Australian Government
Productivity Commission

**PRODUCTIVITY COMMISSION**

**DRAFT REPORT ON THE NATIONAL ACCESS REGIME**

**MS P. SCOTT, Presiding Commissioner**
**MS A. MacRAE, Commissioner**

**TRANSCRIPT OF PROCEEDINGS**

**AT SYDNEY ON THURSDAY, 25 JULY 2013, AT 9.58 AM**

**Continued from 16/7/13 in Perth**

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**MS SCOTT:** Good morning, ladies and gentlemen, and thank you for coming along today. Welcome to our public hearings for the Productivity Commission's inquiry into the National Access Regime following the release of our draft report on 28 May. My name is Patricia Scott and I'm a commissioner on this inquiry and my fellow commissioner is Angela MacRae.

The purpose of this round of hearings is to facilitate public scrutiny of the commission's work and to get comment and feedback on the draft report. A public hearing has already been held in Perth and, following this hearing in Sydney, a hearing will be also held in Melbourne. We will then be working towards completing a final report to government in October, having considered all the evidence presented at the hearings and in submissions, as well as other informal discussions.

Participants in this inquiry will automatically receive a copy of the final report, once released by the government, which may be up to 25 parliamentary sitting days after completion. Sitting days, of course, aren't the same as days, so I'll just flag that for you.

We like to conduct all our hearings in a reasonably informal manner, but I do remind participants that a full transcript is being taken. For this reason, comments from the floor will not be taken, but at the end of the proceedings for the day, which should be around 1 o'clock, if you wish to come forward to make comment, I will invite you to do so.

Participants are not required to take an oath but should be truthful in their remarks, and participants are welcome to comment on the issues raised in other submissions. The transcript will be available to participants and from the commission's web site following the hearings. Submissions are also available on the web site.

To comply with the requirements of the Commonwealth occupational health and safety legislation, you are advised that in the unlikely event of an emergency requiring evacuation of this building, you should note that there will be a warning alert and the staff will direct us to the evacuation area. The assembly point is on the corner of Clarence and Market streets.

I'd now like to welcome Michael Deegan to our hearings. For the purpose of the transcript, Michael, would you state your name, please, and the organisation, and then would you like to make an opening statement.

**MR AUSTEN (ONIC):** My apologies. Michael Deegan is unable to attend.

**MS SCOTT:** Okay.

**MR AUSTEN (ONIC):** My name is John Austen.

**MS SCOTT:** All right, John.

**MR AUSTEN (ONIC):** I'm from the Office of the National Infrastructure Coordinator, which is a small group that assists the infrastructure coordinator Michael Deegan and the Infrastructure Australia Council. I don't represent either the Commonwealth government or the Infrastructure Australia Council. I represent the office.

**MS SCOTT:** Okay. Thank you very much.

**MR AUSTEN (ONIC):** We put in a submission to the inquiry regarding the potential for road investment inclusion in the regime. The issue of investment access for roads in our opinion is a matter of national significance and it's identified in our works on national ports and land freight which the Commonwealth government asked us to undertake.

Improving the framework for investment access relating to heavy vehicles and trucks is an important part of that agenda. There's a lot of discussion at present about how road authorities and governments might identify and fund road improvements for trucks. Our interest is in a slightly different matter. It's a potential for the private sector, for the trucking community and for the customers, to identify and fund things by themselves, so rather than governments and road authorities identifying them, we have taken the complementary view. This is part of the "user pays, user says" agenda put forward by Infrastructure Australia.

Our submission to the inquiry identified the possibility of an investment access regime for some roads but not all roads, such as is in place for some railways and not all railways. Our proposition would be limited to roads which are nationally significant and to the types of roads that might be covered by the National Access Regime and that would be necessary for competition in upstream or downstream markets. The issue is not road access per se but investment into the road network in order to get better access or other pay-off, which might be the use of a bigger vehicle, a longer vehicle, or a better transit time.

This isn't a new idea and there are ad hoc arrangements in place in a number of jurisdictions. They're not coordinated. There does not seem to be a policy framework for them and, following the commission's report on road and rail infrastructure pricing, there was a very limited number of trials for what is termed "incremental pricing". The reports on those trials said they were unsuccessful but they cast doubt on how diligently that trial methodology was in fact pursued. Our interest is in actually pursuing that trial methodology a bit further, and I can talk

about that a bit further later on.

**MS SCOTT:** Good. Thank you.

**MR AUSTEN (ONIC):** We think a national approach which would be consistent with the precepts of the National Competition Policy would offer greater consistency among these ad hoc arrangements and a potential to expand them, and in this respect we think that the National Access Regime in concept is a policy asset. While not going into the details and bits and pieces of it, we think that it gives you important directions of how you might undertake this type of stuff.

The type of approach which might be in mind might be analogous to the Australian Rail Track Corporation's undertaking. Clause 6 of that actually has an investment access type of model in there, and there's a variety of ways in which funding for the investment can be undertaken, including charging, per-tonne charging, or just a gross sum originally.

We think the merits of that type of thing are more efficient identification and provision of investment, because the beneficiaries of the investment are involved in investment decision-making. There's a more transparent and equal footing for roads and railways in having that type of arrangement, which we think is important for cross-modal issues and economy-wide matters, and it allows for coordination across the entire supply chain so we don't have a situation where we do have those rights in a railway and in a port but not in the road that links the two.

The type of investment you might see is where returns through lower trucking costs are greater than the cost of infrastructure. Necessarily, they might be in very, very few situations. We're not saying that this is the answer. We're saying this may be part of an answer. It may not need a co-contribution from government and so projects would not be held up in the hope of government funds later on. Because we think it should be voluntary, we have difficulty seeing a downside straightaway. If it was a compulsory thing, there may be distortions put into it.

We have a couple of examples of potential applications which we are testing at the moment. One is on a national highway, which we call high-productivity vehicles on the Hume Highway, at the moment we're working out a trial methodology for how to implement this type of arrangement there. We'll be publishing that in the near future.

The second one is roads to rail terminals, major rail terminals. We are halfway through a study of the Chullora rail terminal in Sydney, which for some reason has not been linked to the national road network by higher mass limits access, which appears to be an oversight, and it's been so for 20 years without resolution.

A third one which we're looking at in the north-west of New South Wales and south-west Queensland is a group of rural roads, looking to identify which of many roads may be improved in order to more effectively funnel freight down to silos and sub-terminals.

For each of those, we've done what we call an arithmetic proof of concept, which suggests that there are in fact commercial gains available from the investment access type arrangements. We're now trying to operationalise that to see whether in fact there are practical impediments to that type of arrangement.

Other examples which we haven't tested yet might be town bypasses, so instead of having a four-lane, 110-kilometre-an-hour, 10-kilometre bypass, it may be an 80-kilometre-an-hour, single-lane bypass. The benefit for trucks is they don't pull up at traffic lights and the cost may be considerably less. One of the important principles in this is scalability, so the road reservation will need to be scalable up to four lanes, if governments wanted to do that.

Another one, which is reasonably common but doesn't come up in the road sense, it comes up in the land sense, is industrial intersections; for example, intersections onto the Newell Highway and their road designs or, in Sydney, intersections to Eastern Creek. So, what are design standards into Eastern Creek for the customers?

We generally agree with the sentiments of the Hilmer review which were in the draft report, which is a consistent approach to access regulation or access promotion across the economy. It is a good thing, and with a strong focus on the public sector. The largest part of the public sector in the infrastructure area is in fact the road network. We raise this issue in our report to the Council of Australian Governments, and in our reports on land freight. We put publications on our web site about some of the concepts of how this might occur and how it might be undertaken. We've had a look at the arguments in the draft report which were against this, and we're actually not convinced by those arguments, and I can go into those in a bit of detail.

One of the interesting things in the legislation is that our understanding is that the word "roads" is one of the two services which are identified as the types of things that the National Access Regime would apply to, although it seems to be generally understood that that at present it doesn't apply to roads, so we think there's a difference between what the legislation has and what policy understands at present.

I'm happy to take questions. What we'd like the commission to do is to have a look at the concept in a bit more detail, and particularly if it's going to recommend changes to the National Access Regime, how they may impact on roads and how they may impact on road investment, given what we consider is the likelihood that this issue will become more pressing in the next 10 years. Thanks for that.

**MS SCOTT:** Thank you very much. We've got about 15 minutes or so to ask questions. Do you want to lead off?

**MS MacRAE:** I guess one of the things that interests me is that generally when I've been reading your submission and the commentary that you've made there, to start with you were talking about an investment access regime, and I think in some of your other comments you have said that you thought that it wasn't really about access to roads as such but really a matter of access to investment for roads.

I think that's primarily the reason why to this point we've heard a difference of view about how your problem, which we would acknowledge is a problem, would fit inside this legal structure, because I think you would know from our report that we've really identified competition and impediments to competition as being the main issue, and in the same way that I think you struggle to see why we can't see it fitting in the regime, we can't see, from the perspective of road users, where there's a barrier to competition there that would bring you inside the regime.

So if you could just explain a little bit more about how you see this as a competition issue, or whether in fact you would say you think that we've got the overarching goal for the regime incorrect and that there should be some broader goals within the framework of the National Access Regime that would then bring roads inside.

**MR AUSTEN (ONIC):** Okay. I think there are two answers. One is that the legislation gives roads as one of the two services that are an example of what the regime applies to, so there's an issue in that, in that the draftsmen at the time had in their mind that something applies to roads.

**MS SCOTT:** Could apply to roads.

**MR AUSTEN (ONIC):** Could apply to roads. Could apply to railways; could apply to roads. They were the two examples. So that drew our attention. The second thing is that the competition I think it refers to is in upstream or downstream markets. Some ports in Australia are serviced by railway lines and some are serviced by roads, and some of them deal with the same commodities. For example, Port Kembla deals with coal. There's a railway line to Port Kembla and there's a road to Port Kembla. It would appear to us to be fairly strange if the National Access Regime applied to the railway line for one port but not to the road carrying the same volume, the same commodity, to another port.

**MS SCOTT:** It could well apply in both cases if the problem and the rationale were the same, and I think that's really what Angela is trying to draw out. In your opening remarks you seemed to make the point that it was about access to investment rather

than access to, in some ways, the facility itself. So could you just elaborate a bit more on that.

**MR AUSTEN (ONIC):** Sorry, I'm not saying it's about access to investment. I'm saying that the purpose of rail investment is to improve access to the rail, so one of the things is, how can we harness private investment for use in roads like we harness private investment for use in railways? The purpose of investment in a railway, for example, is to increase the size and weight of vehicles able to use the railway, and I'm saying exactly the same principles apply to roads. The purpose of investment in roads is to allow an increase in size and weight of vehicles.

The difference is, to date, there's no national type of process for getting private investment into roads involving users as there is for a railway line. So exactly the same physical and engineering characteristics apply, except for the capacity allocation question, but we actually don't see the difference between the restrictions on access, for example, to a branch line in western New South Wales that can't take a heavy locomotive. The roads to the branch line can't take a heavy truck. There's no actual engineering difference in that, and the purpose of investment in both cases would be to take a heavier vehicle. So we're saying the purpose of investment is to get access via heavier vehicle to serve an end market. Is that clearer?

**MS MacRAE:** I think we still end up sort of talking at cross-purposes. In the case of the port, is there a piece of monopoly infrastructure that means that there's an impact on competition that means that people can't get reasonable access to the port, and what sort of arrangements might we need for that? But the reason for that is that there's a single line and there's no alternative to that, and so it's a point of congestion, and in order to allow for that downstream competition to occur, you need to allow other people onto that line. But as I understand it, in the road case the reason for not allowing bigger vehicles on certain roads is more to do with the local amenity and those sorts of issues, which are not the issues that are germane to the issues with the railway.

**MR AUSTEN (ONIC):** The local amenity things are very important and we recognise that, but there are two reasons for access being restricted to roads. One is local amenity and the other one is the quality of the infrastructure. We're targeting quality of infrastructure. We're very cognisant of the local amenity issue. Chullora is actually an example. There's a single road into Chullora, which is a problem - a single road into the rail terminal - and it's not constrained by local amenity, it's constrained by truck weight. So the reason that trains are underweight going out of Chullora is because of the bottleneck road into Chullora.

So there are examples of it and, as I've said earlier, it may not be widespread, but there are ad hoc arrangements around the country for road access to mines and specific places and we'd like to see a more national approach to that, picking up

places like Chullora and the Hume Highway, to improve the engineering standards where there's no amenity issue and it's a commercial issue.

**MS MacRAE:** I don't know if I heard you rightly, and you can tell me if I'm not getting you right: you said that you'd done some modelling in these cases and you thought there were commercial gains here.

**MR AUSTEN (ONIC):** Yes.

**MS MacRAE:** The next question then is why do you need some overriding regulation to bring people into that? If there are commercial gains, why is that investment not happening?

