RIO TINTO

IRON ORE

Rio Tinto Iron Ore Submission to the Productivity Commission's National Access Regime Review

February 2013

1. Introduction

1. This submission is made on behalf of Rio Tinto Iron Ore (***RTIO***). RTIO is the division of the Rio Tinto Group with responsibility for Rio Tinto's iron ore interests in Australia and other parts of the world. Its Australian interests include the Pilbara iron ore mines operated by Hamersley Iron Pty Limited (100% owned by Rio Tinto) and by Robe River Iron Associates (a joint venture in which Rio Tinto owns 53%), and the infrastructure servicing these mines including rail networks and ports at Dampier and Cape Lambert. This submission reflects the experiences of RTIO regarding declaration under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (***CCA***).

2. Rio Tinto has previously made a submission to the Productivity Commission which commented upon the operation and effect of Part IIIA of the CCA.[1] In that submission, Rio Tinto expressed the view that the access regime, as then constituted within Part IIIA of the Act, created unnecessary burdens for industry. It continues to be RTIO's position that the Act should be amended to include an "efficiency override" in relation to vertically integrated export-dedicated facilities, which can be achieved by giving the relevant Minister power to exempt from Part IIIA services provided by key export facilities on national interest grounds. The reasons for that position are not repeated in this submission.

3. This submission responds to the Productivity Commission's Issues Paper dated November 2012.[2] It focuses upon issues raised by the Productivity Commission in relation to sections 44G(2)(b) and 44H(4)(b) of the CCA (***criterion (b)***) and the role of the Australian Competition Tribunal (***Tribunal***). RTIO has chosen to focus upon these two aspects of the national access regime because they are critical issues that have arisen at various stages during its involvement with Part IIIA.

4. RTIO has had a significant amount of experience with the declaration regime set out under Part IIIA of the CCA as a result of the following:

   - RTIO's railway facilities, which form part of RTIO's iron ore production system in the Pilbara, Western Australia, are the subject of declaration applications lodged on 16 November 2007 in respect of the Hamersley railway, and 18 January 2008 in respect of the Robe railway, which are currently before the Tribunal, (referred to throughout this submission as the ***Pilbara railways matters***);
   - RTIO was an intervener in Tribunal and court proceedings concerning the Pilbara rail facilities of BHP Billiton Iron Ore (***BHPBIO***), including court proceedings in 2008 in respect of the availability of the production process exception contained in the Part IIIA to BHPBIO's Pilbara railways;[3]

[1] Rio Tinto submission dated 13 June 2007 to the Productivity Commission's Annual Review of Regulatory Burdens on Business – Primary Sector, released 19 December 2007.

[2] Productivity Commission, *National Access Regime: Issues Paper*, November 2012 (***Issues Paper***).

[3] These proceedings culminated in the High Court decision of *BHP Billiton Iron Ore Pty Ltd v National Competition Council* (2008) 236 CLR 145.

- RTIO's Hamersley railway was the subject of a declaration application brought by Robe River Iron Associates in August 1998. The infrastructure was ultimately found to fall within the production process exception and so not capable of declaration.[4]

5. Accordingly, RTIO is well placed to comment upon the impact that the Part IIIA declaration regime may have upon owners of nationally significant infrastructure.

6. RTIO's experience with the declaration regime over the last decade demonstrates two key points:

   - First, regulatory intervention into private property rights, if imposed at all, should only be imposed where there is a significant failure in an identifiable (not hypothetical or imaginary) market. Where market forces can resolve issues of access, regulatory intervention is not appropriate given the real risk of regulatory error and the significant burden imposed by regulatory intervention. In terms of the criteria for declaration, this means the private profitability test is the appropriate test for criterion (b).

   - Secondly, the ability to seek merits review of a designated Minister's declaration decision by the Tribunal is crucial to ensuring confidence in the declaration process and enabling the correct decision to be reached. Infrastructure owners and potential users, and those looking at options for future infrastructure investment, need a decision-making framework which is transparent, fair (in the sense of evidence-based assessments being made by an independent decision-maker), reasonably certain and rigorous. This facilitates decisions about investment priorities and project options in a reasonably predictable and acceptable regulatory environment. The current process which allows for merits review by the Tribunal achieves this aim reasonably well. A system in which declaration decisions are potentially exposed to political influences and capture by private interests, without recourse to a rigorous, merits-based assessment by independent specialists, would be extremely damaging to infrastructure investment in Australia.

7. By definition, infrastructure which will become subject to access regulation under the declaration regime is the type of infrastructure whose operations impact upon Australia in terms of the national economy, trade and commerce, or due to its size. Accordingly, errors in determining when regulated access should or should not be imposed will have a huge impact on the nation. It is vitally important that the right decisions are reached.

8. This is especially so when access regulation can potentially be imposed, as is the case with declaration under Part IIIA, *ex post* upon infrastructure which has been privately developed and where investments have been made – and operating systems designed – on the assumption of single use. The impact of mandated sharing upon such infrastructure is potentially far more significant than the case of multi-user infrastructure which always operated and was planned on the basis of a regulated rate of return (for example,

[4] See *Hamersley Iron Pty Ltd v National Competition Council* (1999) 164 ALR 203.

government owned or formerly government owned infrastructure such as gas and electricity infrastructure).

9. The regulatory environment that Australia sets for export infrastructure in particular will have a significant impact upon the ability of Australian operations to compete worldwide, and on the level of infrastructure investment that takes place in Australia given that Australia will be only one of several destination choices for infrastructure projects.

10. Imposing such regulation when it is unnecessary risks significantly damaging the Australian economy without obtaining any commensurate benefits for the nation. This is particularly so in relation to services and facilities primarily dedicated to export industries.

11. These precautions against unnecessary access regulation are crucial given the efficiency of infrastructure used to develop Australia's natural resources – such as facilities that form part of RTIO's iron ore production system in the Pilbara – is key to Australia's economic wellbeing. It is in Australia's interests to ensure any access regime is designed in a manner which does not deter timely and efficient investment in such infrastructure, and which facilitates the cost competitiveness of such infrastructure, to maximise returns on investment to Australia from its natural resources.

12. A private profitability test for criterion (b) and the ability to seek merits review by the Tribunal reduces the likelihood of unnecessary regulatory intervention, thereby reducing the risk of unjustifiable costs to Australia's productivity. It also significantly contributes to fostering a regulatory environment that is rigorous, transparent, fair and reasonably certain, whereas to do otherwise increases sovereign risk which is likely to have a chilling effect on infrastructure investment in Australia.

2. Private profitability is the correct test for criterion (b)

2.1 Introduction

13. One of the key criteria which must be satisfied before a service provided by a facility can be declared under Part IIIA is that it would be uneconomical for anyone to develop another facility to provide the service – criterion (b).

14. An area the Productivity Commission has focused upon in its Issues Paper is what is the appropriate test for criterion (b), asking '*What are the tradeoffs between the different approaches to criterion b? What are the practical implications of the different approaches in terms of what types of facilities would and would not meet criterion (b)?*' and '*What are the long-term and practical implications of the High Court decision on criterion (b) for economic efficiency and investment in infrastructure?*'[5]

15. Since the introduction of Part IIIA there has been considerable debate about the meaning of criterion (b). In particular, does 'uneconomical for anyone to develop another facility' mean:

- that it would be *unprofitable* for anyone to develop another facility (the ***Private Profitability Test***); or

[5] Issues Paper, 13.

