B4 Structural Reform of Public Monopolies

B4.1 The structural reform commitment

Historically some government businesses have enjoyed protection from competition, and consequently, structures have developed that do not readily respond to market conditions. In these cases, if measures to introduce competition are to be successful, structural reform may be needed first.

Structural reform involves removing any regulatory responsibilities from the monopoly business so that the business has no regulatory advantage over rivals and potential entrants. Structural reform may also involve splitting any monopoly elements of the business from potentially competitive elements, in order to avoid the risk of unfair competition via cross-subsidisation from monopoly activities.

Structural reform is particularly important where a public monopoly is to be privatised. Privatisation without appropriate reform risks allowing the monopoly increased scope to abuse its position, to the detriment of consumers and potential competitors.

Under NCP, governments agreed to apply certain procedures to systematically consider business structure issues prior to introducing competition into markets served by public monopolies or privatising their businesses. However, these principles do not require privatisation or the introduction of competition. Clause 4 of the CPA obliges governments to relocate regulatory functions away from the public monopoly before introducing competition into the market served by the monopoly. Also under clause 4, before introducing competition into a sector traditionally supplied by a public monopoly or privatising a public monopoly, governments agreed to review:

- the appropriate commercial objectives of the public monopoly;
- the merits of separating potentially competitive elements of the public monopoly from the natural monopoly elements;
- the merits of separating potentially competitive elements into independent competing businesses;
- the best way of separating regulatory functions from the monopoly's commercial functions;
- the most effective way of implementing competitive neutrality;
- the merits of any community service obligations (CSOs) provided by the public monopoly, and the best means of funding and delivering any mandated CSOs;
- the price and service regulations to be applied to the relevant industry; and
- the appropriate financial relationship between the owner of the public monopoly and the public monopoly.

B4.2 Structural reform activity by jurisdiction

Governments have undertaken a range of structural reforms in the period leading up to the second tranche assessment. Several of these were associated with other elements of the NCP program, particularly related reforms of the electricity, water and gas industries. Structural reform activity in these sectors is discussed in the sections of this report dealing with electricity, gas and water reforms.

This section discusses other structural reform activity relevant to the assessment of jurisdictions' performance against clause 4.

Telstra

The partial privatisation of Telstra in 1997 gave rise to an obligation on the Commonwealth Government to examine the merits of structurally separating the monopoly elements from the non-monopoly elements of Telstra's business. In its first tranche assessment the Council reported the Commonwealth's view that it had broadly satisfied its clause 4 obligations through a series of related reviews prior to the partial privatisation and through more general GBE governance and competitive neutrality processes. The reviews led to a decision not to pursue structural separation but to supplement general prohibitions against anti-competitive conduct (Part XIB of the TPA) and to facilitate access to services through an industry-specific regime (Part XIC of the TPA).

More latterly, the Commonwealth has passed amendments to Part XIB of the TPA that will enhance the ACCC's ability to issue competition notices in relation to anti-competitive conduct and to arbitrate access disputes. These amendments also enable the ACCC to disclose information kept by carriers pursuant to 'accounting separation' record-keeping rules which will assist access seekers in negotiations with access providers.

In preparation for the second tranche assessment the Council commissioned Tasman Asia Pacific (TAP) to assess the ACCC's proposed record-keeping rules and the Commonwealth Government's proposed arrangements for accounting separation of the local fixed network. In addition, TAP was asked to assess the likelihood that the new record-keeping rules will work effectively to facilitate competition in the telecommunications industry.

TAP concluded that the proposed new record-keeping rules are an improvement on their predecessors and will provide the ACCC with the information necessary to detect anti-competitive behaviour. TAP also found that the recent legislative amendments are potentially positive steps towards a ring-fencing model. However, TAP did not consider these arrangements, nor ring-fencing per se, would be adequate to remove Telstra's sources of market power and to combat anti-competitive behaviour. TAP suggested separating the Customer Access Network (CAN), being the natural monopoly element, from transmission facilities and operating the CAN independently under supervision by the ACCC or another regulatory authority.

