



***Submission to the Trade Practices Act Review***

Submission by

The Australian Council for Infrastructure Development

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## Executive Summary

The Australian Council for Infrastructure Development (AusCID) appreciates the opportunity to make a submission to the Trade Practices Act Review. As a representative of investors, operators, financiers and service providers to regulated infrastructure, the Council focuses in this submission on the role that the ACCC plays in the administration of infrastructure regulation.

AusCID recognises the important role that regulation plays in the Australian economy, yet is concerned that inappropriate regulation and poor regulatory decision making processes have the potential to increase the perceived level of regulatory risk in Australia and discourage investment in infrastructure projects.

The administration of the Trade Practices Act (TPA) needs to be substantially improved. Specifically, AusCID identifies key structural problems with the administration of the TPA:

- A poor distinction between regulatory policy and regulatory implementation
- Too many powers in the hands of one regulator
- Perceived conflicts between the ACCC's role as a consumer advocate and its role as an impartial umpire.
- An inadequate level of oversight of the operations of the ACCC.

AusCID recommends that steps be taken to resolve these structural problems.

AusCID strongly supports the establishment of a board of review to oversee the activities of the ACCC. The board of review would have a similar role to that which the Board of Taxation has in the development and implementation of taxation legislation and the ongoing operation of the tax system.

The role played by the board of review would be complementary to that played by the Australian Competition Tribunal, and should have representation from both business and consumer interests. AusCID is of the view that there should be representation on the board from the gas, electricity and telecommunications infrastructure sectors.

These reforms seek to boost confidence in the regulatory system, ensure that the ACCC plays an effective role in the future development of the Australian economy and acts in a manner consistent with wider Government policy.

A more transparent, fair and effective regulatory regime will ensure greater private investment in infrastructure, with significant benefits to the Australian economy.

## 1. Introduction

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.

The Council formed in 1992 and currently has in excess of 100 members, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports. As a result of our membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

As a representative of investors in infrastructure assets, including major investors in businesses that face economic regulation by the ACCC, AusCID is concerned with the broader consequences of the application of the Trade Practices Act by the ACCC, and also the long-term effects on investment that a poorly implemented regulatory regime may have.

AusCID believes that the Trade Practices Review is an excellent opportunity to review the nature of regulation in Australia. As the private sector becomes increasingly responsible for the provision and maintenance of the infrastructure that provides essential services, the framework for investment, particularly the regulatory regime, becomes increasingly central in meeting the objectives of government and the needs of the public. Therefore, it is critical that the framework is designed effectively.

In this submission, AusCID will focus on item 4 in the terms of reference, in which the review is asked to determine whether the competition and authorisation provisions of the Trade Practices Act :

*provide adequate protection for the commercial affairs and reputation of individuals and corporations (in this regard, the Committee may examine the processes followed by the ACCC and the laws under which the ACCC operates, but is not to reconsider the merits of past individual cases);*

In the case of regulation of infrastructure, the Council is of the opinion that processes could be significantly improved.

## 2. Importance of investment in infrastructure

Infrastructure assets have a number of unique characteristics. Infrastructure is an essential contributor to the production of other goods and services. If the provision of an infrastructure service is disrupted there can be widespread multiplier effects leading to significant economy-wide costs.

Infrastructure often exhibits large natural monopoly elements such as increasing returns to scale, low marginal cost of production and limited choice in the provider of the service. Infrastructure assets are also often highly capital intensive, with high sunk costs and a discontinuous investment profile. Infrastructure assets also have long lives and pay-back periods. These traits enhance any natural monopoly characteristics.

For these reasons Governments have generally chosen to regulate infrastructure service providers (both public and private) in order to avoid the inefficiencies which can be generated by monopolies.

However, from the point of view of investors, infrastructure investments are also of a peculiar nature. Infrastructure investments are typically limited use assets. If the project becomes unviable the asset cannot easily be used to provide an alternative service or moved to a different location. Hence investments in infrastructure are relatively inflexible, with a high degree of sunk costs. This means that investors will be very sensitive to the risks associated with those investments. Any increase in risk, or the perception of risk, will result in a reduction in the capital available for investing in infrastructure or an increase in the returns demanded by that capital.

Efficient infrastructure is particularly important for Australia. Not only does Australia have to offset its labour cost disadvantage relative to its Asian neighbours, it also has to overcome very large distances over which goods must be transported. Having more efficient infrastructure services than its competitors is one way by which Australia can gain a competitive advantage.

