Australian Competition & Consumer Commission

Privatisation of state and territory assets and new infrastructure

Submission to the Senate Economics References Committee

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Australian Competition and Consumer Commission
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Privatisations

The Commonwealth, states and territories have flagged a number of privatisations over the next few years, which could significantly impact upon the structure of key infrastructure markets in Australia. The types of assets that could be sold include ports, electricity generators, electricity transmission and distribution assets, as well as possibly railway and post assets.

The Australian Competition and Consumer Commission (**ACCC**) considers that privatisation can unlock potential benefits when implemented appropriately. In particular, businesses post privatisation may be operated more efficiently, which benefits the wider economy. The ACCC is concerned that these continuing benefits of privatisation can be put at risk when governments aim to maximise sale proceeds by taking action that limits competition or minimises or avoids appropriate regulation. These concerns are increased where, in the case of the Asset Recycling Initiative, the Commonwealth Government proposes to provide incentive payments of 15 per cent of the sale proceeds.

The ACCC encourages governments to be cognisant of the incentives and trade-offs between short-term and long-term interests of governments, users and Australians that occur during the privatisation process and to address these matters up front and in a transparent manner.

The ACCC recommends that the Commonwealth require the states and territories to demonstrate that appropriate market structure and/or access and pricing arrangements have been put in place as part of the privatisation process, and link this requirement to any payments made under the Commonwealth Government's proposed incentive scheme for privatisations (the Asset Recycling Initiative).

Inquiry into privatisation of government-owned assets

The Senate has asked the Senate Economics Reference Committee to inquire and report on incentives to privatise state or territory assets and recycle the proceeds into new infrastructure. The Committee is due to report to the Senate by 2 March 2015.

The ACCC is making this brief submission to the inquiry to highlight some of the issues that should be given consideration during privatisation processes.

Potential benefits from privatisation

When implemented appropriately, privatisation can improve the efficiency of investment and operations in the interests of users and the general community, and to facilitate innovative management. Proceeds from the sale can also be reinvested in new infrastructure to improve the welfare of Australians.

The ACCC is of the view that commercial operations should be run by the private sector unless there is a clear public policy objective that can be best met by public ownership. For example, publicly owned businesses could be driven by other incentives, such as addressing policy concerns regarding social welfare.

Importantly, however, the extent to which the above benefits from privatisation are realised will depend upon the extent to which the resulting market structure supports competition and/or appropriate regulatory oversight (where necessary) is instituted at the outset. These issues are further explored below, which also sets out how certain provisions of the *Competition and Consumer Act* 2010 (**the Act**) are particularly relevant to privatisations and can be used to ensure that the benefits from privatisation are realised to the maximum extent possible.

Unlocking the benefits from privatisation

The ACCC is of the view that benefits from privatisation will be maximised where there is strong potential for competition or where, in the absence of competition due to monopoly or near monopoly characteristics, there is sufficient regulatory oversight to ensure that competition in upstream or downstream markets is not hindered.

The ACCC considers that governments should consider and appropriately deal with issues early and upfront in the privatisation process. This provides greater certainty for bidders than ex post arrangements and is essential for promoting efficient investment incentives. By understanding how assets will be structured and regulated upfront, potential acquirers of assets can factor these arrangements into their purchase price and bid accordingly.

Structural reform considerations

Governments should consider the potential merits of structural reform when privatising assets. The Hilmer Review of 1993 recommended consideration of structurally separating potentially competitive activities into a number of smaller, independent business units to facilitate new market entry and competition. As no regulator in Australia has the statutory power to impose compulsory functional separation in any industry sector, it is a matter for governments to make policy decisions to implement structural measures in particular industries. The ACCC notes that the merits of structural reform need to be considered on a case by case basis.

