BHP Billiton
Submission to the Productivity Commission's Inquiry into the National Access Regime
15 February 2013

Contents

A. EXECUTIVE SUMMARY

This submission responds to the Productivity Commission's Issues Paper, dated November 2012, concerning the Commission's inquiry into the National Access Regime.

BHP Billiton makes this submission on the basis of its experience as an owner and user of supply chain infrastructure, as well as its experience as a party to proceedings under Part IIIA of the *Competition and Consumer Act 2010* (**"CCA"**).[1]

1. THE OVERRIDING OBJECTIVE: CORRECT DECISIONS

Part IIIA applications necessarily raise issues of national significance. The cost of dealing with an application can be extremely high. The cost of a wrong decision can be even higher.

There will be cases where the cost of access is not high, and may deliver net benefits. For example, BHP Billiton shares facilities such as airports and accommodation in its iron ore business (see Annexure A). In other cases, however, the costs of access can be excessive and regulated terms will not prevent or address those costs. The defining example of the latter case is Fortescue Metals Group Limited's (**"FMG's"**) applications for Part IIIA declaration of four of the five dedicated iron ore railways in the Pilbara.[2] The Australian Competition Tribunal (**"Tribunal"**) found that Part IIIA access would seriously delay investment and expansion in the relevant iron ore businesses, resulting in decreased iron ore exports; in the case of both the Newman and Hamersley railways, it estimated that billions of dollars of GDP would be lost if access were granted (see part 3.1 of Annexure B). Notwithstanding that conclusion, and BHP Billiton's many submissions to that effect, the National Competition Council (**"NCC"**) had recommended declaration of both railways. This case illustrates that avoiding a wrong decision under Part IIIA is critical for the national interest.

Accordingly, the overriding objective of the Part IIIA declaration framework should be to achieve the correct decision in each case – that is, to achieve a decision in each case that promotes the economic objects of Part IIIA, and of the CCA.[3] BHP Billiton submits that changes to the Part IIIA declaration process should only be considered if they will promote this overriding objective, and should be rejected if they involve any compromise on the quality of decisions produced.

This submission will focus on two critical questions:

- What substantive provisions and procedural elements are required to promote the overriding objective – ie, to ensure that the Part IIIA declaration process produces correct decisions?
- Could the Part IIIA declaration process be streamlined in a way that decreases the time and cost involved?

This submission also makes some observations on "Stage 2" of the declaration process, which governs the negotiation and arbitration of access terms.

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[1] All references to provisions of legislation in this submission are references to the CCA unless otherwise stated.

[2] In FY2011/12, Australian iron ore exports were valued at approximately A$62.7 billion, and comprised 19.8% of all Australian exports. Source: Australian Government Department of Foreign Affairs and Trade, *Composition of Trade 2011-12*, pages 3 and 37.

[3] The economic object of Part IIIA is to promote "the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets" (s 44AA(a)); the object of the CCA is to "enhance the welfare of Australians through the promotion of competition and fair trading" (s 2).

Box 1 – Principal recommendations and observations

Recommendations which promote the overriding objective of correct decisions

1. Declaration criterion (a) requires the decision-maker to be satisfied that access (or increased access) would promote a "material" increase in competition in a market other than the market for the service. This criterion should be amended to require the decision-maker to be satisfied that access would be likely to result in a competition benefit which is substantial – ie, which is meaningful having regard to the national significance of the relevant infrastructure.
2. Declaration criterion (b) requires the decision-maker to be satisfied that it would be uneconomic for anyone to develop another facility to provide the service. The "private profitability" interpretation adopted by the High Court should be retained. This interpretation promotes the objects of Part IIIA, and is superior to the natural monopoly test and the net social benefit test.
3. Declaration criterion (f) requires the decision-maker to be satisfied that access (or increased access) would not be contrary to the public interest.
   (a) Criterion (f) should be retained in its current form (**"public interest criterion"**) and should require the Minister to consider the public interest in the manner identified by the High Court.[4]
   (b) A new declaration criterion (**"proposed economic cost/benefit criterion"**) should be introduced, to require the decision-maker to be satisfied that the likely economic costs of access would not outweigh the likely economic benefits of access.
4. The continued involvement of the Tribunal, with its judicial members, is essential and must be retained.

Recommendations for reducing the cost and time involved in the Part IIIA declaration process

5. Applications for Part IIIA declaration should be made directly to the Tribunal.
   (a) If the Tribunal is not satisfied of one or more of the declaration criteria other than the public interest criterion, the Tribunal should determine that the service not be declared.
   (b) If the application of the public interest criterion will determine the outcome of the declaration application:
      (i) the Tribunal should determine whether it considers that the public interest criterion has been satisfied; and
      (ii) the designated Minister should then have a 60 day period in which to decide whether the public interest criterion is satisfied.
6. A new declaration criterion (**"proposed capacity criterion"**) should be introduced, to require the decision-maker to be satisfied that the facility would have or be likely to have capacity to provide the service.
7. The "production process" exception to the definition of "service" in s 44B should be amended, so that a service involving the use of a material part of a production process is excluded from the definition of "service".

Observations concerning stage two of Part IIIA

8. There are serious concerns with the "reasonably anticipated requirements" provision in s 44W, the ACCC's power to order an infrastructure owner to expand its facility under s 44V, and the fact that Part IIIA does not require that access terms protect an infrastructure provider's legitimate business interests.

[4] *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (14 September 2012). at [42].

B. BHP BILLITON'S EXPERIENCE

Infrastructure is critical to BHP Billiton's business. BHP Billiton uses a vertically integrated, single user, mine, rail and port system to export iron ore in Western Australia. It uses multi-user rail and port infrastructure to export energy coal in New South Wales, and uses both single user and multi-user infrastructure to export metallurgical coal in Queensland and New South Wales (see Annexure A).

2. BHP BILLITON'S EXPERIENCE OF THE PART IIIA DECLARATION PROCESS

2.1 FMG's applications for declaration of BHP Billiton's Pilbara iron ore railways

FMG's first application for declaration of BHP Billiton's Pilbara iron ore railways was made in June 2004. Further applications for declarations of BHP Billiton's Goldsworthy railway and Rio Tinto's Pilbara iron ore railways were made in late 2007 and early 2008. Only the Goldsworthy line has ultimately been declared. The overall costs of all applications, together with the costs of the various court proceedings, is in the order of hundreds of millions of dollars. The proceedings concerning these applications are described in part 1 of Annexure B.

The Goldsworthy declaration was based on a finding that access would promote competition in a rail haulage market within "a corridor around" the Goldsworthy line. BHP Billiton is not aware of anything to suggest that declaration of the Goldsworthy service has in fact promoted competition in any market, or resulted in any form of public benefit.

2.2 Key features of Part IIIA declaration decisions

Declaration applications necessarily give rise to complex technical, commercial and legal issues. Decision-makers applying the declaration criteria to a specific service and facility will often be faced with complex, industry-specific evidence, key elements of which will likely be in dispute (see part 2 of Annexure B).