- that it would be *wasteful of societal resources* for anyone to develop another facility (the ***Social Benefit Test***).[6]

16. This debate was ultimately resolved in the Pilbara railways matters by the High Court.

17. In 2012, the High Court held by a 6:1 majority that criterion (b) ought to be assessed using the 'Private Profitability Test', stating that '[i]f the Minister is satisfied that it would be uneconomical (in the sense of not profitable) for anyone to develop an alternative facility, criterion (b) is met'.[7]

18. The High Court explained that:

> It would not be economical, in the sense of profitable, for someone to develop another facility … unless that person could reasonably expect to obtain a sufficient return on the capital that would be employed in developing that facility..[8]

19. The High Court found that the objectives of Part IIIA would best be served by the Private Profitability Test.

20. In reaching this decision the High Court upheld the unanimous decision of the Full Federal Court, which also adopted a private profitability interpretation of criterion (b).[9] The Full Federal Court found that:

> In summary on this point, we are unable to discern in Pt IIIA of the Act an intention that a person who is….able economically to develop its own facility to provide the service should be able to cross the criterion (b) threshold to access to (*sic*) a competitor's facility merely by showing that it would accord with a regulator's evaluation of productive efficiency. It may be accepted that one of the objects of Pt IIIA is the promotion of productive efficiency, but Pt IIIA strikes the authoritative balance between the promotion of competition and economic efficiency and the 'legitimate interests' of incumbent owners of facilities.
>
> In our opinion, the intention of the legislature was that, if it is economically feasible for someone in the market place to develop an alternative to the facility in dispute, then criterion (b) will not be satisfied. In such a case, there is no problem in the market place that participants in the market place cannot be expected to solve.[10]

21. The Pilbara railways matters are the first occasion on which the High Court and the Full Federal Court have been asked to consider the meaning of criterion (b). The High Court and Full Federal Court decisions rejected the 'Social Benefit Test', which was previously adopted by earlier Tribunals and the National Competition Council (***NCC***), and a 'natural monopoly' variation on that test formulated by the Tribunal in *Re Fortescue Metals Group Limited* [2010] ACompT 2 at [837] (***Re Fortescue***).

---

[6] The Social Benefit Test was articulated in *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) 162 FLR 32, [137] as asking: 'whether for a likely range of reasonably foreseeable demand for the services provided by means of the [facility], it would be more efficient, in terms of costs and benefits to the community as a whole, for one [facility] to provide those services rather than more than one.'

[7] *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36, [107] (***TPI v Tribunal***).

[8] *TPI v Tribunal* [2012] HCA 36, [104].

[9] *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58.

[10] *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58 [99]-100].

22. For the reasons discussed below, the Private Profitability Test should be retained and is to be preferred to other alternatives because:

- it implements sound economic principles;
- it is consistent with the objects and principles of Part IIIA and the CCA;
- it is comparatively straightforward to apply; and
- it is consistent with the operation of the other criteria for declaration contained within Part IIIA.

2.2 Private profitability test implements sound economic principles

(a) Private Profitability Test will not result in inefficient duplication

23. RTIO notes that in its initial submission to the Productivity Commission, the NCC has stated that:

> With respect, the Council considers the High Court's construction to be unsatisfactory. In the Council's view the approach allows for the duplication of a facility in circumstances that are wasteful of societal resources and which reduce productivity by requiring multiple facilities be developed when a single facility could have provided sufficient services at lesser cost.[11]

24. The NCC's suggestion that the Private Profitability Test will result in duplication of a facility in circumstances that are wasteful of societal resources is misconceived. The reason why this is so can be seen most easily from a simplified example.

25. Suppose a new entrant could produce a product at $60 per unit, build and operate a transport facility (or have a third party construct and operate such a facility) to get the product to market for $10 per unit,[12] and sell the product for a market price of $100 (leaving a profit of $30). Suppose further that the incumbent already has a transport facility in place that could transport the new entrant's product for $7 per unit.[13]

26. In this example it is privately profitable to construct and operate another transport facility to service the new entrant. Applying the Private Profitability Test, the incumbent's transport facility could not be declared and would not be subject to regulation under Part IIIA.

27. If we assume that there is spare capacity on the incumbent's transport facility (or that this can be achieved by expansion) the new entrant may approach the incumbent seeking access to the incumbent's existing transport facilities. Provided the new entrant is offering to pay an access fee in excess of the $7 cost of providing access, self interest will lead the incumbent to agree to provide access. If the incumbent refuses access, then the entrant will construct (or have a third party construct) another transport facility and enter the downstream market in any event; the only effect of refusing access is the incumbent foregoes the opportunity to earn some access revenue from the new entrant. The

---

[11] NCC, 'Inquiry into the National Access Regime' (Submission to the Productivity Commission, 1 November 2012), 8.

[12] This would include both capital costs (a return on and of capital) and operating costs.

[13] This would include both capital and operating costs and also diseconomy and disruption costs caused by the new entrant using the incumbent's facility.

incumbent and the new entrant will negotiate an access price somewhere between $7 (the cost of providing access) and $10 (the cost of constructing and using a new facility). If the new entrant offers to pay an access fee of less than $7 the incumbent would not be willing to provide access. Conversely, if the incumbent seeks to charge more than $10 the new entrant would prefer to construct (or have a third party service provider construct) another facility. If construction by a third party service provider were preferred, the new entrant would facilitate the development of the new facility by entering into a usage agreement with that provider at a price ($7 per unit or above) that makes the development of the new facility profitable.

28. Importantly, this conclusion applies irrespective of whether or not the incumbent has market power in the downstream market. Because it will be privately profitable for a new facility to be developed, new entry will occur and market power will be lost irrespective of whether or not the incumbent provides or refuses access.

29. It is useful to vary the above example by supposing that the true costs of granting access to the incumbent's existing facility to the new entrant are not $7 but $20 (for example, in circumstances where the new entrant's use of the incumbent's facility would cause significant disruption and interference with the incumbent's operations). In this scenario, the incumbent would only be prepared to grant access at a fee of $20 or above. In these circumstances the new entrant would prefer to construct (or facilitate the construction of) a new facility at a cost of $10. Accordingly, the incumbent and the new entrant will not be able to reach agreement on an access fee and the new entrant will construct (or have a third party service provider construct) another facility. The facility is being developed because the true costs of access are greater than the costs of developing the facility.

30. As a result, where it is profitable for a new facility to be built declaration is not necessary. The marketplace will ensure that when the true costs of access are less than the costs of constructing a new facility, access on commercially-negotiated terms will be granted. Where the true costs of access are greater than the costs of a new facility, however, then a new facility will be constructed.

31. If, however, it is not privately profitable for a new facility to be built then market forces will not necessarily result in access being granted when that would be the efficient outcome, and declaration may be appropriate (provided the other declaration criteria are satisfied). So, for example, if the true costs of access (including the diseconomy costs) are significantly less than the costs of a new facility and a new entrant could profitably enter the downstream market but only if it can obtain access to the incumbent's facility, an incumbent with monopoly power in the downstream market may have the ability and the incentive to refuse to provide access so as to preserve its monopoly position. In these circumstances the infrastructure is truly a bottleneck that may prevent competition in a downstream market and market forces cannot be relied on to overcome that bottleneck.

32. In summary, the Private Profitability Test is the appropriate filter to determine if declaration may be necessary. If the incumbent's facility can be profitably duplicated, the inter-play of market forces will determine whether it is more efficient to build an alternative facility or have the existing incumbent's facility shared based on commercially agreed access terms.

If, however, an incumbent's facility cannot be profitably duplicated, then that facility could be a bottleneck and declaration may be appropriate if the other declaration criteria are met.

33. The '*Private*' Profitability Test therefore advances social welfare just as much as — indeed, more effectively than — the Social Benefit Test. Moreover, it does so in a way that meshes with the competition policy enshrined in the CCA. Where privately feasible entry is possible, the facility owner and the access seeker will have a common interest with society in finding the least cost solution, and given the information advantages over a regulator, it can be expected they will be best equipped to identify the most efficient outcome.

34. Declaring a facility that can be privately duplicated and imposing regulation unnecessarily has three key disadvantages.

35. First, the market is inevitably in a better position than any regulator or tribunal to determine whether it is truly more efficient for access to be granted or a new facility built. Participants will inevitably have superior information and resources available to them and will have greater experience in the relevant market.

36. Secondly, there are significant risks of over regulation "crowding out" successful private negotiations over voluntary access. If a facility that could be profitably duplicated is declared, a new every entrant has every incentive to "roll the regulatory dice" to see if the ACCC will set a low access price that does not fully capture the true costs of providing access.[14] If, contrary to expectations, the ACCC sets a high access price then the new entrant can at that point switch to either constructing its own facilities or negotiating voluntary access if that was more efficient. If the ACCC sets a low access price however then the only effect of regulation is to transfer value from the incumbent (who has taken the risk of building the infrastructure) to the new entrant.

37. Thirdly, the incentives created through such over-regulation are likely to have the effect of dissuading new entrants from constructing another facility, or having a third party service provider construct it, even though it would be profitable to do so. This is because the new entrant is likely to be motivated to focus narrowly on which option is lower cost for it (regardless of whether this would impose costs on the incumbent as a result of operational inefficiencies, increased infrastructure requirements, delays to expansions and technological developments etc – discussed at [69] below). As a result, the efficiencies that would be generated through a new, alternative facility (potentially bringing online newer technology and lower-cost operations) and the facilities-based competition it would bring, will be foregone.

