The Interstate Transmission of Gas and Electricity: Some Constitutional and Competition Law Issues

*James Philips**

* BA, LLM (Syd). Solicitor, Sydney.

INTRODUCTION

New interstate gas pipeline and electricity interconnections may give a discounted net benefit to Australia of $1,795 million over 35 years.[1]

At present, the only interstate gas pipeline in from Moomba (South Australia) to Sydney (the pipeline from Eromanga Basin in south-western Queensland to Moomba could be classified as interstate, when it comes on stream some time in 1994). There is an existing electricity link between New South Wales and Victoria (1,000 megawatts) and a link between Victoria and South Australia (400 megawatts).

Proposed new gas pipelines include North West Shelf (Western Australia) to Amadeus (Northern Territory), Amadeus to Moomba, North West Shelf to Adelaide and Adelaide to Melbourne. Possible new electricity links include New South Wales to Queensland (400 megawatts),[2] New South Wales to South Australia (300 megawatts) and Victoria to Tasmania (300 megawatts).[3]

The long-distance transmission of gas and electricity is commonly regarded as a natural monopoly, because it is cheaper for one firm to supply the transmission system than for two or more firms to supply it.[4] It is therefore uneconomic to duplicate the transmission system.

The possible significant development in coming years of interstate gas and electricity transmission infrastructure in Australia gives rise to legal issues arising from:

- the fact that a number of the transmission facilities will cross State borders; and
- the character of these transmission facilities as natural monopolies.

The relevant legal issues on which I wish to comment for the purposes of this paper are:

- interstateness—issues arising under the Commonwealth Constitution; and
- natural monopolies—competition law issues.

The principal aspect of the Commonwealth Constitution on which I will comment is s 92, although I will also consider whether s 51(i) may have a role in some contexts.

In relation to competition law issues, I have agreed with Professor Robert Baxt (who is also writing a paper for AMPLA's 1994 Yearbook and Conference) that I will consider the legal regime relating to access to essential facilities under Australia's competition law, whilst Professor Baxt will deal with other competition law issues, particularly the implications of the Hilmer Report.

1. *The Economics of Interconnection: Electricity Grids and Gas Pipelines in Australia* (Australian Bureau of Agricultural and Resource Economics, August 1993), page 35.
2. An agreement was entered into between the New South Wales, Queensland and Commonwealth governments in December 1993 to undertake technical studies, route selection, conduct of necessary environmental approvals, consultation with affected communities and acquisition of line easements for the purposes of this link.
3. *The Economics of Interconnection*, op cit, pp 16, 22 and 23.
4. Ibid, p 1.

To understand some of the hypothetical scenarios posed in this paper, the reader needs to be aware that it is possible that one or more States may perceive it to be in their interests to not participate in a "national electricity grid"—so-called even though it is unlikely to include the Northern Territory or Western Australia—because of the substantial transmission losses that would be sustained in transmitting electricity between those places and other States.

To understand the scale of the States' interest in the current structure of electricity transmission grids (with the only existing interstate connections being the 1,000 megawatt connection between New South Wales and Victoria and the 400 megawatt connection between Victoria and South Australia), it is worth noting that, for example, the revenue which the State of New South Wales received in the six months ending 31 December 1993 by way of dividends and tax equivalents from the Electricity Commission and Sydney Electricity (an electricity distribution authority) was $573,355,900 or 10.16 per cent of total receipts of the State for that period, excluding Commonwealth grants, of $5,646,611,000.[5]

SECTION 92 OF THE COMMONWEALTH CONSTITUTION

Section 92 provides that:

> "On the imposition of uniform duties of customs, trade, commerce and intercourse among the States, whether by means of internal carriage or ocean navigation, shall be absolutely free."

The broad language of s 92 has caused judges difficulty, and allowed them flexibility, in the application of the section to specific facts. One judge has lamented:

> "Some hint at least might have been dropped, some distant allusion made, from which the nature of the immunity intended could afterwards have been deduced by those whose lot it is to explain the elliptical and expound the unexpressed."[6]

The effect of s 92 has been problematic, particularly in relation to:

- the ability of the Commonwealth to regulate interstate trade; and
- the extent to which the intrastate regulation of trade in a manner which impacts on interstate trade is permissible.

The High Court's current interpretation of s 92 is found in *Cole v Whitfield*.[7] *Cole v Whitfield* is a curious judgment: as has been noted, it is in substance an advisory opinion on the meaning of s 92.[8]

5. "Receipts and Outlays", *Government Gazette of the State of New South Wales*, Week No 14/94.
6. *James v Cowan* (1930) 43 CLR 366 at 422 per Rich J.
7. (1988) 165 CLR 360.
8. P H Lane, "The present test for invalidity under s 92 of the Constitution" (1988) 62 ALJ 604 at 613-614.