The costs of access, if declarations had been granted over the other Pilbara railways, would be extremely high. They include the value of exports foregone as a result of delays to investment in infrastructure improvements and expansions. They also include the cost of lost capacity and lost flexibility when single user infrastructure is used to provide third party access. A specific example of where this occurs is the Dalrymple Bay Coal Chain, where the infrastructure elements of the coal chain have been individually rated as capable of delivering 85 mtpa, but when operated in unison, the coal chain has not, to date, delivered an annual tonnage outcome above 64 mtpa. In addition, the Tribunal observed that Part IIIA does not provide the infrastructure owner with certainty that its legitimate business interests will be protected. Specifically, there is no requirement that access terms determined by negotiation or arbitration under Stage 2 must protect the provider in this respect.[5] Even the prospect of Part IIIA declaration is a disincentive to investment in infrastructure (see part 3 of Annexure B).

In other cases, the costs of access may not be prohibitive. There will, for example, be cases where the cost of access or other shared infrastructure use may not give rise to substantial costs. Parties may reach a commercial arrangement to use a facility jointly (Box 9 addresses examples of where this occurs in BHP Billiton's iron ore business). Where infrastructure has always been operated on a multi-user basis, access costs may simply be tolerated (Boxes 10 and 11 provide examples of where this occurs in BHP Billiton's energy coal and metallurgical coal businesses).

The task of Part IIIA decision-makers is to distinguish between those cases where access would, and those cases where it would not, promote the overall economic objects of Part IIIA, by having regard to the likely costs and benefits of access. This is a difficult task, compressed within statutorily imposed time pressures, which can seriously jeopardise the quality of analysis and decisions on the complex and difficult issues declaration applications raise (see part 2.3 below, and the case study in part 2.3 of Annexure B). The task is made

[5] [2010] ACompT 2 (30 June 2010) at [592-606] and [1173].

even more difficult by the fact that there is often no domestic or international "precedent" on which to base a Part IIIA decision.[6] One reason is that Part IIIA is a “catch all” avenue for third party access to infrastructure which is not already the subject of an industry-specific regime.

What Part IIIA must provide is a procedural and legal framework which ensures that declaration is only available in circumstances where the benefits of access to nationally significant infrastructure are greater than the identified costs of access, and is capable of accurately assessing whether those benefits are greater than the identified costs in a particular case.

2.3 The Part IIIA declaration process

To achieve this overriding objective, Part IIIA decision-makers must have the time, resources and skills to conduct a rigorous analysis of the technical, commercial, economic and legal issues raised by Part IIIA declaration applications.

The National Competition Council

The National Competition Council (**"NCC"**) faces significant time pressures under the current regime, which potentially jeopardise the quality of its decision-making. The NCC must collect and analyse a great deal of information from interested parties and carefully review submissions on critical matters. By way of example, these pressures on the NCC were apparent in its approach to the critical task of assessing the capacity of the Newman line. In particular, they were reflected in:

- the limited nature of the data and information available to the consultants the NCC engaged to conduct the capacity modelling;
- the modelling methodology the consultants adopted; and
- the fact that the NCC specified that interested parties should make submissions responding to this modelling – one of the most difficult and critical issues raised by the application – within a period of less than two weeks.

This matter is addressed in greater detail in part 2.3 of Annexure B.[7] These pressures were similarly evident in the NCC's approach to seeking submissions on the application of the "production process" question to FMG's first application.[8]

The NCC's decision-making process is not assisted when, as is often the case, infrastructure providers are not given prior notice of a declaration application. In that case, the provider must provide extensive information about its facility, operations, business and industry in a short period. This is a key difference between the Part IIIA declaration process and other analogous regimes.[9] The NCC's task is complicated because much of the information it requires is commercially sensitive and subject to confidentiality claims which prevent the infrastructure provider and the applicant from fully and directly engaging with each other's submissions. The NCC's task will be even more difficult following the 2010 amendments to Part IIIA, which require the original record which was before the Minister to form the basis of the Tribunal's review (see Box 12). Now parties will provide considerably more information to the NCC than in the past. In this context, concerns about the time, skills and resources

[6] Particularly, in the US, the "essential facilities" doctrine on which Part IIIA has been based, at least to some extent, has largely been abandoned by the US Courts – see *Law Offices of Curtis V. Trinko v. Verizon*, 540 U.S. 398 (2004).

[7] The capacity modelling report was dated 26 February 2006. Responses to the report were due on 10 March 2006.

[8] The NCC allowed approximately three weeks for interested parties to prepare submissions on a point which was "an undoubtedly important question of statutory interpretation", as reflected by the fact that the High Court granted special leave to appeal on this issue (transcript of proceedings, *BHP Billiton Iron Ore Pty Ltd and NCC (Application for special leave)* [2008] HCATrans 119 (High Court of Australia, Kirby J, 7 March 2008). The preliminary issues paper, dated September 2004, was published through the "Capital Monitor" service on 13 September 2004, and submissions where due on 4 October 2004. One submission was received after the due date, on 5 October 2004.

[9] Such as the processes of certification or providing undertakings under Part IIIA, or obtaining informal merger clearance from the ACCC.

available to the NCC cannot be dismissed on the basis that in a number of recent cases the NCC has been able to complete its process within the prescribed statutory timeframes.[10]

The reality is that the NCC is manifestly under-resourced, lacking both the finances and expertise required to fulfil its statutory task. It is not able to undertake the rigorous analysis required to reach the correct outcome (see Box 2), particularly not within prescribed statutory time limits. If the NCC retains its current function, the resources and skills to which it has access will need to be radically overhauled in order for it to be able to fulfil its function in a manner that does not jeopardise the quality of declaration outcomes.

Box 2 – The NCC's and Tribunal's conclusions on FMG's application concerning the Newman railway, which carried 99.5% of the iron ore exported from BHP Billiton's Pilbara operations in 2011-12

	NCC recommendation	Tribunal decision
Criterion (a)	Satisfied	Not satisfied
Criterion (b)	Satisfied	Not satisfied
Criterion (f)	Satisfied	Not satisfied
Outcome	DECLARE	DO NOT DECLARE

The NCC reached a different conclusion to the Tribunal on <u>all</u> of the critical declaration criteria

The Minister

The current legislation assumes the Minister plays an important role in the declaration process. However, both the statutory timeframes which apply to the Minister's decision as well as the complexity of the issues raised mean that the Minister is not able to make a substantive and independent contribution to the decision-making process. If the Minister's role is retained, it is critical that the Tribunal's merits review ("reconsideration") function is also retained, to ensure there is quality decision-making under Part IIIA. The notes in Box 6 explain the important differences between merits review (or reconsideration) and judicial review. Reforming Part IIIA so that declaration decisions are only subject to judicial review, and not to merits review, would seriously jeopardise the quality of declaration outcomes under Part IIIA. In the current framework, merits review is an essential safeguard to avoid the harm of a wrong declaration decision.

[10] NCC, Submission to Productivity Commission Inquiry into the National Access Regime, dated 1 November 2012 , 4.