38. In *Re Fortescue*, RTIO presented expert economic evidence to the NCC and the Tribunal explaining why the Private Profitability Test would not result in inefficient duplication and why it was the preferable approach from an economic perspective. This included statements and affidavits from Professor Robert Willig, Professor of Economics and Public Affairs at Princeton University and from Professor Joseph Kalt, Professor of International Political Economy at the John F Kennedy School of Government, Harvard University.

---

[14] There is a significant risk that access prices set by a regulator will not fully capture the true costs of providing access, particularly inefficiency and diseconomy costs imposed by having a third party on an integrated facility such as RTIO's Pilbara railways. These costs, although potentially enormous, would necessarily be difficult to quantify precisely in advance.

39. Attached to this submission are statements provided by economists Professor Willig and Professor Kalt that were presented to the Tribunal. RTIO draws the Productivity Commission's attention in particular to:

- Professor Kalt's statement of 2 May 2005, especially pages 9–14;
- Professor Willig's statement of 30 June 2009, especially pages 4, 6–14; and
- Professor Willig's statement of 23 September 2009.

40. A number of other objections are sometimes raised to the Private Profitability Test. The more common objections, and an explanation of why they are misplaced, are set out below.

(b) Is it reasonable to assume that the incumbent will act rationally?

41. One of the reasons given by the Tribunal for rejecting the Private Profitability Test in *Re Fortescue* was that:

> it assumes that firms always, or usually, behave in an economically rational manner but from empirical observation we know they do not — especially when it comes to dealing with potential competitors.[15]

42. Contrary to the statement made by the Tribunal, it is perfectly reasonable to assume that market participants will act in a way that maximises their profits. Regulation should not be imposed because of an assumption that market participants will act in an economically irrational manner. Rather, regulation should be imposed only where there is clear market failure, not because of an unjustified assumption that markets will fail because of irrational behaviour.

43. As explained in Professor Willig's statements and as discussed above, under the standard economic theory of bargaining, the facility owner and the access seeker will reach an agreement that maximises joint surplus.[16] If it is privately profitable to duplicate the existing facility but sharing the existing facility is more efficient than developing an alternative facility, joint profits will be greater under shared access, and the two parties are motivated to agree to a facility sharing arrangement. Alternatively, if sharing the facility is less efficient and yields smaller joint profits than developing an alternative facility, the parties will not agree on an access arrangement, and the access seeker will develop its own facility. Thus, if it is privately economical to develop an alternative facility, properly-functioning market mechanisms will enhance competition in a way that efficiently allocates resources and access rights.

(c) Does the Private Profitability Test result in weaker competition between the incumbent and the access seeker?

44. The second reason that the Tribunal gave for rejecting the Private Profitability Test in *Re Fortescue* was that there may be reasons for an incumbent owner who is behaving

---

[15] *Re Fortescue* [2010] ACompT 2, [823].

[16] This is a widely accepted principle in the economics literature on inter-firm agreements and on bargaining. It was first articulated in John Nash, 'Two-Person Cooperative Games' (1953) 21 *Econometrica* 128. It was also discussed in Ronald Coase, 'The Problem of Social Cost' (1960) 3 *Journal of Law and Economics* 1.

rationally to deny access to a potential competitor even when sharing would be most efficient – for example, because forcing a competitor to use a less profitable alternative facility may harm that competitor which would be to the advantage of the incumbent.[17] A similar argument is sometimes made that the Private Profitability Test would allow a situation where an access seeker may enter the market with inefficient production technology or with higher costs and so be a weaker competitor to the incumbent.

45. In fact, developing an alternative facility is likely to lead to more intense competition between the facility owner and the access seeker than would an access declaration. First, the development of alternative facilities will expand the overall capacity available to access seekers and the facility owner, which will impel greater competition, not only between the parties, but with new potential access seekers. This is particularly so in the case of infrastructure facilities with high initial fixed cost and relatively low operating costs. Secondly, the development of alternative facilities is likely to incorporate newer technology which may give the entrant a competitive edge over the incumbent. Thus a new entrant's operating costs (which are the only relevant costs once the facility is built) may well be lower than those of the incumbent. Thirdly, forcing rivals to cooperate by mandated access runs the danger of blunting competition between them. Furthermore, mandating access removes the potential for facilities-based competition developing in the market for the service. The incumbent's monopoly position is being locked in and regulation substituted for competing facilities.

46. In summary, an incumbent is likely to have every incentive to grant access rather than see an alternative facility constructed by a competitor which may result in significant excess capacity, with potentially lower operating costs and better technology than the incumbent's older facility. Accordingly, a rational incumbent is likely to have a bias towards granting access rather than seeing an incumbent build a new competing facility.

47. This issue is discussed in more detail in Professor Willig's statement of 23 September 2009, at pages 5–6.

(d) Are regulated outcomes likely to be preferable to market-driven outcomes?

48. A third reason given by the Tribunal for rejecting the Private Profitability Test in *Re Fortescue* was that:

> it is far from clear that market forces achieve a better result than regulation as a general rule. In any event, it is doubtful that the Tribunal is entitled to assume that the decision-makers regulating Part IIIA will make errors.[18]

49. To suggest that regulation is preferable to market outcomes is fundamentally at odds with principles underpinning the CCA and Part IIIA. The whole purpose of competition laws in general and Part IIIA in particular is to allow competition and market forces to work. Part IIIA is intended to allow competition to occur in dependent markets only where there is a market failure in relation to bottleneck infrastructure. It is not intended to substitute regulation for market-driven outcomes when there is no market failure. Part IIIA was never

---

[17] See *Re Fortescue* [2010] ACompT 2, [823].

[18] *Re Fortescue* [2010] ACompT 36, [823].

intended to be, and should not be, a social engineering regime that applies irrespective of whether there is market failure.

50. In this particular context, assessing what the true costs of access would be (taking into account not only direct costs but also the real costs of disruption that access may cause) and comparing those costs to the costs of constructing a new facility is a complex and information intensive task requiring a detailed understanding of the industry concerned and the operation of the facilities in question. Industry players are clearly in a better position than regulators to make these assessments because of their detailed industry knowledge and experience and greater internal resources to analyse the potential cost and benefits of sharing facilities relative to constructing new facilities.

51. RTIO also notes, and echoes, the observations made by the Exports and Infrastructure Taskforce established by the Australian Government in 2005, that:

> It is important to be realistic about what regulation can and cannot achieve. The information available to regulators is necessarily highly imperfect, so regulators cannot hope to mimic the outcomes that would be secured by fully efficient markets. In fact, the search for fully efficient outcomes is likely to merely add delay, cost and uncertainty to the regulatory process. As a result, any feasible system of regulation is likely to be characterised by a level of 'government failure'. Reflecting this, regulation should be used cautiously, and the costs of regulation taken fully into account in decisions about whether and how to regulate.
>
> …
>
> Even when attention is paid to carefully selecting the form of regulation, there is an inherent tension between regulation and efficient investment. In practice, regulators inevitably have a degree of discretion and that discretion creates risks that investors in infrastructure need to take into account.[19]

(e) Does the Private Profitability Test lead to paradoxical situations?

52. RTIO observes that arguments have also been made that the Private Profitability Test can lead to a 'paradoxical' situation that the better an industry's prospects, or the more efficient a new entrant is, the more likely it is that criterion (b) will not be satisfied and the service will not be declared.

53. In fact, there is nothing paradoxical or concerning about this situation. As Professor Willig explained:

> 11. …If the alternative facility development is privately economical, new competition will likely occur regardless of whether there is mandated access. However, it is under unfavourable market conditions where the development of alternative facilities is privately uneconomical that enhancing competition may require government intervention such as an access mandate. Therefore, a policy of limiting access mandates to situations where enhancing competition requires government intervention (such as when market conditions in an industry are weak) is not paradoxical but rather is a sound approach for enhancing competition.
>
> 12. [Fortescue Metal Group's expert] Professor Gans also criticizes the private test by suggesting that it creates perverse incentives. He claims that the private test would lead to

[19] Exports and Infrastructure Taskforce, 'Australia's Export Infrastructure: Report to the Prime Minister' (May 2005), 20.

