

INDEPENDENT PRICING AND REGULATORY TRIBUNAL NEW SOUTH WALES REVIEW OF THE PRICING FRAMEWORK FOR ELECTRONIC CONVEYANCING SERVICES IN NSW

PEXA'S RESPONSE TO IPART ISSUES PAPER

INTRODUCTION

- 1.1 Thank you for the opportunity to respond to the issues paper (**Issues Paper**) published in connection with the Independent Pricing and Regulatory Tribunal of NSW (**IPART**) review of the pricing framework for electronic conveyancing (**eConveyancing**) services in NSW (**Pricing Review**).
- 1.2 Prior to responding to the specific issues for comment flagged in the Issues Paper, Property Exchange Australia Limited (**PEXA**) would like to make an overarching submission for IPART to consider. In PEXA's view, the timing of the Pricing Review, and any recommended regulatory intervention that IPART may be considering, is premature in the context of a market that is in its infancy and which is subject to a range of dynamic market and regulatory activities. PEXA invites IPART to consider recommending a light handed transitional regulatory measure (such as price monitoring) for an initial period of 5 years, which we note would be within the scope of IPART's Terms of Reference, within which time the eConveyancing market will have a chance to develop and mature, and competition a chance to develop under normal market conditions. There are many interrelated reasons why this is the appropriate course of action for IPART to take in relation to the Pricing Review.
- 1.3 First, PEXA's prices have always been subject to considerable competitive constraint and regulatory oversight. PEXA's prices were originally determined with oversight by the Australian Registrars' National Electronic Conveyancing Council's (**ARNECC**), and in the context of attracting customers away from the incumbent paper based system as a new entrant with zero market share. Ever since that time, PEXA has been subject to binding contractual and regulatory arrangements that have kept prices competitive. These arrangements, under which PEXA has committed contractually to limit any price increases to CPI, were reached through extensive engagement and collective consultation with key industry participants with strong bargaining power over PEXA. The arrangements have subsequently been replicated in the ARNECC Model Operating Rules (**MOR**), and accordingly, the MOR expressly caps PEXA's prices to increase no more than CPI¹.
- 1.4 [REDACTED] This reflects PEXA's nature as a technology start-up, [REDACTED] Since Q4 2018, there has also been a significant downturn in the property sector resulting in PEXA and other ELNOs facing short to medium term supply challenges. Further, PEXA operates in a contestable industry and faces imminent competition from two new ELNOs, one of which, Sympli, has already commenced operations. In these circumstances, the case has not been made for a new pricing regulatory framework beyond the price caps already imposed and PEXA faces very different circumstances to the natural monopolies that are typically subject to heavy handed pricing regulation.
- 1.5 In addition, there are several key ongoing activities that are currently impacting market structure, pricing dynamics and the broader regulatory framework, which make predicting the characteristics of the future eConveyancing industry uncertain. Accordingly, there is a significant risk that any recommendations IPART may make in relation to the pricing framework for eConveyancing services become obsolete or harmful for consumers and industry. These key activities include:

¹ This includes provisions for pass throughs in respect to changes in premiums for insurance PEXA is required to hold, changes in law which impact PEXA's operating costs and additional fees, charges or costs imposed by the NSW Office of the Registrar General, NSW Land Registry Services (**NSW LRS**) or other government agency

- (a) **IGA Review** - the Intergovernmental Agreement (IGA) Review of an Electronic Conveyancing National Law (IGA Review) commissioned by ARNECC, which has extensive scope to review the effectiveness of the original IGA in meeting its objectives to deliver a single national eConveyancing system across Australia, will propose significant changes to the governance and regulatory arrangements for eConveyancing and will advise on market structure and competition issues. It is likely that the IGA Review will result in recommendations being made that substantially affect the regulatory environment, market structure and operability of Electronic Lodgement Networks (ELNs).
- (b) **NSW Interoperability Review** - a review into the interoperability between ELNs at the request of the NSW Office of the Registrar General (NSW Registrar General). Concurrently with the IGA Review there are also a range of interoperability models being explored in NSW with a view to understanding any operational, technical and regulatory issues. Any move to implement an interoperability model in NSW, or nationally, could significantly change market dynamics and regulatory requirements. It is premature for IPART to consider a pricing model based on several potential interoperability models which have not been developed and are not yet understood. There is little prospect of being able to accurately determine the competitive or cost implications of each model at this early stage.
- (c) **Internal Separation** [REDACTED]
[REDACTED]
The separation process will help ensure that PEXA offers its regulated lodgement services on a non-discriminatory basis and that any downstream businesses will not obtain an unfair competitive advantage. This process will result in an altered market structure and competitive environment for eConveyancing services. PEXA also notes that financial settlement of eConveyancing transactions does not fall within the ambit of the NSW Registrar General's regulatory framework and will continue to be regulated by ASIC, APRA and the RBA.
- (d) **Pricing changes** - [REDACTED]
[REDACTED]
- (e) **Competitive and Contestable market** - [REDACTED]
[REDACTED] transforming the conveyancing industry, which together with the move to mandate eConveyancing by certain State Governments has progressively made it attractive for new entrants to enter the market. LEXTECH is in advanced stages of gaining ARNECC approval to operate as an ELN Operator (ELNO). Sympli, another ELNO, has already indicated that it intends to compete aggressively on price, which will further alter competitive dynamics and may well make the need for pricing regulation redundant.
- (f) **Ongoing development of the eConveyancing market** – the transition to eConveyancing is far from complete, and PEXA intends to implement changes and introduce additional instruments for eLodgement that will require additional investment. Significant additional investment in the coming years will also be required by PEXA to transition the remaining jurisdictions to eConveyancing.

1.6 PEXA notes that the terms of reference for this review require IPART to consider (amongst other things): *'The extent to which PEXA invested capital and developed intellectual property to support its ELN in its capacity as the initial ELNO.'* However, this particular issue receives very little

attention in the Issues Paper. The only point at which this important consideration is briefly discussed is in Appendix F.3.1 in the context of how the initial asset base is to be established.

- 1.7 PEXA agrees that the capital invested and intellectual property developed by PEXA is highly relevant to determination of the value of the initial asset base. PEXA considers that all these investments should be accounted for in the initial asset value.
- 1.8 However, PEXA also submits that, in satisfying the requirement for IPART to consider the extent to which PEXA has invested capital and developed intellectual property to support its ELN as the initial ELNO, IPART should consider the impact of different forms of regulation on incentives for future investment. IPART should not pursue any form of regulation that results in under-recovery of PEXA's past investments. This would have a chilling effect not only on any future investments that PEXA may consider to innovate, or provide new or better services to customers, it may also deter efficient investment by other ELNOs for fear of similar treatment.
- 1.9 PEXA submits that the requirement on IPART to consider the extent to which PEXA has invested capital and developed intellectual property to support its ELN as the initial ELNO is critical and deserves much greater prominence and attention by IPART than has been given in the Issues Paper.

2. BACKGROUND TO PEXA AND E-CONVEYANCING

- 2.1 Prior to eConveyancing being added to the COAG Agenda in 2008, all attempts to establish a national conveyancing scheme had been unsuccessful. Despite attempts by Victoria and NSW to progress this reform on their own, COAG ultimately agreed to develop a national electronic system, and NSW, Victoria and Queensland established National E-Conveyancing Development Limited (NECDL) in 2010 to drive implementation of a national scheme. NECDL was later renamed PEXA.
- 2.2 [REDACTED]
[REDACTED] After many years of national discussion and negotiation between governments, financial institutions, conveyancers and lawyers, the Intergovernmental Agreement for an Electronic Conveyancing National Law was signed off by all states and the Northern Territory between late 2011 and early 2012.
- 2.3 Private investors were sought to provide the capital investment needed to develop the highly complex scheme. As highlighted by the earlier failed attempts of various states, considerable risk was undertaken by the private investors that invested capital into PEXA initially and in subsequent capital raisings. [REDACTED]
[REDACTED]
- 2.4 PEXA, through industry collaboration with the peak bodies for the banks, lawyers, conveyancers, land registries and revenue offices, has developed a world-leading eConveyancing system that delivers services beyond the Electronic Conveyancing National Law's national eLodgement focus.²
- 2.5 In its role as industry facilitator and network enabler PEXA has been instrumental in driving this digital change, so that all network participants, including land registries and new ELNOs can benefit from the shift to digital conveyancing.