The Tribunal

The Tribunal has the capacity to make the complex factual, legal and economic assessments required by Part IIIA declaration applications. The judicial members of the Tribunal bring to the process essential skills concerning the receipt of evidence and questioning of witnesses, and independent, critical evaluation of conflicting evidence and contentions. Part IIIA decision-makers are often required to resolve disputes raised by large volumes of complex information and analyse difficult technical and commercial matters. It is uncontroversial that where there are material inconsistencies a decision-maker "may well find that it cannot resolve inconsistencies between its information and written submissions from the person concerned without … a hearing".[11] The analogous experience with determination of difficult applications for merger clearance underlines this point.[12] That is, it is not possible for many complex issues to be resolved "on the papers" where there is no opportunity to question in person the individuals who provide that information. This is a key reason why judicial analytical skills are so vital to the Part IIIA declaration process. The combination of these skills, along with the appropriate commercial and economic skills of non-judicial Tribunal members,[13] means that the Tribunal is far better placed than either the NCC or the Minister to make correct decisions on most of the criteria which are relevant to Part IIIA declaration applications.

The Tribunal is also better able to identify and call for the production of additional specific information relevant to its task. For example, in the Pilbara rail access proceedings, the Tribunal requested the NCC to provide it with information about the development plans of junior iron ore miners;[14] it also ordered the conduct of a specific rail capacity modelling task at the parties' expense (see part 2.3 of Annexure B).[15]

In reality the Tribunal is the only one of the existing three "decision-makers" with the resources and skills to test most of the relevant criteria, to determine the complex issues involved in declaration proceedings fully and accurately, and to make the correct decision.

[11] *Heatley v Tasmanian Racing and Gaming Commission* (1977) 137 CLR 487 at 516 (Aickin J).

[12] *Australian Competition and Consumer Commission v Metcash Trading Limited* [2011] FCA 967. See also *Australian Gas Light Company v ACCC* (No 3) [2003] FCA 1525.

[13] CCA, s 31.

[14] [2010] ACompT 2 (30 June 2010) at [856].

[15] See [2010] ACompT 2 (30 June 2010) from [695]; see CCA, s 44K(6) (which requires the NCC to provide assistance to the Tribunal if so required by the Tribunal); see also ss 44ZZOAAA(4) and (5). While the rail capacity modelling task pre-dated the Tribunal's specific power to request information which is "reasonable and appropriate" for the purpose of its decision, it is a good example of how that power might usefully and efficiently be exercised.

C. POLICY RECOMMENDATIONS

BHP Billiton has considered the procedural and substantive amendments necessary to achieve the objectives of the Part IIIA framework – ie decisions which promote the economic objects of Part IIIA in a manner which reduces the time and costs involved in determining declaration applications. Part 3 contains suggested amendments to streamline the Part IIIA declaration process while promoting the quality of decision-making under Part IIIA. Part 4 contains suggested amendments to the substantive provisions of Part IIIA, which will both streamline and likely improve the quality of decision-making.

3. PROPOSAL TO REDUCE THE TIME TAKEN TO RESOLVE PART IIIA APPLICATIONS

3.1 Introduction

FMG's applications for declaration of the Pilbara railways have occupied the parties, the statutory decision-makers and the courts for over eight years. The total costs are significant. BHP Billiton also has first-hand experience of the public and private costs likely to arise if the Part IIIA declaration process does not produce the correct result.

Against this background, BHP Billiton submits that it would be possible to reform Part IIIA to reduce the time, cost and expense of proceedings, while at the same time promoting the quality of declaration outcomes, by implementing a number of proposals. These proposals are additional to, and not a substitute for, the substantive proposals outlined in part 4 below.

3.2 Summary of recommendations

As set out in Box 1, BHP Billiton makes the following principal recommendations.

(a) Applications for Part IIIA declaration should be made directly to the Tribunal.

  (i) If the Tribunal is not satisfied of one or more of the declaration criteria other than the public interest criterion, the Tribunal should determine that the service not be declared.

  (ii) If the application of the public interest criterion will determine the outcome of the declaration application:

    (A) the Tribunal should determine whether it considers that the public interest criterion has been satisfied; and

    (B) the designated Minister should then have a 60 day period in which to decide whether the public interest criterion is satisfied.

(b) The continued involvement of the Tribunal, with its judicial members, is essential, and must be retained.

Box 3 – Benefits from the proposal to reform the Part IIIA decision-making process

Proposed element	Benefits
Tribunal to determine declaration applications	Reflects the fact that currently only the Tribunal has the required resources and skills to determine most issues in Part IIIA declaration applications. Would achieve significant time and cost savings by removing the current NCC process (see Box 4).
Statutory right for NCC or other appropriate regulatory body to be made a party to the Tribunal proceedings	Preserves a role analogous to the NCC's role in assisting the Tribunal, without imposing an unrealistic task on a significantly under-resourced body.
If the public interest criterion is not determinative of the declaration outcome: Tribunal to determine that the service is not declared	Saves the time and expense involved in requiring the Minister to consider the public interest in cases where the public interest does not determine the declaration outcome.
If the public interest criterion is determinative of the declaration outcome: Minister to make a decision on the public interest criterion which may override the Tribunal's view	Retains the Minister's role in considering the public interest, without requiring the Minister to address the other criteria in an unrealistic timeframe. Enables the Minister to make a fully informed decision on the public interest criterion, with the benefit of the Tribunal's factual findings and legal analysis.
Judicial review of Tribunal's and Minister's decisions	Reflects the importance of judicial review in supervising the legality of administrative decisions, and developing the relevant law.

Box 4 – Time savings from removing the NCC from the Part IIIA declaration process (cases since FMG's first declaration application)

Declaration application	Date of application[16]	Final recommendation	Time saved by removing NCC process*
Fortescue Metals Group Ltd – Mt Newman rail track access	11/06/04[17]	23/03/06	650 days
Lakes R Us Pty Ltd – water storage and transport	29/09/04	10/11/05	407 days
Tasmanian Department of Infrastructure, Energy and Resources - Rail Unit – Tasmania rail track services	01/05/07	14/08/07	105 days
The Pilbara Infrastructure Pty Ltd – Goldsworthy rail track access	16/11/07	29/08/08	287 days
The Pilbara Infrastructure Pty Ltd – Hamersley rail track access	16/11/07	29/08/08	287 days
The Pilbara Infrastructure Pty Ltd – Robe River rail track access	18/01/08	29/08/08	224 days
North Queensland Bio-Energy Corporation Ltd – Herbert River district cane tram network	13/03/10[18]	16/07/10	125 days
Board of Airline Representatives of Australia Inc – Jet fuel supply infrastructure at Sydney airport	26/09/11	13/03/12	169 days

* The total time taken for the NCC to process the application, from the date of application until the date of the NCC's final recommendation.

3.3 Proposal concerning associated procedural and administrative arrangements

In order to support the procedural reforms proposed in the principal recommendations, BHP Billiton submits that:

(a) The Tribunal and the Minister should be required to issue written reasons for all decisions, and their decisions should be subject to judicial review.

(b) The Tribunal should have relevant associated powers to facilitate its determination, including:

(i) a power to make costs orders against parties to the proceeding;[19]

(ii) a power to receive evidence on oath and question witnesses directly;[20] and

[16] The date of application is the date on the application document itself, unless otherwise stated.

[17] This application is dated 11/06/04, however in its Final Recommendation the NCC states that the application was made on 13/06/04 (NCC, *Fortescue Metals Group Ltd application for declaration of a service provided by Mt Newman railway line under section 44F(1) of the Trade Practices Act 1974: final recommendation,* 23 March 2006, 6).