'a paradoxical situation that service declaration was more likely if access seekers were less efficient.' Thus, Professor Gans argues that the private test rewards inefficient access seekers by making declaration more likely when the access seeker is less efficient. This is a flawed characterisation of the private test. There is no basis for claiming that the private test would create perverse incentives if the access regime would not force the facility owners to charge access prices that are below the full cost of access, that is, all the costs that the facility owner would incur, including opportunity costs, in providing access to the access seekers. In this case, the fact that the more efficient firm can profitably develop its own facilities would only give it greater leverage in negotiating terms of access with the facility owner. This would benefit the more efficient firms because such firms would have the options of developing their own facilities or obtaining access to the existing facility. The access seekers would choose the lower-cost option, which would not likely inefficiently exceed the full cost of providing access because the ability to develop their own facilities gives the access-seekers the leverage to negotiate a competitive access price. Thus, there would be no disincentives to achieving greater efficiency.[20]

2.3 The Private Profitability Test is consistent with the objects and principles of Part IIIA and the CCA

54. The object of the CCA generally is 'to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection'.[21]

55. Relevantly, a key objective of Part IIIA is to 'promote the economically efficient operation of, use of and investment in infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets'.[22]

56. The Private Profitability Test is consistent with both the general objects of the CCA and the more specific objects of Part IIIA. In particular, in circumstances where there is no market failure, it allows market-driven outcomes to work rather than substituting regulation for competition. Where, however, there is a genuine market failure and declaration is necessary in order to introduce competition into markets, criterion (b) will be met applying a Private Profitability Test. As a result, the Private Profitability Test is consistent with the emphasis in the objects of the CCA on **promoting competition**. Relying on market outcomes is also the best means of **promoting efficiency**, in all three senses of the term, and of promoting effective competition in upstream and downstream markets, consistently with objects of Part IIIA in particular.

57. The objective concerning efficient investment in infrastructure which was introduced into Part IIIA in 2006 is intended, at least in part, to emphasise that regulatory intervention should not be granted in such a way as to lead to a chilling of investment, as this will have a negative impact on the welfare of Australians in the long run.

58. Part IIIA was never designed to plan or regulate markets per se; it is intended to allow appropriate intervention where there is a specific market failure which has the effect that competition is being blocked in upstream or downstream markets. The rationale for

---

[20] Statement of Robert Willig dated 23 September 2009 at [11]-[12], citation omitted.

[21] *Competition and Consumer Act 2010* (Cth), s 2.

[22] *Competition and Consumer Act 2010* (Cth), s 44AA(a).

declaring services is that it will introduce or increase competition in markets that are *dependent* upon the service at issue.

2.4 Private Profitability Test is comparatively simple and practical to apply

59. The Private Profitability Test can be performed in a relatively straightforward fashion with a minimum of assumptions and predictions about the future effects of regulation. Essentially it requires an assessment of whether constructing an alternative facility would generate a sufficient return on the capital that would be employed in developing that facility. This requires a net present value (***NPV***) or equivalent analysis of the type any investor would undertake in considering whether to make an investment.

60. This point was made by the High Court, which said that:

> Contrary to Fortescue's submissions asking whether it would be uneconomical in the sense of unprofitable for anyone to develop an alternative facility does not ask a question to which no answer can be given with any sufficient certainty. Of course, it is a question that would require the making of forecasts and the application of judgment. But the converse question — whether it would be economically feasible to develop an alternative facility — is a question that bankers and investors must ask and answer in relation to any investment in infrastructure. Indeed, it may properly be described as *the* question that lies at the heart of every decision to invest in infrastructure, whether that decision is to be made by the entrepreneur or a financier of the venture.[23]

61. By contrast, applying the Social Benefit Test requires an assessment not only of the cost of constructing the alternative facility, but also of all of the broader social costs of mandating the provision of access under declaration. These costs could include, amongst other things, the costs[24] arising from:

- congestion and operational inefficiencies;
- conflicts over business priorities and financing that might impede efficient deployment of the facilities and paralyse expansion decisions;
- mis-incentives that suppress sufficient investment in facilities by both the access provider and access seeker.

2.5 Private Profitability Test permits a clear analytical division between the key criteria for declaration

62. Another practical advantage of the Private Profitability Test is that, in contrast to the Social Benefit Test, an economic feasibility approach to criterion (b) enables a clear analytical division to be drawn between each of the criteria for declaration. Applying the Private Profitability Test:

---

[23] *TPI v Tribunal* [2012] HCA 36, [106] (emphasis added).

[24] These costs were the subject of extensive analysis by the Tribunal in *Re Fortescue* [2010] ACompT 2, albeit primarily under criterion (f) rather than criterion (b) (as should have occurred if a Private Profitability Test were not applied - discussed in section [2.7] below) and the Tribunal found that for the Hamersley rail service there was a "probability" that any benefits from mandated access could be "dwarfed by the costs" – at [1319]

- Criterion (b) first asks whether it is unprofitable for anyone to develop another facility. If duplication is possible, then there is no market failure that requires regulatory intervention in order to facilitate competition in upstream or downstream markets. The facility is not a bottleneck and regulation is not required.
- If criterion (b) is met and a facility cannot be profitably duplicated, then criterion (a) proceeds to the next logical question and asks whether access to the service would promote a material increase in competition in an upstream or downstream market. Having established that the facility is a bottleneck, criterion (a) then asks whether mandating access would materially promote competition in a dependent market.
- If a declaration application overcomes the hurdles established by criterion (b) and (a), criterion (f) then requires a wider review of the costs and benefits of access to ascertain whether declaration would be contrary to the public interest.

63. This framework starts with the narrowest question possible, asking increasingly expanding questions, to ultimately determine whether declaration is in the public interest.

2.6 Conclusion

64. In summary, the Private Profitability Test endorsed by the High Court and the Full Federal Court should be retained. It makes good economic sense, is consistent with the objectives of the CCA and Part IIIA, and is comparatively simple and practical to apply.

2.7 An observation on the Social Benefit Test

65. In *Re Fortescue*, the Tribunal formulated and adopted a variation on the Social Benefit Test, applying what it described as the 'natural monopoly' test. Under the natural monopoly test, the Tribunal viewed criterion (b) as asking whether the facility in question could meet reasonably foreseeable demand for the relevant service at a lower total ***production cost*** than if demand were to be met by two or more facilities.

66. Under the natural monopoly test, the only costs to be taken into account are the costs of inputs incurred in providing the service; above rail costs, inefficiency costs and other social costs would be disregarded under this test. The types of social cost the Tribunal declined to take into account under its natural monopoly test included such things as:

- above rail costs;
- the costs of diseconomies and inefficiencies resulting from access;
- the costs of delays to expansion;
- the costs of retardation of technological development; and
- the loss of social benefits of having facilities-based competition.

67. For the reasons discussed above, RTIO believes that the Private Profitability Test is the correct test to apply and there is no reason to amend the existing legislation. It should be noted, however, that the natural monopoly test proposed by the Tribunal in *Re Fortescue* makes even less economic sense than the Social Benefits Test that the NCC and, prior to *Re Fortescue*, the Tribunal, have historically applied.

68. If criterion (b) is to be read as requiring an examination of whether duplication of the facility would be wasteful of societal resources, then regard should be had to *all* of the costs that access will impose relative to the construction of a new facility i.e. the traditional Social Benefits Test. There can be no justification for limiting consideration to the 'below rail' or equivalent costs and ignoring all other costs of providing access as was suggested under the Tribunal's natural monopoly test. The need to address all such costs if a Social Benefits Test were to be applied (albeit inappropriate to do so) was emphasized by Professor Willig in his statement of 30 June 2009 at pages 18-28. Many of these costs were addressed by the Tribunal under criterion (f), which led to the Tribunal's finding in relation to the Hamersley rail service that in all probability the benefits of access would be "dwarfed" by the costs.[25]

69. The costs which RTIO (and Australia) would incur that are additional to the direct "below rail" costs of sharing its rail facilities include the following:[26]

- The inefficiencies that would arise from increased usage of the rail facilities to the point where they operate at or near "choke capacity". One example of such costs is the extra number of train consists required to move the same tonnage compared with the consists required on two separate less congested facilities. RTIO operates over 100 consists, the cost of each being in the order of $100 million. If congestion caused by mandated access led to a 25% decline in consist efficiency (a reasonable assumption for the key routes in the rail system), the extra consists required to achieve the same throughput would entail a cost of $2.5 billion;
- Less flexibility in scheduling, which entails changes numerous times each day to cope with issues such as unexpected ore quality changes, breakdowns, unavailability of manpower (e.g. train or loadout operators), maximizing the value of opportunistic maintenance windows, choke feeding available dumpers at port when one dumper is down etc. If the requirements of a third party have to be taken into account when managing these complex but ever recurring issues, the outcome will inevitably be sub-optimal. The result is lower throughput and lower export income;
- Lost production/export income due to the inevitable delay to RTIO's planned expansion programs that will arise if third parties are involved in or affected by such programs (as will occur if third parties are operating on the RTIO rail lines). The Tribunal accepted such delays were inevitable and that on a "conservative assumption" the cost to revenue of expansion delays would be in the order of $10 billion;[27]

---

[25] *Re Fortescue* [2010] ACompT 2 [1319].