3. RESPONSES TO QUESTIONS IN THE IPART ISSUES PAPER

Proposed approach

Question 1

Do you agree with IPART's proposed approach for this review? Are there any alternative approaches that would better meet the terms of reference, or any other issues we should consider? (see page 21 of the Issues Paper)

- 3.1 PEXA's comments on IPART's proposed approach for its review are set out below:
- 3.2 **Step 1 – Assess the current state of the eConveyancing market in NSW.** PEXA considers that this step should focus not only on current and future competition, but also consider the extent to which existing contractual arrangements and existing regulatory arrangements keep prices in line with the efficient costs of supply. For instance, even if evolving competition is not deemed sufficiently certain to ensure that prices for eConveyancing are efficient, as outlined above, the existing regulatory and contractual arrangements have ensured that PEXA's prices remain competitive by capping increases at CPI from day one (when PEXA had zero market share).
- 3.3 **Step 2 – Decide on the appropriate form of regulation.** PEXA submits that any form of regulation recommended by IPART should be informed by the findings of the first step. The regulatory remedy

² At page 40 of the Issues Paper, a comparison is made to the similarities of eConveyancing services provided in Ontario Canada by 'Teranet'. However, we note that unlike PEXA's offering, Teranet is unable to provide a settlement service.

should be targeted towards any competition problem identified (rather than taking a ‘one-size-fits-all’ approach) and should be proportionate. PEXA submits that there is a strong prospect that significant competition will emerge in this industry, and the main reason for regulation—lack of competitive constraint — can and will be overcome. As the first entrant, PEXA [REDACTED] developed intellectual property to resolve many of the technological challenges associated with eConveyancing. If heavy handed price control regulation is introduced from the outset [REDACTED] this could deter further investment by PEXA and other potential entrants. This would be detrimental to consumers in NSW and other jurisdictions. PEXA notes that the terms of reference for this review require IPART to consider, ‘*The extent to which PEXA invested capital and developed intellectual property to support its ELN in its capacity as the initial ELNO.*’ PEXA submits that in satisfying this requirement, IPART should consider the effect of different forms of regulation on incentives for PEXA (and other ELNOs) to invest future capital and undertake development of intellectual property. As IPART has not yet had an opportunity to conduct a review of the state of competition in the eConveyancing market, recourse to the most intrusive remedies to a competition problem is premature.

3.4 **Step 3 – Decide on an appropriate methodology to set prices.** IPART is required by the terms of reference to recommend a methodology for setting regulated prices for eConveyancing services. However, there is a broad spectrum of approaches to setting prices, ranging from light handed approaches (e.g., indexation of prevailing prices or a transitional period of price monitoring) to more intrusive price-setting. Current prices are linked by both regulatory and contractual mechanisms to those that PEXA offered to consumers initially to build market share in competition with paper conveyancing, and competition is expected to increasingly develop in the short-to-medium term. PEXA therefore submits that it would be prudent to take a more cautious and light handed approach to regulation. This will avoid creating a chilling effect on investment and the imposition of dynamic efficiency losses on society. Given the scope for regulatory intervention to distort the development of an emerging market, PEXA recommends that IPART consider less prescriptive/intrusive forms of price regulation, such as:

- (a) price benchmarking (e.g., against other jurisdictions, or against prices PEXA offered when competing with paper conveyancing);
- (b) indexation of annual price changes based on changes in costs; or
- (c) a transitional arrangement that PEXA would support, would be to implement a price monitoring regime until regulatory certainty is resolved and it is clear how entry into this market has evolved. More intrusive price regulation could be considered in future years if it is established that effective competition will not emerge and if it is clear that CPI price increases are failing to deliver efficient prices.

PEXA does not consider there to be justification for a building block framework to be imposed, and submits this would be a highly inappropriate recommendation for IPART to make.

3.5 **Step 4 – Consider and recommend timeframes and transitional arrangements.** Given ongoing market, policy and regulatory developments, PEXA considers that there is a clear case for a transitional regulatory arrangement. With price increases limited to CPI, current prices set in a competitive environment, [REDACTED], and an increasingly contestable industry it is hard to see any material harm to customers or material inefficiency in employing light handed regulatory arrangements while IPART monitors the ongoing development of the market. Conversely, the risk of regulatory error in applying more heavy-handed regulation at this early stage with so many unknown factors is extremely high and could result in considerable market distortion and consumer detriment.

3.6 PEXA notes that IPART is only required to recommend a form of price regulation. The terms of reference do not require IPART to recommend the implementation of price regulation immediately.

PEXA submits that it would be entirely consistent with the terms of reference for IPART to recommend:

- (a) price-monitoring as a transitional arrangement; and
- (b) a form of price regulation that could be used at some future point in time, if and when it becomes clear that price regulation (rather than price-monitoring) is justified.

Assessing the eConveyancing Market

Question 2

What are your views on the current state of the market? For example, does the continued availability of paper conveyancing in other jurisdictions constrain prices for eConveyancing? What scope is there for new entrants to offer the full range of eConveyancing services? (see page 23 of the Issues Paper)

- 3.7 The market for eConveyancing services is rapidly evolving and has an uncertain future in terms of how it will develop in the short-to medium term. As outlined at paragraph 1.5 above, this is due to a range of reasons, including the fact that the industry is in its infancy, the downturn in demand in the property sector, a lack of certainty regarding the form or adoption of an interoperability model, the entry of significant new competitors, and a number of other key market and regulatory activities.
- 3.8 PEXA's pricing for eConveyancing services are constrained due to a range of existing regulatory obligations and contractual commitments, including:
 - (a) PEXA having set its prices as a new entrant in a competitive environment, when PEXA had zero market share and needed to attract users away from the paper lodgement system. At this time, PEXA negotiated its pricing policy and terms with groups of sophisticated counterparties, including law societies and financial institutions. These counterparties negotiated on a collective basis and had very strong bargaining power.
 - (b) From that time, PEXA has committed to cap any price increases at CPI and this commitment is enshrined in PEXA's contractual arrangements.
 - (c) Compliance with existing pricing regulations, including ARNECC's MOR which provides for structural or functional separation, price controls and equal access for integrators, to be enforced by eConveyancing regulators. Under the new MOR, ELNOs may only increase prices in line with CPI. In addition and as noted in the Issues Paper, *'In NSW, the Conditions of Approval set the annual price cap for ELNOs at CPI minus X, with X set each year by the Registrar General. The Registrar General has set X to zero for 2018-2019.'* (see paragraph 2.3, page 9 of the Issues Paper).
- 3.9 Moreover, while eConveyancing has been introduced since the IGA was signed in NSW, Victoria, Queensland, South Australia and Western Australia, eConveyancing services have still not penetrated the conveyancing markets in a number of jurisdictions in Australia and in respect of all transaction types. For example, Tasmania and the Northern Territory have not introduced eConveyancing, and the ACT was not a signatory to the IGA nor has it introduced eConveyancing legislation, which indicates that the paper conveyancing system continues to exert a competitive constraint (see paragraph 2.5, page 15 and 16 of the Issues Paper). Moreover, not all mainstream documents can be lodged using eConveyancing services. Further, in NSW, where eConveyancing has been mandated, the current source of competition will not be significantly altered by the next phase of mandating as PEXA is already completing the majority of transactions. For example, PEXA is already competing 80% of all NSW transfer lodgements. [REDACTED]

[REDACTED] particularly given Sympli has now entered as a competitor and is expected to compete with PEXA aggressively on price.³ Accordingly, paper lodgements and the entry of large scale new market participants like Sympli will continue to constrain prices for eConveyancing services in NSW and nationally.

3.10 The Issues Paper suggests there are two key factors that are likely to influence the level of competition in the market for eConveyancing:

- (a) the availability of alternative lodgement services, which as noted above, will continue to exist to a level that will constrain prices and foster the development of competition; and
- (b) the interoperability of ELNs.

In relation to this second factor (interoperability), it is suggested in the Issues Paper at page 22 that, *‘without interoperability, competition would require each market participant to subscribe to multiple services, and participants to agree on which ELNO to use for a transaction. This could result in the market converging to a monopoly or a highly concentrated ELNO market structure’*. However, in PEXA’s view, it is presently impossible to guess which model of interoperability (or other arrangements to facilitate competition) will be introduced, or what other regulatory changes will occur.

3.11

[REDACTED]

Question 3

How important are barriers to entry in constraining competition in the eConveyancing market? Are there other barriers or factors that will influence competition in the market? (see page 23 of the Issues Paper)

- 3.12 The fact that there are currently two new entrants in the eConveyancing market suggests that barriers to entry are not prohibitive. However, there were substantial difficulties and involved in setting up the first eConveyancing system, and PEXA alone carried the burden of those difficulties and risks which have lowered barriers to entry for subsequent eConveyancing market entrants.
- 3.13 The regulatory requirements for any prospective ELNO are appropriate and commensurate to the quality and security measures expected of ELNOs in facilitating property transactions.
- 3.14 A new heavy handed pricing regulatory framework is, if anything, likely to deter new entry and stifle incentives to develop eConveyancing – which is a fledgling, innovative market, [REDACTED] Faced with a range of opportunities across eConveyancing more broadly and adjacent services, a new pricing regulatory framework creates a risk that the private sector will allocate its capital to other activities to the detriment of consumers.

³ Australian Financial Review, 23 November 2018 ‘PEXA rival Sympli gets approval to start operating online conveyancing platform’, <https://www.afr.com/real-estate/pexa-rival-sympli-gets-approval-to-start-operating-online-conveyancing-platform-20181123-h1897e>

Question 4

To what extent would pricing regulation increase barriers to entry? Should new entrants be exempt from pricing regulation and, if so, what would be an appropriate market share benchmark at which pricing regulation would commence? (see page 26 of the Issues Paper)

- 3.15 As PEXA stated above, imposing price regulation at this time would be unnecessarily costly and may perversely result in less efficient outcomes and stifle investment in innovation.
- 3.16 Price regulation could well raise barriers to entry, creating uncertainty and signalling to new entrants that they may not recover their sunk investments in developing eConveyancing technologies and services. Regulation limits upside returns but leaves downside returns uncapped. If the regulated price is set too low (i.e., to prevent the recovery of efficient costs of sunk investments, operating costs and the opportunity cost of capital), then there would be little incentive for other firms to follow PEXA's entry into the market. This would stunt the development of a vibrant, competitive market by stifling further investment in innovation.
- 3.17 Restricting price regulation to PEXA alone could distort efficient entry decisions. Exempting new entrants from regulation may result in inefficient outcomes, with less efficient new entrants succeeding at the expenses of more efficient incumbents only because they are not subject to regulation. Applying regulation only to PEXA, and exempting new entrants, would tilt the competitive landscape against PEXA and punish a firm that took the risks and incurred the costs associated with being a first mover (at the request of, and benefit for, the State Governments). This would not only be inequitable, it would also send a perverse signal to any other firm that may otherwise consider innovating in this market that if it is the first mover it may be the subject of regulation, whereas if it waited until another firm makes the first move it could escape regulation. This would deter any firm from innovating.

