. There are two important assumptions here: first, that if the services provided by the pipeline were regulated, the tariffs paid by the retailers would be lower; second, that the retailers would pass through the lower tariffs to consumers. It is not clear from the facts that either of these assumptions would be borne out.
38. In the absence of more detail on the scenario outlined in Example A, it cannot be said that the ACCC Proposed Test would bring about a better outcome relative to the current formulation of criterion (a) or the Exposure Draft formulation.

Example B: Restricting a pipeline operator’s ability to effect a wealth transfer from producers can also be expected to result in efficiency improvements in the upstream market, but may not have any effect on the level of competition in this market if it results in existing producers carrying out more exploration and supplying more gas into the market. In this example, there would be an efficiency improvement and an improvement in consumer welfare but no change to the level of competition.

39. In Example B, it appears to be the case that the relevant pipeline has market power because it is stated to have the ability to effect a wealth transfer from producers. In this case, and assuming the gas transportation services provided by the pipeline are a necessary input for effective competition in the markets in which the producers are active, there does not appear to be any reason why the present formulation of criterion (a) or the Exposure Draft formulation would not apply. The example notes that limiting the ability to effect a wealth transfer would result in efficiency improvements in the upstream market, through greater levels of exploration and supplying more gas, but there would be no change to the level of competition. It is unclear from the example how gas producers supplying more would not result in a change to the level of competition in at least one dependent market. The fact that there may be no increase to the number of competitors is not to the point, rather as discussed above, the relevant question is whether there is any improvement to the condition or environment for competition.

40. As with Example A, more facts would be required to form a view about the application of criterion (a), in particular the users and potential users and the state of competition in downstream markets.

41. In the absence of more detail on the scenario outlined in Example B, it cannot be said that the ACCC Proposed Test would bring about a better outcome relative to the current formulation of criterion (a) or the Exposure Draft formulation.

Example C: Eliminating monopoly pricing on a pipeline that is used to supply a mining company competing in a global commodities market that is already workably competitive could result in greater investment by the mining company (that is, because the risk of hold up is reduced) and increase the volume of commodities it supplies into the market. If the mining company is a lower cost operator, then the increase in supply would displace higher cost suppliers and the equilibrium commodity price would fall. In this example, restricting a pipeline operator’s ability to engage in monopoly pricing would result in an improvement in
economic efficiency and consumer welfare but would have little to no effect on competition if the market is already workably competitive.

42. On the basis of the facts provided in Example C it is not possible to form a view as to whether criterion (a) would apply. As with Example B it appears to be the case that the relevant pipeline has market power because it is stated to be engaging in monopoly pricing. In this case, and assuming the gas transportation services provided by the pipeline are a necessary input for effective competition in the markets in which the mining company is active, the present formulation of criterion (a) or the Exposure Draft formulation would apply provided it could be demonstrated that access (or increased access) would promote a material increase in competition. The example provides that the elimination of monopoly pricing on this pipeline would result in the equilibrium commodity price falling. If this is the case, this is indicative of an improvement in the conditions for competition, as well as an indication that the market is not already workably competitive.

43. In order for a better view as to the application of criterion (a) to Example C, more would need to be known about the other users and potential users, and the state of competition in downstream markets as it is likely that the pipeline is supplying a number of customers, as opposed to one mining customer.

44. Again, in the absence of more detail on the scenario outlined in Example C, it cannot be said that the ACCC Proposed Test would bring about a better outcome relative to the current formulation of criterion (a) or the Exposure Draft formulation.

Example D: In a similar manner to the previous example, restricting a pipeline operator’s ability to engage in monopoly pricing on a pipeline that is used to supply an industrial customer that competes in a workably competitive market in Australia could result in greater investment by that company in its facility and greater output. While this may not give rise to any change in the level of competition in the market, there would still be an efficiency improvement and if the industrial customer is a lower cost producer, it could also result in a reduction in prices for that product, which would benefit consumers.

45. Example D is in the same terms as Example C, except that it refers to an industrial customer as opposed to a mining company and the same considerations as noted above apply. In terms of the application of the criterion (a) – the facts are not sufficient to form a view. It is likely that the pipeline is supplying a number of customers, as opposed to one industrial customer. More would need to be known about the other users and potential users, and the state of competition in downstream markets.
Concluding observations on the ACCC Proposed Test and the ACCC Examples

46. The ACCC Proposed Test would provide the relevant Minister with considerable discretion in determining whether a pipeline should be covered. The national gas objective is expressed in very broad terms and, as such, the ACCC Proposed Test would not provide the decision-maker with any practical guidance on the circumstances in which coverage is likely to promote the objective. Presently, guidance on this complex issue is provided by the coverage criteria, and in particular, criterion (a) and (b) (uneconomic to duplicate).

47. The lack of guidance that would be provided by the ACCC Proposed Test is highlighted in recent extrinsic material relating to the national gas objective which identified that a range of decisions may lead to efficient outcomes which could each have different consequences for the interests of consumers.38

The national electricity objective and national gas objective explicitly target economically efficient outcomes that are in the long term interests of consumers, but the nature of decisions in the energy sector are such that there may be several possible economically efficient decisions, with different implications for the long term interests of consumers.

48. The benefit of a formulation of criterion (a) that is focussed on how access (or increased access) will promote competition in upstream and downstream markets is that it provides a rigorous framework in which to examine the benefits of access and to ensure that any such benefits are public benefits (the long term interests of consumers) as opposed to private benefits. In our view, if third party access to private infrastructure is to be mandated it is important to ensure that the benefits of such regulation are not simply realised by private interests, and this is what criterion (a) presently provides.

49. There are likely to be other benefits associated with maintaining criterion (a) in its current form or as proposed to be amended in the Exposure Draft as part of the coverage test. These benefits include:

a. that criterion (a) has been in place for some 20 years and its application is well understood, including through its application by the Tribunal and the courts. The review by the Full Federal Court of the Glencore decision will further consider and clarify the approach to be taken to criterion (a);

b. parity with the test in Part IIIA which aids consistency in decision-making and may also assist in minimising distortion of investment decisions in essential infrastructure.

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38 South Australia, House of Assembly, Hansard, 26 September 2013, 7171.
50. In summary, and in light of the considerations set out above, the examples provided by the ACCC are said to be situations which may not be addressed by the current coverage criteria and which should be addressed, but in our opinion those examples do not provide a sound basis for replacing the coverage criteria with the ACCC Proposed Test.

18 October 2016

[Signature]

N J Young

Ninian Stephen Chambers

C M Dermody

Level 14, Castan Chambers