Given the importance of infrastructure services to the economy, the Government has a key responsibility in ensuring those services continue to be delivered to an appropriate standard. One part of ensuring this occurs is to set policy to encourage efficient investment in infrastructure assets in order to enhance reliability and service standards in the longrun. In this case the Australian Government must develop an investment climate which is responsive to these capital needs and which will encourage investment in Australia's infrastructure.

### 3. Regulatory risk

Infrastructure and utility businesses are highly capital intensive. The investors which are required to put equity into these businesses seek the best possible risk weighted return for their funds. The market for these funds is global, as evidenced by the very high proportion of foreign ownership of Australian infrastructure and utility businesses. Australian investors, too, seek the best risk weighted return from their shareholders funds wherever the investment may be. There is no room for parochialism.

One of the major risks an investor in any utility considers prior to investing is regulatory risk. This is the risk that the rules surrounding the regulation of the business will vary from those rules the investor assumes apply at the time of investment.

Any perception of increased regulatory risk decreases Australia's chances of attracting investment funds or increases the required return on that capital. Ultimately, regulatory risk – real or perceived – has the effect of increasing the price of both regulated services for consumers and of reducing their quality.

#### *3.1 Approach to Regulation*

An essential role of any regulator is to balance the needs of consumers today with those of consumers in the future. While a reduction in the price of a regulated service may be positive for certain customers in the short term, if it means that capital dries up and investment is not made in improving services then those customers may be worse off in the long run.

Furthermore, services may not currently extend to all potential consumers. For example, electricity or gas distribution may not extend to all regional areas of the State. If investments in regulated assets are seen as risky, or appropriate sharing mechanisms between investors and consumers are not available, then potential consumers who are currently not serviced by the utilities in question may find that no investors are willing to fund service extensions.

As already discussed, infrastructure is peculiar in that its availability also stimulates other forms of economic development. A well structured regulator should therefore consider nationwide economic development issues as well as the cost of service to existing customers. It should be fundamentally concerned with encouraging investment, innovation and efficiency gains in existing businesses. This should include the impact on the attractiveness of Australia as an investment destination as a consequence of regulatory decisions.

#### *3.2 Consequences of poor regulation for Australia*

As far as investors are concerned there are significant problems with the current approach to regulation of infrastructure in Australia. If investor confidence in the regulatory system is not improved, several negative outcomes can be expected.

- Investment funds will go to other, less risky jurisdictions or else require a premium for perceived regulatory risk. This will result in increased costs for customers in the long run.

- Investment in innovation and upgrading will not be approved by boards, as there will be little or no perceived additional return for this risky expenditure.
- Capital raising for the expansion of existing businesses will be impossible or more expensive than necessary, again leading to increased costs for customers in the long run.
- Government options for delivering infrastructure and utility services will be restricted. Private sector investment in these types of monopolistic or semi-monopolistic activities will be curtailed because of the fear of restrictive and heavy handed regulation in the future, irrespective of current promises of a light handed approach.

Ultimately, all of these outcomes mean that a potentially vibrant and innovative infrastructure and utilities sector which could, with the correct incentives, become an international centre of excellence and export technology for Australia will instead become a liability. Investment in the State generally will be affected and ultimately, the cost of services to consumers will increase while service standards are barely maintained or fall.

## 4. Administration of the Trade Practices Act by the ACCC

The Australian Competition and Consumer Commission, as the entity charged with the administration of the Trade Practices Act, as well as related consumer protection and regulatory roles, has a large amount of influence over the operation of the Australian economy. This is a role which is to at least some extent necessary – yet the processes by which the powers granted to the ACCC under the act are applied and the vigour to which they are implemented has led to serious concerns from businesses. Specifically, AusCID is concerned with the long term effects that a poorly implemented regulatory regime may have on investment in regulated industries.

### *4.1 Difference between regulatory policy and regulatory implementation*

The first critical issue that needs to be considered is what the role of the ACCC actually is. AusCID very strongly believes that the role of the ACCC is in the implementation of regulatory policy, not the making of regulatory policy.

Where is the line? In AusCID's view, regulatory policy is the establishment of the broad framework and processes for regulation. Regulatory policy also involves those regulatory decision which will impact significantly on other areas of government policy.

Regulatory implementation is the process of making detailed decisions which are consistent with the broader regulatory policy. This may involve decisions on detailed technical issues, where regulatory expertise is necessary.