The Council invited comment from the Commonwealth Government on the TAP advice. The Commonwealth considered the analysis insufficient to show that the current regulatory regime had failed to promote competition. It noted that the ACCC is at a critical stage in the development of the regulatory regime, with the declaration

of local call services likely, and that it is too early to say whether or not the regime has worked. The Commonwealth also considered that the TAP report contained insufficient analysis of the nature, extent and effect of economies of scale and/or scope in CAN services, and inadequate substantiation of the costs and benefits of structural separation.

The Commonwealth noted that a statutory review of Part XIB of the TPA is scheduled for 2000, and this will allow for a thorough assessment of the telecommunications regime, including the effectiveness of current accounting separation arrangements.

The Council agrees that the legislative amendments just passed, and the regulatory development being undertaken by the ACCC, go some way towards satisfying the Commonwealth Government's CPA clause 4 obligations arising from the partial privatisation of Telstra. To test whether these obligations have been fully satisfied, the Council will be looking for the statutory review of Part XIB in 2000 to examine the costs and benefits of alternatives to the current regime, including structural separation of the local fixed network from non-monopoly elements. As suggested by the Commonwealth, such an examination would require thorough analysis of the nature, extent and effect of any economies of scale and scope in the telecommunications industry, including the CAN. Such analysis goes to the heart of the purpose of the obligations created by clause 4 of the CPA. The Council is not aware of any comprehensive Commonwealth analysis of this issue. The Council will consider further progress made by the Commonwealth on this matter in its third tranche assessment.

Sydney Basin airports

In its first tranche assessment, the Council raised the issue of the Commonwealth's failure to conduct a clause 4 review prior to the sale of the long-term leases operated by the Federal Airports Corporation (FAC).

The Council recognised at that time that arrangements already in place or being contemplated by the Commonwealth, might encompass many of the questions of structure which would be addressed in a clause 4 review of the FAC.

In September 1998, the FAC was abolished and the Commonwealth's remaining airport holdings were leased to newly created Commonwealth-owned companies. The Sydney Airport Corporation Limited (SACL) managed the Sydney Basin airports, Sydney (Kingsford Smith), Bankstown, Camden and Hoxton Park. In addition, Essendon Airport was created as a subsidiary company of SACL.

The SACL airports are regulated under the *Airports Act 1997*. This removes the responsibilities from the lessees for the regulation of land use and environmental planning and control, commercial and retail trading and liquor licensing. In relation to on-airport activities, including commercial and retail trading and liquor licensing, the approach has been to subject airport lessees to State regulations.

The Commonwealth has put in place arrangements aimed at encouraging competition between airports. The *Airports Act 1996* prohibits airlines from owning more than 5 per cent of an airport operator company, and imposes cross ownership restrictions of

15 per cent between the Sydney airports (Kingsford Smith and Sydney West) and Melbourne, Brisbane and Perth airports.

An economic and regulatory regime has also been established, administered by the ACCC. The prices oversight scheme provides for a CPI-X cap on defined aeronautical services. There is also price monitoring of aeronautical-related services outside the price cap. The SACL airports are currently not subject to section 192 of the *Airports Act 1996*, which provides for declaration of airport services. However, they are subject to Part IIIA of the *Trade Practices Act 1974*, which allows access seekers to apply for declaration.

Assessment

The outstanding issue for a clause 4 review is the determination of the appropriate structure for the Sydney Basin airports, including the proposed second airport, prior to privatisation. The Commonwealth has given an undertaking that its future processes will consider structure and competition issues for Kingsford Smith and the proposed second international airport, although there is currently no timeframe for these questions to be considered.

The Council is satisfied that, to date, the Commonwealth has introduced an industry structure and regulatory framework that is appropriate in terms of the issues raised by clause 4.

TasRail

In November 1997, the Commonwealth Government sold the Tasmanian rail services (TasRail) to Australian Transport Network (ATN). This included both track and above rail facilities. TasRail did not conduct any passenger services. The Commonwealth originally acquired TasRail as part of its buyout of state railways.

The Commonwealth has advised that it did not conduct a formal clause 4 review prior to the sale of TasRail. It is currently examining the extent to which the issues raised by clause 4 have been otherwise considered and whether the intent of clause 4 has been fulfilled.