In addition, while the ACCC cautions against imposing unnecessary restrictions on firms' abilities to participate in markets, the ACCC encourages governments to consider integration issues that could raise concerns in the future. Where the sale of an asset is likely to confer enduring market power, governments should carefully consider at the beginning of a privatisation process whether legislative restrictions on vertical integration might be warranted. For example, the Commonwealth Government used legislative measures to address vertical integration concerns in the telecommunications industry by imposing wholesale-only restrictions and provision for ownership restrictions on the National Broadband Network (**NBN**). Having these restrictions in legislation ensures that structural separation should not be subverted in the future by allowing NBN to directly supply services to retail customers, or entering into ownership arrangements with retailers and other carriers.

Regulatory arrangements

Assets with monopoly characteristics, however, are likely to raise competition concerns regardless of who acquires or operates the asset—that is, market structure cannot be used to address potential monopoly issues such as high pricing or poor service quality. In these instances, the ACCC is of the view that there needs to be sufficient regulatory oversight to ensure that competition in upstream or downstream markets is not hindered.

Without an adequate regulatory regime (covering access and/or pricing), monopoly infrastructure service providers would be capable of earning monopoly profits or foreclosing competition. Benefits would therefore flow to investors, at the expense of users of the asset and, ultimately, end consumers. Inadequate economic regulation can also dampen investment in markets that depend on access to the monopoly asset, thereby denying at least some of the benefits the community could obtain from greater competition.

In the ACCC's experience, appropriate economic regulation will be more likely to promote competition by providing efficiency benefits and aligning operations and investments across supply chains related to the monopoly asset. In turn, this will improve national and state productivity and benefit those in the supply chain and consumers.

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

The ACCC's view is that access and pricing issues are best addressed through access undertakings under Part IIIA of the Act, which is the primary legislation governing Australia's National Access Regime. Part IIIA is designed to address concerns through a public assessment process in industries where an infrastructure asset with natural monopoly characteristics forms a bottleneck for firms operating in upstream or downstream markets. The access undertaking provisions of Part IIIA are flexible and can be adapted to be made 'fit-for-purpose' such that the level of access or price regulation can be tailored to the level of market power held by the acquirer or operator.

Other considerations under the Act

The ACCC notes that privatisation through the sale of an asset or the granting of a lease over an asset is subject to section 50 of the Act. Section 50 prohibits acquisitions that would have the effect, or likely effect, of substantially lessening competition in any market. The ACCC conducts a merger review of the privatisation and considers competition concerns arising from the identity of a proposed acquirer or operator.

Although parties have a number of options for obtaining clearance of the transaction under section 50, parties usually seek an informal merger review by the ACCC. Depending on the findings of this review the ACCC will decide whether to (i) not oppose the acquisition; (ii) not oppose the acquisition subject to section 87B undertakings; or (iii) oppose the acquisition.

In some circumstances a merger remedy such as a section 87B undertaking may be appropriate to address competition concerns in an infrastructure privatisation. It is important to note, however, that merger remedies cannot extend to addressing competition issues arising from the monopoly characteristics of the infrastructure that exist regardless of who owns it. In other words, where privatisation represents a bare transfer of the monopoly asset from the government to the private sector, the sale is unlikely to lead to a substantial lessening of competition in a market, and therefore merger remedies would not be available. Merger remedies seek to address concerns where a proposed acquirer or operator has horizontal interests and/or is vertically integrated at the time the acquisition occurs.

As noted above, the ACCC therefore considers that any competition issues arising from the monopoly characteristics of the asset should be dealt with upfront by governments, and that Part IIIA access undertakings are the most effective way to address these competition issues.

Potential unintended consequences

The ACCC understands that the Commonwealth Government is considering incentivising privatisation of government-owned assets through the implementation of an Asset Recycling Initiative. Under this initiative, the Commonwealth Government proposes to provide states and territories with incentive payments of 15 per cent of the sale price of privatised assets, with the returns to be reinvested into new priority infrastructure projects.

In its June 2014 submission to the Government's Competition Policy Review, the ACCC noted that there are signs that in privatising assets, Australian governments are focusing overly on short term budget goals without sufficient regard to longer term competition.