[26] As mentioned above, many of these costs were taken into account by the Tribunal under criterion (f): see *Re Fortescue* [2010] ACompT 2 [1230] - 1288], thus leading to the conclusion that the costs are likely to "dwarf" the benefits of access. However, as stated above, if a Social Benefits Test is to be applied, there is no justification for not taking them into account under criterion (b).

[27] *Re Fortescue* [2010] ACompT 2 [1328].

- Lost production/export revenue due to the inevitable delay in introducing new technologies and operating practices designed to achieve an increase in efficiency and throughput;
- Loss of the benefits that would flow to the community from infrastructure competition that would be thwarted by mandated sharing when the alternative would likely have been a new and competing facility.

3. Removal or restriction of merits review by the Tribunal will dampen infrastructure investment

3.1 Introduction

70. RTIO understands that, primarily in response to criticisms of the time taken for some declaration applications to be finally resolved, there have been calls to remove one or more levels of the three tiers of decision-making from the declaration process. RTIO wishes to focus upon the issues raised by the Productivity Commission in relation to the continued role of the Tribunal in the declaration process.

71. RTIO's extensive experience of the declaration regime has demonstrated to it the vital role the Tribunal plays in contributing to a decision-making process which is reasonably certain, transparent and fair. RTIO's experience also demonstrated that the Tribunal is well-equipped to identify appropriate cases for regulatory intervention, and has significant advantages over the NCC and the designated Minister in terms of its ability to test propositions, obtain additional information, thoroughly review and analyse evidence, and apply a combination of legal, economic and business expertise in its decision-making to reach the correct decision.

72. In the Pilbara railways matters, the Tribunal undertook a comprehensive assessment of evidence and tested propositions put by all sides to reach evidence-based conclusions. Its reasoning was clearly demonstrated in the detailed reasons for decision which it published. The specialist expertise of Federal Court judges with experience in competition law, business people with industry knowledge, and economists, was applied in testing the evidence to determine whether the application met the relevant criteria for declaration. The fact that RTIO did not agree with the Tribunal's application of the natural monopoly test in relation to criterion (b)[28] does not detract from RTIO's support for the principle that maintaining the Tribunal's role is vital. In fact, as explained earlier[29], the Tribunal considered and made appropriate findings on all relevant issues (especially the true costs of access versus the benefits of access). RTIO disagreed with the Tribunal's interpretation of criterion (b), but this did not affect the outcome as the Tribunal considered the costs vs benefits under criterion (f) and based its decision on this criterion, instead of criterion (b). If the Private Profitability Test had been applied under criterion (b), the same outcome would have followed, given the Tribunal's finding that it could not be satisfied that it was

[28] See section [2.7] above.

[29] As discussed in footnote 25 above.

unprofitable to build a new line to duplicate the Hamersley and Robe facilities.[30] Further, if the Tribunal had applied the Social Benefit Test under criterion (b) it would have reached the same conclusion, as it would have done its exhaustive cost/benefit analysis under criterion (b) rather than criterion (f).[31]

73. By contrast, declaration decisions made by the Minister do not appear to involve an independent testing of the evidence, but instead rely upon the findings of the NCC which has a very limited ability to rigorously test parties' assertions with no power to cross-examine witnesses. Calls for additional material in order to assist the Minister to make a fully informed assessment appear to be rarely made (indeed, it may be that designated Minister lacks the power to seek further information, given the absence of any express grant of power to do so in Part IIIA). The brevity of Ministerial declaration decisions suggests that the reasoning employed in the decision-making process is not as detailed as that of the Tribunal. Only short reasons for decision are published: 10 pages in the case of the Pilbara railways matters (but more typically, decisions run to 2 to 5 pages only), which provide limited insight into the reasoning process and have limited precedential value for access seekers and infrastructure owners. Moreover, declaration decisions made by a designated Minister only bring to bear the experience of the relevant politician, his or her advisers and the NCC — they do not have the advantage of specialist legal, economic and business expertise, and evidence that has been tested under cross examination, as is the case with the Tribunal.

74. Accordingly, RTIO believes that the current safeguard built into Part IIIA of merits review by an independent expert body in the form of the Tribunal works well. It contributes to a regulatory environment which is rigorous, transparent, fair and reasonably certain and accordingly is more conducive to reaching correct decisions on the legislative criteria . This in turn facilitates decisions about investment priorities and project options to be made by infrastructure owners and potential access seekers alike and provides a climate that does not discourage investment in infrastructure.

75. RTIO considers that removal of parties' rights to seek merits review by the Tribunal, or restricting the review in some manner, would have a serious negative impact on investment in infrastructure in Australia. It is wholly inappropriate to leave declaration in the hands of a Minister in circumstances where the Minister does not have the ability to seek a review by experts or an ability to test evidence and submissions in a rigorous and transparent manner. This would increase sovereign risk and lead to diminished infrastructure investment in Australia.

---

[30] See *Re Fortescue* [2010] ACompT 2, [964]-[965].

[31] As the Full Federal Court observed, the Tribunal took into account under criterion (f) costs and benefits which in previous Tribunal decisions had been considered under criterion (b), and the costs it considered under criterion (f) would have been taken into account under criterion (b) had the Social Benefit Test been applied: see *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2011] FCAFC 58 [104], [108].

3.2 When dealing with infrastructure of national significance, obtaining the 'right' decision should be accorded a higher priority than a quick decision

76. The Productivity Commission has asked '*Do all of the institutions involved in Part IIIA contribute to effective and efficient decision-making? If so, how? If not, how could their roles, or the interaction between them, be improved?*'[32]

77. In order to be credible, the declaration regime must be conducive to producing "correct" decisions which are evidence-based, and the product of thorough assessments based on clear reasoning and well-understood criteria. There is also a desire to ensure that they are made in a timely manner. In striking the balance, however, RTIO has a strong view that priority should be accorded to ensuring a process that is most likely to achieve a correct declaration decision, rather than a process which has as its principal objective speed in decision making. Substance should prevail over form.

78. This is particularly so given that the access regime contained within Part IIIA applies to services provided by infrastructure of national significance, usually involving very high cost assets whose operating efficiency will almost certainly have a material effect on the Australian economy. Imposing access regulation on such infrastructure unnecessarily may well give rise to substantial losses to the Australian economy for no discernible benefit, particularly in the context of infrastructure involved in key export industries. Further, making a hasty decision, that is not subject to a substantive merits review, on matters such as the true cost of access (for both the interested parties and the wider Australian community) is fraught with danger and, given the significance of the facilities involved, could cost Australia dearly.

79. As his Honour Justice Finkelstein observed in his written submission to the Senate Standing Committee on Economics, 'decisions made under Part IIIA have far-reaching consequences. The consequences of an erroneous decision have the potential to cause significant loss to both individuals and the community as a whole.'[33] His Honour also noted when he appeared before the Committee that 'To be declared, a facility has to be of national significance. The stakes for the parties and the stakes for the nation are high. It goes without saying that it is imperative that at each level the correct decision is made insofar as that is humanly possible.'[34]

80. This was vividly illustrated in the Pilbara railways matters. RTIO asserted that significant costs were likely to result from declaration of its railways, but the NCC and Minister were unable to adequately test the likely extent of such costs. The Tribunal however undertook a thorough, expert review of the evidence and conducted its own investigations. This rigorous merits review enabled the Tribunal to conclude that costs in the region of billions of dollars were likely to result from declaration of the RTIO railway lines, which in all

---

[32] Issues Paper, 23.

[33] The Hon. Ray Finkelstein, 'Submission to the Senate Standing Committee on Economics on the Trade Practices Amendment (Infrastructure Access) Bill 2009' (18 December 2009), 6.

[34] Transcript of Proceedings, *Inquiry into Trade Practices Amendment (Infrastructure Access) Bill 2009*, Senate Economics Committee, 5 February 2010, E30.