Assessment

The Council considers that, as a review was not conducted, the Commonwealth has not met its clause 4 obligations in respect of TasRail.

Australian National

Australian National, a Commonwealth Government enterprise, operated above and below rail businesses in South Australia. The Commonwealth separated these businesses and sold them off over the period 1993-1998.

- Australia Southern Railroad leased the track corridor used to provide intrastate freight services (no passenger) for 50 years and bought the corresponding above and below rail assets. Access arrangements were established by the South Australian Government through the *Railways (Operations and Access) Act 1997*.

- Great Southern Railway bought the above rail infrastructure used to provide interstate passenger services. The track for these interstate services was transferred to Australian Rail Track Corporation (ARTC) which is currently developing an access regime to cover all track that forms the 'national interstate track system'.

The Commonwealth has advised the Council that a formal clause 4 review wasn't undertaken prior to the sale of Australian National.

Assessment

Given that a review has not been conducted, the Council is of the view that the Commonwealth has not met its clause 4 obligations in respect of Australian National.

Australian Wheat Board

In December 1997 and July 1998, the Commonwealth Government legislated to privatise the Australian Wheat Board (AWB) into a grower owned and controlled company (the AWB Ltd) as of July 1999. The legislation extends the existing wheat export monopoly indefinitely and vests its management in a new statutory body, the Wheat Export Authority (WEA). It confers an exclusive export (monopoly) right on AWB Ltd for five years.

The privatisation of the AWB and the extension of its export monopoly have implications for both the Commonwealth's clause 4 and clause 5 obligations. Clause 4 obliges the Commonwealth to review the structure and commercial objectives of the AWB prior to privatisation.

The primary functions of the WEA will be to manage and approve requests to export wheat from organisations other than the AWB Ltd and to monitor the use of the monopoly by the AWB Ltd.

The WEA will comprise three members – a Chairperson, an industry representative and a government representative. It will be funded for the first five years from AWB reserves not transferred to the AWB Ltd.

In considering requests by third parties to export wheat, the WEA must consult with AWB Ltd, and can only approve bulk wheat exports where AWB Ltd has approved the export. The WEA will be required to develop guidelines, in consultation with AWB Ltd, for assessing export applications. The Explanatory Memorandum to the *Wheat Marketing Legislation Amendment Act 1998* suggests that these guidelines could reflect the current AWB discretion to grant consent for non-bulk exports, that is, niche and speciality wheat and wheat exported in bags or containers. In the Explanatory Memorandum, the Commonwealth Government recognised that AWB Ltd will have a 'considerable degree of market power' with respect to exports and has exempted the AWB Ltd's export activities from the *Trade Practices Act 1974* under section 51(1).

The WEA must report to the Grains Council of Australia (a wheat growers industry body, formerly the Australian Wheatgrowers' Federation) on its activities at least twice annually.

In the year 2004, the Commonwealth will conduct a review to examine the WEA's management of the export monopoly and the use and appropriateness of the AWB Ltd's monopoly export right.

The Commonwealth has stated that statutory and commercial arrangements for the wheat export market will be clearly separated. However, the legislative inter-relationships between the WEA and AWB Ltd, in particular AWB Ltd's effective veto power over WEA decisions on export requests by third parties, raise significant questions about the effectiveness of separation in practice.

Assessment

There is some doubt as to whether the Commonwealth has so far considered structural matters relating to the privatisation of the AWB through a clause 4 process.

A clause 4 review would need to consider:

- the appropriateness of granting a five year exclusive export monopoly right to a private company;
- reforms made or impending in related grain industries, and whether reformed former monopoly marketing businesses (such as ABB Grain Ltd) and other market participants are at risk of unfair competition by virtue of the wheat export monopoly;[15]
- the appropriateness of the WEA structure; and
- the effectiveness of structural separation of regulatory and commercial functions, with particular attention to:
  - the appropriateness of the inter-relationships between the statutory body and the private company;
  - the potential for conflicts of interest to emerge between the WEA and the AWB Ltd; and
  - the potential for regulatory capture.