Question 5

What factors influence the effectiveness of potential multi-homing or interoperability solutions in promoting competition? (see page 30 of the Issues Paper)

- 3.18 IPART has sought views on the effectiveness of different interoperability solutions (including multi-homing), and the relative costs of implementing different multi-homing and interoperability models.
- 3.19 PEXA recognises that the lack of interoperability is a relevant factor for IPART when considering the state of competition in the eConveyancing market. However, PEXA submits that consulting on the effectiveness and pros/cons of different interoperability and multi-homing solutions extends beyond IPART's terms of reference for this review. IPART has only been asked to conduct a review of the state of the eConveyancing market. IPART has not been asked to design or consult on the architecture of multi-homing and interoperability solutions.
- 3.20 As IPART's issues paper notes, both ARNECC and the NSW Government are considering interoperability. There is no need for IPART to further duplicate this process in order to meet the terms of reference for this review.
- 3.21 Interoperability is an extremely complex issue, and the precise interoperability design will help determine how the eConveyancing market unfolds and evolves in the future. PEXA agrees that interoperability is an issue that the industry, in partnership with Government, will need to address. This issue needs to be examined carefully and methodically through a separate process that is not constrained by the time pressures of a short review of the type IPART has been asked to conduct. Any solutions proposed and adopted through such a short process risk being premature, and

implemented without proper consideration of the long-term implications for this industry. There is significant scope for unintended harm to consumers and investors if the wrong solution is adopted, and these consequences would be long-lasting. As above, for this reason PEXA's view is that IPART should consider recommending transitional arrangements for an initial period while the eConveyancing market develops, an interoperability model is determined and competition is able to develop under normal market conditions.

- 3.22 PEXA considers that even preliminary views expressed by IPART through this relatively short review about the merits of different interoperability and multi-homing solutions could result in an ill-considered solution being imposed on the industry by Government.
- 3.23 Therefore, PEXA submits that IPART should not express any views, or draw conclusions, about the pros and cons or desirability of particular interoperability and multi-homing solutions. PEXA considers that it is unnecessary for IPART to express a view in this regard.
- 3.24 PEXA considers that IPART should simply acknowledge that lack of interoperability could limit the potential for competition to emerge in this market. IPART should remain agnostic about which interoperability solutions ought to be, or are likely to be, adopted. However, in order to be constructive, PEXA has provided a detailed response to question 6 below.

Question 6

What are the relative costs of implementing the different potential multi-homing or interoperability solutions between ELNOs? (see page 30 of the Issues Paper)

- 3.25 As noted previously, interoperability is a factor that will influence competition, and PEXA supports competition that delivers genuine consumer benefits. The costs of interoperability (for example the cost of all the systems required to build and maintain new connections, plus any increased risk of fraud or error), must be weighed against the identified benefits. In its response to the *NSW Interoperability Review*, PEXA outlined the principles we believe should be considered in determining an interoperability model, those principles being:
- (a) interoperability should not increase the risk of fraud or error in conveyancing transactions, relative to the risk for transactions conducted in a stand-alone ELN;
 - (b) any interoperability in relation to financial settlements should be by agreement by all impacted parties nationally. Financial settlement interoperability should not be the subject of a mandate by any state or Registrar given the broad impact on financial services;
 - (c) interoperability should promote competition and innovation by allowing ELNOs to compete on features including, but not limited to price. In a sensitive technology-driven market like eConveyancing, competition on quality and innovation is likely to be significant to Subscribers;
 - (d) interoperability should not (in aggregate) increase costs to consumers;
 - (e) interoperability should not negatively impact the user experience, including through additional risk or complexity;
 - (f) interoperability should preserve the existing benefits of choice in relation to practice management software (or integrated software provider), without duplicating the functions that integration already provides; and

- (g) the model of Interoperability proposed must be consistent with principles of good regulation such as the NSW Government Guide to Better Regulation. One basic principle of this guide is that costs of new regulation should not be higher than the benefits.

3.26 PEXA is in agreement with IPART that *‘the same interoperability solution would be adopted across all jurisdictions. Without a coordinated national approach, there would be duplication of investment as well as lower savings in terms of network infrastructure costs for participants including ELNOS and financial institutions’* (see paragraph 4.3.4, page 30 of the Issues Paper). Allowing new entrants to cherry-pick the most profitable jurisdictions would put them at a competitive advantage to PEXA. If new ELNOs are not obliged to operate nationally, they should in our view be subject to a levy used to fund Universal Service Obligations in less profitable or unprofitable jurisdictions.

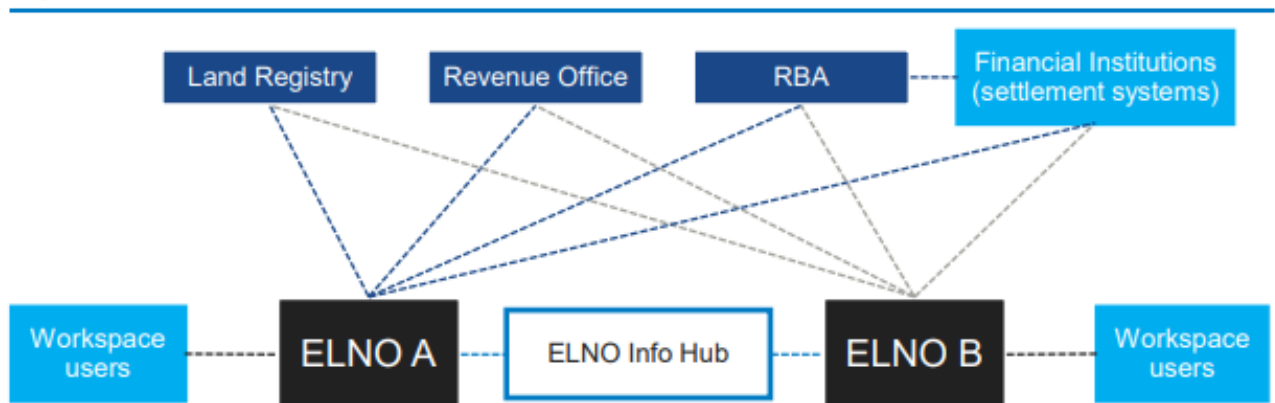
3.27 As there is currently no certainty regarding interoperability, IPART has indicated it will assess each alternative model in terms of its likely effectiveness in fostering competition (see paragraph 4.3, page 27 of the Issues Paper). PEXA believes that rigorous quantitative and qualitative analyses are required to understand the real costs, risks and benefits associated with each proposed interoperability model and viable alternatives to them (including the status quo). PEXA suggests each model proposed by IPART (Figures 4.2-4.5, below) is assessed by reference to the following factors:

- (a) protocol for selection of lodging ELNO;
- (b) billing model;
- (c) integration requirements and costs;
- (d) requirements for significant re-design;
- (e) potential failure points; and
- (f) fundamental change to eConveyancing.

3.28 The views expressed by PEXA below are preliminary only and have not been subjected to a thorough analysis. These views may change as further work is undertaken.

Figure 4.2: Possible network structure with an ELNO information hub

Figure 4.2 Possible network structure with an ELNO information hub



Note: Workspace users include the staff of solicitor/conveyancing firms and financial institutions.

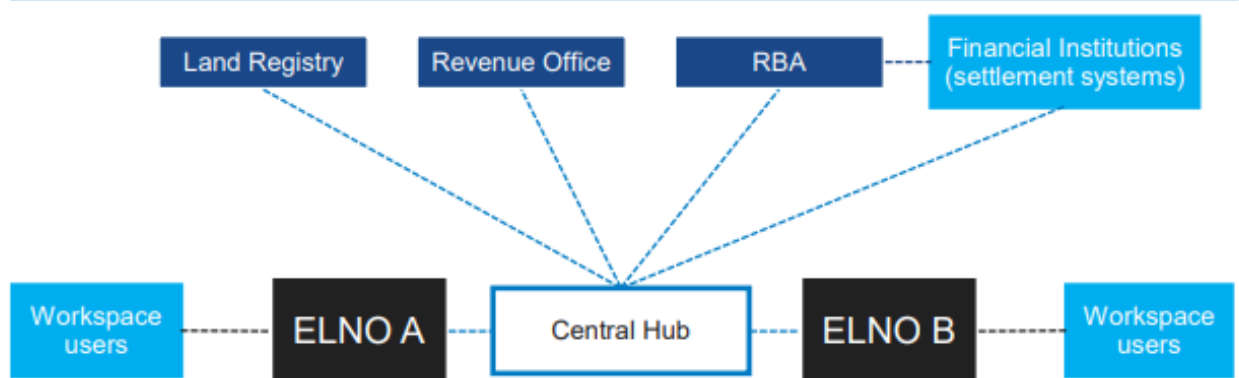
Data source: IPART.