I will not comment on judicial decisions before *Cole v Whitfield*, on the basis that *Cole v Whitfield* is a seminal decision which represents a new interpretation of s 92.[9]

Whitfield managed a crayfish farm which sold crayfish in Australia and internationally. It grew crayfish in Tasmania for this purpose. When it did not have enough of its own crayfish to satisfy demand, the farm bought crayfish. It bought a catchment from a South Australian fisherman. The crayfish were all of a size greater than the prescribed minimum size at which crayfish could be caught in South Australia. The crayfish were smaller than the prescribed minimum size in Tasmania. An inspector with the Tasmanian Fisheries Development Authority found some of the South Australian catch at the farm managed by Whitfield—these crayfish had been cooked. Whitfield was charged under Tasmanian regulations with possession of undersized crayfish. He pleaded in effect that the Tasmanian regulation was invalid under s 92 of the Constitution.

In an unanimous judgment of all seven members of the High Court, the court described a principle to the effect that a law is impugned by s 92 if its effect is discriminatory against interstate trade or commerce and the law thereby protects intrastate trade and commerce of the same kind.

The regulation under which Whitfield had been charged did not discriminate between crayfish caught in Tasmania or elsewhere. This may have been enough to dispose of the case. However, the court went on to consider the purpose of the regulation (to assist in the protection and conservation of Tasmanian crayfish). This was not a protectionist purpose.

The fact that the court went on to consider the purpose of the Tasmanian regulation even after it had found that the regulation did not discriminate between crayfish caught in Tasmanian waters and outside Tasmanian waters indicates that:

- the test enunciated by the court (discriminatory and thereby protectionist) should not be taken too literally;
- protectionism is the evil prohibited by s 92—discrimination in this context occurs to enable protection of intrastate trade to occur.

The difficulty with the proposition that s 92 is aimed against attempts to introduce protectionist legislation is that this is as broad and general a statement as the text of s 92 itself. We are likely to continue to see difficulties in interpreting s 92, even with the *Cole v Whitfield* test.

These difficulties are illustrated by the case heard by the High Court immediately after it had heard *Cole v Whitfield*: *Bath (Commissioner of Business Franchises for the State of Victoria) v Alston Holdings Pty Ltd*.[10]

9. See, for example, ibid at 604: "A new test for the application of s 92 to a law challenged under this section of the federal Constitution was created by the decision of the High Court of Australia in *Cole v Whitfield* . . ." and *Cole v Whitfield* at 407: "Departing now from a doctrine which has failed to retain general acceptance, we adopt the interpretation which, as we have shown, is favoured by history and context."
10. (1988) 165 CLR 411.

In *Cole v Whitfield* the High Court had been unanimous. In *Bath v Alston Holdings* the court was divided 4:3.

The regulation under consideration by the court prohibited the retail sale of tobacco in Victoria by unlicensed persons. The fee for a retail licence was a fixed amount plus 25 per cent of the value of all tobacco sold by the licensee in a previous period which had not been bought in Victoria from the holder of a wholesale tobacco merchant's licence. Wholesalers also paid fees for wholesale licences. Fees for wholesale licences were calculated as a fixed amount plus 25 per cent of the value of all tobacco sold by the licensee in a previous period.

The form of this regulation was clearly discriminatory. All members of the court agreed on that. The majority found the Victorian regulation invalid because it was protectionist in form and in substance. That was because the effect of the legislation was:

> "to discriminate against tobacco products sold by wholesalers in the markets of another State and to protect both Victorian wholesalers and the products which they sell from the competition of out of State wholesalers and their products."[11]

The minority also looked at the effect of the regulation. Whereas the majority had emphasised that the effect was to discriminate against purchases from interstate wholesalers, the minority emphasised that the effect of the regulation was to preserve the State's revenue base (by encouraging purchases from Victorian wholesalers, who had paid tax to the State) and to avoid discriminating against Victorian wholesalers.

In economic terms, the majority treated the relevant market in which it looked for a protectionist effect as the market in which wholesalers sell cigarettes to retailers. The minority found as a fact that, looking at the markets in which both wholesalers and retailers bought and sold cigarettes, the effect of the Victorian regulation was not protectionist because the effect of the retail licence fee was to ensure that a licence fee had been payable in Victoria in respect of all cigarettes sold by retailers in Victoria, irrespective of whether the retailer had bought the cigarettes from a Victorian wholesaler or an interstate wholesaler.

The minority judgment is interesting for two reasons. First, implicit in the minority's judgment is that when considering whether regulation is protectionist it is appropriate to look at each functional market for a product—for example, sale by manufacturer to wholesaler, and sale by wholesaler to retailer. If the aggregate effect of the legislation at all functional levels of the market for a product is not protectionist, the legislation is not protectionist even though it may have a protectionist effect in relation to one functional level of the market for the product. This contrasted with the majority's implicit finding that it is enough to find protection in a single functional market for a product—for example, sale of a product by wholesaler to retailer.