'probability' would have 'dwarfed' the benefits of access being granted.[35] This risk of unnecessarily incurring significant losses would not be borne by RTIO alone, as the flow-on effects to Australia in terms of lost exports, royalties and income taxes would be enormous.

81. In any event, amendments made to the declaration regime in 2010 (which did not apply in relation to the Pilbara railways matters) address any ongoing concerns regarding the length of time the declaration process takes.

82. As the Productivity Commission knows, the 2010 amendments relevantly:

- Impose more certain 'expected periods' within which the NCC, designated Minister, and Tribunal are required to reach decisions, which can be extended in the case of the NCC and the Tribunal;[36]
- Restrict the Tribunal in its decision-making to information taken into account by the original decision maker, subject to the ability to request additional information the Tribunal considers reasonable and appropriate;[37]
- Give the Tribunal power to award costs in review proceedings;[38] and
- Give the Tribunal a discretion as to whether to stay the Minister's declaration decision when parties seek a review of the decision.[39]

There is no reason to believe that the amendments Parliament introduced to reduce the time it takes for decisions to be made are inadequate or ineffective. Reduction of delay was the clear intention behind the amendments.

3.3 Ability to seek merits review contributes to effective decision-making.

83. In RTIO's experience, the ability to seek merits review of a declaration decision by the Tribunal ensures a more effective decision-making process than if the final decision were left solely to the designated Minister.

84. First, the Tribunal provides a necessary safeguard against the potential for capture by private interests and the politicisation of declaration decisions.

85. While the Hilmer Committee recommended declaration decisions being made by Ministerial determination rather than by an independent body, it noted the risk that 'the existence of a

---

[35] *Re Fortescue* [2010] ACompT 2, [1319].

[36] The NCC and the Tribunal must make decisions within 180 days, unless a further request for information has been made, which effectively 'stops the clock': ss 44GA, 44ZZOA. A failure by the NCC or Tribunal to make a decision within the expected period does not invalidate their decisions and they are both able to extend the period for making decisions on their own initiative. The Minister must make a decision within 60 days, or will be deemed to have decided not to declare the service: ss 44N, 44J(7), 44NB.

[37] *Competition and Consumer Act 2010* (Cth), s 44ZZOAAA.

[38] *Competition and Consumer Act 2010* (Cth), s 44KB.

[39] *Competition and Consumer Act 2010* (Cth), s 44KA.

broad discretionary regime may create pressures on the Minister to declare an essential facility to advance private interests'.[40]

86. The Hilmer Committee recommended that the Minister's power to declare be made subject to a safeguard that the Minister could only declare a service if the NCC had made a positive recommendation in favour of declaration following public inquiry.[41] This requirement was not included in the regime that the Government ultimately introduced. Instead, a safeguard was included in the form of the ability to seek a merits review by the Tribunal of Ministerial decisions.

87. RTIO believes that there would be a significant risk of declaration decisions being perceived as susceptible to capture by private interests, and as being based on political considerations rather than an evidence-based assessment of the legislative criteria, if the entitlement to seek merits review by the Tribunal was removed.

88. Secondly, merits review by the Tribunal enables evidence to be assessed and tested in a way that does not occur at the NCC or Ministerial level. The ability to have a rigorous, transparent, evidence-based assessment of the legislative criteria by an independent body leads to greater confidence in declaration decision-making. It ensures more effective decision making, whether as a consequence of a merits review having been undertaken by the Tribunal, or by reason of the discipline imposed upon the NCC and the Minister whose decision might be subject to review.

89. The effectiveness of the Tribunal's role was considered relatively recently in the context of the Senate Standing Committee on Economics – Legislation Committee review of the Government's proposed *Trade Practices Amendment (Infrastructure Access) Bill 2009*.

90. During the Senate Standing Committee on Economics' review of the proposed Bill, various submissions were made, including by RTIO, to the effect that the ability to have an expert body testing material is crucial to having a declaration regime that fosters sound decision-making. The point was well illustrated by the President of the Tribunal, the Hon. Justice Ray Finkelstein, who appeared before the Senate Standing Committee on Economics in his personal capacity. His Honour explained that declaration applications, by their very nature, raise 'exceedingly complex' issues of fact and law.[42] He gave an example from the Pilbara railways matters of the type of complex issues that arise, and the choices the decision-maker is required to make between competing views. His Honour explained that in the Pilbara railways matters, the issue of capacity was central to the question of whether the railways should be declared. He noted there were various theories about how to determine capacity on a railway, different ways to model capacity, and factual considerations to be taken into account for the different models. His Honour believed that '[r]esolving that on the papers is simply not possible, and that is a key question in a case'.[43]

---

[40] 'National Competition Policy Review' (August 1993), 250 (***Hilmer Report***), quoting a New Zealand Ministry of Commerce report of similar effect: NZ Ministry of Commerce, 'Review of the Commerce Act 1986' (1989) *Reports & Decisions*, 8.

[41] Hilmer Report, 266.

[42] Transcript of Proceedings, *Inquiry into Trade Practices Amendment (Infrastructure Access) Bill 2009*, Senate Economics Committee, 5 February 2010, E30.

[43] Ibid E31.

91. RTIO agrees with the view that the resolution of competing complex theories and factual assertions on the papers, without the rigour of cross-examination and the application of specialist expertise, is wholly inappropriate. Yet this is the situation that occurs at the level of decision-making by a designated Minister.

92. RTIO considers that the Tribunal's role in the process increases transparency in decision-making, increases accountability at each tier in the process, and ensures a thorough and rigorous evidence-based assessment of the legislative criteria. This promotes investor confidence in and certainty of the regulatory environment, which minimises the disincentive to infrastructure investment.

93. RTIO believes that ensuring an environment which encourages rather than dampens infrastructure investment is a key focus of the declaration regime, given that an express objective of Part IIIA, as set out in section 44AA of the CCA, is to promote the economically efficient operation of, use of and investment in the infrastructure through which services are provided, which in turn will promote effective competition in related markets.

3.4 Given the high costs of inappropriate regulatory intervention, the incursion of some costs in ensuring correct decisions is reasonable

94. The Productivity Commission has also asked '*How well do the Part IIIA institutional arrangements balance the need for sound, transparent and accountable decision-making against the cost of seeking (or denying) third party access?*'[44]

95. RTIO's experience of the declaration regime demonstrates that getting the decision right is to be accorded significant weight, given the extensive costs to parties and to Australia of imposing regulation unnecessarily or inappropriately. For the reasons outlined above, RTIO believes that retaining the role of the Tribunal is vital to ensuring rigorous, transparent and accountable decision-making which is most conducive to ensuring correct outcomes.

96. RTIO is not aware of any evidence which suggests that the possibility of review being sought in the Tribunal has operated to dissuade potential access seekers from applying for declarations or continuing to pursue applications, or has dissuaded infrastructure owners from seeking review of decisions to declare services.

97. Further, there is a safeguard against the strategic use of review applications in Part IIIA to delay or frustrate proceedings, which was introduced by the amendments made in 2010. The Tribunal now has the ability to award costs in review proceedings.[45]

The costs found to be likely if access had been imposed on Hamersley

98. By way of example, the Tribunal and the Full Federal Court ultimately found that regulatory intervention into RTIO's Hamersley railway was inappropriate. The magnitude of the costs of access imposed as a result of such intervention was assessed by the Tribunal as enormous, with billions of dollars of export revenues likely to be lost.

---

[44] Issues Paper, 23.

[45] *Competition and Consumer Act 2010* (Cth), s 44KB.

99. The Tribunal found that for the Hamersley railway, where there was high demand, regulated access would result in two broad categories of cost. First, regulated access was likely to lead to delays in RTIO making changes on its lines, whether by way of expansions, adopting new operating practices or introducing new technology, which would result in significant costs.