[18] This application was not received by the NCC until 22 March 2010 (NCC, *Application for declaration for access to services provided by the Herbert River tramway network: final recommendation*, 16 July 2010, 7).

[19] Presently, under s 44KB(1) the Tribunal has the power to order costs against a party to proceedings for a review of a declaration decision under section 44K.

(iii) powers to require an appropriate regulatory body (for example, the NCC or ACCC) to provide it with relevant information and assistance, and to request other persons to provide it with relevant information. The current requirement that these powers may only be exercised by issue of written notice should be removed.[21]

(c) An appropriate regulatory body (for example, the NCC or the ACCC) should have a right to be made a party to the Tribunal's proceedings.

(d) The Tribunal should ensure that in each case at least one non-presidential member sitting on the Tribunal has specific experience in, or knowledge of, the industry to which the declaration application relates.

Box 5 - Benefits from associated procedural and administrative arrangements

Proposed Elements	Benefits
Power to make costs orders	Appropriate power given the scale and complexity of proceedings (reflects the current arrangements).
Power to receive and test evidence on oath	Critical in facilitating the rigorous factual analysis required by the declaration criteria (there is some uncertainty about whether the Tribunal has this power when reconsidering a declaration decision, following the High Court's 2012 decision).
Power to obtain assistance from an appropriate regulatory body, and from other persons	Reflects the current arrangements under Part IIIA, but the removal of the requirement that the Tribunal issue written notices in order to exercise information-gathering powers would enable the Tribunal to question individuals orally, without the need to comply with cumbersome and inefficient procedural requirements.
Tribunal member with relevant industry knowledge	Would assist the Tribunal in understanding the industry and issues relevant to the declaration application, with potential time and cost savings.

3.4 Alternative proposals should be approached with significant caution

Any proposal to increase the role of the NCC, or limit the potential for merits review by the Tribunal of the Minister's decision, raises the very real and unacceptable prospect of severely compromising the quality of declaration decisions. In this respect, it is critical to recognise that judicial review does not serve the same purpose or achieve the same effect as merits review. Judicial review plays a crucial role in reviewing the legality of a decision, and developing the relevant law, but not in reviewing the substantive quality of that decision (see Box 6).

Any proposal to limit or eliminate merits review from the current Part IIIA process would lead to final decisions being made by decision-makers that are manifestly under-resourced and/or inappropriately time-constrained for their task, with inadequate skills and capability to carry out the complex inquiries required to determine difficult declaration applications. Such an outcome would be unacceptable having regard to the significance, in terms of the public interest and private property rights, of declaration decisions.

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[20] Presently, under s 105(1) the Tribunal has a general power to take evidence on oath or affirmation. Under s 105(2), a member of the Tribunal may summon a person to appear before the Tribunal to give evidence and to produce such documents as are referred to in the summons. There is some uncertainty, following the High Court's 2012 decision, about whether these powers apply to the Tribunal's reconsideration of declaration decisions under s 44K.

[21] Presently, the Tribunal has the power to require the NCC to provide assistance (s 44K(6)) or to provide information by written notice (s 44K(6A)) in the course of the Tribunal's reconsideration of a declaration under s 44K. The Tribunal also has power to request such information it considers reasonable and appropriate for making its decision (s 44ZZOAAA(4)) by giving a person written notice of the type of information and timeframe in which it must be provided (s 44ZZOAAA(5)). This submission does not express an opinion on which regulatory body should appropriately have the role of providing information and assistance to the Tribunal.

Having suggested an alternative approach to rationalising the Part IIIA process, as above, BHP Billiton will not address in detail proposals to increase the role of the NCC, or limit the role of the Tribunal within the current framework. However BHP Billiton would seek to do so, if the Commission intends seriously to consider any such proposal.

Box 6 - Why judicial review is not an effective substitute for merits review

The function of judicial review is to prevent administrative bodies from exceeding their powers or neglecting their duties. It is the means by which a supervising court determines the limits of the power of a public authority. It does not have as its object the avoidance of administrative injustice or error.[22]

That this is so can be seen from the grounds upon which the supervising court can act. A court may intervene in the administrative process if there is:

- procedural impropriety – that is where the public authority fails to act fairly or ignores the procedural rules that have been expressly laid down for it to observe;
- illegality – that is where the authority exceeds the powers conferred on it; or
- unreasonableness (sometimes referred to as "Wednesbury unreasonableness") – that is when the authority's act is so outrageous in its defiance of logic that no sensible person who had applied his or her mind to the question to be decided would have acted that way.

For historical and constitutional reasons the ambit of judicial review in Australia is narrower than in other common law countries, particularly England and Canada.

In Australia, so far as federal authorities are concerned, the reviewing court must find "jurisdictional" error before it can intervene. In other words, for constitutional reasons, errors made by administrative bodies are divided into those which are authorised (non-jurisdictional errors) and those that are not (jurisdictional errors). It is only with the latter kind of error that the court can set aside a decision.

One significant consequence of this distinction is that errors of fact, even serious errors of fact, usually cannot be corrected by a reviewing court. The rule is that "there is no error of law simply making a wrong finding of fact".[23] In other words, so long as there is some basis for a factual finding in the material before the public authority even if the reasoning process is illogical, no reviewable error has taken place.[24] For an error of fact to be reviewable it must be shown that there was 'no evidence' to support the finding.

4. HOW SHOULD PART IIIA IDENTIFY CASES WHEN DECLARATION IS NOT APPROPRIATE?

4.1 Introduction

The declaration criteria and the definition of "service" under Part IIIA should preclude declaration when the costs of access would substantially outweigh any benefits from access, and in other circumstances when access would not promote the objects of Part IIIA. Where possible, a consideration of these issues should occur without the need for extensive factual analysis.

4.2 Summary of recommendations

As set out in Box 1, BHP Billiton makes the following principal recommendations.

(a) Declaration criterion (a) requires the decision-maker to be satisfied that access (or increased access) would promote a "material" increase in competition in a market other than the market for the service. This criterion should be amended, to require

[22] *AG v Quinn* (1990) 170 CLR 1 at 35 – 36.

[23] *Waterford v Commonwealth* (1975) 132 CLR 473 at 481, 483.

[24] *Australian Broadcasting Tribunal v Bond* (1991) 70 CLR 321 at 356.

the decision-maker to be satisfied that access would be likely to result in a competition benefit which is substantial – ie, which is meaningful having regard to the national significance of the relevant infrastructure.

(b) Declaration criterion (b) requires the decision-maker to be satisfied that it would be uneconomic for anyone to develop another facility to provide the service. The "private profitability" interpretation adopted by the High Court should be retained. This interpretation promotes the objects of Part IIIA, and is superior to the natural monopoly test and the net social benefit test.

(c) Declaration criterion (f) requires the decision-maker to be satisfied that access (or increased access) would not be contrary to the public interest.

(i) Criterion (f) should be retained in its current form ("public interest criterion") and should require the Minister to consider the public interest in the manner identified by the High Court.

(ii) A new declaration criterion ("proposed economic cost/benefit criterion") should be introduced, to require the decision-maker to be satisfied that the likely economic costs of access would not outweigh the likely economic benefits of access.

(d) A new declaration criterion ("proposed capacity criterion") should be introduced, to require the decision-maker to be satisfied that the facility would have or be likely to have capacity to provide the service.