The use of a *post tax* revenue model in the determination of access prices is a useful example of regulatory policy making, rather than implementation. By choosing to use a post tax framework, the ACCC removes any benefits that the regulated firm may have received as a result of the Governments taxation policy, such as accelerated depreciation.

Under a post tax model, taxation benefits are confiscated and transferred to consumers – removing any investment incentive that the Government might have given to ensure investment occurs. In this case, not only does the ACCC take a position of making regulatory policy, in doing so it also removes the ability of the government to make taxation policy with regards to regulated businesses.

The need to draw a line between regulatory policy and regulatory implementation is made more clear when considering the limited public scrutiny that the ACCC is subject to. The aims and process for regulation should be specified by Government, with the regulator to focus on applying the process to the case at hand and determining the outcome.

AusCID considers that greater oversight of the activities of the ACCC by both Government and a board of review (as discussed later) would enable the distinction between regulatory policy and regulatory implementation to be made more clearly and effectively. This would inspire greater confidence in the regulatory system and ensure that the process of regulation does not hinder other Government policy.

## 4.2 The range of ACCC powers

The sheer range of powers which are held by the Commission is a concern to regulated businesses. The ACCC has the power to significantly change the structure and outcomes of markets, with impacts on the wider economy. However there is little oversight of this use of their powers and significant conflicts between the exercise of different powers.

The ACCC has power to prosecute or make decisions on the following areas:

- Misuse of market power provisions and predatory pricing under s46 of Part IV,
- Price fixing under s45
- Exclusive dealing under s47
- Mergers under s50
- Access regulation under Part IIIA
- Part XIB for anticompetitive conduct and part XIC for access issues in telecommunications,
- The Prices Surveillance Act, including the new price monitoring regime for airports
- The National Gas Code,
- Regulation of electricity transmission and
- Consumer protection under Part V

The above list gives an idea of the level of responsibility delegated to the ACCC, yet not all of these powers are complementary to each other. There are few advantages to having powers for access regulation and the powers under Part IV administered by the same organization. In some cases, there are conflicts which are difficult to overcome, such as the need to be a consumer advocate in some areas and an impartial umpire in others.

Due to the fact that the ACCC has such a wide range of powers there is a significant danger in having a poor relationship with the regulator. It is perceived that a poor relationship can lead to a greater level of interest from the regulator in the activities of the firm. Therefore there is perceived to be a significant incentive to develop a good relationship with the regulator. This puts a significant amount of power in the hands of the Commission.

Critically, oversight of the use of these powers is limited. In a recent letter to the editor of the Australian Financial Review, Sitesh Bhojani, the acting Chairman of the ACCC, described some of the features of the oversight regime for the ACCC:

*Unlike a number of other agencies, the focus of the ACCC's work is not the making of numerous administrative decisions.*

*Its allegations must be proved in the Federal Court and can be appealed to higher courts.*

*The Australian Competition Tribunal was established to hear appeals on certain decisions of the ACCC. Other complaints can be lodged with the ombudsman. The ACCC is also at risk of suit for defamation if it improperly damages the reputations of companies or individuals.*

*Further, the ACCC annual report is tabled in Parliament. Its activities are also regularly reviewed by parliamentary committees.<sup>1</sup>*

For an organization with the level of power that the ACCC holds, this is simply not adequate.

It is recognised that in many cases the ACCC cannot make decisions, but bring prosecutions to the Federal Court. While this is a formal way of keeping the powers of the Commission in check, the reality of the operation of the system of trade practices regulation in Australia is that many businesses will not risk being taken to court by the ACCC, and will therefore come to an agreement with the ACCC on issues of dispute. It is through these avenues that the ACCC can exercise “soft” power very effectively.

In the area of access regulation of infrastructure, the ACCC does make decisions, but these decisions are able to be appealed to the Australian Competition Tribunal. However, the ACCC has been actively campaigning to reform this part of the decision making process, particularly in the area of telecommunications regulation. AusCID considers that it is inappropriate for the ACCC, as an “impartial umpire” should be actively campaigning to remove the merits appeal rights of access providers, and in the process, increase the ability of the ACCC to make final, unappealable decisions.

### **4.3 Conflicts**

There are key conflicts between the economic regulation, prices surveillance and third party access elements of the ACCC’s responsibilities where an impartial judge is needed to make fair, long term determinations and the elements dealing with anti-competitive and unfair market practices where the aim is consumer protection.