- 3.29 **Protocol for selection of lodging ELNO:** The preferred lodging ELNO is likely to be selected by protocol in these models except for the ‘Central Hub’ (Figure 4.3) and ‘Infrastructure ELN’ (Figure 4.4), as well as in multi-homing.
- 3.30 **Billing model:** The billing model here is unclear because presumably the ‘ELNO Info Hub’ would charge each ELNO, who in turn would charge its Subscribers. It is also not clear whether the lodging ELNO would charge the non-lodging ELNO a lodgement fee.
- 3.31 **Integration requirements and costs:** By requiring every Financial Institution to become integrated with every ELNO in the market this model creates a significant barrier to entry. The estimated cost of this is upwards of \$10 million⁴ for each link between an ELNO and Financial Institution, with additional costs presumably incurred by new ELNOs. This also represents a duplication of effort and resources for both the integrated parties and for industry.
- 3.32 **Requirements for significant re-design:** PEXA anticipates the following significant changes would be required to implement [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- Figure 4.2 would further require [REDACTED] ELNOs and the ‘ELNO Info Hub’, as well as substantial testing requirements. It is unclear which entity would be responsible for this.
- 3.33 **Potential failure points:**
- (a) In the proposed structure of Figure 4.2, the ‘ELNO Info Hub’ becomes a potentially critical point of failure with the ability to impact all lodgement transactions in the network if there is a technical issue.
 - (b) PEXA accepts in principle that interoperability offers the prospect of an alternative ELN in the event of a ‘catastrophic failure’. However, while interoperability might offer increased resilience in the event of permanent or long-term failure, it would have no value as a resilience measure to counter a temporary failure of the proposed ‘ELNO Info Hub’. Under this model, Financial Institutions, land registries, revenue offices and the RBA must still connect to each ELNO.
- 3.34 **Fundamental change to eConveyancing:** PEXA notes that efficiency is a core principle of eConveyancing. The definition of ‘Electronic Workspace’ under the MOR contemplates and requires an electronic workspace generated by an ELN to be a shared workspace. Accordingly, any requirement to duplicate or mirror workspaces instead of operating from a single source of truth is a fundamental change to this core principle and will increase the risk of transaction errors due to data mismatch.
- 3.35 PEXA further notes that where ELNs operate independently, each may develop a different settlement model and innovate in relation to the connections it will require, and the facilitators it will rely upon. It follows that having one ‘Central Hub’ will not produce the same competitive efficiencies for consumers.

⁴ IGA Issues Paper, page 21, available at https://www.arnecc.gov.au/_data/assets/pdf_file/0007/1433509/iga-review-issues-paper.pdf.

Figure 4.3: Possible network structure with a central hub

Figure 4.3 Possible network structure with a central hub



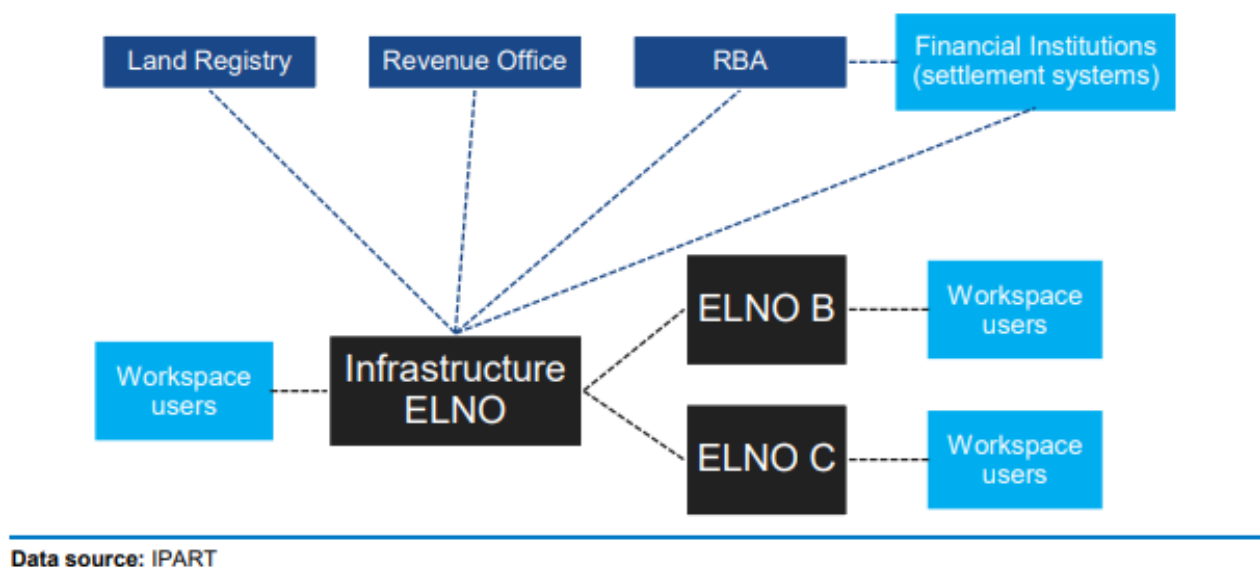
Data source: IPART.

- 3.36 **Protocol for selection of lodging ELNO:** There is no need in the model proposed in Figure 4.3 for a protocol to determine which ELNO will lodge, as the ‘Central Hub’ always performs that function.
- 3.37 **Billing model:** As with Figure 4.2, the billing model here is unclear, and PEXA notes that introducing a ‘Central Hub’, presumably with additional fees, would likely lead to a higher cost for consumers.
- 3.38 **Integration requirements and costs:** Figure 4.3 requires only one integration between the central infrastructure and the ‘Central Hub’, rather than requiring all ELNOs to integrate with each central infrastructure body. [REDACTED]
Additionally, all transactions would be required to go through the ‘Central Hub’, regardless of whether there is an interoperable element.
- PEXA notes that the ‘Central Hub’ proposed in Figure 4.3 is actually an ELNO by definition. Figure 4.3 requires all other ELNOs to become retail gateways which lead to the ‘Central Hub’ ELNO (similar to model in Figure 4.4 (below)). This is a significant change to the regulatory framework and definition of what an ELNO is.
- 3.39 **Requirements for significant re-design:**
- (a) Implementing this model would require new integrations between ELNOs and the ‘Central Hub’, which raises subsequent questions as to which entity would be responsible for building, testing and maintaining these connections.
 - (b) Figure 4.3 would require extensive re-design of process flows and orchestration logic about how workspaces are compiled within the current PEXA platform.
- 3.40 **Potential failure points:** similar to Figure 4.2, the ‘Central Hub’ becomes a critical point of failure with the ability to impact all transactions with central infrastructure bodies (see paragraph 3.33 above).
- 3.41 **Fundamental change to eConveyancing:** As above, PEXA notes that any requirement to duplicate or mirror workspaces instead of operating from a single source of truth is a fundamental change to the core principles of eConveyancing and will increase risk of transaction errors due to data mismatch and it would be preferable to populate a single workspace in the Hub.

- 3.42 It is unclear to PEXA how the proposed 'Central Hub' differs from the current PEXA platform, which was established as a Public-Private Partnership for this very purpose. Within its current infrastructure, PEXA accepts data from integrated software providers, performing a very similar function to the 'Central Hub' in this model.

Figure 4.4: Possible network structure with an access regime

Figure 4.4 Possible network structure with an access regime



- 3.43 **Protocol for selection of lodging ELNO:** There is no need in the model proposed by Figure 4.4 for a protocol to determine which ELNO will lodge, as the 'Infrastructure ELNO' always performs that function.
- 3.44 **Billing model:** The model proposed by Figure 4.4 appears to contemplate the 'Infrastructure ELNO' fulfilling a dual wholesale/retail ELNO function. It follows then that the 'Infrastructure ELNO' would require a dual billing model incorporating both wholesale and retail prices, or contain a separate retailer for non-integrated parties. The billing implications of this model are not clear.
- 3.45 **Integration requirements and costs:**
- (a) Figure 4.4 requires new integrations between ELNOs, which raises subsequent issues in relation to responsibility for constructing, testing and maintaining these connections as well as any integrated systems.
 - (b) Working from this assumption, all new ELNOs would perform a purely retail function, which would require changes to the framework and definition of what an ELNO is.
 - (c) PEXA notes that it would be in a unique position to fulfil the 'Infrastructure ELNO' role as the mature and proven platform in the market.
- 3.46 **Requirements for significant re-design:** Figure 4.4 would necessitate extensive re-design of elements of PEXA's system, including the subscriber and user management, and authentication models, which would require a new ability to accept signed instruments.

PEXA is already a critical piece of eConveyancing infrastructure and reliably handles 80% of all NSW transfers today.