(e) The "production process" exception to the definition of "service" in s 44B should be amended, so that a service involving the use of a material part of a production process is excluded from the definition of "service".

4.3 Declaration criterion (a) – declaration should only be available where the competition benefits from access are substantial

The experience with Part IIIA has shown that services may be declared even when the only competition benefit identified under criterion (a) is a relatively insubstantial, hypothesised benefit. For example, the Tribunal's declaration in relation to the Goldsworthy line was based on a finding that access would promote competition in a "rail haulage market" within "a corridor around" the Goldsworthy line.[25] BHP Billiton is not aware of anything to suggest that declaration of the Goldsworthy service has in fact promoted competition in any such (or any other) market, or resulted in any form of public benefit.

Given the significance of a declaration in terms of private use of infrastructure and associated property rights, and the potential for access to impose significant costs, criterion (a) should at least test for a competition benefit which is substantial – ie, which is meaningful having regard to the national significance of the relevant infrastructure – and is at least likely to occur, rather than being a theoretical possibility. The Commission has previously acknowledged related concerns, including that criterion (a) could not be relied on to provide "a bulwark against inappropriate declarations";[26] however the subsequent legislative amendment to include the word "material" in criterion (a) has done nothing to address these concerns.[27]

4.4 Declaration criterion (b) – the private test best promotes the objects of Part IIIA

Only the "private profitability" test adopted by the High Court promotes the making of correct declaration decisions, being decisions which promote the objects of Part IIIA. The alternative tests – the natural monopoly test and the net social benefit test – should be rejected.

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[25] [2010] ACompT 2 (30 June 2010) at [147-148].

[26] Productivity Commission 2001, *Review of the National Access Regime,* Inquiry Report No 17 (2001) page 190; see generally discussion at 170-193.

[27] The amendment was introduced by the *Trade Practices Amendment (National Access Regime) Act 2006*; see the Tribunal's observations at [2010] ACompT 2 at [583, 584].

BHP Billiton respectfully agrees with the High Court's reasoning in relation to the adoption of the private test for criterion (b) (see generally Annexure B). BHP Billiton submits that only the private profitability test:

- precludes declaration when the incumbent infrastructure operator faces competitive constraint from the potential development of an alternative facility, such that its behaviour concerning pricing and other terms for use of its facility is likely to be constrained, and competition is likely to exist in related markets regardless of whether declaration occurs. In this situation, access is unlikely to promote the objects of Part IIIA.

- allows declaration where there is no realistic (ie profitable) possibility that an alternative facility will be developed.

- provides a clear test which is readily assessed by those for whom Part IIIA has the greatest potential commercial application – that is, those whose business it is to own/operate, or to consider the development or use of, nationally significant infrastructure facilities.

- fosters competition between facilities – by fostering the development of alternative facilities where this is privately profitable, the private test fosters competition benefits arising from facilities-based competition. These benefits include the potential to minimise barriers to entry in downstream markets, to foster the adoption of new technology and efficiencies, and to reduce prices and costs. In practice, this facilities-based competition is likely to occur precisely when the costs of access (and benefits of facilities-based competition) are high.

In circumstances where the natural monopoly and private tests produce different results, the outcome applying the private test is superior, in terms of promoting the objects of Part IIIA, than the outcome applying the natural monopoly test (see part 2 of Annexure C on this point). The same is true of circumstances where the net social benefit and private tests produce different results.

For these reasons, BHP Billiton submits that the test as formulated by the High Court, including the High Court's interpretation of "anyone", should remain the test for criterion (b). BHP Billiton submits there is no justification for departing from the High Court's interpretation of "anyone"; rather, the appropriate course is for the law on this point to be developed over time. Given the clarity of the objects of Part IIIA, there is no basis for presuming that this or any other aspect of criterion (b) would be applied in a manner that frustrated those objects.

These matters are addressed in further detail in Annexure C.

4.5 Declaration criterion (f) – retain the current public interest criterion, and introduce a new criterion to assess the costs economic and benefits of access

The need for a rigorous analysis of the public interest, and the costs and benefits of access

The experience with Part IIIA has shown that the costs of a wrong declaration can be extremely high, potentially valued in the billions of dollars in lost GDP (see part 3.1 of Annexure B). The approach taken by the Tribunal to date has been to consider the costs and benefits of access in assessing the public interest. This consideration is warranted, given the potentially large costs and benefits of access. The analysis required is broadly similar to the public benefits analysis the ACCC conducts when considering an authorisation application,[28] and which the Tribunal must conduct when considering a merger authorisation application.[29]

However, following the High Court's 2012 decision (see Box 12 in Annexure B), it appears unlikely that in future a full cost-benefit analysis will always be undertaken under criterion (f).

[28] See CCA, s 90(5A) to s 90(9).

[29] See CCA, s 95AT (Tribunal power to authorise mergers) and s 95AZH (prohibition on authorisation of merger unless it results in sufficient public benefit).

Put briefly, the High Court found that the phrase "public interest" in criterion (f) allows consideration of a range of matters which "is very wide indeed", and noted that conferring on the Minister the power to decide whether criterion (f) was satisfied "is consistent with legislative recognition of the great breadth of matters that can be encompassed by an inquiry into what is or is not in the public interest and with legislative recognition that the inquiries are best suited to resolution by the holder of a political office".[30] Accordingly, on the High Court's interpretation, criterion (f) does not appear to require a full and careful cost-benefit analysis by the Minister, or by the Tribunal when reconsidering the Minister's decision.[31]

In BHP Billiton's view, both the economic cost/benefit analysis and the Minister's more inherently policy-based consideration of the public interest (as described by the High Court) are required (under criterion (f) or otherwise) to ensure that Part IIIA decisions do not allow declaration where the costs of access are likely to outweigh the benefits and where the objects of Part IIIA will not be promoted. Accordingly, BHP Billiton recommends that the public interest criterion be retained in its current form to serve the function identified by the High Court, being a consideration of a broad range of policy issues but a new criterion should be introduced (the proposed economic cost/benefit criterion) which requires the decision-maker to be satisfied that the likely economic costs of access would not outweigh the likely economic benefits of access. This new criterion should require the decision-maker to undertake a full analysis of the economic costs and benefits of access. The High Court's determination that the inquiry undertaken by the Tribunal on these points was not correct as a matter of law does not change the fact that this inquiry is highly desirable as a matter of policy to ensure that the correct decision is made in each case.

The analysis should not exclude likely costs or benefits on the basis that they may be addressed or allocated between the parties at the negotiation/arbitration stage if the service is declared, as these are economic costs and/or benefits that are borne by society, one way or the other. The consideration of the likely consequences of access at the declaration stage is critical, as it is likely to be the only opportunity to identify any "big picture" consequences of access.[32] This will assist to streamline the declaration process, by allowing issues which may preclude declaration to be raised at the outset of the application, avoiding unnecessary costs and time involved in conducting further analysis of the application.

4.6 Introduce a new criterion, to assess whether the facility has or is likely to have capacity to provide the service

An additional way to ensure that the declaration criteria preclude declaration in circumstances where access is likely to impose significant costs and limited benefits, as well as to streamline the decision-making process, is to introduce a new criterion that the decision-maker be satisfied that the relevant facility would be likely to have existing capacity to accommodate access if declaration occurred.