On this basis, the Council does not consider that the Commonwealth has met its clause 4 obligations with respect to the privatisation of the AWB. The Council expects that these issues will be considered as part of the clause 5 review of the AWB legislation.

TABs

During the second tranche assessment period, several governments have moved towards privatisation of their Totalisator Agency Boards. For example:

[15] See below a description and assessment of the reforms by Victoria and South Australia to the Australian Barley Board.

- New South Wales has privatised its TAB;
- Queensland is currently debating the sale of its TAB; and
- the ACT has undertaken a scoping study for the possible privatisation of the ACTTAB.

This privatisation activity might appear to raise obligations under clause 4, to the extent that TABs operate as public monopolies. However, TABs face competition from a range of providers of gambling services, including other jurisdictions' TABs. While this competition does not take exactly the same form, for example, other jurisdictions' TABs are accessible by telephone rather than through a physical presence, the Council accepts that each jurisdiction's TAB is not a monopoly provider of gambling services. Clause 4 is therefore not relevant.

There are some remaining competition questions, however, relating to regulatory neutrality. The New South Wales TAB, which was privatised under legislation passed in December 1997, has a 15-year exclusive licence to provide a Centralised Monitoring System (CMS) for all gaming machines operated by registered clubs and hotels throughout New South Wales. Subsequent legislation (May 1998) granted the New South Wales TAB an exclusive 15-year licence to enter into agreements with clubs and hotels to install and run gaming machines on their premises and share in the profits derived from their operation.

The role of the CMS is to collect data on gaming machine operations throughout New South Wales. In part, these data are used to assist calculation of taxation obligations arising from the operation of gaming machines – previously, inaccurate assessment of gaming machine turnover had resulted in losses of taxation revenue to the State). However, the regulatory role of the CMS has possible implications for competition – particularly in relation to the access the TAB might have to information on machines operated by its competitors.

As discussed in the section of this report dealing with the NCP legislation review program, the Council will consider progress in relation to legislative restrictions on gambling activity in its third tranche assessment, following the Productivity Commission review of the economic and social impacts of gambling currently underway. The Council will take account of any implications for competition flowing from relevant matters, including the regulatory role of the New South Wales TAB, as part of this assessment.

Australian Barley Board

In 1997, the Victorian and South Australian Governments' commissioned a joint review of their *Barley Marketing Acts 1993*. The review recommended deregulation of domestic and export barley marketing arrangements in both States.[16]

As part of their barley market reforms, the States decided to privatise the Australian Barley Board (ABB), a statutory body established under the Barley Acts with the

[16] See Section B5 for a discussion of relevant legislation review matters.

power to compulsorily acquire and market the barley crop in both States, by mid-1999. The two governments established a government/industry Restructuring Committee to work through the issues associated with privatisation. The Committee's privatisation recommendations included:

- the establishment of a grower owned and controlled company to succeed the ABB (ABB Grain Ltd) to conduct domestic barley trading;
- the establishment of a wholly-owned subsidiary of ABB Grain Ltd (ABB Grain Export Ltd) to receive existing stocks of pooled barely and to have statutory marketing powers over bulk barley exports until mid-2001; and
- trading rules for both companies to ensure all grain sales and grain swaps are transparent and auditable (Parliament of South Australia 1999).

Victoria enacted legislation to give effect to these arrangements in April 1999. South Australia passed mirror legislation in May 1999.

Assessment

In general, the Council does not support the granting of statutory marketing powers to private companies. However, with respect to ABB Grain Export Ltd, the Council acknowledges:

- the relatively short period of time until the export barley market is opened to competition (that is, mid-2001); and
- the structures designed to ensure transparency in the dealings between the domestic and export operations of the companies until the export market is opened to competition in order to minimise the risk of domestic market distortions.

Therefore, the Council considers the Victorian and South Australian Governments have met their clause 4 obligations with respect to the ABB.

Victorian public transport system

The Victorian public transport system has been subject to considerable structural reform.

Until 1993, the Public Transport Corporation (PTC) provided a significant part of Melbourne's public route bus transport services. In December 1993, the National Bus Company assumed responsibility for about 75 per cent of the service previously provided by the PTC. In April 1998, the Melbourne Bus Link Company assumed responsibility for the balance of the services provided by the PTC.