Secondly, it is interesting that the minority formed the view that the effect of the licence fee at the retail level was equivalent to the licence

11. Ibid at 426.

fee at the wholesale level. It is not apparent from the reported decision of the case that this opinion was based on expert evidence given by an economist.

Perhaps it would be desirable for the High Court to make explicit that before a court can apply the two limbs of the *Cole v Whitfield* test, it must first determine the relevant product and functional market or markets in which it is looking for discrimination of a protectionist kind.

If this extra, and logically first, step were added to the *Cole v Whitfield* test, it would throw into sharper focus the difficulty that judges are likely to experience in defining markets. This might encourage courts to explicitly rely in s 92 cases on expert economic evidence on the question of market definition.

One commentator has suggested that, since *Cole v Whitfield*, it has become essential for courts hearing s 92 cases to rely on expert economic evidence. The commentator has suggested that this process will be too time consuming for the High Court, and made the suggestion that the High Court should remit s 92 cases to the Federal Court for the purpose of hearing appropriate evidence as to the economic issues which appear now to be relevant to the *Cole v Whitfield* approach to the interpretation of s 92.[12]

In *Barley Marketing Board (NSW) v Norman*[13] the seven members of the High Court gave a joint judgment in which they held that legislation which established a board in which all barley produced in New South Wales was vested did not contravene s 92 because it did not discriminate against the interstate trade in barley or interstate traders in that commodity.

The court applied the *Cole v Whitfield* test. As there was no discrimination against interstate trade, the regulation was not impugned by s 92.

We have seen that in *Bath v Alston Holdings* the judges who gave the majority judgment chose to focus on discrimination in the functional market in which retailers buy from wholesalers. The minority judges looked at two functional levels of the relevant product market, the level at which wholesalers buy from manufacturers and the level at which wholesalers sell to retailers.

In the *Barley Marketing Board* case, the difficulty which emerged in the application of the *Cole v Whitfield* test was not the apparent scope for the different definition of the relevant market or markets: the difficulty was in the process of an identifying discrimination. The High Court found that the relevant marketing board legislation did not lead to any discrimination because:

- interstate maltsters and intrastate maltsters were all prohibited from buying from intrastate producers of barley; and
- interstate maltsters and intrastate maltsters were all able to buy from the Board.

12. A S Bell, "s 92, Factual Discrimination in the High Court" (1991) 20 FLR 240 at 250. See also R Cullen, "s 92: Quo Vadis?" (1989) 19 WA L Rev 90 at 123.
13. [1990] 65 ALJR 49.

There was therefore no discrimination against out-of-State maltsters.

The court did not pose the question whether there was any discrimination against intrastate producers. Presumably the answer would have been that there was, because intrastate producers were prohibited from selling to anyone other than the Board.

Perhaps the reason that the court did not pose this question was that it is only discrimination against interstate buyers or sellers that matters for the purposes of s 92, because discrimination against intrastate buyers or sellers cannot be protectionist. If that was the reason for the court's failure to consider whether there had been discrimination against intrastate producers, it would be interesting to hear expert economists testing that hypothesis.

Another question which the court did not pose was whether the marketing board legislation was discriminatory against interstate producers in that their barley was not vested in the Board. The court appears to have accepted that the vesting of barley in the Board was in the interests of small producers of barley.[14] Why wasn't the exclusion of interstate small producers discrimination against them?

The court's method on this point is all the more surprising because the court had expressly considered whether interstate and intrastate maltsters were treated equally. Why wasn't the same methodology appropriate in relation to producers of barley?

If the court's judgment contained an explanation based on economic evidence as to why discrimination of a protectionist kind could occur against maltsters but not against producers, it would be easier to understand the basis of the court's failure to enquire whether there was discrimination of a protectionist kind against producers.

Similarly in *Bath v Alston Holdings* it would be easier to understand the majority's focus on one functional level of the cigarette market if there was economic evidence that the cigarette retailers' licence fee was protectionist even though it could apparently be characterised as merely equalising the effect of the cigarette wholesalers' licence fee at a different level of the market for cigarettes (manufacturers to wholesalers) in respect of cigarettes bought interstate.

The *Barley Marketing Board* and *Bath v Alston Holdings* cases give rise to two unresolved questions:

- is it impossible, as a matter of law or economics, for discrimination with a protectionist effect to occur against some market participants? If so, how is this class of participants identified?
- can a court have regard to more than one functional level of a market for goods and services in considering whether there is discrimination with a protectionist effect, or can it only look at the functional level of the market at which the measure which has given rise to the s 92 claim operates?

A consequential question is whether these questions should be answered with the benefit of economic analysis, or simply by more new judicial law without apparent economic input.

14. Ibid at 55.

I would like to consider some of the implications of this law for the interstate trade of gas and electricity.