In practice, the question whether a facility has or will have capacity to provide the service is a critical issue, as noted by the Tribunal in its comments about the intensity of use of the two Pilbara railways it determined should not be declared.[33] If the facility does not have and is not likely to have capacity to provide access at the time that declaration is sought, this is a good indication that the requirement to provide access would be likely to cause significant costs by disrupting a capacity-constrained system.

If this question had been asked and answered at the beginning of the declaration process, it would have accurately predicted the outcome of the Tribunal's factual analysis in the Pilbara rail access proceedings.

Introducing a declaration criterion to test this critical issue would mean that declaration applicants would be better placed to judge their prospects of success, and infrastructure owners would be better able to assess the likelihood of a declaration application succeeding, without the need to predict the outcome of the analysis required under the other declaration

[30] [2012] HCA 36 (14 September 2012) at [42].

[31] [2012] HCA 36 (14 September 2012) at [42] and [112].

[32] [2010] ACompT 2 (30 June 2010) at [1174].

[33] Expressly acknowledged at paragraphs [22–24] of the Tribunal's summary of its judgment in [2010] ACompT 2.

criteria. It would also have the effect in many cases of streamlining the declaration decision-making process by ruling out the applications that are unlikely to be successful at the outset, therefore avoiding the unnecessary time and costs involved in the complex decision-making process which is required in relation to the other declaration criteria.

4.7 The "production process" exception – services which involve the use of a material part of a production process should be excluded from the definition of "service"

The High Court held that the "production process" exception to the definition of "service" in s 44B does not prevent the declaration of a service which involves the use of part – even an "integral" part – of a production process.[34] Accordingly, the effect of the production process exception is that businesses which use facilities as part of a tightly integrated business operation face the risk that a service provided by some of those facilities may be declared under Part IIIA.

The production process exception should be amended so that the definition of "service" in s 44B excludes the use of a production process, and of any material part of a production process.

This amendment could also streamline the Part IIIA decision-making process by significantly reducing the time and cost involved. For example, had the production process exception operated in this way, FMG's application for declaration of the Newman line could have been resolved almost two years before the Tribunal's 2010 decision, if not earlier.[35]

5. FURTHER OBSERVATIONS – STAGE TWO OF PART IIIA

BHP Billiton does not have first-hand experience of "stage two" of the declaration process – ie, the negotiation and arbitration of access terms.

However, BHP Billiton is aware that serious concerns have been raised with aspects of that process – specifically, with:

- the existence of a power for the ACCC to order an infrastructure owner to expand its infrastructure to accommodate a third party (see Box 7); and
- shortcomings in the provisions in s44W(1)(a), which address the availability of a declared facility to the provider for use to meet its "reasonably anticipated requirements" (see Box 8).

The serious issues raised in relation to these provisions reflect a further concern, which is that stage two of Part IIIA does not require that access terms determined by negotiation or arbitration protect the legitimate business interests of the provider.[36]

Each of these concerns has the potential to impose substantial and non-compensable costs on the providers of declared infrastructure, and so to deter investment in that infrastructure.

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[34] *BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2008] HCA 45 at [36].

[35] Specifically, the High Court published its decision in [2008] HCA 45 in September 2008 – almost two years before the Tribunal's decision on the Pilbara rail access case. Further, had the production process exception clearly excluded the use of a material part of a production process from the definition of "service", it may have been possible to resolve this issue before it came before the High Court.

[36] [2010] ACompT 2 (30 June 2010) at [592-606] and [1173].

Box 7 – Concerns with stage two: the power to require an expansion[37]

Section 44V(2) provides that the ACCC may make an arbitration determination with regard to any matter relating to access by a third party, including requiring the provider to *extend* the facility. The Tribunal has expressed the opinion that this enables the ACCC to order a provider to *expand* their facility to accommodate a third party.

This is a potentially dramatic power, which would constitute "a serious interference with a firm's right to go about its own affairs, and undertake its own style of operation, as it thinks fit", and result in the ACCC "having a significant project managing role" in an infrastructure provider's business.

There are serious questions about whether and how such a power could ever be exercised in practice given the complexity of the operational, commercial and legal matters which would need to be addressed to facilitate its exercise. To name just a few: Who would own the expansion and the land on which it was built? How would the cost and risk of the expansion be apportioned, including if the third party's business failed? Who would be responsible for day to day decision-making about the nature of the expansion – would the provider have to give the third party ongoing access to the project site to make these decisions? If so, how would a dispute be resolved if the third party sought to implement the expansion in a way which did not comply with the provider's safety standards?

BHP Billiton recognises that there is a need for a power to order infrastructure owners to undertake extensions to a facility, to a limited extent, to facilitate interconnection between facilities for the purposes of access. However, the power to order an infrastructure owner to expand their facility is a radically different, more intrusive power. The experience to date suggests that the exercise of such a power would raise serious, potentially insurmountable, legal and commercial challenges.

[37] See, on this point, [2010] ACompT 2 (30 June 2010) at [726].

Box 8 – Concerns with stage two: displacing the provider's use of the facility[38]

Section 44W(1)(a) provides that the ACCC must not make a determination that would prevent an "existing user" from obtaining a sufficient amount of a declared service to be able to meet their "reasonably anticipated requirements, measured at the time when the dispute was notified." On its face, it appears that this provision should give the infrastructure provider and other pre-existing users priority to use the facility, so that their use of the facility is not displaced when a new party seeks to access the facility. However there are serious concerns about this apparent safeguard.

- The "safeguard" does not give providers or other pre-existing users priority to use the facility if their requirements increase after "the time when the dispute was notified". For example, if a dispute were notified before a provider received government approvals to develop a particular mine, s 44W(1)(a) would not necessarily give the provider priority to use the facility in relation to production from that mine once approvals were granted.
- The provider and other pre-existing users could quickly lose their priority. In particular:
    - A provider would initially have priority over an access seeker (Party A). However if Party A negotiated access terms and began using the facility, and then later notified a dispute, it would from that point onwards have the same priority as the provider: "at the time when the dispute was notified", Party A's reasonably anticipated requirements would rank equally with the provider's requirements.
    - The same outcome would occur in relation to the provider and Party A if another party (Party B) sought access and notified a dispute: "at the time when the dispute was notified", the provider and Party A would have equal priority.

The consequence of this "safeguard" could be that the sole developer of a nationally significant facility, or long term users of a nationally significant facility, could quickly find themselves ranking equally for priority with access seekers who may have only used the facility for a brief period, and may not have invested in the facility on anything like the scale of the incumbent provider and users. These outcomes fundamentally undermine incentives for providers and infrastructure uses to make significant, risky and sunk capital investments.

Related concerns have been identified with the provisions concerning the protection of "pre-notification rights" in s 44W(1)(b).

[38] See, on this point, [2010] ACompT 2 (30 June 2010) at [597-603], and [1251–1254].

ANNEXURE A

EXAMPLES OF INFRASTRUCTURE SHARING IN BHP BILLITON'S BUSINESS

1. SHARED INFRASTRUCTURE IN BHP BILLITON'S IRON ORE BUSINESS

Sharing infrastructure does not necessarily give rise to high inefficiency or other costs. In some cases, the benefits from sharing infrastructure may outweigh the associated costs. There are cases where this occurs in BHP Billiton's Pilbara iron ore operations, as described in Box 9.