**MR AUSTEN (ONIC):** That's a very good question and at Chullora nobody could explain to us why that happened. Maybe it's a cultural matter. Maybe it's an expectation that government will step in later on and provide a subsidy for it. I don't know.

**MS MacRAE:** Again if I'm characterising the scheme properly that you're thinking about, if you had an undertaking arrangement like an ARTC thing, you said - again if I heard you correctly - that you wanted those arrangements to only be voluntary.

**MR AUSTEN (ONIC):** Yes.

**MS MacRAE:** So what would make people enter into a voluntary arrangement to sort of have an investment proposal come together, when they're not doing it in what is essentially a voluntary arrangement now? If we're not talking about something that's going to be mandatory, how is that different from - - -

**MR AUSTEN (ONIC):** They may be unaware of it. The incremental pricing models, for example: the idea, I understand, was to conduct a comprehensive series of trials across the country. Two were conducted, and when the incremental pricing people looked around the country, they looked for situations where there was no bridge, because they thought that people wouldn't want to pay to fix a bridge. So it may be a cultural thing, but there does seem to us to be some impediment in there as to why this private investment doesn't occur. But, as you say, simply putting it in a voluntary regime doesn't create investment. There's no investment in the branch lines in western New South Wales, even though that's available as well, and that may be because it's unprofitable to do so or because parties out there are waiting for the government to fix them up.

**MS MacRAE:** I guess the final piece of the puzzle that I'm trying to get at is how overlaying a sort of voluntary arrangement through the National Access Regime is going to give you - what's the value in that from your point of view, in bringing

people together? There are no barriers to those people coming together now, and there seems to be commercial gain in it, so what does a voluntary arrangement do for you? Where's the lever in that? What's the difference it's going to make?

**MR AUSTEN (ONIC):** It gives people a system and case studies and things to follow. Our looking at the incremental pricing trials, which weren't really trials at all, is that they are just "Would you like to drive a truck down a road?" which to us is not a trial. There's no methodology. There's no pattern or shape to it. It's just that there was an idea and it didn't happen.

**MS MacRAE:** But do you need the National Access Regime to give you that pattern and shape?

**MR AUSTEN (ONIC):** No, you don't, but we're saying for the purposes of, in the long run, the direction of making roads look more like a utility, at least for heavy vehicles, it would be desirable for there to be consistency so we don't have a special thing over here for roads which is quite different and inconsistent with national precepts in the other utilities over there.

**MS MacRAE:** Except that I think, again if I'm understanding you correctly, the rules that we use under the National Access Regime to try and determine which rail lines would fall under the system and which wouldn't - and, as with roads, most aren't going to be inside - then they will be different, I think.

**MR AUSTEN (ONIC):** Yes, but again, the essential facilities of national significance, et cetera, I would think is a pretty good guide as to where you'd be looking for these things, rather than on an ad hoc basis; say for example Chullora, which is the second-biggest container facility in Sydney, which is on the national rail line, which is subject to an access undertaking - that might be one of those places.

**MS SCOTT:** Have you had an opportunity to look at the Department of Infrastructure's submission and, if you have, could you comment on why you think their approach is incorrect?

**MR AUSTEN (ONIC):** There are a couple of things that have turned up in that one. It said that the access regime wasn't designed to address these types of issues, which may in fact be the case, but we need to explain why the word "roads" appears in the definition of services. So it may not apply to roads, it may not have been designed for roads, but somebody had in their mind, in contemplation, roads.

The second was the view that there's insufficient evidence to conclude that road operators have incentive to deny access in order to limit competition. The "in order to limit competition" seems to impose a test of intention. The question which is

relevant is "Does it actually affect competition in an upstream or downstream market?" rather than whether there's an intention.

The third thing is the claim that "governments don't have a commercial incentive to deny access to heavy vehicle operators". Well, they do have a commercial incentive to deny access, because if they provide access and their road wears out - sorry. They have a financial incentive to deny access. They have no source of funds. This is the point of the heavy vehicle charging initiative. Unless they have funds for access, they have an incentive to deny access. They don't make a profit by providing access, but they can make a loss; the denial of access prevents them from making a loss. That's the point behind the heavy vehicle charging initiative and other reforms. I think the terminology is that they're asset protectors, so presumably that's for a financial reason.

Road restrictions which are related to technical, safety and engineering factors are identical to those in railways, so that would say that the regime shouldn't apply to railways. So I don't understand some of those points.

**MS SCOTT:** Okay. Going back to your comment about competition and, I guess, Angela's original comments about the appropriate rationale for a National Access Regime, are you aware of any examples where a restriction on heavy vehicles from accessing road infrastructure has resulted in a reduction in competition in dependent markets? I can see how it may have resulted in congestion and - - -

**MR AUSTEN (ONIC):** I haven't assessed that - not the competition - but it has resulted in lower weights on the road into Chullora. It has resulted in shorter vehicles on the Hume Highway. It has resulted in particular types of vehicles on grain roads. So I can point to the vehicle. I actually haven't assessed what's happened in upstream or downstream markets.

**MS SCOTT:** Yes, right, but that's really the test that we're - - -

**MR AUSTEN (ONIC):** That's right.

**MS SCOTT:** Okay, yes.

**MR AUSTEN (ONIC):** Yes, I appreciate that.

**MS SCOTT:** John, I think we're nearing the end of the time that we've assigned to you. We were thinking about going with general questions, but that would probably take us on a whole new tangent and really probably be frustrating for all concerned, because it will probably take too much time. Is there any last comment you would like to make?

**MR AUSTEN (ONIC):** Thanks very much for your time.

**MS SCOTT:** All right. Thank you very much for coming along.

**MR AUSTEN (ONIC):** And best wishes for the report.

**MS SCOTT:** Thank you. Thank you for coming along and thank you for your submissions. We appreciate them.

**MS MacRAE:** Thank you.

**MS SCOTT:** I now call to the table John Cleland, please, from Anglo American. Good morning, John. Thank you for coming along today. For the purpose of the transcript would you state your full name and your role with Anglo American, please.

**MR CLELAND (AAMC):** John Cleland, and I'm Head of Infrastructure with Anglo American Metallurgical Coal.

**MS SCOTT:** Thank you. Would you like to make an opening statement?

**MR CLELAND (AAMC):** Yes, thank you. Firstly, thank you for the opportunity to be here today and to make submissions to this very worthwhile inquiry. As mentioned, I'm John Cleland. I'm head of infrastructure at Anglo American Metallurgical Coal. We are the second-largest exporter of metallurgical coal from Australia and also produce thermal coal in Queensland and New South Wales. We have contractual rights to 33 million tonnes of port and rail capacity in Queensland and a further four million tonnes in New South Wales. We rely on the National Access Regime and certified state access regimes to gain third party access to rail and port facilities, and have a significant interest in the outcome of this inquiry.

Anglo American acknowledges that access providers and infrastructure owners and investors must be able to recoup a legitimate return on their risks and investments. It is firmly of the view that regulating and controlling industries where monopolies exist in the supply chain is the only way to ensure that the Australian market and the Australian economy as a whole can remain efficient and internationally competitive.

Anglo American is generally supportive of the recommendations that the commission has included in the draft report and appreciates the opportunity to appear here today. In particular we support the commission's acknowledgment of the need for specifically crafted regulation for different situations rather than a one size fits all solution. We find this particularly important for dealing with different ownership structures which, in the case of bulk commodity networks, include vertically integrated private-sector-developed railways in the Pilbara; privatised ex-government-owned open-access facilities, including those with vertical integration, such as Aurizon Group in Queensland; and finally, greenfield facilities developed as privately funded, multi-user facilities, such as the WICET [Wiggins Island Coal Export Terminal] development at Gladstone and proposed developments at Abbot Point further north in Queensland.

All these examples of monopoly-owned facilities have different reasons for being regulated and different competitive market issues to protect against and cannot all be governed by one form of regulation, and in fact we believe there are particular risks in trying to apply a single form of regulation to all those asset categories.

I think it's worth making the observation that the regulation of privatised government open-access facilities has been relatively effective to date, but I think we would seek to differentiate between the success of the regimes to date and the applicability of the regimes to further expansion of those assets and networks.

What we are generally seeing in Queensland at present is a move towards return expectations on the part of infrastructure owners beyond the regulated rate of return and the potential for some degree of investment hold-up as a result. As I mentioned, investment hold-up unless superior returns are available is a particular issue and risk to the coal industry and bulk export industries generally, and our contention is that there are clear examples of this occurring in Queensland.

A further point to make at this juncture is that Anglo American is firmly of the view and supports the commission's finding in the draft report that central coordination of supply chains is critical. It's critical to the efficient operation of the supply chains and it is critical to ensuring that expansion of the single elements of the supply chain, be it port or rail, are done with cognisance to the capacity of the whole supply chain so we avoid the situation which has existed in Queensland where there are ports developed to a certain nameplate capacity but insufficient rail capacity to actually meet that nameplate capacity.

I'll now make some specific comments in relation to the privatisation of government assets generally. There is a historical context here, inasmuch as privatisations of government-owned assets in the case of the coal industry have really occurred within the last 15, 20 years, so there is effectively a sort of transitional period. Clearly many substantial investments made within the resources sector were made on the basis of government-developed and government-provided infrastructure facilities, and that has clearly changed. Uncertainty over future access conditions and pricing can and will have a deleterious impact on investment decisions, both in relation to new projects and the expansion or continuation of existing projects and operations.

Governments, as owners of monopoly infrastructure, were able to balance the requirements for an adequate return with maximising the facilities to maximise royalty revenue and contribute to employment and economic activity. The same expectation cannot be reasonably applied to infrastructure owners of all privatised facilities.

The issues arising with privatisation can, however, be addressed through appropriately applied regulation, with the imperative being to have that regulation in place prior to the sale of the asset. Obviously, "appropriately applied" will mean it applying before the finalisation of the privatisation process.

A very important point here is that this creates a natural tension between

ensuring appropriate regulation is in place prior to privatisation and the maximisation of sale proceeds or, to put it another way, there is likely to be a trade-off between sale proceeds and future revenue streams to government through royalties, taxation revenue, employment and economic activity. I can't state that point with enough importance. It really is critical to the consideration of the privatisation of future assets and it applies to the operation of the National Access Regime. There is of course a purely political element to it as well because of the realities of budget pressures on governments, which are outside the scope of this report and this process but need to be acknowledged.

DBCT - I'm referring to the Dalrymple Bay Coal Terminal when I use the acronym DBCT - represents a good example of regulation being implemented prior to privatisation and, as a result, continued access and reasonable rates for users. That said, however, there have been issues with DBCT in terms of the length of time it took for the terminal to be expanded when the coal industry was expanding rapidly in the sort of early-to-mid 2000s and earlier. That really came about as a result of some contention between the infrastructure owner - the asset owner - industry and government as to who should be funding that expansion and at what rate of return the expansion should be made.

The Queensland government has recently sold the Abbot Point Coal Terminal and is likely to contemplate selling the RG Tanna terminal within the Gladstone Ports Corporation. Rather than leaving access to these privatised facilities to the complete discretion of new owners, governments must ensure that regulation protects users' rights to transparent and non-discriminatory access, expansions, master planning and appropriately controlled pricing, and that must be done prior to the privatisation, which is the point I made earlier.

Finally on this point, Anglo American is not suggesting that the only form of regulation is government controlled. We believe that some of the most successfully applied regulation is actually facility based, and we would use the example here of the long-term commercial framework which exists between Port Waratah Coal Services and Newcastle Port Corporation, which is essentially a long-term contractual arrangement between the ports and Newcastle Port Corporation as the lessor.

Finally and in conclusion, I'll just make some general comments in relation to the commission's draft report. Anglo American strongly agrees that the natural monopoly test is the preferred test for declaration of infrastructure or assets and believes that the private profitability test will result in perverse outcomes, particularly in multi-user environments as are prevalent in the coal industry. I think the private profitability test really was developed out of discussions and tension in relation to access to the Pilbara Railways and, as I say, if applied to multi-user environments such as exist in the coal industry I think there will be some very

perverse outcomes.

Furthermore, with the private profitability test, we believe there is the risk of some currently regulated assets or the owners of regulated assets seeking revocation of that regulation on the basis of the private profitability test.

Anglo American believes that it's critical to recognise that monopolists have extensive power over users whether or not the monopolists are vertically integrated. That's a very important point. The impact of operational or disruption costs should only go so far as to preclude an access declaration when the cost to the owner will outweigh the benefit to every single potential user. Really the disruption cost test should be applied post-declaration and upon the instance of each actual application.

The public interest test should only be employed as a catch-all to determine if, although meeting all other criteria, an access declaration is not in the public interest. It should not be used as an extra hurdle for users who are seeking an access declaration. To put that more simply, the burden of proof should remain with the access provider rather than being transferred to the access seeker, and this is the differentiation between a negative and a positive ultimate test in that regard.

Thank you again for the opportunity to be here today. That concludes my formal comments and I'm happy to take any questions.