State marketing scheme for electricity

Let us assume that New South Wales introduced legislation which required all electricity generated in New South Wales to be sold to the Electricity Commission (which trades under the name "Pacific Power"). This scenario assumes that either the Electricity Commission is not the sole generator of electricity in New South Wales, or that the barriers to entry in the New South Wales electricity generation market are not perceived to be insurmountable. A marketing scheme of this sort would not be necessary if the Electricity Commission had a present and unassailable monopoly on electricity generation in New South Wales.

It seems that the effect of the *Barley Marketing Board* decision is that a scheme like this would not contravene s 92 of the Constitution, provided that the scheme was not coupled with discrimination by the Electricity Commission against buyers from the Electricity Commission who were situated outside New South Wales.[15]

The reader will recall that in the *Barley Marketing Board* case the High Court found that legislation which established a board in which all barley produced in New South Wales was vested did not contravene s 92 because it did not discriminate against the interstate trade in barley or interstate traders in that commodity. The rationale was that interstate traders could buy from the Barley Marketing Board. The court did not consider discrimination at the producer-to-trader functional level of the barley market. The electricity marketing scheme which I have described is directly analogous.

It might be expected that as a commercial matter, a scheme like this may produce different behaviour at the wholesale (Electricity Commission to buyer) level because it would have the effect of giving the Electricity Commission very substantial power in that market.

Whether competition law would effectively constrain such an instrumentality would then have to be considered.

It might be that a marketing scheme of this sort would be attractive to a State which was connected to a national grid but which wished to give its instrumentality very considerable power in the wholesale market.

The use of the State marketing scheme for electricity such as the scheme that I have described above could be attractive to a State which found itself unable to avoid participating in a national electricity grid, but was unwilling to either reform its intrastate electricity industry or to diminish the flow of monopoly rent profits from its State-owned electricity industry to the State.

15. It is uncontroversial to note that s 92 applies to electricity: see eg *Bank Nationalisation Case* (1948) 76 CLR 1 at 381-382.

The reader will see that a number of comments that I have made in relation to a marketing scheme of this sort describe economic phenomena which I have not tested. The purpose of describing this hypothetical scenario is to test whether a particular structure would be invalid under the Constitution and not to authoritatively describe the economic outcomes which would result from that structure.

Of course, my comments in relation to a State marketing scheme for electricity, would also apply to a State marketing scheme for gas. However, the level of State vested interest in the current structure of the gas industry is much lower than in the electricity industry. It is correspondingly less likely that States will resist the development of a national gas grid.

Does s 92 prohibit States from disconnecting from an interstate grid?

It seems fairly clear that legislation which had the effect of causing disconnection of a State from an interstate grid would be discriminatory (in that it targeted only those transmission connections which connected the State with other States) and protectionist (in that it prevented the sale of electricity across the relevant State boundaries). The legislation would appear to be clearly invalid under the *Cole v Whitfield* test.

It is perhaps more likely that any disconnection would occur as a result of executive action by a State electricity transmission authority, which may or may not be acting at the direction of the relevant Minister. Would executive action of this sort contravene s 92?

Professor Howard has stated that:

> "It is settled that s 92 applies as much to executive as to legislative interference with freedom of interstate trade."

He cites a number of cases in support of this proposition.[16]

An executive attempt to physically disconnect a State from an interstate electricity grid could therefore be restrained. A State which wished to resist participation in an interstate grid, but which was already connected with other States, may have to consider other methods.

Does s 92 prohibit States from keeping their electricity transmission grids full, with the effect that interstate electricity cannot flow into the intrastate grid?

The idea here is that electricity transmission systems have a maximum capacity which cannot be safely exceeded. I assume for the purpose of this example that there is a switch at the point of interconnection of State A's grid with State B's grid, and the switch is controlled by an

16. C Howard, *Australian Federal Constitutional Law* (3rd ed, 1985), pp 316-317.

instrumentality of State B. If the transmission grid at the point of interconnection was already carrying electricity at its maximum safe capacity, State B's grid management entity may argue that it must use the switch to prevent electricity from State A's grid flowing into State B's grid.

For the purposes of considering this scenario, I will ignore the likelihood of this being a probable scenario—it is a physically possible scenario and could be achieved by accident or design.

A plaintiff attacking this scenario would be seeking an order based on the premise that the conduct of State B's instrumentality in keeping the intrastate grid full at the point of interconnection was discriminatory in a protectionist sense.

I will assume for the sake of simplicity that the generator, power user and transmission authority who would probably each be involved in the process of keeping State B's grid full are all part of the same State-owned enterprise.