Box 9 – Shared infrastructure use in BHP Billiton's iron ore business

Barimunya Airport

The Barimunya Airport is owned by a joint venture between BHP Billiton and Rio Tinto. The airport services approximately 50 flights (ie take-off and landing) of 100 seat jet aircraft each week for Rio Tinto and BHP Billiton, which transport personnel involved in BHP Billiton's mining operations at Yandi, and Rio Tinto's mining operations at Yandicoogina. Under the joint venture arrangement, BHP Billiton manages, operates and maintains the airport, and operating and capital costs are shared equally between BHP Billiton and Rio Tinto. Each party funds their own flights. During summer months, when high temperatures require derating (effectively, a reduction) of aircraft capacity, BHP Billiton personnel regularly fly on Rio Tinto flights, and vice versa. Plans are underway to expand the Barimunya airport and improve the associated facilities, involving an anticipated capital cost of approximately $7 million.

Pilbara accommodation

BHP Billiton requires significant accommodation facilities to house the personnel involved in its Pilbara iron ore operations; some facilities are owned by BHP Billiton, and others are provided by a third party contractor. In some cases, BHP Billiton makes use of these facilities available to other Pilbara iron ore miners. For example:

- BHP Billiton operates a camp at Redmont, approximately 240 km South East of Port Hedland, which houses fly-in fly-out personnel. During 2012, BHP Billiton made a total of approximately 200 rooms at the Redmont camp available for use by FMG, and by Hancock Prospecting personnel involved in the Roy Hill project.
- In some circumstances, BHP Billiton may have excess accommodation capacity in one location, and insufficient capacity in another. During 2012, BHP Billiton engaged in "room swaps" on a one-to-one basis with Hancock Prospecting in this situation. These swaps occurred on request, and on a quid pro quo basis, and allowed BHP Billiton to "swap" rooms at its Redmont, Cowra and Turner camps, in return for the same number of rooms in Port Hedland.

2. SHARED INFRASTRUCTURE IN BHP BILLITON'S ENERGY COAL BUSINESS

BHP Billiton's Hunter Valley energy coal business operates a mine, contracts for rail capacity and ships through two ports (it is a significant shareholder in one of those ports). BHP Billiton's experience with multi-user infrastructure in the Hunter Valley is described in Box 10.

Box 10 – BHP Billiton's experience in the Hunter Valley

The Hunter Valley Coal Chain ("**HVCC**") is used by 11 coal producers operating 40 mines to transport coal from 30 train loading points to three coal loading terminals at the Port of Newcastle.[39] The Australian Rail Track Corporation ("**ARTC**") operates the associated rail track pursuant to a Part IIIA access undertaking, and a number of private companies operate rolling stock. Two of the coal terminals are owned and operated by Port Waratah Coal Service ("**PWCS**"), an incorporated joint venture which includes several Hunter Valley coal producers and other interests; the third terminal is owned by the Newcastle Coal Infrastructure Group ("**NCIG**"), an incorporated joint venture between six producers (including BHP Billiton). The NCIG terminal is undergoing capacity expansion works, and PWCS is seeking government approvals to develop a fourth terminal ("**Terminal 4**"). The Hunter Valley Coal Chain Coordinator ("**HVCCC**") co-ordinates the HVCC.

Background

During 2009, the Newcastle Port Corporation, PWCS, NCIG and coal producers agreed to implement Capacity Framework Arrangements ("**CFA**"), to provide a "long term solution" to capacity constraints in the HVCC. Under the CFA, it was agreed that the PWCS terminal would be expanded, the NCIG Terminal would be developed (including to make 12 mtpa of capacity available to non-NCIG producers), and land would be leased to PWCS to construct Terminal 4, if required. Further key elements include:

- **the establishment of the HVCCC:** an independent organisation which plans and coordinates the daily operation and long-term capacity alignment of the HVCC. All Hunter Valley producers and eight major supply chain service providers are HVCCC members and represented on the HVCCC Board.
- **promotion of contractual alignment:** which attempts to ensure that capacity rights are aligned across the supply chain, so that the HVCC can achieve contracted capacity. In particular, the PWCS terminal expansions were to be underpinned by long term "take or pay" contracts between producers and PWCS, a condition of which is that producers have sufficient rail capacity allocation to enable use of their terminal allocations.
- **determination and use of "system assumptions":** which underpin the determination of HVCC capacity, and operate, effectively, as contractual performance standards for HVCC users.
- **triggers for Terminal expansions:** which provide for mandatory terminal expansions if prescribed long term demand thresholds are met. NCIG has completed one such expansion – stage 2 (a 12 mtpa expansion of NCIG to 53 mtpa) and is currently constructing stage 3 which will increase capacity to 66 mtpa. The threshold for PWCS to construct Terminal 4 was triggered in 2011. If an expansion is triggered, but there is insufficient demand to fund the entire expansion using long term contracts, the balance will be funded by an industry levy imposed on all terminal users, regardless of whether they participate in the expansion. Coal market conditions have changed significantly since the Terminal 4 trigger was satisfied, and demand may now be less than that trigger (it may potentially be able to be satisfied without constructing some or all of the Terminal 4 capacity).
- **capacity transfers:** producers may trade part of their terminal capacity allocation with another producer, but must not charge the acquiring producer more than 105% of the cost-recovery fee charged by PWCS or NCIG for the relevant allocation.

[39] Hunter Valley Coal Chain Coordinator, "HVCCC Overview Presentation" (23 October 2012). Available online at: http://www.hvccc.com.au/Communications/Miscellaneous%20Presentations/HVCCC%20Overview%202012.pdf.

Capacity and expansion arrangements in the HVCC

Contracted capacity shortfall: The current arrangements have improved, but not achieved, contractual alignment. Currently, the rail network operates at 13 – 15% below contracted capacity, so that producers can only use around 85 – 87% of their allocations.[40]

Difficulties in allocating responsibility for shortfalls: There are significant challenges in incentivising supply chain participants to achieve contracted capacity, since there is little if any prospect of clearly identifying and allocating responsibility for shortfalls. Accordingly, there are significant challenges to being able to write contracts which hold users accountable if their conduct reduces the availability of contracted capacity, and such contractual terms are currently only used to a limited extent.

Flexibility trade-off: The HVCC arrangements are very "rules-based", and aim to provide producers with (some very limited) “certainty” about the availability of contracted capacity. Producers devote substantial resources to facilitating these arrangements, and have limited ability to depart from the rules. This lack of flexibility can translate into capacity losses. For example, if a producer's short-term demand for HVCC capacity fluctuates, it can seek to trade its unused capacity, or request the ARTC to adjust this varied demand in its schedule, so that the producer could use their allocation at a later date. However in practice, these are difficult options, and are only used to a limited extent.

Rail and port expansions are not aligned: there are no rail equivalents to the mandatory thresholds which apply for port expansions; instead, the ARTC makes rail expansion decisions independently; the Rail Capacity Group, a representative body of rail users, can endorse and recommend, but not make decisions on, rail expansions.

