

## National Competition Council

Level 21, 200 Queen Street Melbourne 3000 Australia

GPO Box 250 Melbourne 3001 Australia

Telephone 03 9981 1600 Facsimile 03 9981 1650

Website: [www.ncc.gov.au](http://www.ncc.gov.au)



Ref:

29 November 2012

Mr David Headberry  
Headberry Partners Pty Ltd  
2 Parkhaven Court  
Healesville Victoria 3777

Dear Mr Headberry

### **Application for coverage of the South Eastern Pipeline System**

I refer to the application by Kimberley-Clark Australia (KCA) for coverage of the South Eastern Pipeline System (SEPS) and to our telephone discussion today.

In our discussion the NCC noted areas where it considered that KCA should develop its application by providing additional information that would be relevant to the NCC's recommendation on the application. The additional information sought relates to the National Gas Law coverage criteria (a) and (b). In addition the NCC asks that KCA examine the extent of confidential information in the application and consider whether any of this information can be made publicly available (or that KCA provide alternative information to support its claims).

**Criterion (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**

Whether competition will be materially enhanced in a dependent market(s) depends on the extent to which the pipeline service provider can and is likely to, in the absence of coverage, use market power to adversely affect competition in the dependent market(s). If the service provider has market power, as well as the ability and incentive to use that power to adversely affect competition in a dependent market, then coverage would be likely to improve the environment for competition, offering the prospect of tangible benefits to consumers (including reduced prices and better service provision).

The application at places suggests that KCA considers that there may be a (global) tissues and paper products market, a gas production market and a downstream gas user market. The NCC asks that KCA more clearly identify the relevant dependent market(s) and explain how access (or increased access) to the pipeline services provided by the SEPS will promote a material increase in competition in this

market(s). While there may be several relevant dependent markets, it may be sufficient in practice to examine only one or two of the most likely market(s).

**Criterion (b): that it would be uneconomic for anyone to develop another pipeline to provide the pipeline services provided by means of the pipeline**

The NCC's consideration of criterion (b) under the National Gas Law is directed by the recent *Pilbara Rail Appeal decision* by the High Court of Australia (The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal [2012] HCA 36). The High Court determined that the test under declaration criterion (b) (which is akin to the test under coverage criterion (b)) is one of profitability. The High Court said that criterion (b)

uses the word "uneconomic" to mean "unprofitable" [and] is to be read as requiring the decision maker to be satisfied that there is not anyone for whom it would be profitable to develop another facility. (at [77])

The High Court went on to say that

the central assumption informing and underpinning this construction of criterion (b) is that no one will develop an alternative service unless there is sufficient prospect of a sufficient return on funds employed to warrant the investment. And criterion (b) is read as directing attention to whether there is "anyone" for whom it would be economical (in the sense of profitable, or economically feasible) to develop another facility to provide the service. (at [82])

The High Court also made a number of observations about the nature of the criterion (b) inquiry. To assist you in providing the additional information sought by the NCC I have set out below some relevant High Court's observations.

- The meaning previously given to the word "anyone" in criterion (b) as excluding the incumbent owner or operator of the facility 'proceeded from an incorrect construction of criterion (b)'. The High Court said that "anyone" in criterion (b) 'includes existing and possible future market participants.' (at [105])
- Whether it would not be profitable for someone to develop another facility to provide the service requires that 'the person could reasonably expect to obtain a sufficient return on capital that would be employed in developing that facility' (at [104]). If someone could profitably develop an alternative facility as part of a larger project, it would be  

necessary to consider the *whole* project in deciding whether the development of the alternative facility, as part of that larger project, would provide a sufficient rate of return' (at [104])
- Asking whether it would be unprofitable for anyone to develop an alternative facility is not asking a question 'to which no answer can be given with any sufficient certainty'. The High Court said that  

it is a question that would require the making of forecasts and the application of judgment. But the converse question – whether it would be economically

feasible to develop an alternative facility – is a question that bankers and investors must ask and answer in relation to any investment in infrastructure. Indeed, it may properly be described as the question that lies at the heart of every decision to invest in infrastructure, whether that decision is to be made by the entrepreneur or a financier of the venture. (at [106])

- The High Court observed that a private profitability test may result in the duplication of a natural monopoly but said that

duplication would occur only if it were profitable for another to develop an alternative facility to provide the service (despite the fact that total market output could be supplied at lowest cost by one facility). It *would* be profitable for another to develop an alternative facility if the new facility is more efficient than the existing facility... . And if the new facility is *not* more efficient than the existing facility, it is to be doubted that development of the new facility in competition with a natural monopoly would be profitable. Especially would that be so where, as here, the capital costs of establishing the new facility would necessarily be very large. (at [102])

The NCC's assessment of the application against criterion (b) will require it to consider whether it is profitable to duplicate the SEPS. While the application deals with this to some extent (in particular the discussion in various places of pipeline capacity utilisation) it would assist the NCC's consideration if there were some supporting data on the cost of duplicating the SEPS. In this regard, you indicated that KCA may have some information on the cost of duplication and the consequences for transport tariffs. This information would assist the consideration against criterion (b).

#### **Confidential information**

In addition to seeking additional information to support the arguments on criteria (a) and (b), the NCC notes that much of the data in the application supporting KCA's claims is currently confidential. As discussed, it would assist KCA's claims if there are publicly available supporting data: it is difficult to test claims where supporting data are not publicly available. The NCC would like KCA to review the extent of confidential information with a view to ensuring that information supporting KCA's arguments is, as far as possible, publicly available.

#### **Consequences for period for submissions on the KCA application**

The NCC proposes to provide until close of business 7 January 2013 for KCA to submit the additional information. The effect of this will be to extend the time such that the 15 working day period for public submissions on the KCA application will commence on 8 January 2013 and conclude at close of business on 29 January 2013.

I look forward to receiving the additional information by 7 January 2013. You are welcome to call me on 03 9981 1607 if you have any questions. As discussed we are also happy to meet with you in Melbourne if this would assist.

We propose to place this letter on the NCC's website along with the application so that other parties are aware of the nature of the additional information that the NCC has sought from KCA and the reasons for and operation of the extension of the time for this matter.

Yours sincerely

A handwritten signature in blue ink that reads "Ross Campbell". The signature is written in a cursive style with a large initial 'R'.

Ross Campbell  
Director