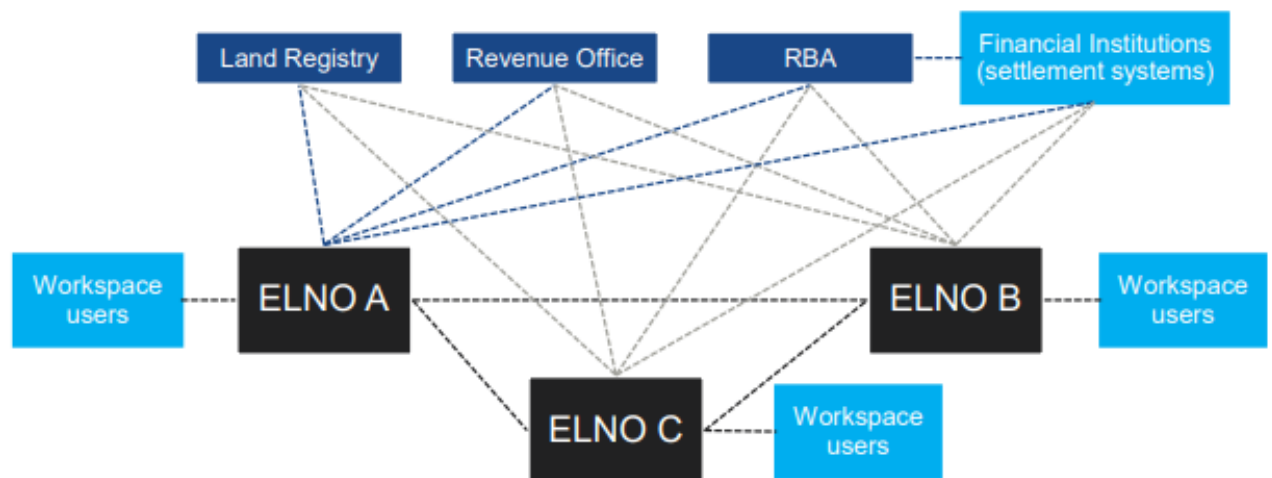
- 3.47 **Potential failure points:** As noted above, in relation to Figures 4.2 and 4.3, the ‘Infrastructure Hub’ becomes a critical point of failure with the ability to impact all transactions with central infrastructure bodies if it incurs a material technical issue. In this context the least risk option would be for PEXA to act as the Infrastructure Hub given its strong track record of reliability.
- 3.48 **Fundamental change to eConveyancing:** Implementing the ‘Infrastructure Hub’, as contemplated in Figure 4.4, would mean one single workspace is populated resulting in a single source of truth. PEXA notes that although the definition of an ELNO would be altered, should PEXA be the Infrastructure Hub, this model remains true to the principles of eConveyancing as there would be improved efficiencies, no duplication involved, and PEXA is already proven to be resilient and reliable.

Selecting one unified interoperability model will deliver the greatest benefits to the industry and end-consumers. The model should be developed consistent with the principles outlined earlier, without detracting from network security, increasing the risk of fraud or error, or detracting from platform operations or development. PEXA believes the ‘Infrastructure ELNO’ model is the most consistent with the principles of eConveyancing.

This model allows PEXA to maintain its platform design and operations, with other ELNOs able to integrate to PEXA in the same way that software providers do. This would be more efficient and deliver a competitive market enabling differentiation on value-adding front-end features.

Figure 4.5: Network Structure with direct connections between ELNOs

Figure 4.5 Network structure with direct connections between ELNOs



Data source: IPART

- 3.49 **Protocol for selection of lodging ELNO:** Figure 4.5 does not alter which ELNO is used by subscribers for the transaction.
- 3.50 **Billing model:** We assume here that each ELNO will charge its Subscribers, with the lodging ELNO charging the non-lodging ELNO an additional fee. Without the benefits of a central ELNO/Hub, this proposed model appears to incur extra costs for subscribers without the efficiency benefits of one central platform.
- 3.51 **Integration requirements and costs:** By requiring every Financial Institution to become integrated with every ELNO in the market, this model creates a significant barrier to entry. The estimated cost

of this is upwards of \$10 million⁵ for each link between an ELNO and Financial Institution, with additional costs presumably incurred by the new ELNOs. There is a further assumption that all Financial Institutions will agree to, and have the capacity to, integrate with new ELNOs within reasonable timeframes. This additionally represents a duplication of effort and resources for both the integrated parties and for industry.

- 3.52 **Requires new integrations between ELNOs:** In this model, it will be necessary to build and maintain these connections and test with other ELNOs as well as integrated systems.
- 3.53 **Requirements for significant re-design:** Under the model in Figure 4.5 it will be necessary to re-design process flows and orchestration logic about how workspaces are compiled. This would be a significant change in PEXA's existing platform. There would be a requirement to re-design elements of system such as trust/authentication models, which would also require a new ability to accept signed instruments.
- 3.54 **Potential failure points:** Figure 4.5 creates interdependency between ELNs in which each has the ability to impact on, or interfere with, all transactions in the network if one ELN experiences technical difficulties.
- 3.55 **Fundamental change to eConveyancing:** As above, any requirement to duplicate or mirror workspaces instead of operating from a single source of truth is a fundamental change to the core principles of eConveyancing and will increase risk of transaction errors due to data mismatch.

PEXA notes that this model likely represents both cost and logistical inefficiencies, as well as the most complexity in design and orchestration, as it requires consent and cooperation from multiple parties is constructing, testing and maintaining connections between all ELNOs, as well as subsequent connections between ELNOs and central infrastructure bodies.

3.56 **Conclusion**

In light of the significant uncertainty surrounding costs in all proposed interoperability solutions, PEXA urges caution in taking the next step to introduce a national framework for interoperability and cannot see how IPART can accurately determine the effects of each of the interoperability models on competition in a way to meaningfully develop a pricing model. This is a significant reason for IPART to initially consider a transitional model while the industry develops. Neither industry nor consumers, nor indeed government, will support such fundamental changes to a vital piece of infrastructure, regardless of whether they are introduced nationally or by any single jurisdiction in the absence of comprehensive investigation and consultation. PEXA believes establishing national working groups in these areas, with industry-wide representation and clear objectives in terms of outcomes and timeframes, is the best way forward for all stakeholders. The costs and benefits of each interoperability model, as well as multi-homing instead of interoperability, must be closely considered.

Question 7

How will vertical integration or the potential for vertical integration influence competition between ELNOs and the efficiency of the conveyancing process? (see page 31 of the Issues Paper)

- 3.57 There will be many efficiencies to be gained through vertical integration in the eConveyancing sector. The IPART Issues Paper lists the examples of property search functionality and conveyancing software such that competitors can offer end to end conveyancing systems (see paragraph 3.3, page 31 of the Issues Paper).

⁵ IGA Issues Paper, page 21, available at https://www.arnec.gov.au/_data/assets/pdf_file/0007/1433509/iga-review-issues-paper.pdf.

- 3.58 The MOR already contains obligations to protect against any vertical foreclosure, such that any vertical integration of an ELNO will not provide its upstream or downstream businesses with an unfair competitive advantage against those entities which are not vertically integrated (see paragraph 3.3, page 31 of the Issues Paper). The Issues Paper notes it is not clear how these requirements will be enforced in practice or what would be considered a breach. In response to this, PEXA submits that it is subject to stringent oversight by ARNECC, including an obligation to submit a separation plan which will be reviewed closely and compliance with the MOR is a necessary condition of an ELNO's approval to operate.
- 3.59 IPART suggests that it will be important that the pricing regulatory framework that is recommended '*ensures that eConveyancing prices do not cross-subsidise complementary services in other competitive markets.*' (see paragraph 3.3, page 31 of the Issues Paper). However, in PEXA's view, it is equally important to recognise a converging market in property information services which may rely on such vertical integration for access into the ELNO market. For example, Sympli is expected to be offering straight through processing with InfoTrack. As Sympli's shareholders have significant market share in their respective markets (i.e. ASX in equities trading, clearing and settlements, InfoTrack in property information services and conveyancing software which has been integrated to more than 20 other conveyancing software platforms), it can offer a more competitively attractive service with scope for cross-subsidisation of the ELNO by other businesses.

Question 8

How should the pricing regulatory framework for ELNOs address vertical integration or the potential for vertical integration in eConveyancing? (see page 31 of the Issues Paper)

- 3.60 PEXA submits that vertical integration can provide significant efficiency benefits, and in competitive industries those efficiencies are ultimately passed through to consumers. Hence, it is important from a societal efficiency and welfare perspective that the pricing regulatory framework should not distort incentives for ELNOs to adopt efficient vertical integration structures. However, as noted above, the MOR already contains requirements for operational separation of the ELN and other upstream or downstream services offered by an ELNO.
- 3.61 IPART's concern that the pricing regulatory framework should not cross-subsidise complementary services in other competitive markets is reasonable. This issue has arisen in other regulated industries. For example, there has been a recent focus in relation to regulated electricity networks that such businesses should not leverage their market power to skew competition in their favour in related and nascent complementary markets.
- 3.62 A number of regulatory solutions have been developed to deal with this issue. IPART's Issues Paper mentions ring-fencing of regulated services as one possible solution, but expresses concern that ring-fencing restrictions may be difficult to monitor and enforce in practice.

There are usually two key challenges in monitoring and enforcing ring-fencing arrangements:

- (a) First, ring-fencing guidance needs to be clear, specific and fit-for-purpose.
- (b) Second, asymmetries of information between regulators and regulated businesses can make it difficult to verify compliance with ring-fencing requirements.