In 1997, the Government commissioned a major review of the structural reform options for the metropolitan tram and train networks. The review examined matters covered by clause 4 of the CPA and made recommendations that were subsequently adopted by the Government.

The Government has adopted a two-stage approach to structural reform of the public sector train, tram and rail freight businesses.

- From 1 July 1998, five separate corporations were created under the Rail Corporations Act to provide metropolitan train and tram services and country rail passenger services (Bayside Trains, Hillside Trains, Swanston Trams, Yarra Trams, V/Line Passenger). The PTC remains as a statutory corporation with a limited life to manage residual non-operational functions and to provide certain integration services for the new operating corporations.

- The Transport Reform Unit of the Department of Treasury and Finance has almost completed a process of franchising the five businesses to the private sector.

A Public Transport Division within the Department of Infrastructure has been established to manage all contractual arrangements with public transport service providers.

Guarantees of third party access to infrastructure have been established in the privatisation arrangements.

Public transport industry regulation is fully separated from service provision. A separate Public Transport Safety Directorate has been established within the Department of Infrastructure to regulate safety across all the public transport modes.

Assessment

The Council is satisfied that Victoria has met its clause 4 obligations in respect of the introduction of increased competition and privatisation of the public transport system.

V/Line Freight

The V/Line freight business has been sold with a long-term lease over the country rail infrastructure. Operational control and maintenance responsibilities for the leased infrastructure lie with the private operator. The entire country network leased to the new operator of the V/Line freight business, plus its Dynon freight terminal, will be subject to a third party access regime. The Office of Regulator General will be the regulator under the regime.

In the public sector, V/Line conducted an uneconomic business of transporting parcels and palletised freight. This was considered to have a significant community service obligation (CSO) element. Continuation of this was a condition of sale and a specific and defined CSO payment will be made to the private sector operator.

The Government made these decisions after conducting a review of the structural reform options for the intra-state freight network. The review found that the gains in terms of competition from a vertically separated track and freight business would be outweighed by the technical inefficiencies that separation would introduce.

Assessment

The Council is satisfied that Victoria has met its clause 4 obligations in respect of the introduction of increased competition and privatisation of the intra-state freight network.

ACT Milk Authority

In 1998, the ACT Government reviewed its *Milk Authority Act 1971* (the Milk Act). The review considered, amongst other things, the dual regulatory and commercial roles that resided in the Milk Authority.[17]

Under the Milk Act, the Milk Authority of the ACT was responsible for acquiring and marketing milk in the ACT (commercial functions), but also for determining maximum retail prices for milk, market entry and franchising arrangements (regulatory functions). In practice, these dual functions gave the Milk Authority a monopoly over milk marketing in the ACT. The review noted that the Milk Act "*was not meant to preclude competition in the ACT market, but this has occurred as a result of the dual roles of regulation and marketing being merged*"(ACT 1998).

To address this problem, the review recommended that:

- regulatory functions be administered within a government department;
- a commercial entity be created to market and promote the *Canberra Milk* brand; and
- the Minister refer determination of maximum retail prices to the Independent Pricing and Regulatory Commission (IPARC).

Since the review, the ACT Government has moved to separate the Milk Authority's regulatory and commercial functions. The ACT Government has done this by dividing the Milk Authority's regulatory, commercial and price determination roles between three agencies within government, such that:

- the Department of Urban Services is responsible for regulatory functions, notably public health and safety;
- the Office of Financial Management within the Chief Minister's Department is responsible for commercial functions through its oversight of the Milk Authority, which is now responsible for managing existing distribution franchise contracts and purchasing raw milk contracts; and
- the IPARC will shortly be made responsible for advising the Minister for Urban Services on maximum retail price determinations.

Assessment

The Council is satisfied that the ACT has separated the commercial and regulatory functions of the Milk Authority and, therefore, met its second tranche clause 4 obligations. However, as the Australian dairy industry is undergoing a period of significant change, the Council will continue to monitor developments in the dairy industry in all jurisdictions, including the ACT, in future assessments of progress.

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[17] See section B5 for a discussion of relevant legislation review matters.