**MS MacRAE:** Thank you very much.

**MS SCOTT:** John, we've probably got about 20 minutes and we probably will use all that time asking you questions and getting your responses.

**MR CLELAND (AAMC):** Terrific

**MS SCOTT:** We've heard from other participants that the natural monopoly test is unworkable and they've cautioned us to reconsider that in light of their concerns about its practicality. They're saying that no access seeker, such as yourself, would be in a position to reliably predict whether the test will be satisfied or not. Could you talk about the workability of both tests, given you've had exposure to this issue. What's your view on the workability of both tests?

**MR CLELAND (AAMC):** That's a very good question and, unfortunately, it's a very complex area. As I sort of made comment through my remarks, there is no one-size-fits-all here. However, we are of the view that the natural monopoly test does work, particularly in relation to ports and railways in the circumstance of bulk commodity export industries.

The point is, the greater public good or the greater economic benefit results

from the application of that test and being able to ensure that a natural monopoly can be forced to expand or be declared, simply to avoid the risk of having to inefficiently duplicate pieces of infrastructure.

**MS SCOTT:** Okay.

**MS MacRAE:** You just mentioned expansions there, and I'd be interested in following that through a little bit. You'll know from our report that we're saying that these powers of expansion and extension have been not much tested at the federal level but there has been more experience at the Queensland level. I just wondered if you could tell us a little bit more about the Standard User Funding Agreement [SUFA] that you have with Aurizon and how difficult that's been and whether there are lessons from that for the national case and whether the issue of extension and expansion is something where there might be reforms required.

**MR CLELAND (AAMC):** Sure. Having acknowledged in my remarks that infrastructure owners are entitled to a reasonable rate of return and a reasonable risk profile, the whole issue of expansion is very complex and I don't envy your task in determining how expansions can be mandated or forced in the future.

As I said, in Queensland there have been examples where expansions or extensions have only been undertaken when the network owner or the asset owner has been able to generate a return well in excess of the regulated WACC [Weighted Average Cost of Capital], and that was really the genesis of the SUFA arrangements.

In commenting on SUFA, I should say that the SUFA arrangements are yet to be finally approved by the Queensland Competition Authority. There is sort of a high-level agreement between Aurizon and coal producers on sort of the key terms of the SUFA arrangement, but clearly they have not yet been tested in a real-life example and I suspect it will be some time before that is the case. However, having said that - and on the assumption that the SUFA arrangements are actually endorsed by the QCA and implemented - they are of critical importance, because they do provide an alternative to the infrastructure owner generating an unreasonable rate of return, if you like, in relation to any expansion. It provides the user of that infrastructure the opportunity to invest at its own cost of capital to ensure that the expansion is undertaken without there being effectively an economic rent charged on the way through.

There probably is a view within the industry that it's unlikely that the SUFA arrangements will ever actually be used. I think the more important thing is, they will provide a point of leverage for industry to ensure that, in the absence of a sufficiently robust regulatory environment to ensure that Aurizon does expand, their rate of return is ultimately reasonable. However, it may well be that the SUFA arrangements do come to pass and there are real examples of users directly investing

in the industry, which has happened elsewhere in the country of course - - -

**MS MacRAE:** Yes.

**MR CLELAND (AAMC):** - - - but just never within a regulatory environment. It's always been done on purely a commercial arm's length basis.

**MS MacRAE:** What was different in this case that meant that something didn't happen voluntarily? You got to a point where you just couldn't agree the rate of return. That was the real sticking point.

**MR CLELAND (AAMC):** No, on the contrary. The rate of return in relation to two particular expansions of the Queensland coal network was agreed with industry, but the general view within industry was that there wasn't a great deal of choice but to agree to those rates of return, given that port investments and mine investments at either end of the network had already been committed to.

**MS MacRAE:** Right. You also talked about greenfields investments, or assets moving from public to private hands; that it's a good idea to work out the access arrangements prior to those things happening. What sort of principles do you think the government should use in relation to choices around facility based arrangements that, as you said, have worked quite well in some cases; mandatory undertakings for certain assets perhaps; or leaving things to the more general regime. Do you have a view about how they would make the choices in those cases?

**MR CLELAND (AAMC):** Yes. You've gone to the point of it, inasmuch as there are different choices. In the case of Newcastle, we believe that the facility based regime has worked very effectively.

I think it depends largely on what the ongoing contractual relationship between government and the asset will be. Where a government is privatising assets on the basis of 49- or 99-year leases, then there is the opportunity to build access and pricing principles into the lease. Alternatively, it can be done on a purely commercial basis, as effectively was done with the WICET arrangement, or the WICET development, or, as you say, it can be left to a general access regime.

If I was to express a preference, I think it's best done on sound commercial principles, and there will always be issues specific to each location that probably tend to suggest arrangements directly applicable to that location or that development, and I'm really referring there to contractual or commercial development arrangements probably being preferable. But clearly the existence of the National Access Regime and various other regimes is critical to ensuring that those are developed on the right basis.

**MS SCOTT:** I would like to go back to your submission in relation to assessment of whether coordination costs outweigh access gains. Your proposition is that these would be best addressed at the arbitration stage rather than the assessment and declaration stage. Could you elaborate a little bit further on that, given that all of this requires assessment and judgments, thinking about foreseeable demand and so on and thinking about the total market. There are a significant number of judgments that have to be made. Why does this one concern you being done at this stage rather than at the arbitration stage?

**MR CLELAND (AAMC):** Sorry, which one?

**MS SCOTT:** This is the assessment of the coordination costs.

**MS MacRAE:** Which we've said would be a variation on criterion (b) - that we include coordination costs at that stage - and your submission has said that it would be better to only apply that at the arbitration stage, so at the next stage, which is where it currently will sit.

**MR CLELAND (AAMC):** I think our point there was really ensuring that coordination costs don't ultimately determine whether an asset is declared or not.

**MS SCOTT:** In our draft report we do say this would be quite a critical change, and we use some examples where international literature suggests that this can really be quite deterministic about whether something would be declared or not. You implied that it's unworkable. I guess I'm wanting to tease that out with you, given that there are many other things that you have to make assessments on: foreseeable demand, cost structure and so.

**MR CLELAND (AAMC):** I think the key point we were trying to make there was a differentiation between the various forms of application and differentiating between, in the case of a rail network, a single user wanting a single train path for a specified period of time, which would have almost no impact on capacity, versus a major user with multiple load points seeking multiple train paths over an extended period of time, which would have a material impact on capacity.

The point is that those coordination costs need to be assessed on a case-by-case basis and shouldn't necessarily be deterministic at the outset of a declaration decision.

**MS SCOTT:** But if you then proceed through the process and they do weigh heavily in the final determination, arbitration or whatever, haven't we then effectively wasted an opportunity to take those into account at an early stage; a bit like our consideration of the threshold test? Isn't it better to consider these things up-front than to go through a very expensive and convoluted process and find at the end of the

day, "Wait a minute, the coordination cost means that it is actually not possible to arrive at a charge that would be acceptable to the access seeker and reasonable recovery of costs for the infrastructure provider."

**MR CLELAND (AAMC):** Yes, I think that's a reasonable proposition, so long as you can accurately determine exactly what sort of applications will be made right at the outset.

**MS SCOTT:** I think it's the word "exact" that I'm getting a little hung up about, John, because people are trying to obviously be very precise in these declaration processes and there's a lot at stake. But at the end of the day it has to be an estimation exercise, using your best information available, rather than an incredibly precise, exact science; the weighing up of waiting for later but discovering in fact that coordination costs make this proposition not viable versus taking those into account at an early stage in the process, acknowledging that coordination costs and a number of other things require careful assessment and judgment and using the best estimates available. So the exactitude comes later - - -

**MR CLELAND (AAMC):** Sure.

**MS SCOTT:** - - - but in the meantime you've had considerable costs. Could you talk about that sort of weighing up. I mean, total foreseeable demand is quite a challenge in itself.

**MR CLELAND (AAMC):** I hear what you're saying. There will be a range of different scenarios or different situations here. In the case of some facilities or assets, a determination on the impact of coordination costs can probably be made at the outset of the declaration stage.

**MS SCOTT:** Okay.

**MR CLELAND (AAMC):** In the case of others - and particularly rail networks with multiple load points and multiple destinations, or multiple ports - it's much more difficult to make a categorical determination at the outset - - -

**MS SCOTT:** Yes.

**MR CLELAND (AAMC):** - - - and there are risks in doing so, because effectively the determination could be made on a particular scenario whereas there are other scenarios which are very relevant, and particularly, in the case of bulk commodities, to smaller producers, where they may lose that ability to seek access at a later date.

**MS SCOTT:** Okay.

**MS MacRAE:** In relation to the criteria we talked about and the changes that we're looking at, the High Court, going through the private profitability test - you mentioned in your opening statement, and I think in your submission as well, the possibility of revocation, given that change in interpretation.

**MR CLELAND (AAMC):** Yes.

**MS MacRAE:** How real do you see that threat and, if it was to come to pass, how dramatic would that be from your point of view?

**MR CLELAND (AAMC):** I think as a general observation there is no question that owners of regulated assets within bulk commodity supply chains are seeking to minimise the impact of access regimes and regulation on their ability to generate a return and operate their assets. So any change in legislation or regulation which provides the opportunity to do that is an issue.

In the case of bulk commodity supply chains - and particularly the Queensland coal network - revocation of regulation would be a very significant issue inasmuch as at this point that regulation provides a very effective mechanism for access seekers to gain capacity within the networks with ports and for returns to be kept at a reasonable level. In the absence of regulation, particularly where you have vertically integrated operators such as Aurizon Network, who operate above rail in a competitive market and below rail in a notionally regulated market - in a regulated monopoly market - I think there would be very severe risks and ramifications, both perceived and real, from any revocation of existing regulation.

**MS MacRAE:** So it's something that obviously you look at but you wouldn't have any firmer information you'd want to share with us about how likely something like that might be.

**MR CLELAND (AAMC):** How likely?

**MS MacRAE:** Revocation might be.

**MR CLELAND (AAMC):** Revocation?

**MS MacRAE:** Yes.

**MR CLELAND (AAMC):** It's difficult. I don't think I'm in a position to answer that, given that I don't represent a regulated asset here. I guess I'm more speculating, if you like, that it will be an objective of those owners to minimise or seek revocation if at all possible.

**MS SCOTT:** John, we might turn to some of the points you made in your opening

remarks. I think I caught the comment that you said something about perverse outcomes that could be envisaged from the private profitability test. Could you just expand on that and talk about what exactly those perverse outcomes - - -

**MR CLELAND (AAMC):** That goes - - -

**MS SCOTT:** Goes straight back to that one?

**MR CLELAND (AAMC):** - - - straight back to Angela's point in terms of perverse. A perverse outcome would be an existing regulated asset - certain revocation on the basis of the private profitability test; for example, Aurizon Network arguing that the regulation of that network should be revocated on the basis that large multinational resource companies such as Anglo American are in a position to build infrastructure in their own right.

**MS SCOTT:** Okay. We've heard from other participants in this process that the ACCC's power to direct expansions is completely unworkable and they say that, if push came to shove, a firm that's unwilling to see its facilities expand or extended could effectively make that completely impractical: they don't need to cooperate; they could change their approaches.

I guess from my background in communications, in the past there have been accusations that the infrastructure provider can lose keys to the exchange or suddenly find that they've changed the capacity arrangements, so the access seeker turns up to effectively use spare capacity that was available the day before but it's suddenly not. You could work to rule but still make it effectively unmanageable for the access seeker. Would you like to comment on that. Is that a real risk and, if that is a real risk, does that then make the discussion about expansions and extensions really quite a philosophical one?

**MR CLELAND (AAMC):** I certainly hope not. I think it goes back to the point I made that the regulation of privatised government monopolies - and once again referring to the Queensland example - has worked well through the period where those assets have effectively been utilising previous government investment. However, they haven't worked effectively when it comes to expansion.

We referenced in our submission the examples of the Goonyella to Abbot Point expansion project and the Wiggins Island rail project, both of which saw returns well in excess of the regulated WACC achieved by the asset owner and both of which industry came away with the view that it hadn't been a balanced commercial discussion. There was really no choice but to accept those rates of return.

I said at the outset in my comments that we acknowledge the need for an adequate rate of return, or a risk return profile acceptable to asset owners, and how

that is determined. It might be that regulators have effectively intellectualised the WACC to too low a level in some situations, and telecommunications and electricity networks are a good example where there hasn't been sufficient incentive for asset owners to expand, and that's sort of a separate issue, if you like.

From our perspective, there are real issues here inasmuch as a monopoly asset owner can, as you've articulated, prevaricate and effectively delay expansion to a point where the access seeker has really no choice but to either invest elsewhere, which is a particular risk to the industry and the Australian economy generally, or accept the asset owner's return expectation. That's particularly the case, as I said earlier, in the case of a rail network. You have a port development at one end of it and a mine development at the other, both of which generally have longer lead times than a rail expansion. So it leaves a rail network owner in the position where they effectively get to negotiate last and have a significant degree of power as a result.