3.63



Question 9

What form of regulation for ELNO pricing do you support? Why (see page 33 of the Issues Paper)

- 3.64 For the reasons explained in response to Question 1, PEXA considers price monitoring for a transitional period of approximately 5 years is the most appropriate form of regulation at the present time. This would allow time for the industry to develop a potentially workable interoperability solution, and for new entry to emerge. Indeed, a deliberately cautious approach to regulation that does not move immediately to intrusive price regulation is likely to encourage further entry and the development of competition.
- 3.65 PEXA suggests that following that transitional period, IPART could conduct a follow-up review into the state of the eConveyancing market to see if there is a stronger case for price regulation at that point in time (e.g., if competition has not emerged as expected, and if it is clear that CPI price increases are not delivering efficient price outcomes).
- 3.66 If at some time in the future IPART establishes that there is a strong case for formal price regulation, revenue caps would be more appropriate than any of the potential price cap options. Setting individual price caps would require decisions about cost allocation which would likely be contentious, open to regulatory error and challenging. Setting price caps imposes volume risk on ELNOs but ELNOs have little ability to manage volume risk.
- 3.67 Further, PEXA submits that since the eConveyancing market is in its infancy, and competitive constraint has been and will be material, all ELNOs should have the ability to flexibly explore pricing structures that might provide them with a competitive advantage and meet users' particular preferences. Prescriptive price cap regulation might stymie innovation in pricing, thereby hindering competition. As noted previously, PEXA has always limited its price increases to CPI and this is now enshrined in the national MOR which is applicable to all ELNOs.

Question 10

If we decide to use an index to adjust the initial regulated prices in the following years of the regulatory period, is CPI an appropriate index? If not, what other index could we use? (see page 33 of the Issues Paper)

- 3.68 In principle, outcomes will be most efficient if the index used by IPART to set a price path reflects the efficient costs of eConveyancing. Depending on what drives the costs of eConveyancing, the most appropriate index might be different to CPI. However, in the absence of an obvious alternative to CPI, and provided indexation is used only as a transitional price-setting approach, PEXA considers that it would be reasonable to cap price increases to changes in CPI.
- 3.69 If a CPI indexation approach is adopted, PEXA proposes that the initial prices to be indexed should be prevailing market prices (which were established in a competitive environment).

Question 11

What measures will our pricing framework require to enable flexibility and innovation for new entrant ELNOs? (see page 33 of the Issues Paper)

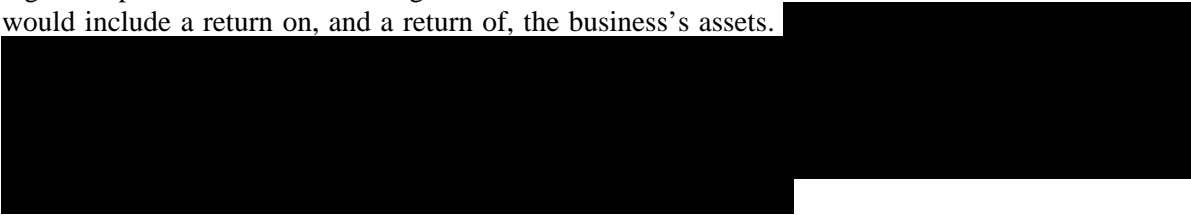
- 3.70 PEXA submits that any pricing framework recommended by IPART should:
- (a) Avoid prescriptive pricing regulation in the short-term. As explained above, there is no strong case for intrusive price regulation in this market as competition is likely to emerge over time. If circumstances change such that formal price-setting is required in the future,

revenue caps would be preferable to price caps since ELNOs have little ability to manage volume risk. If prices are to be set in the short-term, the least distortionary approach would be to index current prices using some measure of inflation.

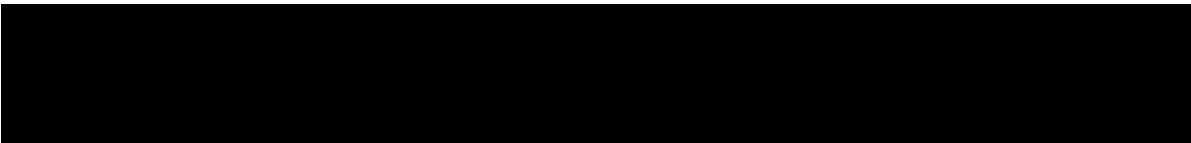
- (b) Allow re-openers and pass-throughs to deal with unforeseen and unmanageable cost changes. Without these arrangements in place, there is the risk of regulated prices being inefficient and regulatory risk increasing.
- (c) Avoid any forms of regulation that makes specific assumptions about technology, infrastructure and cost structures. Regulation that effectively locks in specific technologies, infrastructure design and cost structures make innovation more difficult and may hinder the development of competition in the eConveyancing market. The industry is nascent and technology driven – it is almost certain to change significantly in the short term.
- (d) Avoid any forms of regulation that makes specific assumptions about efficient scale or minimum efficient scale, because innovation may change this very quickly. This is an emerging market and it is very difficult to anticipate with any confidence what scale might be efficient in this industry.

Question 12

Do you consider recommending prices based on the costs of a notional benchmark efficient ELNO is an appropriate way to promote competition in the eConveyancing market? If yes what is an appropriate set of characteristics for the benchmark efficient ELNO? (see page 34 of the Issues Paper)

- 3.71 While the concept of a notional benchmark efficient ELNO may be attractive, there is a risk of pushing this too far: so far there is no market evidence to suggest that a benchmark efficient ELNO would differ substantially from PEXA. That is, the best available evidence on the costs of a benchmark efficient ELNO are PEXA's actual, observed costs. It is not clear that a notional benchmark efficient ELNO could expect to develop the same eConveyancing services without incurring substantially the same costs as has been incurred by PEXA.
- 3.72 If the notional benchmark efficient ELNO is supposed to have lower costs than PEXA, perhaps because it can learn from the innovations that PEXA has implemented, it is important to recognise explicitly that those lower costs will need to be recovered from fewer transactions since a second-mover is unlikely to capture the whole market. That is, it would be inappropriate to assume that the costs of a benchmark efficient ELNO would be lower than PEXA's due to a learning effect, but simultaneously inappropriate to assume that the benchmark ELNO is a first-mover monopolist or benefits from the market-share that a first-mover is likely to develop.
- 3.73 PEXA's understanding of IPART's approach, and our view of appropriate regulatory practice, is that regulated prices should enable a regulated business to recover its efficient costs. These efficient costs would include a return on, and a return of, the business's assets.
- 

3.74



- 3.75 Accordingly, PEXA submits that the regulatory asset base for a benchmark efficient ELNO should include all intangible assets and investments [REDACTED] as well as capital assets (such as physical capital, IT systems).

Question 13

What firms or industries are comparable to a benchmark ELNO in terms of their exposure to market risk? What percentage of debt rather than equity would an efficient ELNO be able to sustain to finance its assets (ie, the gearing level)? (see page 36 of the Issues Paper)

- 3.76 IPART's most recent WACC methodology decision defined the efficient benchmark firm (for the purposes of determining the WACC allowance and benchmark capital structure) as '*a firm operating in a competitive market and facing similar risks to the regulated business.*' PEXA submits that IPART should adopt this definition of the efficient benchmark ELNO when determining a WACC allowance and benchmark capital structure for eConveyancing.
- 3.77 This definition requires IPART to consider the risks faced by the regulated business. Any efficient eConveyancing firm entering the market needs to:
- (a) undertake significant technological development work and testing. This requires significant trial and error, both for the initial platform and software development to launch as well as for ongoing R&D;
 - (b) invest in system security to ensure reliable and timely settlement, as well as data protection; and
 - (c) invest in acquiring users.
- 3.78 The comparators used to determine the WACC allowance and benchmark capital structure of the benchmark ELNO should reflect these risk characteristics as closely as possible.
- 3.79 There are no perfectly comparable industries that match all of these risk characteristics. Hence, IPART should consider using information from a number of industries that share these risk characteristics with the benchmark ELNO.
- 3.80 The precise comparator industries that should be used ought to be given more detailed consideration and be subject to further consultation by IPART. However, some initial suggestions for industries (using the Thomson Reuters industry classification system) that could be investigated as potential comparator industries include the following:
- (a) Software & IT Services – to reflect the risks of developing and rolling out innovative technological solutions in a new industry;
 - (b) Pharmaceuticals and Medical Research – to reflect risks related to R&D activities and where profits are uncertain; and
 - (c) Banking and Investment Services – to reflect the risks associated with investing in system security, reliable settlement services, and in customer acquisition.

- 3.81 None of these industries on their own are likely to be close comparators to a benchmark ELNO, so IPART should consider combining or triangulating estimates from each of these industries (if, following further research, they are found to be relevant) to determine a suitable WACC allowance and capital structure for the benchmark ELNO. In connection with this, PEXA also submits that it is appropriate for the specific risk incurred by PEXA in transforming the industry to be accounted for in this calculation. [REDACTED]

[REDACTED] This is a distinctive feature of PEXA's role in the eConveyancing market that sets it apart from other close comparators.