The case of greatest assistance in considering the plaintiff's prospects is probably *Castlemaine Tooheys Ltd v State of South Australia*.[17]

In *Cole v Whitfield* the High Court recognised that the s 92 guarantee against protectionism was not absolute:

> "A law which has as its real object the prescription of the standard for a product or a service or a norm of commercial conduct will not ordinarily be grounded in protectionism and will not be prohibited by s 92. But if a law, which may be otherwise justified by reference to an object which is not protectionist, discriminates against interstate trade or commerce in pursuit of that object in a way or to an extent which warrants characterisation of the law as protectionist, a court will be justified in concluding that it nonetheless offends s 92".[18]

In the *Castlemaine* case, the court had to consider State legislation which provided that:

- retailers of beer were obliged to accept the return of and refund a deposit on non-refillable beer bottles, but were not obliged to accept the return of refillable bottles; and
- the deposit payable on return of a refillable beer bottle was $0.04 while the deposit paid on return of a non-refillable beer bottle was $0.15.

South Australian brewers used refillable beer bottles, whilst Castlemaine Tooheys Ltd (which was trying to break into the South Australian market from interstate) used non-refillable beer bottles which it brought into South Australia.

All seven members of the High Court found that the South Australian legislation was in breach of s 92. In a joint judgment of five judges (Mason CJ, Brennan, Deane, Dawson and Toohey JJ) it was said:

17. (1990) 169 CLR 436.
18. *Cole v Whitfield* at 408.

". . . interstate trade, as well as intrastate trade, must submit to such regulation as may be necessary or appropriate and adapted either to the protection of the community from the real danger or threat to its welfare or to the enhancement of its welfare. . .".[19]

The analysis required to ascertain whether State legislation or regulation is in breach of s 92, as described in the *Castlemaine* case, has been summarised[20] as:

(1) Is there a legitimate local interest in need of protection?

(2) Are the measures necessary or appropriate and adapted to protecting the local interest?

(3) Is the impact on interstate trade and commerce incidental and not disproportionate to the achievement of the objective of protecting the public interest?

This analysis would require some adaptation in order to be applied to executive action of the sort which I have assumed exists in our hypothetical scenario, where a State-owned electricity monopoly kept an interstate grid full at the point of an interstate connection.

The outcome of a case on this scenario would turn very much on its facts, depending on factors such as those raised in the *Castlemaine* case.

Presumably if, for example, the fullness of State B's grid was caused by the fact that State A's interconnection was at a point in State A's grid between a major power generation facility and an aluminium smelter, it may be likely that a court would find that the inability of interstate electricity to enter the grid was an incidental effect of the need of State B's electricity supplier to supply the aluminium smelter with electricity. In this case the conduct may not contravene s 92.

If however it appeared that State B's electricity authority was routing electricity via the point of interconnection even though routing the electricity in that way was not the most cost-effective way to route the electricity, a court may find that this conduct was disproportionate to the achievement of the objective of supplying electricity to customers. In this case the conduct may contravene s 92.

Does s 92 impose on the States an obligation to build high capacity transmission interconnections between the States?

Section 92 does not in its terms impose an obligation on anyone to construct interstate infrastructure. I am not aware of it having been found, or even argued, that s 92 imposes such a positive obligation.

In ascertaining the meaning of s 92 in its *Cole v Whitfield* decision, the High Court looked in some detail at the debates and Conventions which preceded the drafting of the Commonwealth Constitution. It

19. *Castlemaine* at 472.

20. G Carney, "The Reinterpretation of s 92: The Decline of Free Enterprise and the Rise of Free Trade" (1991) 3 Bond LR 149 at 163.

would be surprising if those debates and Conventions provided any basis for an argument that s 92 imposes a positive obligation to build infrastructure. At the time of the debates and Conventions, States were connected by sea, road and rail. It seems unlikely that the question of other forms of infrastructure connections for trade would have been considered.

It seems unlikely that s 92 imposes on the States an obligation to build high-capacity transmission interconnections between the States.

Does s 92 impose on the Commonwealth an obligation to build interconnecting transmission systems?

It seems to me that it will be difficult to make out this argument, for the reasons considered under the previous subheading.

However, it is worth considering in this context the possibility of the Commonwealth choosing to use its power under s 51(i) to build interconnections.

Section 51(i) provides that:

> "The Parliament shall, subject to this Constitution, have the power to make laws for the peace, order and good government of the Commonwealth with respect to trade and commerce . . . among the States."

The hypothetical scenario gives rise to a number of issues:

- is the construction of an interconnection trade or commerce?
- if it is, is it interstate trade and commerce?
- could the Commonwealth acquire a corridor of land for the purpose of building the interconnection?
- in building the interconnection, would the Commonwealth have to comply with State planning and environmental laws?
- once the interconnecting transmission lines were in place, could the Commonwealth actually connect them to the State transmission grids at each end of the interconnection?

The second of these issues can be disposed of quickly—if the activity of building the interconnection is trade or commerce, it is clearly interstate trade or commerce as the interconnection will cross a State border.

In relation to the first issue ("is the construction of the interconnection trade or commerce?") *Australian National Airways Pty Ltd v Commonwealth*[21] is authority for the proposition that the provision of an interstate transport service is trade or commerce for the purposes of s 51(i). The provision of an interstate electricity transmission service appears to be directly analogous.