- Inefficiencies would arise from delayed or sub-optimal new operating practices and technology. Any changes which required the participation of a third party or otherwise impacted the third party's use of the line were likely to require, as a practical matter, consultation or even approval of the third party. This would inevitably involve delays and might even dissuade the railway owner from introducing changes, particularly where compensation may be payable to a third party user.[46] The Tribunal concluded that:

  > any delayed or sub-optimal changes to technology or operating practices may cause significant harm to the incumbents and to the public interest generally. The evidence shows that keeping at the forefront of technological developments is an important part of RTIO's and BHPB's strategy in the highly competitive global iron ore market. The loss of any advantage may have serious long-term consequences.'[47]

- Costs would arise from delays to expansion, or sub-optimal investment. A rational incumbent was likely to negotiate with a third party user to try and reach agreement on the extent and cost of expansions and the allocation of additional capacity, and such negotiations would lead to delays.[48] As discussed at [69] above, in relation to the RTIO rail network, these costs would be in the order of $10 billion dollars of lost export revenues to Australia on what the Tribunal acknowledged was a 'conservative' estimate of a 3 month average delay.[49]

100. Secondly, regulated access was likely to discourage the development of alternative infrastructure, leading to loss of dynamic efficiency that would flow to the community from infrastructure competition and the inevitable efficiency improvement that would follow. A new line – the development of which would be discouraged by regulated access – would potentially:

---

[46] The Tribunal gave the example of a railway owner considering implementing automatic train operations, which requires technology involving the remote control of trains from a central location. It observed that such an advance may be impossible if a third party train continues to operate in the traditional manner. It also noted that railway owners in the industry regularly experimented with new practices and technology including changes to train configurations, mine hub strategies, blending practices, port strategies and use of "sprinting" and new technologies: *Re Fortescue* [2010] ACompT 2, [1238] – [1239].

[47] *Re Fortescue* [2010] ACompT 2, [1243].

[48] *Re Fortescue* [2010] ACompT 2, [1247], [1264]-[1269].

[49] See *Re Fortescue* [2010] ACompT 2, [1296] – [1298], [1328]. An expert appearing for RTIO estimated that an 18 month average delay would result in a $40 billion dollar loss of export revenues to Australia, see *Re Fortescue* [2010] ACompT 2, [1296].

- provide less constrained access than would be available through access to the incumbents' line.[50]
- use more efficient technology which may lead to opex savings compared with use of an older line and older operating technologies;
- lead to greater external benefits (in the short run and the long run through the multiplier effect) such as economic growth and employment in the immediate region as well as regions where equipment and raw material would be sourced from;
- create greater capacity compared to an expansion. The Tribunal considered that if more capacity was created than was immediately needed to cater for third party demand, this could be inefficient in one sense, but in another sense, this could promote dynamic efficiency in the long run. Having spare capacity on an alternative line would give greater future flexibility for unanticipated growth in the demand for above or below rail services. A relatively large upfront increment in line capacity could be more socially efficient in the long run than a series of short-term increments in capacity by the incumbent, and could lead to greater certainty for future planning purposes.[51]

101. As a result, the Tribunal ultimately found that it was probable that the costs of access to the Hamersley service would 'dwarf' the benefits.[52]

102. Further examples of the costs of access are provided at [69] above.

The contrast between the performance of the Pilbara and the east coast

103. Another illustration of the potentially high costs of declaring infrastructure unnecessarily (by virtue of the fact that declaration can transform a single user facility into a multi-user facility) is the output response from Australian coal producers to increasing global demand for coal compared to the output response from Australian iron ore producers to increases in iron ore demand over a similar period of time.

104. During a period of increased global demand for commodities, the single user system utilised in Australia's iron ore industry demonstrated a much greater capacity to respond in a timely and efficient manner than Australia's multi-user, regulated coal infrastructure system.

105. Between 1999 and 2011, world-wide demand for coal and iron ore increased significantly.[53] The shift in demand led to increases in the export values of both coal and iron ore from

---

[50] The Tribunal considered that severe logistical and commercial constraints would be imposed on third parties in the case of the RTIO railways to ensure there was no interference with the RTIO's flexible business model. The Tribunal gave the examples of third parties being required to run their trains with minimal notice in less than ideal conditions, and likely being required to operate trains which are compatible with the incumbent's trains, potentially restricting or precluding their use on lines owned by the third party, *Re Fortescue* [2010] ACompT 2, [1230].

[51] *Re Fortescue* [2010] ACompT 2, [1235]-[1237].

[52] *Re Fortescue* [2010] ACompT 2, [1319].

[53] Between 1999 and 2011, total worldwide trade in black coal grew by 104.6% and total worldwide trade in iron ore grew by 140.6%.

2003 onwards, providing opportunities for producers in both industries to increase the rate of growth of their exports. However, only iron ore producers in aggregate were able to respond to the positive price signal by significantly expanding production capacity and exports.

106. Australia's iron ore exports increased at a much greater rate than that of coal and while Australia's market share of seaborne trade declined in coal it increased significantly in iron ore.

Figure 1 Australian exports of iron ore and coal: 1999-2011

Share (%)	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Australian market share – seaborne coal	**34.8**	**34.5**	**34.0**	**35.2**	**33.2**	**32.1**	**31.9**	**29.9**	**29.3**	**31.2**	**31.8**	**31.3**	**27.2**
Australian market share – seaborne iron ore (a)	**39.9**	**40.4**	**40.2**	**39.1**	**39.9**	**40.5**	**40.7**	**39.5**	**39.1**	**41.8**	**45.1**	**45.9**	**49.3**

Source: Australian Commodity Statistics (various issues), Resources and Energy Statistics Annual 2012 and Roger Rose, Chief Research Economist, BREE (pers. com. 31 January 2011)

(a) Where world seaborne iron ore trade is defined as exports from Australia, Brazil, India, South Africa, Mauritania and Venezuela.

107. Australia's exports of black coal (both thermal and metallurgical) grew by 58.9% during the period, whereas Australia's exports of iron ore grew by 186.1%. Australia's coal export growth was less than the growth in worldwide seaborne coal trade and accordingly Australia lost market share in world seaborne coal trade. Conversely, Australia's iron ore growth was greater than the growth in total iron ore trade and accordingly Australia's market share increased during this period (Figure 1).

108. RTIO believes that a key reason why Australian iron ore producers were able to increase production and take advantage of the increase in demand more rapidly than coal producers lies in the difference between the way transport infrastructure used in the two industries is managed and controlled.

109. The single-user, owner-operated infrastructure that Australian iron ore producers typically use enabled a quick response to market developments and rapid expansion of operations. By contrast, Australia's coal supply chains are generally comprised of multi-user infrastructure, with each different component of the chain owned by a different service provider. During the period of increased demand and export value, Australian coal producers accordingly faced a number of barriers to investment, as coordination difficulties across stakeholders with varied interests impacts upon investment and multi-party use creates little incentive for producers to invest directly in infrastructure where others benefit or are able to crowd the investor out. As a result, they were not able to change operations and expand as quickly to the changed market conditions and so were not able to take full advantage of the export growth opportunities that arose.

110. Sam Walsh, now Chief Executive of Rio Tinto, was the Chief Executive Officer of RTIO during this period of increased commodities demand. In 2009 he observed how RTIO had capitalised on the opportunities presented by the surge in demand by undertaking several expansion projects at a total cost of over US$8 billion (at that time), and how the company was able to increase its sales almost threefold since 2000. Mr Walsh attributed RTIO's ability to respond rapidly to the increase in demand as key to this success, and considered that involving third parties in RTIO's rail system would mean it would crucially take longer to achieve expansions or changes in the mode of operation. He based his assessment of the negative impact of third party use in part on 'Rio Tinto management's frustrations in achieving timely system expansions of Rio Tinto's coal operations on the east coast of Australia, which had meant the company lost market share to foreign competitors'.[54]

111. Accordingly, the consequences of regulatory intervention under Part IIIA – potentially transforming single user owner-operated infrastructure into multi-user regulated facilities – could be extremely damaging to the ability of Australian industries to respond to changing market conditions and could cost the nation dearly. Such regulation should not be imposed if there is no demonstrable market failure that justifies such a substantial intervention.

3.5 Merits review generates superior outcomes to judicial review

112. Finally, RTIO wishes to address the Productivity Commission's question of '*What is the rationale for merits reviews under Part IIIA? Could judicial review suffice?*'[55]

113. RTIO assumes that the basis of calls for the removal of merits review in place of judicial review is a perception that each of the Minister and the Tribunal undertakes the same task in performing a merits assessment, and accordingly the time taken for final declaration decisions to be reached could be reduced by removing a perceived unnecessary overlap.

114. As regards delay, RTIO notes that, as discussed in [82] above, amendments have recently been made to the declaration regime to reduce the time in which declaration decisions are made and there is nothing to suggest these amendments will be ineffective. Accordingly, there is no factual basis for any current concerns that the ability to seek merits review leads to any unacceptably delay in the finalisation of a declaration decision.