**MS SCOTT:** If it is the case that the arrangement has led to a higher than commercial WACC, you're anticipating that, whatever reluctance applied previously in the discussions, that should slip away in terms of the workability then of any extension or expansion, because the access provider is, effectively, more than recovering the cost.

**MR CLELAND (AAMC):** Yes, "more than recovering" is the nub of the debate, if you like, with the access owners.

**MS SCOTT:** So in terms of workability, just to clarify, your view is that you don't favour above commercial rates of return. If it was the case they were above commercial rates of return, you're not anticipating that you would then also be lumbered with a work-to-rule set of prevarications to - - -

**MR CLELAND (AAMC):** Yes. It really goes to the overall risk return profile, and I think what we're saying is that a rate of return in excess of the regulated WACC is not necessarily a bad outcome, provided the level of risk being accepted by the asset owner is commensurate with the rate of return being sought. What I think is likely to happen in some of these situations is that the asset owner will seek an above-regulated rate of return whilst continuing to enjoy, effectively, a regulated risk profile.

**MS SCOTT:** John, you've cautioned in your submission and in your opening statements about the trade-off that governments face with privatisations; short-term gain, long-term pain, like you say.

**MR CLELAND (AAMC):** Exactly.

**MS SCOTT:** Are you aware of any principles for effective regulation of privatised

infrastructure that could be codified into a generic arrangement? We're quite conscious that some state governments are privatising ports, intermodal facilities and so on. Is it the case that it's horses for courses - you have to look at each individual facility - or do you think that it is possible to arrive at a set of principles that could be applied more broadly? If you say "yes" on the second one, have you got them in your pocket today?

**MR CLELAND (AAMC):** I was going to say, don't ask me to cite an example. So yes, but I can't cite it. No, I don't have them with me. I think at a macro level there should be consistent principles and those principles should be around pricing, access, expansion and operation - and particularly around coordination - but realistically each situation is going to be different and require slightly different solutions, and that's back to the comments about the nature of the regulation; whether it's through a regime or whether it's through a lease or through commercial arrangements.

I think the example of DBCT is worth looking at in more detail, because it has worked relatively well, apart from the fact that it didn't work effectively when there was a near-term requirement to expand the capacity of the facility.

The PWCS [Port Waratah Coal Services] arrangements in Newcastle have worked very well, I believe, both in terms of the efficient operation of that terminal and also the expansion. But realistically it's going to require situation-specific outcomes, once again making the point that in Queensland in particular the regimes have worked well up until the point where there is a requirement for expansion or extension, and then we've come up against this block consistently.

**MS MacRAE:** Sorry to come back to expansions and extensions again, but in relation to that there are safeguards that the asset seeker must fund any requested extension and expansion and that the owner gets to retain the ownership of those things.

**MR CLELAND (AAMC):** Yes.

**MS MacRAE:** Do you feel those safeguards are reasonable and are they practical? Can you make them work, or is one of the reasons that these agreements don't work at this expansions and extensions phase that those sorts of safeguards that are in there make them just an impossibility to be able to settle?

**MR CLELAND (AAMC):** I think the only safeguard at the moment is user funding and, as I said, there's no precedence for it at this stage. There's an in-principle agreement between industry and Aurizon, yet to be approved by the QCA. So I think that's yet to be really borne out.

As I said at the outset, we're really only 15 to 20 years into this process of

privatisation and the movement away from 100 per cent government ownership of monopoly infrastructure assets in bulk commodity supply chains.

**MS MacRAE:** You're optimistic, though, that a way will be found? You have got something that's effectively back at the regulator now for approval that meets that sort of safeguard requirement?

**MR CLELAND (AAMC):** I'm acknowledging that in-principle agreement has been reached.

**MS MacRAE:** Yes, okay.

**MR CLELAND (AAMC):** I wouldn't say I'm optimistic that it will actually ultimately provide a solution. To look at it from an asset owner's perspective, in some ways it's a somewhat convoluted and suboptimal outcome to have your users actually investing directly into your asset. It throws up a whole lot of sort of corporate governance and other complexities that are far from ideal.

**MS MacRAE:** Yes.

**MR CLELAND (AAMC):** I think asset owners generally would prefer to be investing - ultimately that's what they should be there for, is to invest in their own networks and generating a satisfactory rate of return.

**MS MacRAE:** Yes. So this will be as much a lever to try and get that sort of ultimate outcome, you think, as necessarily - - -

**MR CLELAND (AAMC):** Absolutely. Yes, that's a very realistic assumption.

**MS SCOTT:** This is probably ambitious to ask at this stage of the proceedings, but we've got about five minutes. One of the key things in the report was that we drew attention in the Pilbara case to the fact that we were dealing with large commodity exporters who were price takers and that the capacity in the longer term for any producer to really move the price by their supply to market is minimal; zero.

**MR CLELAND (AAMC):** Yes.

**MS SCOTT:** We made, therefore, the remark: what were the right incentive structures in terms of firms having access to infrastructure? If you're in a price-taking world, what's the incentive to deny someone access when really their supply to the market is not going to affect your price at all? There may be other issues, and we discussed those at length. I'll just now focus in on price taking. What do you think of that argument and, if you thought it sounded valid in the case of large iron ore price takers, what would it mean for coal?

**MR CLELAND (AAMC):** I think the key distinction between iron ore and coal is that in the coal industry to date there hasn't been extensive industry ownership of infrastructure.

**MS SCOTT:** Right.

**MR CLELAND (AAMC):** There's the case of PWCS, which is industry owned; there's WICET, which is currently under construction which is industry owned; and then there's the existing Abbot Point Coal Terminal, which is now owned by an aspiring Galilee coal producer in Adani.

So I don't think you can necessarily draw the parallel, and I think I'd be right in saying that the issue of Pilbara has not been so much around the perceived market threat of another player; it's been the impact on the operation and efficiency of the rail network or the ports that has been the key driver of that debate, if you like.

**MS SCOTT:** Yes.

**MR CLELAND (AAMC):** But I do take your point that ultimately in a price-taking market there should be no impact from additional players coming on.

**MS SCOTT:** And therefore the incentives really of the infrastructure provider and the access seeker in some ways are aligned.

**MR CLELAND (AAMC):** Yes. Yes, they should be. I'll make the further point here of course that iron ore generally is much more of a homogeneous commodity than coal. In the case of coal you have thermal coal and you have metallurgical coal and all the different sort of gradings within each of those two broad areas. So it might be that within coal there are much more definable market segments than is the case with iron ore.

**MS MacRAE:** They might tell us differently! I was just going to ask about the production process, and I don't know whether you've thought about this too much, but again looking at those submissions we've received from some other participants, they've suggested to us that the production process exception to the definition of a service under Part IIIA - so that exclusion - should be changed to exclude not just access to the production process but also access to infrastructure used as an integral part of the production process.

I guess from the asset owner's side they're saying the production process exception, given the most recent court findings, has from their point of view become largely irrelevant; that it doesn't really provide much of a filter any more: "We need to strengthen that up. Why don't we make it broader in these terms?" as I've just

described so that anything that is an integral part of the production process should be included in that first stage. Would you have a reaction to that?

**MR CLELAND (AAMC):** Not specifically. Once again I think there is a very clear distinction between the Pilbara and the multi-user Queensland environment here. The Pilbara, where the infrastructure has been developed over a long period of time by generally single companies, is a very different environment to what exists in Queensland, where all the facilities have been government developed and have always been by their nature multi-user.

So that argument may have some currency in the Pilbara. In Queensland there's no single user who has a complete pit-to-port solution, if you like - pit-to-port ownership of the infrastructure or supply chain - where they can argue that it is part of the production process.

**MS MacRAE:** Okay, thank you.

**MS SCOTT:** I'll make this the last one, John, so thank you for your patience whilst we traverse the territory backwards and forwards. I'm going to come to the public interest test. You make the comment in your submission - and you made it today as well - that you worry about the shift of onus from - the onus of proof in some ways - about the public interest test from the infrastructure provider to the access seeker, and I also think that you draw out that if criteria (a) and (b) are satisfied in some ways it's almost as if the public interest test has been met already.

Do you think it's possible that really all the matters relevant to public interest can be covered by (a) and (b), or do you think it's necessary to retain (f)? I think you want it retained as it is, but we were thinking about changing it, as you know, to this positive interest test. But I guess the first key question: can (a) and (b) do all the heavy lifting on the public interest test?

**MR CLELAND (AAMC):** Probably not. I think we're of the opinion that (f) in the negative sense should be there as well to ensure there is that overriding issue, if you like, or overriding consideration of the public interest.

**MS SCOTT:** Some people suggest there's been lots of gaming going on - not necessarily in your sector but possibly in others - in relation to access and that the lengthy processes we've seen and the considerable costs involved reflect a willingness to use this process in a broader context of strategic placements of firms within the sector.

I wonder whether shifting the emphasis from access provider to access seeker wouldn't reduce the opportunity for or the encouragement of gaming. You question whether it's appropriate, because some things that should get up will not get up, but I

guess I'm coming from the other side, having heard all these arguments about gaming and cost; that in fact, if something is so marginal, maybe it's good to then make it as a positive test rather than a negative test. Could you comment on that, particularly because you must have been reading about these cases for years. Do you want to make any remark on this gaming issue?

**MR CLELAND (AAMC):** Once again I would sort of seek to differentiate between the Pilbara and Queensland. I think the gaming you're referring to really happened in the Pilbara rather than in Queensland. I think making this a positive test runs the risk that the gaming is even more of a risk, inasmuch as the asset owner can force his obligations back onto the access seeker rather than having to prove it themselves, if that makes sense.

**MS SCOTT:** So basically your view is that the incentive structures may change but that will not overcome - - -

**MR CLELAND (AAMC):** No.

**MS SCOTT:** - - - the incentive for gaming where it exists.

**MR CLELAND (AAMC):** Exactly.

**MS SCOTT:** Okay. John, thank you very much for your time today and for your submissions and for coming along and answering such a broad range of questions.

**MR CLELAND (AAMC):** Thank you for having me; much appreciated.

**MS MacRAE:** Thank you.

**MS SCOTT:** Welcome to our hearings today. For the purposes of the transcript, Luke and Simon, would you like to introduce yourselves and make an opening statement.

**MR WOODWARD (GT):** Thanks very much, presiding commissioner. Luke Woodward; I'm a partner from Gilbert and Tobin.

**MR MUYS (GT):** I'm Simon Muys; I'm also a partner from Gilbert and Tobin.

**MR WOODWARD (GT):** We thought we would just briefly explain our background, because we're not from a particular company where it's obvious. That will probably credential us and maybe suggest we're partisan, and those things often go hand in hand. But we'll just at least explain that, and I'll speak to my experience briefly and then Simon Muys can speak to his, and then we'll just briefly outline some of the points addressed in our first submission and our supplementary submission and give kind of a high-level take-out on the commission's recommendations.

Before I do all that, I should say we welcome very much the opportunity to put the submissions in and to be able to attend the hearing and participate in the discussion. We've found it, from our perspective, a very timely process and a great draft report, so we very much appreciate that.

I'm a partner in the competition and regulation group at Gilbert and Tobin. We have over a long period of time advised infrastructure providers, infrastructure seekers and regulators, and governments actually, in the design of access regimes. We represented Virgin Blue, as it then was, in relation to the Sydney Airport matter, including the arbitration that was ultimately concluded. We acted for Services Sydney on the declaration of the city water-sewerage system. We acted also for Caltex in relation to the jet pipeline installation. We've acted for different governments and regulators, including the Essential Services Commission, Queensland Competition Authority, at times IPART and ESCOSA in South Australia. Anyway, I just thought I'd sort of put that context.

**MR MUYS (GT):** For my part, I've been involved in various sides of these debates over the years. I was involved at one point acting for BHP in the Pilbara dispute. More recently I've been advising Rio Tinto Coal in the coal discussions going on in Queensland, which I know John was speaking to you at length about this morning. I'm a longstanding regulatory adviser to Telstra and was involved in their NBN discussions, so have some central sort of experience there, and I've advised the QCA and other regulators and port authorities and other governmental bodies on both the design and the application of their various regimes. So I'm a little bit of a mongrel in terms of my experience.

**MS SCOTT:** We couldn't say that!

**MR WOODWARD (GT):** Just to then make some brief remarks, we would see that the Competition Principles Agreement that's been the overarching kind of framework for the National Access Regime, but also the National Access Regime in Part IIIA, has made a valuable contribution to the liberalisation of the Australian economy over the last two decades and we see that that policy framework, including Part IIIA, continues to have an important role to play in providing the framework for access to nationally significant infrastructure and also providing government guidance to state and territory governments generally in relation to access issues.