- 3.82 Given that there are not close comparators for a benchmark ELNO, the benchmark capital structure could be determined by investigating empirically the typical gearing of firms in the comparable industries identified, and then cross-checking those estimates with PEXA's actual gearing while also accounting for PEXA's unique history and circumstances.

Question 14

How should we assess the efficient costs of providing eConveyancing services? (see page 37 of the Issues Paper)

- 3.83 The only relevant information available is the costs that PEXA has actually incurred to date. Since PEXA incurred the costs in the context of trying to enter the market, competing with traditional conveyancing and maintaining competitiveness in the face of potential new market entrants, there is every reason to expect that these costs are efficient. Trying to assess efficient costs in some other way is likely to lead to material regulatory error, and could have the perverse outcome of deterring otherwise efficient entry and competition. [REDACTED]

Question 15

Should ELNO's assets and costs be shared between states according to the proportion of conveyancing transactions or the number of subscribers in each state? Are there other approaches to sharing ELNO's costs and assets across multiple states? (see page 38 of the Issues Paper)

- 3.84 PEXA operates nationally, developed infrastructure to serve the national market and sets prices on a national basis. It is likely that the scale economies of eConveyancing and applicable regulatory arrangements would drive other efficient ELNOs to do the same. Moreover, PEXA does not allocate common costs to each jurisdiction. Importantly, PEXA's approach to pricing has ensured that eConveyancing will not become cost prohibitive for jurisdictions that are yet to introduce eConveyancing and prevents ELNOs from cherry picking profitable jurisdictions at the expense of consumers in certain other states.

Question 16

Are there benefits to ELNOs having nationally consistent prices? (see page 39 of the Issues Paper)

- 3.85 As a national operator, it is PEXA's preference to have nationally consistent prices and PEXA's current prices do not vary by jurisdiction. Economic efficiency is maximised when prices are cost reflective. Hence, if there are no significant jurisdictional-specific costs, the most efficient outcome would be to have nationally consistent prices.
- 3.86 Much of PEXA's costs relate to building national infrastructure. By definition, those costs are not jurisdiction-specific. If jurisdiction-specific prices are to be set, that would require a full allocation

of PEXA's national costs to individual jurisdictions. Cost allocation can be a challenging task in practice as there is no clear first best approach to allocating national costs. Hence, it would be simpler to determine nationally consistent prices, without attempting to set jurisdiction-specific prices using a cost allocation methodology.

Question 17

Should eConveyancing customers in states where ELNOS incur lower costs of providing eConveyancing services pay the same price as states that have higher costs? (see page 39 of the Issues Paper)

- 3.87 In the long-run, there is no obvious efficiency justification for having the same prices in states that have different jurisdictional levies.
- 3.88 However, it should not be cost prohibitive for the remaining jurisdictions, namely Tasmania, the Northern Territory and the Australian Capital Territory to transition to eConveyancing. It would also not be optimal from a consumer perspective for new entrants to cherry pick the most profitable jurisdictions.
- 3.89 By comparison, relevant prices charged by Financial Institutions do not vary by jurisdiction. Further, some transactions involve multiple jurisdictions.

Question 18

Are there any other issues relevant for considering whether our recommended NSW pricing regulatory framework could be an appropriate model for a national regime? (see page 39 of the Issues Paper)

- 3.90 In order for the NSW pricing regulatory framework to be an appropriate model for other jurisdictions, it first must be fit-for-purpose. As discussed previously in this response, given the current state of the eConveyancing market, price monitoring would be by far the most appropriate approach at this stage. Further, pricing has been considered at the national level with ARNECC concluding after extensive industry consultation that a three year CPI price cap was most appropriate.

Question 19

Who should bear the costs of implementing an interoperability solution and how should the costs be recovered? (see page 42 of the Issues Paper)

- 3.91 Ultimately, consumers are the beneficiaries of interoperability and a competitive eConveyancing market, and consumers should bear the costs of implementing interoperability. ELNOS should be able to recover these costs through prices, including through any regulated prices.
- 3.92 As noted above in response to Question 5, the precise interoperability solution that will be adopted is unknown at the present time. Given this uncertainty, PEXA submits that IPART should assume that the actual costs of interoperability solutions should be treated as a cost pass through when setting regulated prices.

Question 20

In an interoperable transaction, should one or multiple ELNO(s) complete lodgement with the land registry and financial settlement with the RBA, and which ELNO(s) should perform these activities? (see page 42 of the Issues Paper)

- 3.93 PEXA's view is that one ELNO should be selected as both the lodging and settling ELNO in order to preserve delivery versus payment. The appropriate ELNO to fulfil this role will most likely be the ELNO of the Responsible Subscriber. In any case, there will need to be a protocol to determine this irrespective of whether interoperability is introduced or 'multihoming' develops.

Question 21

What are the likely cost drivers of an interoperable transaction? (see page 42 of the Issues Paper)

- 3.94 Cost drivers of interoperability will depend on the exact interoperability solution that is adopted. Accordingly, PEXA holds the view that it is not possible to comment meaningfully on cost drivers at this stage given the unresolved status of the IGA Review and uncertainty regarding which interoperability model (if any) might be adopted.
- 3.95 However, a core principle of the national electronic conveyancing system is to achieve greater efficiencies than would be possible in a paper-based system, enabling cost savings to be passed on to end-consumers. Consistent with this, rigorous quantitative and qualitative analyses are required to understand the real costs, risks and benefits associated with each proposed interoperability model and viable alternatives to them.
- 3.96 PEXA generally considers that interoperable transactions will increase costs in the following ways:
- (a) the requirement to build interoperability capability introduces significant cost in design, building, testing and maintenance, regardless of whether or not a single transaction is processed using the model. Once implemented, interoperability interfaces would require ongoing testing, change management, transaction support and operations;
 - (b) the Lodging ELNO in any transaction will be required to assume ultimate responsibility for execution and accept the risk that something hasn't worked correctly in the interoperability interface (unless this risk can be transferred); interoperability also carries an increased requirement to provide operational support for the transaction. Given the sensitive nature of the industry, increased risks and costs associated with security and data need close consideration;
 - (c) the increased costs associated with interoperability could deter new entrants, who should be encouraged to enter the market; and
 - (d) there may be further long term costs implications as no one ELNO in the proposed interoperability environment (where the models put forward require data synchronisation) could introduce a special feature or service offering, or improve on its existing functionality without waiting for the other to do the same. This could result in a loss of competition based innovation and efficiency.

Recommending prices for the services provided by NSW Land Registry Services and Revenue NSW

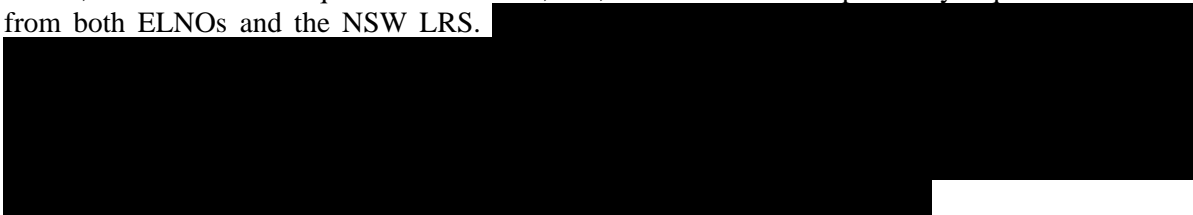
Question 22

What is the most appropriate pricing methodology for NSW LRS's services to ELNOs? Are there other alternative approaches we should consider? (see page 45 of the Issues Paper)

Fees for Service

- 3.97 IPART asserts that for the pricing methodology for NSW LRS, it will consider which prices are to be regulated and then the appropriate form of regulation. It additionally proposes to look at whether the NSW LRS fees reflect the efficient costs of providing lodgement support services to ELNOs.
- 3.98 In relation to fees for NSW LRS services, PEXA notes that it has reduced costs and increased transactional integrity for Land Titles Offices (LTOs) nationally. The LTOs are now capturing these benefits through extraordinary margins in the fees they charge the public and, in the case of NSW, South Australia and Victoria, they have monetised these profits through granting concessions to private sector operators netting \$2.6 billion, \$1.6 billion and \$2.8 billion respectively.
- 3.99 In relation to a fee-for-service model, it is unclear what service, if any, the NSW LRS is providing ELNOs. PEXA notes that neither the NSW LRS nor Revenue NSW facilitates settlement. The facilitation function applies to lodgement, which is the NSW LRS's core function. In light of the small number of paper lodgements, the NSW LRS's role is to receive lodgements and charge lodgement fees.
- 3.100 PEXA rejects the assertion that the NSW LRS's claims to provide services in accepting documents for lodgement (at 6.1 of the Issues Paper). The NSW LRS services include registering the lodged documents and maintaining the Land Titles Register. However, it is PEXA who supplies the lodged documents which allows them to complete that function.