As long as the Commonwealth-built interconnection could not be used for carrying intrastate electricity on either side of the border, the interconnection would carry electricity in the course of interstate trade

21. (1945) 71 CLR 29.

and commerce. If the interconnection could carry intrastate electricity, it would cease to have the characteristic of providing interstate trade and commerce for the purposes of s 51(i).[22]

Currently it appears unlikely that the Commonwealth will attempt to force the pace of formation of a national electricity grid by building interstate transmission interconnections. The Commonwealth government has offered $100 million in its "One Nation" statement for grid upgrading and new interconnections between the States. According to Senator Collins, the current Minister for Primary Industries and Energy, the Commonwealth, New South Wales and Queensland governments are working co-operatively to do the necessary work to make a grid interconnection between New South Wales and Queensland a reality.[23]

As the possibility of the Commonwealth unilaterally seeking to build interstate connections seems, at this stage, hypothetical, I will not in this paper consider the other issues identified above in relation to the possible use of s 51(i) for the purpose of the Commonwealth building interstate electricity connections.

It is worth noting, however, that s 51(i) may give the Commonwealth the power to take some action to encourage the development of a national electricity grid if it perceives that the current co-operative Commonwealth/State approach to the development of a national grid is not working because of express or tacit opposition from one or more States.

What about gas?

The constitutional issues which I have considered in the above hypotheticals are equally applicable to gas. I have framed them in relation to electricity for simplicity, and also because the lower level of State vested interest in the gas industry makes State agendas less complex in relation to the development of the interstate trade of gas.

ESSENTIAL FACILITIES AND AUSTRALIAN COMPETITION LAW

The long-distance transmissions of gas and electricity are commonly regarded as natural monopolies because it is uneconomic to duplicate the transmission systems.

The owner of a transmission system could, in an unregulated environment:

- extract monopoly profits from users of the system; and
- prevent some buyers and sellers from doing business on the route controlled by the monopolist.

22. Ibid.
23. Ministerial Address to the Electricity Supply Association of Australia, Sydney, 20 April 1994.

This conduct in the Australian gas or electricity markets would obviously be inimical to the creation of interstate markets in gas and electricity.

How is the monopoly power of transmission system owners controlled in Australia?

There are a number of current developments which will affect the answer to this question. For this reason, it would not be productive for this paper to focus exclusively on the question of whether s 46 of the *Trade Practices Act* 1974 provides an adequate or complete answer to the question. I will therefore deal with the issue of the regulation of access to transmission facilities as follows:

- what is the essential facilities doctrine?
- can s 46 of the *Trade Practices Act* play a role in relation to third party access to transmission facilities?
- how is it proposed that third party access to transmission facilities will be ensured under the national electricity grid model?
- what are the relevant recommendations of the Hilmer Committee?
- how is Victoria dealing with the issue of third party access to transmission facilities in its reform measures?
- what has the Council of Australian Governments ("COAG") decided to do on this issue?

What is the essential facilities doctrine?

Section 2 of the *Sherman Anti-Trust Act* 1890 provides that:

> ". . . every person who shall monopolise, or attempt to monopolise, any part of trade or commerce . . . shall be guilty of a misdemeanour . . ."

One of the tests which the United States Supreme Court has developed in determining whether a misdemeanour under s 2 has been committed is the essential facilities doctrine.

The essence of the doctrine is that any person who controls a facility that is essential to another person's ability to compete in a market is guilty of monopolisation under s 2 if the person refuses to allow the other person access to the facility on reasonable terms.[24]

The first case dealing with a unilateral refusal to grant access to an essential facility was *Otter Tail Power Co v United States*.[25] Otter Tail was a vertically integrated generator, transmitter and retailer of electricity. The company refused to allow another party to transmit its

24. J G M Shirtcliffe, "Access to Essential Facilities in Electricity Supply", September 1991, written whilst the author was the holder of the Energy and Natural Resources Law Association (New Zealand) Law Scholarship in 1991. My description of the doctrine is based principally on Shirtcliffe's paper.
25. 410 US 366.

electricity using Otter Tail's transmission system. The Supreme Court held that this refusal contravened s 2 of the Sherman Act and ordered Otter Tail to "wheel" (the United States term) the other party's power. The court did not, however, expressly rely on what is now known as the essential facilities doctrine.

The first case in which that doctrine was expressly enunciated was *Hecht v Pro-Football Inc.*[26]

The owner of a football stadium refused a team access to the stadium. The owner had promised another team, the Redskins, that it would not allow teams other than the Redskins to use the stadium. The court held that the stadium was an essential facility which must therefore be shared on fair terms.