We would see that the infrastructure challenges today have changed from where they were historically with the implementation of the National Access Regime. We think the policy priorities for access to infrastructure now often involve questions of investment in expansion and extension of capacity around capacity-constrained facilities compared to 20 years ago, where we were really looking at the question of efficient use of spare capacity, typically in public infrastructure.

We see that, compared to where we were 20 years ago, the obvious and perhaps more tractable candidates for access have largely been addressed through sectoral regimes; in particular, telecommunications, gas, electricity, some rail. Some interesting and challenging areas have also been addressed; for example, payment systems. So we think probably what we're left with are the more difficult challenges in relation to infrastructure, such as rail and ports. We think there are real challenges around water and sewerage infrastructure access.

We take the view, not consistent with the commission's conclusions, that there are some simple cases for access regulation that just haven't adequately been addressed, and we would call out airports as one of those, but we know that's not the view that's been put by the commission.

It's clear that private commercial agreement between the service provider and access seeker is the most desirable means to achieve access, but really a legal framework for mandated access to key infrastructure remains appropriate. It actually provides an incentive to reach commercial agreements.

We do see that there are some problems with the design of the National Access Regime - some gaps in terms of how it applies to current issues - and we'll come back to that. That's why we see this inquiry as timely. We do see the process for seeking access through declaration has been cumbersome, costly and time-consuming, with not really much of a successful track record of access under Part IIIA of itself, but that doesn't mean that the overall regime isn't actually achieving policy goals.

We had called out in our initial submission a lack of clarity around kind of the policy objectives, or maybe a fair way of putting it is that the kind of overlapping policy objectives that have been hidden within Part IIIA were really called out with the High Court decision. We would characterise them maybe not perfectly but really on the one hand, if there's an objective to protect competition in related markets - and this was one of the principal initial focuses of the Hilmer inquiry, because it was looking at cases for gaps in the Trade Practices Act.

If that's its focus, to protect competition in related markets from controllers of bottleneck infrastructure refusing access, we see that objective as really supporting a private profitability test and largely a technical set of considerations and implying a limited ministerial role, but we also see an important role for the tribunal in merits review in that context. If, however, the policy objective is to promote socially efficient use of monopoly infrastructure and avoid inefficient monopoly pricing and access terms, we see that objective supporting a natural monopoly test and a large role for government, through ministers, and a more narrow role for the tribunal.

We see that lack of clarity around the policy objectives has resulted really in much of the debate over the last 20 years and really is central to the issues dealt with in the High Court in the Pilbara Railway matter. We don't think that the High Court, which is a textual analysis of the act, has resolved the policy issues, and that's why we think there's an important role for the Productivity Commission to step in here and why it's so timely. We see the High Court decision as having left us with basically elements of both. It's got a private profitability test but, on the other hand, it has really expanded the role of the minister beyond what people may have thought in Part IIIA and has confined the role of the tribunal.

We see both these policy objectives as being legitimate and important and for us the answer to how you solve this is context and, importantly for us, we see the context of the particular infrastructure and where you are in the sort of stage of the development of infrastructure being very important to what approach you might take.

In particular, we would say that in most cases for new or newly privatised infrastructure, or in situations where the government may be granting a licence or an approval to develop something, then really access should be settled up-front. It is a governmental issue and, in those circumstances, the natural monopoly test makes perfect sense. It is a governmental role. We see - and we will come onto it in a moment - that practically nowadays they should really be thinking about practical ways to deal with future expansion and investment.

On the other hand, we see kind of a narrower role for Part IIIA. We see it really has been the backstop and we see, in that circumstance, that it's largely likely to apply in that context to infrastructure which has already been invested in by

private parties without a clear policy framework for access and we see in that situation that a private profitability test from our perspective is appropriate in that context. So we actually would see a private profitability test as being appropriate to then retaining the rights of the owner.

Having reviewed the commission's draft report, we have no fundamental issues with the analysis and consideration but, because of that different context and approach, it does lead us to some different conclusions on some important matters. I'll just briefly touch on some of those in a moment.

The other thing that we wanted to call out in our supplementary submission, or the submission in response to the draft report, is that there is the opportunity we're seeing in the final report to provide guidance to what amendments might be made to the Competition Principles Agreement and to the CIRA [Competition and Infrastructure Reform Agreement] and we know that the commission has called out some issues. We have been encouraged to be bolder in terms of what might be put into the Competition Principles Agreement and the CIRA, because we see that as not just guiding what's in Part IIIA but, in effect, Australian governments coming together to agree the overall policy framework.

Very briefly, I'll just give you a headline of where we've come out on some of the recommendations. In relation to the proposal with respect to criterion (a), that it be amended to be clear that it's a comparison of competition with and without access or reasonable terms and conditions through a declaration, we in general have no difficulty with that recommendation.

I went through two different access matters for the access seeker in which it was clear the access provider wanted to bring into the question on access and declaration, in effect, the second-guessing of what the determination would be under the arbitration. I think in both cases the counsel and the tribunal dealt with those issues. I think - this is anticipating maybe a question - it's impossible to completely say it should all be left to the arbitration. I think there are some issues that need to be considered up-front, but so long as we're not in a situation of second-guessing that outcome, we have no general difficulties with that proposal.

In relation to criterion (b), in the specific context of Part IIIA we would support a retention of private profitability but what we would generally support is the guidance to government when it's considering ex ante access regulation and the natural monopoly test.

In relation to the public interest test criterion - the implications of the observations that I've made already in Part IIIA - we would see it being a narrow test focused really around sort of costs and benefits. We do think there is a residual role - important work to be done - depending on how much up-front costs one takes account of in criterion (b).

We have no particular difficulty with the reversing of the onus of proof. I can say from practical experience that, as an access seeker, we sought to make the point that the case needs to be, in effect, decided in the negative. Once you're in those processes, counsel and the tribunal engage in the substantive issues and, to be honest, we don't think there's much in it and it would seem appropriate to, in effect, reverse it, and you'd be satisfied overall that it's passed the public interest test, which is focused on costs and benefits.

We agree with the recommendations in relation to extension and expansion. In effect, what we're saying is, there's an opportunity to go further and have that picked up and reflected in the CPA [Competition Principles Agreement]. Also we think that it may not just be the ACCC in the context of Part IIIA that should be developing guidelines but maybe the broad set of state and territory regulators involved in the process who are not stakeholders.

**MS SCOTT:** Just on that, if you don't mind the interruption, COAG processes can take some time, and experience of jurisdictions varies on access issues. Given your opening comments about the fact that you see really the emerging issues being in expansions and extensions - and we've heard earlier testimony today about where some issues in Queensland are now at - what time frame would you say needs to be put on this being resolved through all jurisdictions working on it?

So where's this bringing everyone together versus urgency - or maybe you don't see the urgency issue - and, I guess, what would be the appropriate time frame? In our draft we've used phrases like "as soon as possible" and so on. Could you give some indication when some matters do get resolved through COAG quite quickly but other things can take many years.

**MR WOODWARD (GT):** I'll make a couple of brief remarks and then I'll hand over to Simon Muys. COAG processes will take whatever they consider to be appropriate. It would be desirable and better, if there is an urgency, to be as soon as possible. The commission's report will provide a real lead in the interim to state and territory officials and regulators about kind of what the right approach is. So even if nothing further was achieved in that very short term and it took a little bit longer, there would be value in calling that out.

There are specific questions about 44W and how the High Court decision and other aspects kind of flow into state and territory regimes, which is probably where a lot of the heavy lifting for expansions might be actually taking place. But in calling out some of those issues now, even if governments don't resolve a position about that, it's probably desirable compared to what seems to be at the moment a position that, for example, 44W is kind of a template set of principles. We would see them, from an ex ante perspective, as probably being too restrictive.

So, yes, some urgency, but that doesn't mean, even if that's not going to happen, there's no value in actually calling these issues out.

**MR MUYS (GT):** I'll make just a couple of perhaps practical observations based on, like John, the experience in Queensland, which I think is perhaps where this issue is at the moment experiencing the most focus.

The issue there in respect of COAG and the CPA principles is a little bit more complicated, of course, because the QCA Act under which that process is being governed reflects the 44W constraints and not so much the pure language from the COAG principles. In a sense, therefore, some of the development that might or might not happen around 44W is perhaps more directly relevant to the Queensland situation than the broader CPA.

In terms of time frames, at this point in the commodity cycle clearly a great deal of expansion is perhaps unlikely, in a number of these markets in any event. That being said, there are obviously current regulatory processes in Queensland with UT4. It's an 18-month or two-year type of process. I suspect it might be ambitious to think that we could get COAG leadership on something like that before that's reached the end of its period.

As you rightly point out, I think, there are a number of imminent privatisations that are in the same sort of commodity markets and I think it would be very valuable if, as part of those processes, they were able to have a greater steer from the COAG principles around their approach to access issues.

**MS SCOTT:** If I could paraphrase you - do justice to your point, Simon - leaving aside issues live and boiling away in Queensland, the pressure on expansions and extensions in the resource sector is probably coming off, but wouldn't it be great if governments were well placed for next time around?

**MR MUYS (GT):** Precisely.

**MS SCOTT:** That they had very good, clear, robust, rigorous guidelines that didn't bind that we then were hamstrung in expansions next time.

**MR MUYS (GT):** I think that's well put, yes.

**MR WOODWARD (GT):** But privatisations are - - -

**MS SCOTT:** Yes, and getting the things done right. Are you just about at the stage that - - -

**MR WOODWARD (GT):** Yes.

**MS SCOTT:** Okay. I'm conscious of the time. We cheated you out of five minutes at the start, so we've probably got 25 minutes. All right? I want to come back to your movement between liking the natural monopoly test and also liking the private profitability one, and one is ex ante and one is after the event. What happens at the point of - almost like transubstantiation. This thing changes and the arguments change as a consequence. So what's the principle that drives that?

**MR WOODWARD (GT):** It's really two. Firstly, we think from a government policy perspective that a natural monopoly test makes sense and it's certainly appropriate, but we have real concerns that where private parties have invested in a context in which there was no policy framework or access regulation - having made that investment, that they could be put to the position of having to allow access to their infrastructure in circumstances where someone else would actually develop that atmosphere.

**MS SCOTT:** So the movement is from public to private, effectively?

**MR WOODWARD (GT):** Yes, because if it was still in public hands, then it's actually a judgment call for government about what it wants to do with that. When people have invested not in that context, one should be careful about basically, in effect, changing the rules.

**MS SCOTT:** All right.

**MR MUYS (GT):** Maybe I could comment too. I think certainly privatisation is the clearest and most obvious. To your point, I think the point of investment, in our mind - that moment of investment - is, if you like, the point of transubstantiation, to use your - - -

**MS SCOTT:** I don't pronounce it as well you.

**MR MUYS (GT):** No, that's all right. So I think that's critical, but not just privatisation. We've seen in Queensland and elsewhere project approvals where there are compulsory acquisition processes or leases being granted, or other things, to greenfield projects. In that policy context, where it's ex ante and certainty has been put down for the investment, we would similarly see the natural monopoly test potentially being used.

**MS SCOTT:** Okay. I just want to explore this a bit longer. I'll probably test everyone's patience as I go. What's your reaction then in your support for the principles of expansion and extension powers under the regime? Let's say the asset is now clearly entirely in private hands. Someone made passing reference during the comprehensive briefing by a leading legal firm about expansion and extension

power, but at that moment in time of the investment it didn't seem likely that that was going to occur. But two resource booms later they suddenly find themselves in a predicament that someone has come along and said, "We're access seekers and, sure enough, you clearly own this asset. It's clearly privately owned. But in terms of competition the issue is that we consider there should now be an expansion or extension."

Why does your concern about private interests not skew your thinking in a certain direction or direct your thinking in a certain direction on expansions and extension?

**MR WOODWARD (GT):** I'll have one quick go.

**MR MUYS (GT):** I'll have a crack too.

**MR WOODWARD (GT):** It's a good question. We'd like to think we're being consistent, and we think the expansion and extension framework should be addressed up-front, ex ante, and when you're doing that you will not be governed by the kind of thinking that has the restrictions, for example, in section 44W. I make that personal comment about where I think that action really came from and why it's actually quite limited.

So we don't have a necessarily violent objection to 44W sitting in Part IIIA if it's residual and it's likely only to be applied to existing private investment, but we would think that, if you were designing these frameworks up-front, you should actually have a more liberal framework in which expansions can be achieved.

**MS SCOTT:** Simon, you wanted to say something.

**MR MUYS (GT):** I was going to make an observation that - and it may not be directly on point, but I think it goes to the same issue - just as one has a concern about investment certainty for the asset owner, I think it's equally right to be concerned about the sunk investments of those users - particularly where you've got sort of long-lived regulated assets, and the Aurizon Network is a good example of this. You have a number of users that have invested - sunk - a lot of money over a long period of time into assets in reliance on a certain understanding of the way that that asset would operate moving forward and the way that investment would occur into that network and the way capacity would grow to meet demand. I think those expectations are appropriate to consider, as well as, as you put it, the private rights; post-privatisation of an Aurizon or some other buyer.