New connections

- 3.101 IPART proposes to recommend appropriate fees and fee structure that NSW LRS can charge ELNOs for building a system for connection and performing ongoing maintenance. IPART has expressed a preference for a 'building block approach' to the extent that assets and investment required for NSW LRS to develop, build and operate a system to connect new ELNOs are significant.
- 3.102 PEXA, submits that the requirements to build, test, and maintain interoperability requires investment from both ELNOs and the NSW LRS. 
- 3.103 We recognise the imperative to charge fees on new entrants for initial connection. When PEXA built the first e-platform and connection it was necessary for NSW LRS to engage in order to facilitate eConveyancing. If new ELNOs seek to enter the eConveyancing market there is no incremental benefit to the (privatised) NSW LRS in connecting with them. Ultimately, if the NSW Registrar General decides to grant a licence to a second or third or fourth ELNO, then they have made the decision that NSW LRS must incur these additional costs, and those will likely be passed on to

consumers. It is PEXA's view that the correct way for consumers to pay those increased costs is in increased lodgement or LSS fees.

- 3.104 PEXA strongly disagrees with the suggestion that the NSW LRS can introduce new fees on an existing ELNO. There is no benefit for existing ELNOs to invest in facilitating new connections between the NSW LRS and other ELNOs.

Question 23

What firms or industries are comparable to NSW LRS in terms of their exposure to market risk? What percentage of debt rather than equity would NSW LRS be able to sustain to finance its assets (i.e. the gearing level)? (see page 45 of the Issues Paper)

- 3.105 IPART's motivation for seeking to understand the appropriate comparators to NSW LRS appears to be for the purposes of determining an allowed rate of return for NSW LRS. In this regard, PEXA notes that there is unlikely to be any 'pure play' comparator firms or industries that reflect the activities undertaken by NSW LRS that could be used to set NSW LRS's allowed rate of return.
- 3.106 The closest comparators are likely to be companies that are engaged in document management, storage and retrieval, as those are activities that NSW LRS is primarily engaged in. Two examples of listed firms that are engaged in such activities are:
- (a) Iron Mountain Pty Limited (**Iron Mountain**), which PEXA notes historically has provided document storage services for NSW LRS; and
 - (b) Recall Holdings Ltd (before it was acquired by Iron Mountain)

As there may be other similar firms that IPART could consider as suitable comparators following further research, PEXA submits that IPART should consult on the set of comparators used to determine NSW LRS's allowed rate of return before the comparator set is finalised.

Question 24

Do you agree with our proposed approach to allocating shared assets and costs? Are there other approaches or issues we should consider? (see page 46 of the Issues Paper)

- 3.107 The proposed approach to allocating shared assets and costs is sensible. To ensure efficiency, we would also propose that any allocation of shared assets and costs should ensure that allocated costs are within the bounds of incremental and stand-alone costs.

Question 25

Do you agree with our proposed approach to accounting for any cost savings to NSW LRS arising from the introduction of electronic lodgement services? (see page 47 of the Issues Paper)

- 3.108 The LTOs across Australia, including the NSW LRS, are the major beneficiaries of the efficiencies created by PEXA. Electronic lodgement systems drive the digitisation of documents, standardise lodgements and reduce errors, rework, requisitions and the time required to review physical documents. They also remove the need for document storage and maintenance within the LTOs. The LTOs are now capturing these benefits through extraordinary margins in the fees they charge the public and, in the case of NSW, South Australia and Victoria, they have monetised these profits through granting concessions to private sector operators netting \$2.6 billion, \$1.6 billion and \$2.8 billion respectively.

- 3.109 The proposed approach to allocating shared assets and costs is sensible. Any estimate of the costs of NSW LRS should be based on efficient costs. We expect that there would be two consequences of eConveyancing for the efficient costs of NSW LRS: the total cost of NSW LRS would be lower; the share of total cost allocated to conveyancing would be lower. To ensure efficiency, we would also propose that any allocation of shared assets and costs should ensure that allocated costs are within the bounds of incremental and stand-alone costs.

Question 26

Should Revenue NSW charge ELNOs for its electronic system? (see page 48 of the Issues Paper)

- 3.110 If IPART determines that Revenue NSW must incur some efficient costs when providing services to ELNOs, it is reasonable for Revenue NSW to recover those efficient costs from ELNOs. PEXA submits the appropriate time to be charged this fee would be at the time when ELNOs facilitate the collection of stamp duty revenue for a transaction via financial settlement on a transaction by transaction basis. PEXA notes that there are a number of efficiencies that Revenue NSW may be the beneficiary of, this includes compliance data being submitted to Revenue NSW to reduce revenue slippage and bringing forward revenue collection to transaction completion (rather than by a returns process). PEXA also submits that the assessment of fees Revenue NSW can charge should take into account any of those efficiency dividends achieved by the supply of data, reduction of rework, better compliance program capability and timelines of revenue being paid.
- 3.111 However, ELNOs should be permitted to pass those costs through to customers in transparent prices. This would be reasonable since ELNOs have no direct control over the costs that Revenue NSW incurs when providing services to ELNOs, and these costs would be driven by customers' transactions. PEXA notes one point of concern which would require further consultation is that Revenue NSW has not set up their system to take full advantage of such an approach as they currently do not forward calculate revenue based on settlement date.
- 3.112 Nevertheless, an approach that passes through Revenue NSW's efficient costs via regulated prices in a transparent manner would be consistent with the way in which IPART regulates other industries, such as water. For example, Sydney Water is permitted to pass through the efficient bulk water and desalination costs that IPART determines for Sydney Water's suppliers, WaterNSW and Sydney Desalination Plant, respectively.

Question 27

If Revenue NSW were to charge for services to ELNOs, on what bases should the fees be set? (see page 48 of the Issues Paper)

- 3.113 IPART should set the charges that Revenue NSW is permitted to recover from ELNOs by making an assessment of Revenue NSW's efficient costs. As explained in response to Question 26, ELNOs should be allowed to pass through in full, via regulated prices, the efficient charges for Revenue NSW that IPART determines.
- 3.114 PEXA proposes that Revenue NSW charges be determined as a charge per transaction. This would ensure that Revenue NSW's costs are recovered in proportion to ELNOs' usage of Revenue NSW's electronic system. Heavy users would pay a larger contribution of Revenue NSW's efficient costs and be allowed to pass through that share of costs to their customers.

Timeframes and transition

Question 28

When could businesses implement prices recommended by this review? What factors affect that timing and any transitional measures required? (see page 50 of the Issues Paper)

- 3.115 PEXA would be required to consult with its stakeholders and Subscribers (under existing contractual arrangements) to adjust its Participation Agreement terms (which includes price) that govern its eConveyancing services (i.e. financial institutions, solicitors, subscribers and practitioners). Those Subscribers are likely to also need time to adjust their own pricing schedules with their own customers. There would need to be sufficient time so that those notifications, negotiations/consultations, and the implementation of those time frames, can be managed.

Question 29

What is the appropriate determination period for ELNO, NSW LRS and Revenue NSW prices? What factors should we take into account when deciding on a determination period?

- 3.116 The benefit of a longer regulatory period is lower regulatory compliance costs (since there would be longer intervals between price reviews) and certainty about future regulated prices for a longer period of time. However, shortening the regulatory period would allow any regulatory or forecasting errors to be corrected more frequently, which means consumers and regulated businesses do not need to remain locked into regulated prices that are no longer fit-for-purpose. Shorter regulatory periods may be appropriate if there is reason to think that circumstances in an industry might change rapidly (e.g., because of fast technological progress, or because the market structure might change rapidly because there is a realistic prospect of significant new entry).
- 3.117 One approach to obtain the benefits of long regulatory periods (i.e., certainty, stability) whilst addressing uncertainty, would be to allow the application of 're-openers'. There are different ways in which re-openers could be implemented. One model would be to specify upfront events or changes in circumstances that would warrant a re-opening of the pricing decision within a regulatory period. These could be automatic triggers, or require an interested party (e.g., the regulated business or customers) to apply to the regulator for a re-opening. Such a model would be appropriate if the possible events that could trigger a material change in circumstances are reasonably clear and foreseeable.
- 3.118 At the other end of the spectrum would be a set of arrangements whereby the events that would cause a re-opening of the decision are not specified in advance. Rather, stakeholders would need to apply to the regulator setting out a case for re-opening a decision, and the regulator would need to decide whether there is a case for the re-opener to proceed. It would be important for the regulator to set out its criteria for evaluating whether a re-opener should be heard, to ensure consistency of regulatory approach over time, and also to deter stakeholders from pursuing trivial or vexatious claims.
- 3.119 As outlined above, PEXA initially favours the application of a 5 year transitional regulatory period. Given the uncertainty over how this industry may evolve in the short-term, it would not be appropriate for IPART to specify the re-opener events or triggers.

Question 30

Should the scope of future reviews be similar to the current review, or focus on particular aspects of pricing? (see page 50 of the Issues Paper)

- 3.120 For the reasons explained in response to Question 9, PEXA supports a light handed approach to regulation in the short-run (including price-monitoring rather than price setting, or indexation of prevailing prices as a transitional arrangement) to allow competition and innovation in this market to emerge and flourish. PEXA supports the idea of a future review to consider whether circumstances in the market have changed and, if so, whether a different approach to regulation would be warranted.
- 3.121 The scope of future reviews should be the same as, or similar to, the scope of the current review. In particular, future reviews should:
- (a) reconsider the state of competition in the market, and the extent to which ELNOs are subject to competitive, regulatory or policy constraint; and
 - (b) reflecting this, reconsider the appropriate form of price regulation for ELNOs. Depending on how the market evolves, there may be cause to change to a more or less prescriptive form of regulation, or to remove regulation altogether if the evidence suggests sufficient competition has emerged.