The description of an essential facility which has been most frequently cited in recent years[27] appears in *MCI Communications Corp v AT & T Co*[28] which requires:[29]

"(1) the control of the essential facility by a monopolist;

(2) the competitor's inability practically or reasonably to duplicate the essential facility;

(3) the denial of the use of the essential facility to a competitor;

(4) the feasibility of providing the facility."

This test obviously gives rise to a number of questions such as: what is an essential facility? what is a practical or reasonable inability to duplicate? and what is denial of use?

I do not propose to analyse these issues, or the doctrine. My purpose in providing a short description of it is simply to ensure that the reader is aware of the existence of this doctrine. As anti-trust law is more developed in the United States than competition law is in Australia, I believe that an awareness of the United States treatment of the issue of access to essential facilities which are natural monopolies is useful background in considering this issue in the context of the Australian gas and electricity industries.

Can s 46 of the Trade Practices Act play a role in relation to third party access to transmission facilities?

The essential elements of a s 46 cause of action are:[30]

- the firm whose conduct is being examined must possess a substantial degree of market power;
- the firm must have engaged in conduct for one or more of several purposes which relevantly include the purpose of preventing entry of a firm into a market; and

26. 570 F 2d 982.
27. Shirtcliffe, op cit, p 17.
28. 708 F 2d 1081.
29. Ibid at 1132-3.
30. See Sweeney QC, "Section 46 Trade Practices Act", a paper given on 3 November 1993 at a seminar organised by the University of Sydney Faculty of Law on the topic "Current Issues in Restrictive Trade Practices" at pp 2-3.

- the conduct must constitute a taking advantage by the firm of its substantial market power.

The seminal Australian case is *Queensland Wire Industries v Broken Hill Proprietary Co Ltd.*[31] BHP was in a position to substantially control the market for relevant steel products and had refused to sell one of those products to Queensland Wire on reasonable terms. The High Court held that this refusal contravened s 46, and that BHP should supply the product to Queensland Wire on reasonable terms.

If third party access to natural monopoly gas and electricity transmission facilities is not dealt with by either special purpose regulatory regime or a new essential facilities regulatory regime, s 46 as interpreted in the *Queensland Wire* case would seem to provide the basis for an action by a third party seeking access to transmission facilities on reasonable terms.

I do not propose to analyse this issue in detail in this paper because my objective is to give an overview of developments which may impact on third party access to gas and electricity transmission systems in Australia. Further, it appears unlikely that the issue of third party access to central facilities will be left to the existing provisions of the *Trade Practices Act* (see "What are the relevant recommendations of the Hilmer Committee?" on the following page).

How is it proposed that third party access to transmission facilities will be ensured under the national electricity grid model?

In its October 1993 report, *Regulatory Arrangements for a National Electricity Market*, the National Grid Management Council ("NGMC") recommended (at para 4.3.1) that third party access to the electricity transmission system should be regulated in the following manner:

- there would be a connection code of conduct, prepared by the NGMC and endorsed by COAG;
- parties connecting to the grid would enter into a contract giving a commitment to each other to meet the NGMC's proposed National Grid Protocol standards and conditions;
- a failure to comply with the contract/Protocol could be pursued through the courts on a common law breach of contract basis;
- the Trade Practices Commission (or if the Hilmer Committee's recommendations are adopted, the Australian Competition Commission) would oversee the code of conduct and provide advice to the NGMC on its terms;
- the provisions of the *Trade Practices Act* would be available, in addition to common law actions for breach of the connection contract/Protocol; and
- if the *Trade Practices Act* is amended to implement the Hilmer Committee's recommendations for provision of access to essential facilities, an action under those provisions could also be taken.

31. (1988) 167 CLR 177.

This structure could be characterised as more light-handed than the alternative model considered by the NGMC, which would involve the creation of a national electricity industry specific regulator. The industry specific approach was rejected by the NGMC for a number of reasons, including that it was not consistent with the Hilmer Committee's recommendations.

What are the relevant recommendations of the Hilmer Committee?

The most relevant recommendations of the Committee[32] are:

- that all Australian governments should adopt a set of principles aimed at ensuring that public monopolies are subject to appropriate restructuring, including:
  - — the separation of regulatory and commercial functions;
  - — the separation of natural monopoly and potentially competitive activities; and
  - — the separation of potentially competitive activities into a number of smaller independent business units;[33]
- that a new legal regime be established under which firms could in certain circumstances be given a right of access to specified essential facilities on fair and reasonable terms. Key features would include:
  - — the regime could only be applied to a facility without the owner's consent if declaration was recommended by the proposed National Competition Council after a public inquiry;
  - — the access declaration would specify pricing principles for the individual facility;
  - — the access declaration would specify any other terms and conditions relating to access designed to protect the legitimate interests of the owner of the facility; and
  - — all access agreements would be required to be placed on a public register;[34]
- that it is not appropriate to have industry specific competition regulators.[35]

The first of these three points relates to industry structure. The third relates to regulatory structure. The most specifically relevant point is the second point—if this recommendation is implemented, a party seeking access to a natural monopoly transmission facility may have a basis of legal redress in addition to s 46 of the *Trade Practices Act*.