**MS SCOTT:** Thank you. Luke, you said existing private investment. I just wanted to clarify. What about if we're talking about 10 years down track? COAG has got together and it's established very rigorous processes and so on and things are much

clearer and case law is - Part IIIA - a walk in the park. Suddenly someone comes along and builds a new asset. I just want to check: are you taking it that the provision of those - clearly "a framework" means that a new investment will also be covered by expansions and extensions power, or are you saying that - I just want to go back to the word "existing".

**MR WOODWARD (GT):** In that scenario, if at the point in time the person was investing and there was no access regulation framework in place for them - - -

**MS SCOTT:** But a general arrangement relating to Part IIIA.

**MR WOODWARD (GT):** Then Part IIIA should apply in the way in which we would see Part IIIA, but if the government has got to approve, for example, a rail corridor or a compulsory acquisition or the government has got to approve something that might be a monopoly, then the government ought to turn its mind at that point in time to those issues. In that situation it should turn its mind not just to whether it's to be regulated or not regulated - we have no difficulty with the natural monopoly test in that situation - but also actually really what's a workable framework for ensuring that that asset will be expanded over time.

**MS SCOTT:** Let me see if I've understood that. That therefore means that at that point in time, with this entirely private asset, this entirely new venture, you just want the certainty up-front with the application in that case of the natural monopoly principles?

**MR WOODWARD (GT):** Yes, because basically the rules of the game for investment are clear up front - - -

**MS SCOTT:** So beforehand, natural monopoly; something after the event but before expansions and extensions, privately profitable; and on expansions and extensions, natural monopoly again.

**MR WOODWARD (GT):** I'm not sure. All we're saying is that, in the situation where there is to be future investment, government turns its mind to these issues and that, if it implements then the expansions and capacity regime, they're the rules of the game that would apply for future investment.

**MS SCOTT:** Okay.

**MR WOODWARD (GT):** But if it doesn't, then you shouldn't be subject to kind of a residual Part IIIA at that point in time, other than one which had a private profitability test, and in that situation we have no particular difficulty with the current 44W.

**MS SCOTT:** Okay.

**MR MUYS (GT):** I think our observation would be that - not so much the private profitability or natural monopoly test at that later stage, but I think section 44W factors are actually perhaps the more relevant checks at that point about the position of the infrastructure owners.

**MR WOODWARD (GT):** What your point is getting at there, each is just another investment. There's the first investment and then there's the capacity to expand it. In effect what we're saying is maybe simply this: if it's ex ante, understood. Before you do the investment, then the natural monopoly test seems appropriate. Government should turn their mind actively to what the right policies would be, not just for the investment but for the expansions. If the investment is done and we're in an ex post regime and there hasn't been a clear framework for that, then one might be more restrictive private profitably - - -

**MS MacRAE:** Sorry, I just want to follow this a little bit more. So the private profitably test - your preference for that to be ex post, as I understand it, is that you feel that people have made investment decisions; that now it's unfair to sort of change the rules of the game. You said your private profitability test is a higher hurdle. It's almost a question then of why you say those assets shouldn't just be excluded?

**MR WOODWARD (GT):** Sure, that's a fair point. There's a judgment call in that. One can't absolutely say one thing is right or another and, you know, maybe it's reflective of the position of our legal background; that we would see that people should be investing in a situation of certainty, but I can't say it's - - -

**MS MacRAE:** But you did feel that it was a higher hurdle.

**MR MUYS (GT):** We did.

**MS MacRAE:** So it seemed that it was an alternative that meant that you would be - - -

**MR WOODWARD (GT):** It may not always be a higher hurdle actually, but - - -

**MS MacRAE:** Well, that's why I'm asking, because we've also heard that; that it may not always be a higher hurdle.

**MR MUYS (GT):** No, my observation was really made in the context of criterion (b), thinking about it being there, in a sense - - -

**MS MacRAE:** Right.

**MR MUYS (GT):** - - - and, if it was there, what do you do with it, as opposed to, do you need it at all in the context of - - -

**MS SCOTT:** You're very Irish; you're starting from where we are.

**MR MUYS (GT):** I wouldn't get to Dublin from here!

**MS SCOTT:** We're discussing the monopoly rights in asking questions, and I'm stepping back.

**MS MacRAE:** I've lost my train of thought now. The natural monopoly test, the way you described it: do you like the way we've defined it in the way we've proposed for our suggested modifications? If anything, I think the way you described it in your opening statement was that you were looking for something a bit broader, more of a social net benefit test.

**MR WOODWARD (GT):** No, no, sorry. That is just - - -

**MS MacRAE:** No? Okay.

**MR WOODWARD (GT):** - - - the inexactitude of those comments. But, no, we have no difficulty with it. We think the focus of it is right, because it's actually focusing around natural monopoly to serve, which is truly the definition of it: to serve the market. I can say, for example, having worked on the Caltex jet fuel pipeline matter, you have basically two pipelines going into Sydney Airport, and if you define it narrowly by being a natural monopoly from point A to point B - because one goes from point A to point B and the other goes from point C to point B - we think you miss the point; that you've really got to be thinking about a natural monopoly to serve the overall market.

**MS MacRAE:** Okay.

**MR WOODWARD (GT):** So there's a lot of nuance in that, but we thought the expression of that was the right approach.

**MR MUYS (GT):** The other point I would make to that, which is I think one you also make in your report, is the important interaction there between (b) and (f). If you take that more disciplined approach to (b), there are a number of costs that need to find their home somewhere and be factored in, and it's important that they find their way into (f) and you've got a workable (f) operating, otherwise I think you have got a problem.

**MS MacRAE:** In relation to (f), as I understood it your view was that the

evidentiary base wouldn't change much in relation to our suggested change to make it a positive test. Do I understand you correctly to say that, because we have also heard the contrary view from other people; that, you know, if anything, it should basically be quite different and it would be quite a different sort of test you're proposing.

**MR WOODWARD (GT):** This is people's views about kind of how onuses practically play out when you're in front of the decision-maker in this situation. Everyone scrambles; kind of put the onus on someone else. But I'm not so confident that in practice it's actually made a difference in the matters that I've been involved in.

**MS MacRAE:** Okay.

**MR WOODWARD (GT):** We would certainly, as an access seeker, want to make it clear, in effect, that you can't put the onus back on the access provider, but ultimately you've got to deal substantively with the issues, and decision-makers - counsel and the tribunal - will do that. But actually, more a point of principle, we had no difficulty with working around from a point of principle. We thought it was quite all right.

**MS MacRAE:** Okay.

**MR WOODWARD (GT):** As Simon has pointed out, the costs need to find their place in the assessment. We understand coordination costs in criterion (b). That's fine. But, you know, other kinds of issues about downstream costs; your observations about markets where they're price takers. If they're not found in (b), then they should really probably find their place in (f). They need to find a place there. So we had no difficulty with it. We also think it institutionally supports what you're proposing in terms of, if the minister doesn't make a decision - it just kind of assists the whole process, that's all.

**MS MacRAE:** Yes.

**MR MUYS (GT):** There are a number of those challenges from the draft report that I think together actually do a great deal to clarify the evidentiary process, so the "have regard to" change I think is a good one also. We support the Law Council in that, I think. The combination of that, and the change in the onus - I think as we say in our submission, we would even go further in fact and set up that much more sort of clear and explicit cost-benefit analysis along the lines of the one the Law Council I think proposed in their first submission.

**MS MacRAE:** Can I just ask in relation to the - because you were proposing that we have both the private profitability and the natural monopoly test - we've heard quite a lot of differences of view about the workability of those two tests, and some

might say that neither of them is very workable and keeping both of them would be the worst of all worlds. But do you have a view about that, and in particular, I suppose, the extent to which, you know, if you had something that you regarded as an adverse finding and you wanted to contest that in an appeal, what sort of data might you have available to you to allow you to do that?

**MR WOODWARD (GT):** As sort of competition lawyers, you operate all the time in areas of uncertainty. I don't think either is an easy test to grapple with for either party, and it just changes your focus around the way you go about establishing it.

The Sydney Airport jet fuel pipeline was actually analysed in the context of private profitability. We did not actually agree with the way in which that was dealt with, but that was dealt with in that context of operating in that environment. Other matters are dealt with under, you know, the social benefits or, in effect, the natural monopoly test. It just changes your focus. You've got to find the evidence where you find it and you've got to deal with the issues. I don't think that practically we would change much. I think it would be hard to say one is more intractable and less capable of very good judgments being made by regulators about it than not.

**MR MUYS (GT):** I would agree with that. I think clearly there are problems - not problems, difficulties with establishing foreseeable demand, clearly, and the cost structure that goes with that on the one hand. On the other hand, you've got to establish market counterfactuals if you apply the private profitability test, but then that's not something that isn't done by the ACCC in other contexts at other times. So neither of those is insurmountable.

**MS MacRAE:** Okay, thank you.

**MS SCOTT:** I might go to undertakings, if that's all right.

**MR WOODWARD (GT):** Yes.

**MS SCOTT:** In your initial submission you note support for requiring undertakings as part of other regulatory processes - for example, a lead undertaking - and that these should be an important part of the legal machinery to establish and monitor access arrangements. Given that the undertaking pathway was intended to be voluntary, do you have any concerns regarding the use as mandatory access arrangements?

**MR WOODWARD (GT):** No. We would prefer that, where governments are taking the decision on an ex ante basis, an asset should be subject to access regulation and that they turn their mind to that issue. If you turn your mind to that issue, then you shouldn't leave it to the residual application of Part IIIA, or the declaration process within Part IIIA. If governments in that situation want to avail

themselves of the institutional capabilities within the ACCC and a process in which someone proposes something in the ACCC - considers it - that seems a very kind of flexible way to deal with it. The alternative is that government designs the regime.

So we have no particular difficulties with the framework in which governments may mandate that a party submit an access undertaking. Our only issue would be that you shouldn't just have a general position of granting some kind of effective monopoly or significant right on the basis that an undertaking might be lodged and then, you know, it either never is or it's very uncertain about that. So you need to make sure it actually happens.

**MR MUYS (GT):** I'd agree. I think it's very workable. It's been shown to be workable, and Dalrymple Bay is a good example and ARTC [Australian Rail Track Corporation] in New South Wales - all examples of lead undertakings, as you say. I think it makes far more sense for the terms of access to be set up-front, because when there's certainty around them it makes far more sense for that to be proposed in the first instance by the operator or the investor; than it is government imposing a framework over the top of them. So I think it provides the flexibility and the suitability for the context, which is I think our key point when we are talking about undertakings.

To Luke's point, I think the key is transparency for us. If governments are going to require undertakings - and we think in relevant circumstances they should feel free to do that - there needs to be transparency around what, when, and consultation around implementation of that obligation, whereas I think, for example, in Queensland we've seen a couple of cases where undertakings - or at least one where an undertaking has been required but in a very sort of non-transparent sense, and no-one is quite sure still, I think, where that's ended up.

**MS SCOTT:** I just wonder, gentlemen, about the vision that you think governments and regulators have. You know, things are privatised; they've moved from ex ante now to privately profitable. They've moved from "Wait a minute. Don't set any rules for me now, because I've embarked on this private investment." Even assets that were entirely public and then move into the private sector can then go through a major expansion phase and the bit that was supposedly public could be a smaller portion over time. You must have encountered that argument with Telstra, Simon.

**MR MUYS (GT):** Sure, yes.

**MS SCOTT:** Was this a former public asset or is this now a - you know, at what point does - again I guess it goes back to this issue about when do you move from this passage, this key point, and I was thinking in terms of undertakings. It might not be in a government's eye that suddenly this asset has greater significance than it ever did; that upstream and downstream markets now are significantly curtailed by - - -

**MR WOODWARD (GT):** Yes.

**MS SCOTT:** How visionary do you see governments being in this space? Is there confidence to think that they will be as visionary as you think they should be?

**MR WOODWARD (GT):** The short answer to that is: probably no better than a human being, given they're made up of human beings. So the answer to that would be, "Try to turn your mind to it and think about it," but you may not pick up every issue, and something may come later, in which case government is in a position to, if it wants to, implement - basically, government can change the rules of the game.

But the declaration process is slightly different. A private party is coming and triggering a process to seek access to a particular asset through that process, and so that's different from government having kind of broadly turned its mind to that issue. Governments may down the track say, "No, actually, I think this asset should be regulated," and they may, we say, take account of history, take account of context, take account of the investment positions. They might take account of all of those matters or decide to apply a natural monopoly test, decide to impose access regulation. So we're not saying government kind of gets one shot at it. We are just saying the declaration process really is residual, is a backstop, and we think in that situation, in effect, one private party shouldn't be able to trigger that.