The ACCC has a concern that implementation of the Asset Recycling Initiative in its current form may exacerbate this issue, by further incentivising states and territories to seek a higher sale price for privatised assets at a cost to Australians—in particular, not taking the unique opportunity to address competition issues arising from market structure or lack of appropriate regulatory oversight as a way of making the asset more attractive to buyers.

Indeed, the ACCC is aware of some instances in the past where governments may have achieved a higher sale price at the cost of competition. For example, when Sydney Airport was privatised, the Commonwealth Government provided the acquirer with the valuable right of first refusal to operate any second Sydney airport (recently announced to be located at Badgerys Creek). The right of first refusal, along with certain provisions of the *Airports Act 1996*, confers

on the operator of Sydney Airport a potential monopoly over the supply of aeronautical services for international and most domestic flights in the Sydney Basin, with the real prospect that the potential for competition between Sydney Airport and an independent operator of a second airport will be foreclosed. Indeed, the National Audit Office has found that the sale price for Sydney Airport was higher than a number of possible valuation benchmarks, including the government's own estimate of the sale price in the 2001-02 budget.

More recently, the ACCC also understands that anti-competitive provisions have been included in contracts between the states and potential acquirers, which are not transparent to the wider public. The ACCC has noted its concern about governments entering into arrangements designed to maximise sale proceeds though reducing the prospect of competition.

The ACCC recognises that governments often face difficult trade-offs when privatising assets. However, these less than optimal outcomes effectively impose a tax on future generations of Australians and hinder Australia's competitiveness in the world market.

Recommendation

Accordingly, the ACCC recommends that the Commonwealth require the states and territories to demonstrate that the appropriate market structure and/or access and pricing arrangements have been put in place as part of the privatisation process. For example, if the states and territories were required to outline the proposed arrangements up-front, then the Commonwealth could take these factors into consideration when reviewing proposals under the Asset Recycling Initiative. Further, the Commonwealth could hold the states and territories accountable for implementing the accepted arrangements at each of the key payment milestones.

There are a number of ways in which the adequacy of market structure and/or access and pricing arrangements could be assessed. Options include tasking an agency such as the ACCC or the National Competition Council with the role of providing the Commonwealth with advice on the adequacy of proposed arrangements. Another option could be the formation of an independent taskforce to assist with reviewing the appropriateness of such arrangements.

Tasking a competition regulator or independent task-force with this role is not uncommon internationally. For example, in Israel the *Law for the Promotion of Competition and Reduction of Economic Concentration* enacted in 2013 requires that the Israel Antitrust Authority and a body known as the Reduction of Economic Concentration Committee (chaired by the Antitrust Commissioner) assess economy-wide concentration and industry-wide competitiveness prior to privatisations and other major public tenders.[1]

Similarly, in Turkey, the Turkish Competition Authority (and its decision making body – the Competition Board) has a role in the privatisation process in providing its views to government on competition effects of privatisations.[2] This advice can involve providing views to the government on market structure issues including the need for implementing vertical separation prior to privatisations.

Further information

The ACCC reiterates that there is no 'one size fits all' approach to privatisations and matters need to be considered on a case by case basis. In some instances, addressing structural issues may help to alleviate competition concerns, while in other instances alternative options including regulatory oversight need to be applied.

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1 See http://duns100.globes.co.il/en/article-the-concentration-law-are-we-selling-the-state-to-foreigners-and-where-are-we-headed-to-1000941165; and http://www.freshfields.com/uploadedFiles/SiteWide/Knowledge/Israel%20concentration%20law.pdf, both accessed on 20 January 2015.

2 See http://www.intosaiksc.org/archives/9thmeeting/9thturkey.pdf, accessed on 20 January 2015.

As noted above, the ACCC would welcome the opportunity to discuss directly with the relevant government(s) the issues that may arise in respect of specific privatisations processes.

For further information, please contact Mr Matthew Schroder, General Manager, Infrastructure & Transport – Access & Pricing Branch