There is great risk that the ACCC will not be able to fill both these roles adequately. Indeed, it is highly likely that even if the ACCC performed both roles adequately, it would be perceived as having a consumer bias in those areas where impartiality is needed. This perception of bias can undermine confidence in the regulatory system and lead to a greater perception of regulatory risk, and thus impact on investment in regulated assets.

There are no significant “economies of scope” or benefits to the community in having all of the elements of the Trade Practices Act currently dealt with by ACCC under one roof. There is little opportunity to share experience between the diverse and specialised sections of the ACCC and the processes involved in administering,

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<sup>1</sup> “ACCC has enough overseers already” Australian Financial Review, 14/6/2002, p79

for example, Part IV does not help to develop confidence in the Commission's processes in other areas, for example access regulation.

There are few benefits in having the range of powers held by the ACCC administered by the same organisation. Yet there can be significant costs in terms of negative perceptions by investors and businesses of the administration of the Trade Practices Act by the ACCC. Therefore AusCID supports greater oversight of the ACCC to increase the transparency of the regulatory process and ensure that the risk of negative perceptions affecting investment is minimised.

## 5. An Oversight Board for the ACCC?

As discussed, the ACCC has significant power in implementing public policy, yet the oversight framework over the ACCC is not commensurate with the power that it holds.

As a public institution, openness, transparency and the long term interest of the public are critical to the success of the organization. However, as noted above, there are some deficiencies in the processes that the ACCC undertakes, or in the perception of the way that the ACCC undertakes them and as such it does not meet these goals.

One of the best ways to ensure that these goals were being met would be to improve the oversight of the ACCC – to ensure that standards of openness and transparency were being upheld, and that the actions taken by the ACCC are open to review and debate to ensure that they meet the long term interests of Australia.

AusCID recommends the establishment of an oversight board to review decisions made by the ACCC and ensure that the ACCC is adequately implementing the regulatory policy of the Government.

The board would be similar in style and complementary to the Board of Taxation established to oversee the Australian Taxation Office. The Board of Taxation has been proved to be an effective tool in communicating the concerns of taxpayers, both at a business and consumer level, on the implementation of taxation policy.

AusCID members consider regulation and taxation to be two key policy issues with the potential to significantly deter investment in infrastructure. The Board of Taxation is an effective mechanism that can be used to convey specific concerns with the implementation of tax policy. A similar mechanism to convey concerns regarding the implementation of regulation would help to reduce the level of regulatory risk perceived in Australia.

The role that the board or review would take would be complementary to the role currently played by the Australian Competition Tribunal (ACT). While the ACT is charged with reviewing specific regulatory decisions, the board of review would be in a position to review the wider operation and conduct of the ACCC.

AusCID recommends that the mandate of the board not be limited to the ACCC's enforcement of the Trade Practices Act. The ACCC also has a role in the economic regulation of the gas pipelines and electricity transmission industries. These areas should be open to the same level of review as the ACCC's powers under the Trade Practices Act.

In terms of the representation on the board of review, there should be representation from both businesses and consumers. Representation from Government would also be appropriate on the board. It would be sensible to draw this representation from across all of the sectors which are regulated by the ACCC.

In the area of infrastructure, the unique issues faced mean that sector specific representation would be useful. The major customers of infrastructure services are businesses rather than consumers. As such, there are strong incentives for businesses, particularly those that use infrastructure intensively, to argue for lower

prices, when in the long term the public interest is best served by slightly higher prices and the resulting greater investment in public infrastructure.

An open dialogue on regulatory issues is essential in maintaining confidence in the regulatory system. AusCID considers that a board of review will assist in maintaining this open dialogue and maintaining confidence in the regulatory system.

## 6. Conclusion

Confidence in the regulatory system is a key driver of investment in Australia. Increased levels of regulatory risk do deter investment, particularly in infrastructure.

AusCID strongly considers that reform is needed to the processes by which the ACCC undertakes administration of the Trade Practices Act, to ensure that confidence in the regulatory system is maintained.

AusCID recommends that a board of review be established to oversee and review the actions of the ACCC.

This board should cover all regulatory decisions made by the ACCC, including both the Trade Practices Act and economic regulation conducted by the ACCC under other legislation, such as the National Gas Access Code.

The board should include representatives of both business and consumer groups, with relevant experience in those areas regulated by the ACCC. Specifically, AusCID recommends that the board should include a representative of the owners of and investors in each regulated infrastructure sector – most critically gas, electricity and telecommunications.

These reforms do not seek to bridle the ability of the ACCC to make regulatory decisions, but to ensure that the regulatory system is more transparent and is consistent with both Government policy and the public interest.