**MR MUYS (GT):** The only thing I would add is, I'm not convinced that the practical difficulty is all that great. We're talking about nationally significant assets and if you're talking about a railway line through the Galilee Basin, if you're talking about the Central Queensland Coal Network, if you're talking about one of the major coal commodity ports, the decision is there to be made and it's a decision that you can make. Now, do the market dynamics change over time in a way that might materially change the outcome? It's possible.

To Telstra, to use that example, the copper access network [CAN] - and the ACCC have made this point on many occasions - is seen as the core monopoly asset that is the competitive concern or the source of market power that they're regulating for, and whilst that expands in ways and shapes, there are, if you like, sometimes generational changes, so you might go from a copper to a fibre network, which was of course the source of a sort of significant rewrite of the entire framework, but in terms of incremental expansion over time, that CAN has shifted a little bit, but its fundamental character hasn't really changed all that much.

**MS SCOTT:** Okay. Thank you. We're running out of time, but I just want to get your views on an issue that's been raised by other parties to this process. They have cautioned us on expansions and extensions and said, "Extensions, there may be a case for a power to exist, but expansions, no way in the world. This is dangerous and

threatening private profitability rights," and so on. Do you think it's possible - legally and, from a policy perspective, practically - to make the distinction between an expansion and an extension?

**MR WOODWARD (GT):** I don't, but - - -

**MR MUYS (GT):** No.

**MS SCOTT:** Okay. Thank you. Thank you very much, gentlemen. You've done very well. I have to say I've got a whole load of questions that go on for several pages. Alas, time beats us. Thank you very much for coming today and subjecting yourself to the sun. We're now going to have a break for 15 minutes, so that will bring us back here at about 22 past, thank you, and we'll resume with Mike Smart.

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**MS SCOTT:** Let us now resume our hearings. I call to the table Mike Smart, please. Good afternoon, Mike.

**MR SMART:** Good afternoon.

**MS SCOTT:** For the purposes of the transcript would you please give your full name, and would you like to make an opening statement?

**MR SMART:** I would, thank you. My name is Michael George Smart. Thank you, commissioners, for the opportunity to appear. I'll confine my remarks to the production process exemption and the competing tests for criterion (b).

I'd like to begin by introducing myself and explaining my qualifications to speak on this topic. I am a director of the Sapere Research Group, which is an economic consulting firm, and a member of the Competition and Consumer Committee of the Business Law Section of the Law Council of Australia, although I appear today in a personal capacity and the opinions I express are not necessarily the opinions of those organisations.

In 2001, I assisted in the preparation of expert testimony in the Competition Tribunal case, the Duke Eastern Gas Pipeline. I prepared numerous reports in support of revocation of the Moomba to Sydney pipeline. I testified before the Competition Tribunal in the Virgin Blue 2005 case; that's the declaration of Airside Services at Sydney Airport. I have prepared economic reports in support of light regulation of several gas pipelines, including the Moomba to Sydney pipeline.

In addition to these Part IIIA matters, I have worked in the field of competition economics since the year 2000 on a range of mergers, Part IV enforcement matters, and telecommunications matters under Part XIB and Part XIC, and I am presently advising the New South Wales government on a review into the New South Wales rail access regime.

Turning to the production process exemption, I think a large part of the problem that's been experienced so far is that there is no settled definition of the term "production process" either in law or economics, leading to confusion in the legal interpretation. The final resolution of this issue for the Pilbara iron ore railways is not generalisable to other industries.

I believe that the commission accepts an argument put by myself and others that the most economically sensible approach to this exemption is to adopt a transaction cost economics approach, a la Oliver Williamson, to the cost-minimising boundaries of the firm as a filter for allowing or prohibiting a declaration. I submit that transaction cost economics should be explicitly evoked in a statue to clarify judicial interpretations in future.

The commission's draft report solution, which is to deal with coordination costs in criterion (b), will not work under either the natural monopoly test or the private profitability interpretations of criterion (b). If it is a natural monopoly test, then the fact of transaction cost savings will only increase the strength of the natural monopoly power that the incumbent holds, thereby virtually guaranteeing declaration in those circumstances. Alternatively, if it is the private profitability test, then the transaction cost savings of the incumbent are not really relevant to the calculation. It's the entrant's cost structures alone that are considered in the private profitability test.

The net social benefit test would permit coordination costs to be properly taken into account, but unfortunately that particular test has been rejected by nearly all commentators as a legally unsound basis for criterion (b).

Turning to the choice of tests for criterion (b), based on my own practical experience with declaration matters I would like to challenge the commission's draft report conclusions on the best test for criterion (b). My starting point is to highlight two polar types of cases in which the various criterion (b) tests can be straightforwardly implemented.

In type 1 the incumbent facility has spare capacity, low marginal costs and high replacement costs, and in type 2 the incumbent facility has already been bypassed or is about to be. In type 1 cases, typified by the Sydney Airport Airside Services and Freight Australia applications, the natural monopoly test would lead one to conclude that criterion (b) is satisfied. In all but the most extreme cases, the private profitability test would also lead to the same conclusion.

Now, the characteristics of these extreme cases - that is, where the private profitability test would come to a different answer - are that the incumbent prices are not cost-reflective. The entrant enters at a smaller scale than the incumbent facility and the interplay of incumbent and entrant strategies is such that the entry event fails to discipline the incumbent's pricing. So in other words, where the incumbent decides to accommodate entry rather than resist it, that's where the private profitability test could lead to an incorrect conclusion.

These extreme cases could be detected by the application of a modified form of SSNIP test. This test is often used, as I'm sure you know, in market definition. It asks whether a potential rival could defeat a small but significant non-transitory increase in price by the incumbent by substituting its services in sufficient quantity. In type 2 cases, typified by the first of the Tubridgi Pipeline revocation applications and arguably the Eastern Gas Pipeline coverage application, the private profitability test would lead to a conclusion that criterion (b) is not satisfied, but the natural monopoly test as applied in practice could lead to an opposite conclusion.

Now, I submit that the natural monopoly test leads to an incorrect conclusion in these cases. Facility based competition exists, yet declaration is indicated regardless. If there is any doubt about the effectiveness of the facility based competition in disciplining the incumbent's pricing, then the modified SSNIP test could resolve the matter.

There is case law precedent supporting this type of use of the SSNIP test. If you refer, for example, to the Duke Eastern Gas Pipeline case, 4 May 2001, at paragraphs 106 to 108, 116 to 124, 139 to 143, a SSNIP analysis was presented by one of the experts in that case in support of a conclusion that criterion (b) was not satisfied. While the tribunal did not accept that point concerning criterion (b), it did accept the SSNIP analysis and in fact founded its conclusion that criterion (a) was not satisfied on that analysis.

My view is that in cases that are not so clear-cut as type 1 and type 2, neither the private profitability nor the natural monopoly test would be easy to implement. There is a view that the natural monopoly test is easier to implement than the private profitability test. This view is perhaps founded on the apparent ease with which the NCC has applied the natural monopoly test in its cases to date. This simplicity is misleading in my view.

Historically, the analysis of hard cases, at least in terms of gas pipelines, boils down to this: gas pipelines have natural monopoly characteristics; the facility subject to the application at hand is a gas pipeline; therefore it satisfies criterion (b). The problem with this analysis, if it needs to be pointed out, is that there is no specific quantitative examination of the facts of the case before the criterion (b) conclusion is reached. That is why the natural monopoly test seems so simple. It hasn't been applied properly.

In summary, while neither test for criterion (b) is particularly easy to apply to the hard cases, in polar cases the private profitability test performs better. Where there is doubt about the efficacy of facility based competition, a form of SSNIP test would help to illuminate the issues and reach a conclusion. I hesitate to ask for explicit recognition of the SSNIP approach in the statute, but clearly it would be helpful if its use in cases of this sort could be further legitimised.

**MS SCOTT:** Thank you. We might start with the production process and then maybe move to other areas if time permits, and we'll try to wrap up just after 1 o'clock.

**MR SMART:** All right.

**MS SCOTT:** We've heard from other participants into this inquiry process that the

High Court's ruling in 2008 regarding production process exemption - so it's BHP Billiton Iron Ore v the National Competition Council - means that it's unlikely ever to apply. In your initial submission, however, you stated that it is difficult to generalise from that result, so could you elaborate on that. When do you think it will apply or could apply and why do you think that other participants are having a more emphatic view than your own?

**MR SMART:** I think the High Court's judgment in the Pilbara matter was, as I read it anyway, quite specific to the facts of the case. There was a very particular production process that was articulated: whether the blending of iron ore in the process of transporting it by train was indeed a production process. That was what the High Court ruled on, so to take that finding and then apply it to a completely different industry seems to me very difficult.

As to the proposition that production process is virtually irrelevant now based on that non-acceptance of a production process exemption, I think if Ford went to Holden and said, "We would like to use your assembly line on weekends," the production process exemption would be available, and there may be other cases where there is a similarly high degree of transaction cost that would be created by declaration, and there I think the production process exemption could play its intended role.

**MS MacRAE:** Left unchanged, do you think the production process exemption as it's currently - you said you'd like it clarified. Calling up economics in legislation would be difficult, I think, but how would you - - -

**MR SMART:** Well, there's certainly precedent for that in the act.

**MS MacRAE:** Well, I'd be interested in exactly how you would propose to do that. We suggested in our report that it was a good first filter but that it didn't do much beyond that. Do you think it's an adequate filter? What role do you think it should play, and specifically what do you think it should be looking like?

**MR SMART:** I agree that it should play the role of a first filter. I think, based on the experience that it hasn't been a very effective first filter, the fact that it took so many years to apply it in the Pilbara case shows that it's not really a quick analysis; it's a very slow, drawn-out process. So I guess I felt that just giving some economic content to that phrase would help a lot. We'd open the door to running economic evidence in cases where that was a point of contention, and I think that's all that's really needed to give some rationality to the debate.

**MS MacRAE:** So did you see the decision that was made in the Pilbara case as the right one in relation to production process?

**MR SMART:** In that particular case?

**MS SCOTT:** In that particular case.

**MR SMART:** Well, I don't know. Am I in contempt of court if I - - -

**MS SCOTT:** Yes, that's okay. Looking forward maybe to similar issues if they arose, what is your view about the right production process test that should be brought to bear?

**MR SMART:** I think there should be some analysis of transaction costs, or coordination costs as you've put it in the draft report, and I think that needs to be weighed up against the pro-competitive benefits of having more players involved in the market. Now, how that would play out in a railway line which is said to be part of the production process I suppose does depend on the particulars of the case, but I'm conscious that in the Hilmer report where they talk about the production process exemption, the wording certainly suggests that railway lines would not normally be considered a production process, and if that was the default position, I think that would be useful in giving some certainty to the parties.

**MS SCOTT:** I guess one of the protagonists in that case, though, would say that the Hilmer committee and the secretariat couldn't envisage a production process that emerges later; looks like a railway line, but effectively, as you know they argue, it's this complex melding of suitable ores to achieve a certain very fine mix. I know a lot of people encourage us to always go back to Hilmer, but at the end of the day we're dealing with the legislation and the legislation doesn't reflect all aspects of Hilmer. Is that the right reference point? Is it right, now that technology has moved on?

**MR SMART:** I think the technological dynamism is a very important point. When you look at where this production process exemption probably comes from conceptually, I think people have in mind the Ford versus Holden thing.

**MS SCOTT:** They do.

**MR SMART:** You know, something that happens inside the factory walls.

**MS SCOTT:** That's right.

**MR SMART:** And it seems quite legitimate to keep an outsider from using your factory, but of course in the world today, production processes are intercontinental. One product travels enormous distances in being made, and so you can't use bricks and mortar to say, "That's the end of the production process." To answer the beginning of your question, maybe the safest way to do this would be to say that unless a very clear production process with high transaction costs of disruption can

be clearly demonstrated then we move on and we don't bother further with the filter, rather than get bogged down on what can be a very complex calculation.

**MS SCOTT:** Okay. You mentioned the Eastern Gas Pipeline matter. Could testing for a natural monopoly in a market based test, as we have proposed in the draft report - a possibly improved natural monopoly test - prevent inappropriate declarations by considering the existence of substitutes, in your view?

**MR SMART:** What was argued in the Eastern Gas Pipeline case, of course, was that the Moomba to Sydney pipeline was effectively a substitute facility for the Eastern Gas Pipeline, and when the interpretation shifted from supplying the market in Sydney to the question of taking gas from Longford and then supplying it in Sydney, then the analysis turned to the question of could that interconnect which then joins the Moomba to Sydney pipeline form a viable substitute to the Eastern Gas Pipeline.

Some of the analysis which I did in that case performed a type of SSNIP analysis and it looked at various stages of expansion that could be made to the interconnect, which is a fairly small-diameter pipeline; looked at the cost and capacity increments, and then looked at what capacity there would be to defeat a SSNIP by the Eastern Gas Pipeline. The conclusion that I reached in looking at that analysis was that it was a highly effective substitute for the Eastern Gas Pipeline and, on that basis, that coverage should have been refused on the grounds of criterion (b).