32. *National Competition Policy—Report by the Independent Committee of Inquiry—Executive Overview* (Australian Government Publishing Service, August 1993).
33. *National Competition Policy—Report by the Independent Committee of Inquiry* (Australian Government Publishing Service, August 1993), pp 16-17.
34. Ibid, p 18.
35. Ibid, p 21.

How is Victoria dealing with the issue of third party access to transmission facilities in its reform measures?

Perhaps the most exciting and significant reform in Australia to date in relation to access regimes for gas and electricity transmission systems is the Victorian government's reform policy set out in *Reforming Victoria's Electricity Industry—Stage 2—A Competitive Future —Electricity*.[36]

The reforms (which the government proposes will be implemented in mid-1994) will involve Victoria's electricity supply industry being restructured into eight State-owned companies. One of these will own, maintain and manage Victoria's high voltage electricity grid. The company will remain State owned.[37]

It seems that access to the grid will be available:

- on the supply side—to the proposed new Victorian electricity generator, Generation Victoria (which will comprise eight generating units which will trade as independent suppliers); and
- on the user side—to the proposed five new distribution companies and to large commercial or industrial customers.

The mechanism for determining access to the grid will be a competitive wholesale market, which will be run by another independent company.

As the Victorian reforms are said to be fully consistent with the Hilmer Committee's recommendations,[38] it would seem that as reform of the industry continues in Victoria other parties may gain access to the grid through the wholesale market. The report expressly contemplates that more customers will enter the wholesale market[39] but does not refer to the entry of new generation entities. It does, however, contemplate the further reform of generating assets,[40] and commits the Victorian government to making a decision on the optimum structure for the generation sector by July 1995,[41] which is when it is proposed that the national grid will come into operation.

What has COAG decided to do with respect to third party access to transmission facilities?

At its meeting on 25 February 1994, COAG relevantly:

- agreed that any recommendation or legislation arising from the Hilmer Committee's recommendations would be applicable to all

36. Victorian Office of State Owned Enterprises—Department of The Treasury, February 1994.
37. Ibid, p 3.
38. Ibid, p 9.
39. Ibid, p 9.
40. Ibid, pp 11 and 16.
41. Ibid, p 16.

bodies, including Commonwealth and State government agencies and authorities;[42]

- agreed that the Commonwealth will consider assistance to the States and Territories for loss of monopoly rents;[43]
- noted (in relation to gas transmission) that legislation to promote free and fair trade in gas, through third party access to pipelines, should be developed co-operatively between jurisdictions and be based on the following principles:
  - pipeline owners and/or operators should provide access to spare pipeline capacity for all market participants on individual and negotiated non-discriminatory terms and conditions;
  - information on haulage charges, and underlying terms and conditions, should be available to all prospective market participants on demand;
  - if negotiations for pipeline access fail, provision should be made for the owner/operator to participate in compulsory arbitration with the arbitration based on a clear and agreed set of principles;
  - pipeline owners and/or operators should maintain separate accounting and management control of transmission of gas;
  - provision should be made for access by a relevant authority to financial statements and other information necessary to monitor gas haulage charges; and
  - access to pipelines should be provided by either Commonwealth or State/Territory legislation based on these principles by 1 July 1996;[44]
- noted that Heads of government were addressing the question of access to essential facilities in the context of their consideration of the Hilmer Report on National Competition Policy and that any legislation arising from decisions in this context would be able to cover gas pipelines;[45]
- agreed to principles for a national competitive electricity industry, including those which I have outlined under the subheading "How is it proposed that third party access to transmission facilities will be ensured under the national electricity grid model?": See above, p 468.

Interstate Gas Pipelines Bill

The Interstate Gas Pipelines Bill 1993 contains proposed statutory requirements which would facilitate third party access to interstate gas pipelines.

42. Council of Australian Governments, Hobart, 25 February 1994, *Communique*, p 1.
43. Ibid, p 2.
44. Ibid, pp 27 and 28.
45. Ibid, p 28.

On 27 February 1994, Minister Collins announced that the Bill would be deferred as a consequence of the COAG meeting decisions which I have described above.

CONCLUSION

I have already expressed my conclusions in relation to the constitutional questions which I have considered. In summary, the Constitution neither presents any major impediments to, nor provides a guarantee of, progress to national markets in gas and electricity.

In relation to legal rights of access to natural monopoly gas and electricity transmission systems, the current position is untested (but probably favourable to those seeking access). The important issue on this topic is the rate of progress which is achieved in implementing the proposed reforms which I have outlined. If governmental statements of intention are sincere and are translated into action by Australian governments, it seems that gas and electricity suppliers and consumers can look forward to future markets in which there is more competition.