115. Moreover, the decision-making process of a Minister and the Tribunal are not the same. As explained above, a more extensive and rigorous assessment of evidence involving specialist expertise and testing of assertions by interested parties is or should be undertaken by the Tribunal as part of a merits review. This does not occur in the decision-making process being undertaken by a designated Minister. Accordingly, there is no unnecessary 'overlap' built into the process. Rather, RTIO believes that the ability to seek merits review from the Tribunal is deliberately designed to promote sound decision-making and thereby foster confidence in the process. This of course engenders confidence in investment in vital infrastructure in Australia, in contrast to the situation that would prevail if there were no such independent review process.

---

[54] Affidavit of Samuel Walsh sworn 30 March 2009, sections 2 and 4.1, filed in the Pilbara railways proceedings before the Tribunal.

[55] Issues Paper, 26.

116. As discussed in section [3.375] above, RTIO considers the rationale for including an ability to seek merits review by the Tribunal in the declaration process is to: (1) provide a safeguard against the actual or perceived potential for politicisation of the process and capture by private interests, which would undermine confidence in the declaration regime; and (2) ensure a rigorous, transparent, evidence-based assessment of the legislative criteria is able to be carried out by an independent specialist body in appropriate circumstances, which imposes a discipline on decision-making at all levels, contributing to the generation of transparent, fair, reasonably certain, and sound decisions.

117. RTIO agrees with the general principles enunciated by the Exports and Infrastructure Taskforce in 2005 regarding merits review in the context of regulated access to export infrastructure:

> There are many virtues to full merits review. To begin with, it imposes greater accountability on regulators, correcting decisions that are not capable of rigorous justification. Additionally, by articulating the underlying principles that guide the relevant decision, the review process can provide guidance for future regulatory decision making and enhance the predictability of, and confidence in, the regulatory process. Last, it can help ensure the political independence of the regulatory process.
>
> As a general matter, where regulators rely on coercive powers to override property rights, there is a compelling case for providing effective and extensive rights of appeal. As a result, it is essential that the scope for merits review remain available where it is now provided for, and be made available in those state and territory regimes where it currently is not.[56]

118. The option of judicial review by courts would be wholly inadequate to meet these objectives.

119. Judicial review may be available under the *Administrative Decisions (Judicial Review) Act 1977* (Cth) and at common law in the original jurisdiction of the Federal Court under section 39B of the *Judiciary Act 1903* (Cth) or the High Court under section 75(v). Grounds for judicial review include where the decision maker:

- displayed a lack of good faith in the exercise of the power;
- failed to adhere to the legal requirements of the power;
- exercised his or her power without the establishment of a jurisdictional fact;
- failed to consider matters that they were required to consider;
- took an irrelevant consideration into account;
- made a decision which was so unreasonable that no reasonable authority could properly have arrived at it;
- denied procedural fairness to a person affected in making his or her decision.

120. These grounds are primarily concerned with the process of consideration; they leave a very narrow window of opportunity for challenging the *substance* of a Minister's decision.

---

[56] Exports and Infrastructure Taskforce, 'Australia's Export Infrastructure: Report to the Prime Minister' (May 2005), 44–45. It is noted that the preferred approach of the Exports Infrastructure Taskforce for access regulation was not the current review system under Part IIIA.

121. In any event, these grounds may be very difficult to prove given the typically brief nature of Ministers' reasons for decision in this area. As noted at [73] above, Ministers generally issue very short reasons for declaration decisions which provide very limited insight into the reasoning process adopted by the Minister. Typically, reasons for decision range from 2 to 5 pages long, with the reasons in the Pilbara railways matters extending to 10 pages which is still notably brief given the Tribunal's 483 pages of detailed reasons. Ministers generally re-state the main conclusions of the NCC in their reasons, without any detailed overview of the matters that informed these conclusions. Accordingly, there is little scope for parties to identify judicially reviewable errors in a Minister's reasoning.

122. The inadequacies of a limited judicial review of the decision making process can be illustrated in the context of 'deemed' decisions by designated Ministers pursuant to section 44H(9) of the CCA. In that circumstance, there is no record of any decision at all. No reasons for decision are advanced. This is not a de minimis risk, as to date there have been a number of instances where a designated Minister has failed to make a decision within the required timeframe, resulting in a deemed decision to not declare the relevant service.[57]

123. Furthermore, courts are traditionally reluctant to interfere where a discretion has been vested in a Minister by the Parliament regarding what constitutes the national interest — a concept that is similar to 'public interest' in criterion (f). For example, in the case of *Wight v Pearce* (2007) the Federal Court was performing judicial review of a Ministerial decision under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) which calls for the Treasurer to make an assessment of the national interest. The Court was unwilling to infer that the Treasurer was not satisfied that the acquisition was contrary to the national interest, even though the Treasurer's reasons:

- merely stated that the Treasurer was satisfied that the acquisition 'is contrary to the national interest';
- did not provide any reasons for the decision made; and
- did not clearly identify any matters conceivably relevant to the national interest on the facts.[58]

124. This is likely to reduce the viability of judicial review to address substantive errors in Ministerial decision making even further.

---

[57] See:

- Specialized Container Transport's application to declare New South Wales rail track services (from Sydney to Broken Hill) which was lodged in February 1997.

- New South Wales Minerals Council's application to declare New South Wales rail track services in the Hunter Valley which was lodged on 2 April 1997.

- Six related Sydney Services Pty Ltd applications to declare sewage services which were lodged on 3 March 2004.

- Fortescue Metals Group Ltd's application to declare part of the Mt Newman Railway which was lodged on 15 June 2004.

- North Queensland Bio-Energy Corporation Ltd's application to declare services provided by the Herbert River tramway network which was lodged on 22 March 2010.

[58] *Wight v Pearce* (2007) 157 FCR 485, [119]–[122].

125. For these reasons, RTIO believes that judicial review neither serves as an adequate safeguard against political excess nor fosters effective decision making in any substantive sense.

4. Conclusion

126. RTIO's experience of the declaration regime over the last decade makes it well placed to offer insights into how the declaration criteria and processes impact upon owners of nationally significant infrastructure in practice, particularly infrastructure used for export.

127. That experience has shown that the Private Profitability Test best identifies when regulatory intervention into private property rights *may* be able to be justified. It is the appropriate "gateway" criterion and if it is not satisfied then the process of considering declaration/mandated access should cease.

128. The High Court and the Full Federal Court fully considered the statutory language, extrinsic materials, and economic theories supporting various interpretations of criterion (b) and concluded that the Private Profitability Test was the most appropriate in all the circumstances.

129. For the reasons explained above, the Private Profitability Test is the approach to criterion (b) which is most consistent with the language and objectives of the legislation, best identifies market failure requiring regulatory intervention, and most effectively enables a social cost-benefit analysis of the desirability of alternative facilities to be undertaken.

130. There has not been any opportunity to test the effectiveness of the Private Profitability Test yet, as no applications have been fully assessed since the High Court's decision last year. The utility of the test should be properly considered through practical application before any substantive changes are made. Practical application will demonstrate that the Private Profitability Test is the approach best placed to perform the social cost-benefit analysis which the Social Benefit Test seeks to approximate.

131. RTIO's experience also demonstrates that the ability to seek merits review of a designated Minister's declaration decision by the Tribunal is crucial to ensuring that parties have confidence in the declaration regime and that the regime promotes rigorous, transparent, fair and reasonably certain decision making, leading to sound outcomes. Without the safeguard and discipline of merits review by the Tribunal, sovereign risk would increase and infrastructure investment in Australia would be harmed.

132. Furthermore, the costs of getting declaration decisions wrong are high. Australia's productivity will be significantly harmed when access regulation is imposed unnecessarily or inappropriately. Merits review by the independent, expert Tribunal helps foster better decision making – a regime which incorporates such review is more likely to lead to correct outcomes than a regime which leaves declaration decisions solely in the hands of politicians.

133. Given the amendments made in 2010 to reduce delays in the declaration regime, it would be premature now – when no reviews have gone before the Tribunal under the amended regime – to call for change to the Tribunal's role based on delays. There is no evidence to show changes are necessary post the amendments.

134. RTIO believes that substantive incursions on the role of the Tribunal would damage the credibility of the regime and undermine investor confidence in Australia's regulatory environment for infrastructure.

Attachment 1 – Professor Willig's Statements

Attachment 2 –Professor Kalt's Statement