**MS SCOTT:** So with our suggested change in the draft report, which requires looking at the total market and looking at substitutes, do you think that would be a step forward? Do you support that recommendation?

**MR SMART:** I don't really have a problem with the natural monopoly concept as a test. My concern is (a) with the ease of actually applying it to specific cases and then (b) with the way it actually has been applied in practice which, as I mentioned, leaves something to be desired from an evidentiary point of view.

**MS MacRAE:** Can I just ask about the other issue around criterion (b). We've included in there that coordination costs should be included, and we did that because we thought that would be potentially - and we've had some views on this, so we'll be looking at it again, but we thought this is a range of costs which could potentially be so large as to overwhelm the benefits that you might get from declaring a service. So the intention was that this was adding something to make declaration - I don't know if I can say the words "make it more difficult", but it would give you another factor that you would take into account. But your view of it seemed to be that we were making things easier rather than harder and I just can't quite follow your logic, so I'm just wondering if you'd go through that for me.

**MR SMART:** Okay. I guess it's important that we flesh this out a bit. I started in

my supplementary submission to consider this issue by asking, in a step-by-step manner, how we could go about including these coordination costs in a criterion (b) analysis. Clearly, to my mind, it matters which interpretation of criterion (b) you take and so I looked at each case separately and, as I mentioned in my brief remarks, if the question is whether the facility is a natural monopoly, it just seems to me that the existence and acknowledgment of these coordination costs will increase the strength of that natural monopoly. The coordination costs are a facet, if you like, or a dimension of natural monopoly, because what you're saying is that it is less costly from a social point of view to do this as an integrated business than to have separate facilities.

**MS SCOTT:** Couldn't you argue the reverse? I just want to check that.

**MR SMART:** How would that work?

**MS SCOTT:** Well, I just want to check. Again, one of the advantages with hearings is that we get to understand each other and try and arrive at at least a common language, even if we don't arrive at common concepts. If there were considerable diseconomies associated with having two operators using the one railway, the coordination costs could be very, very substantial, so even though it may at first blush appear to have many natural monopoly characteristics, the coordination costs would effectively swamp the potential gains from increasing access to the second operator.

**MR SMART:** I see. So you're comparing the incumbent facility, with two separate people using it, to two separate facilities.

**MS SCOTT:** Correct.

**MR SMART:** And so the conclusion then would be that these coordination costs would be part of the cost of the unitary facility.

**MS SCOTT:** Yes.

**MR SMART:** And that might make it economic, in a social sense, for two separate facilities - - -

**MS SCOTT:** Could be. Yes, that's right.

**MR SMART:** I can see that that might work. I think the evaluation of it would require a great deal more of the evaluators than has been put into these tests so far.

**MS SCOTT:** Yes, but it seems to me that it's a clear argument that's been used in the Pilbara matters - and is still being used in the Pilbara matters in relation to, as we

understand it, what's happening now with people seeking access through the WA regime - of this issue of "I have this dedicated line and if I need to have multiple players on it, if there are very substantial risks, very substantial coordination costs, then this could outweigh the benefits that come from providing access in terms of upstream and downstream markets."

Now, it cuts both ways, because you could say that to the extent that those costs can be covered through access charges, if that could be reflected in access charges then maybe there's no harm done, but I just wanted to test that out. I think that, therefore, probably accounts for the fact that you were saying things that sounded very different to what I thought you were going to say.

**MR SMART:** You've raised two things that I'd like to respond to, so I'll respond to your question first, but I'd like to come back to this question about can access charges adequately compensate the incumbent for what they have lost, because I think that's a very important and separate part.

To answer your question, let's actually look at the Pilbara railways. The issue there is that coordination across the whole supply chain, from the mine to the port, is what makes these firms so successful. When you're looking at this criterion (b) assessment of the railway alone, then you're really just taking into account, I suppose, the nuisance costs on the railway alone of having another operator there. Now, there will be some degree of nuisance cost, but it may not be the dominant issue.

The issue may be the knock-on effects for the mining schedule and for the port schedule of having to delay your train so that access to the track can go ahead. I think it's that sort of whole-of-supply-chain issue which is really where the coordination costs are important. I don't think that's picked up in a criterion (b) analysis of a railway line by itself.

**MS SCOTT:** I think if other participants were here, they might say, "Well, it's not a matter so much of a nuisance cost." I mean, commentary along the lines, "Look, this was the greatest risk the company faced at that particular time, in part because of their concern" - to try and do justice to their argument - "that all it would take was a major derailment and where would they then be? The risks were unlikely to be able to be reflected in any access charge that was likely to emerge from a regulatory system." Is that a fair summary of their position?

**MS MacRAE:** Yes.

**MS SCOTT:** You describe them as nuisance costs. I'm not too sure some of these other participants would be comfortable with that terminology.

**MR SMART:** Maybe I've been a little brief in saying that. My reference to nuisance costs was really just the interference between trains belonging to different operators along the railway line.

In that case you mentioned of a catastrophic derailment by an access seeker, the problem is not so much that it delays the train; the problem is that it brings the entire supply chain to a halt. So again it's a problem that you don't see when you're only looking at the railway line. It's a systemic problem, and this is my concern. Systemic problems won't get proper weight if you're looking at a criterion (b) assessment just on the one link in a supply chain.

**MS SCOTT:** And the systemic problem that you're referring to in the broad there is - could you just elaborate on that.

**MR SMART:** Okay, sure. To make a supply chain that works, you have to coordinate investments at the mine and the railway and the port. If you've got a third party which has got property rights over one part of that chain, then it does affect the way you do your planning and investment for the whole chain.

**MS MacRAE:** I think your argument is, if we're saying - in looking at broadly how the coordination costs impact on this railway, and we're saying that really means just what happens on the railway, you're missing actually the main part of the problem, because the costs are what happens on the railway - there are costs there, and this is called a nuisance cost, but I'm sure you'd agree that, you know, there could be bigger ones - - -

**MR SMART:** There could be bigger ones.

**MS MacRAE:** - - - but the really bigger ones are out here: what it does at the mine and what it does at the port - - -

**MR SMART:** That's right.

**MS MacRAE:** - - - and you're concerned that those things aren't going to be included. Even if we talk about coordination costs more generally, is the regulator going to say, "Well, that's about what happens on the railway and that's the extent of my concern and I'm not going to look outside of that."

Just coming back to the natural monopoly and private profitability tests, I think if I understood you correctly you felt that the private profitability test was - well, I think we would agree, so I'll put this to you first: that whether we use natural monopoly or private profitability there's a common set there that's quite a large set.

**MR SMART:** That's right.

**MS MacRAE:** So if we use one or the other test, we've agreed.

**MS SCOTT:** Yes.

**MS MacRAE:** So we've both been grappling with the problem of what do we do with the smaller set that lies outside of it. It's the much harder to define set, and we did grapple with this very long and hard, I can assure you. I think it's fair to say that it is a very difficult question, and we spent a lot of time on it. We eventually fell on the side of the feeling that the natural monopoly test would be the test that was more likely to capture those cases where we thought we would, and we've outlined some reasons for that in that report.

I think we're also agreed that either test is difficult, so we're not saying either test is going to be an easy one, especially for these outlier cases. Can you just elaborate for me again what you think the benefits of the private profitability test would be over the natural monopoly test in those cases, in those hard - - -

**MR SMART:** Sure. I always think of these cases where an asset is already being bypassed or is about to be.

**MS MacRAE:** Yes.

**MR SMART:** We've seen a number of cases where the decision has been for declaration despite the fact that there is facility based competition, and I find this very frustrating. I think clearly the private profitability test would cut through that and give you a sensible answer.

The natural monopoly test seems to have led to the wrong answer. Now, whether it's right to blame the natural monopoly principle or whether it's just the application of it, I'm not sure, but I think one of the things that people say about the need for a natural monopoly test, which I think maybe misconstrues the problem, is that the natural monopoly test protects society from making inefficient, duplicated investments. Bear in mind this is a competition law; this is not an efficient investment law.

**MS MacRAE:** Yes.

**MR SMART:** So what's relevant is whether that extra investment is helping or impeding competition. So when I was talking about this SSNIP test as a means to test the efficacy of this additional facility, I think that really gets to the nub of your point. The problem with an unnecessary extra facility, if there is a problem, is mainly that it doesn't put the pressure on the incumbent to reduce costs. I think that's the essence of it. The problem is not that there's this wasted investment. That's a subject for somebody else's law.

**MS MacRAE:** Yes. I think we would agree with you about that too. We heard a lot about a single-minded focus on production efficiency, as if that was the only thing that mattered. At the end of the day certainly we would agree with you that it's not. I think one of the reasons that we entered - and we've just discussed about taking the wider definition of the market and including substitutes - was to try and get around this problem of, well, there is another facility here that's producing something that is - you know, there's a substitute here, and it could be a direct substitute - almost a duplication of a line or whatever. So we tried to get around that problem of the inappropriate use of the natural monopoly test in those instances where there did seem to be already - that had been bypassed, and that seemed to be more than a good reason to say that declaration wouldn't be warranted.

**MR SMART:** Just on that, perhaps I didn't read your draft report carefully enough on that point.

**MS MacRAE:** Sure.

**MR SMART:** I didn't really pick up on that nuance.

**MS MacRAE:** Okay. The concern we had around the private profitability test was what would happen if the regulator assessed that, "Well, we think it is privately profitable for someone to duplicate this infrastructure, so we've now made that assessment, so we're not going to declare," and then two, three, five years later still no-one has actually come along and duplicated. You've still got this problem of a bottleneck infrastructure. Nothing has emerged. "What do we do now?"

It was that sort of concern that we might get regulatory error, and because we've got this single test - and I'm trying to draw to my mind about the criteria that, where we knock one out and say that it's - and you've then lost the case because you've got to meet them all. The natural monopoly test has the advantage that, if you fail the natural monopoly test, you can still maybe pass some of the others. Have I got that around the wrong way in my head? So there was less risk in regulatory error with the natural monopoly test. They were two things that we had in our mind, and I just wondered if you'd like to comment on those.

**MR SMART:** What I had in mind with the private profitability test is that we'd only really be able to find that a new facility was privately profitable if it was very close to being built; that is to say, it's either been built already, as in some of the cases I've talked about, or there's a definite plan to build it, it's got financial backing, and so you can plainly see that it's about to happen.

In all other cases it's pretty speculative, and I would agree with you that we

shouldn't take the regulator's judgment that, on the basis of their current financial theory, this facility should be able to attract funding. That would be too speculative.

**MS SCOTT:** This is a hard question; possibly unfair: taking the current circumstances as they seem to be playing out in the Pilbara regarding possible discussions about railway lines, possible sales of railway lines, possible use of railway lines, if we have this privately profitable test and someone seeks access, could it be the case that you would then advise, "No, wait a minute, discussions are under way. There are plans in someone's drawer back in Queensland that could see a railway coming through or - - -"

**MR SMART:** I think we would need more than that.

**MS SCOTT:** All right.

**MR SMART:** We'd need more than that. I think you would have to be pretty close to a financial commitment to the project.

**MS SCOTT:** Okay.

**MR SMART:** I think if it's prior to that stage, it's really too soon.

**MS SCOTT:** All right. Were you here for the testimony from Gilbert and Tobin?

**MR SMART:** Yes, I was.

**MS SCOTT:** Were you persuaded by the dual test that they suggested?

**MR SMART:** I'm not a lawyer, so I can't really say how these things would work in a legal sense, but I think a single test is a bit cleaner for all concerned, whichever one it is.

**MS SCOTT:** Okay.

**MR SMART:** Can I just comment - sorry I meant to come back to this earlier - on this question about whether access charges can fully compensate an incumbent for the losses they will suffer through declaration. My feeling is, there are circumstances where they cannot; where no access charge could. The problem comes back to this transaction cost view of the boundaries of the firm.

What declaration does is, it gives third parties rights over the incumbent's property. Even if there is never an arbitration, even if there's never a court case over it, those rights exist, and that changes the landscape. That changes the boundaries of the firm permanently and that creates new types of transactions that didn't exist

before, or the possibility of new transactions. That possibility itself has costs, and those costs are suffered even if there never is access granted and, if there's never access granted, there's no possibility of recoupment on the incumbent's part.

**MS SCOTT:** The heavy-handed regulation.

**MR SMART:** Yes. I mean the threat of regulation.

**MS SCOTT:** Yes. Thank you very much for coming along and for making submissions to us. I now just want to check that there's no member of the public who feels the urge to come forward to make any comment on the record. I'll take that as a "no". So I'm able now to thank Simon, Anna and the team and draw this hearing to a close. Thank you very much.

AT 12.57 PM THE INQUIRY WAS ADJOURNED UNTIL
MONDAY, 29 JULY 2013