Observations on outcomes in the HVCC

The HVCC faces serious and significant efficiency and investment challenges, especially compared to the efficiency and investment outcomes able to be achieved by a vertically integrated single user system. In particular:

- producers cannot ship their full contracted tonnages, and currently "pay more to get less", since they can only ship around 85 – 87% of what they "bought" under contracts;
- there is significant potential for misaligned port and rail expansions;
- there is a risk that mandatory expansion triggers could result in construction of capacity in excess of demand, including if some or all of expansion tonnes could be satisfied using existing infrastructure;
- producers can be required to fund expansion tonnes which neither they nor other producers want: this is an inefficient use of capital;
- responsibility for capacity shortfalls cannot be effectively identified and allocated; and
- price caps on capacity trading discourage efficient infrastructure investment, since producers know that, if they decide not to use the capacity they fund, the best return they can make is 5% above their costs (ie less than many regulated rates of return).

[40] Importantly, no one supply chain participant is solely responsible for this outcome – it represents the collective effect of all participants' activities; see HVCCC, "HVCCC Overview Presentation" (23 October 2012) referenced above.

3. SHARED INFRASTRUCTURE IN BHP BILLITON'S METALLURGICAL COAL BUSINESS

BHP Billiton's Queensland metallurgical coal business operates seven mines (with two new mines under construction), contracts for rail capacity, and ships through four ports, three of which are privately owned. BHP Billiton is currently moving to operate its own limited above rail operations for this business, while at the same time continuing to contract for rail capacity with external above rail providers.

One aspect of BHP Billiton's experience with multi-user infrastructure in its metallurgical coal business is described in Box 11.

Box 11 – No regulatory or contractual solution to infrastructure expansions

BHP Billiton's metallurgical coal business uses the central Queensland coal rail network operated by Aurizon (formerly QR National). Use of the network occurs under a rail access regime which has been certified under Part IIIA.[41]

Aurizon has publicly stated that it is not prepared to invest in major expansions of its rail network infrastructure at the regulated rate of return under the certified access regime. Accordingly, since September 2010, Queensland coal companies have engaged in complex negotiations with Aurizon to develop a commercial framework to enable third parties to fund an expansion of the rail network to accommodate increased tonnages. These negotiations are ongoing, and have not yet produced an outcome.

The Queensland negotiations are occurring in circumstances where the relevant rail network has historically serviced many coal producers, and has not been developed as a single user operation. Significant costs and lost efficiencies have arisen within this process despite the fact that the process is occurring within the context of a certified access regime.

The inherent inefficiency of this certified access regime is accepted by all parties because of the history of Aurizon's rail infrastructure. Namely, the infrastructure was previously Queensland Government owned and was purpose built to provide government owned multi-user rail services to minerals and resources companies.

[41] See the decision of Hon. David Bradbury (Parliamentary Secretary to the Treasurer) made under section 44N of the CCA, dated 19 January 2011.

ANNEXURE B

PART IIIA DECLARATION: THE EXPERIENCE IN THE PILBARA RAIL PROCEEDINGS

1. BHP BILLITON'S EXPERIENCE: APPLICATIONS FOR DECLARATION OF PART OF A COMPLEX, VERTICALLY INTEGRATED BUSINESS

1.1 BHP Billiton's iron ore business

BHP Billiton's Pilbara iron ore business operates a vertically integrated, single user mine, rail and port system. To maximise capital efficiency, the mine, rail and port operations are tightly coupled. To maximise system throughput on a daily basis and over the medium term, BHP Billiton requires whole of system control, flexibility to respond to unforeseen events, and the ability to undertake continuous improvement and trials. BHP Billiton's recently commissioned integrated control centre in Perth (costing some $150 million) means that this control is becoming more integrated. BHP Billiton has invested approximately US$19 billion in its Pilbara iron ore operations over the last 10 years,[42] and in 2012 achieved its twelfth consecutive record annual production from these operations.[43] In FY 2011/2012, BHP Billiton's revenue from its Pilbara iron ore business was US$22.6 billion.[44] Almost all of the iron ore produced by BHP Billiton's Pilbara iron ore business is exported.

1.2 FMG's applications for declaration of the Pilbara iron ore railways

Between June 2004 and early 2008, FMG applied for Part IIIA declaration of rail track access services provided by BHP Billiton's Newman and Goldsworthy railway lines, and by Rio Tinto's Hamersley and Robe River railway lines. The NCC recommended that all four services be declared; in May 2006 the Honourable Peter Costello MP was deemed not to have declared the Newman railway service, and in October 2008 the Honourable Wayne Swan MP declared the services on the Goldsworthy, Hamersley and Robe River railways.

The parties sought review of the four Ministerial decisions by the Tribunal, which ultimately heard the four proceedings together during the period from September 2009 to February 2010. The NCC participated in these proceedings. The effect of the Tribunal's decision, in June 2010, was that the Newman and Hamersley services were not declared, and the Goldsworthy and Robe River services were declared (although the Robe River declaration was only for 10 years).

The Tribunal's decisions concerning only the Rio Tinto railways were appealed to the Full Court of the Federal Court. The Full Court's decision, in May 2011, had the effect that the services on those railways were not declared. BHP Billiton was a party to, and the NCC participated in, that appeal.

The High Court granted FMG special leave to appeal, and heard the appeal in March 2012. BHP Billiton was a party to, and the NCC participated in, that appeal. In September 2012, the High Court set aside the Full Court's orders, quashed the Tribunal's decisions on the Hamersley and Robe River services, and remitted those proceedings to the Tribunal.

On 8 February 2013, the Tribunal set aside the Minister's decisions to declare the Hamersley and Robe River services, bringing an end to the remitted proceedings before the Tribunal (subject to any appeals). BHP Billiton was not involved in the remitted proceedings.

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[42] BHP Billiton ASX announcement, "Western Australia Iron Ore Dual Harbour Strategy", 24 August 2012.

[43] BHP Billiton ASX announcement, "BHP Billiton Limited 2012 AGM Speeches", 29 November 2012, p 8 (speech by Marius Kloppers).

[44] This figure reflects BHP Billiton's share of production from the Pilbara operations it manages; it therefore understates total revenue from iron ore produced by these operations.

Box 12 – The High Court's 2012 decision on the Pilbara rail access case[45]

The High Court made the following findings:

- **The Tribunal's role:** the Tribunal erred in conducting a wide-ranging, de novo determination of the matters before the Minister, including by accepting substantial new evidence. The Tribunal's task is to reconsider the Minister's decision with reference to the material before the Minister, supplemented, if necessary, by additional information obtained by exercise of the Tribunal's powers to require information or assistance from the NCC under s 44K(6))[46] – Part IIIA "neither permits nor requires a quasi-curial trial between the access seeker and the facility provider as adversarial parties, on new and different material, to determine whether a service should be declared".[47]
- **Criterion (b): uneconomical for anyone to develop another facility:** the Tribunal erred in adopting a natural monopoly test when applying criterion (b), and should instead have applied criterion (b) by asking whether there was anyone in or able to enter the market for the relevant service who would find it economical, in the sense of privately profitable, to develop another facility to provide that service. The High Court held that "anyone" includes the incumbent facility operator.
- **Criterion (f): public interest:** the phrase "public interest" in criterion (f) allows consideration of a range of matters which "is very wide indeed". Conferring on the Minister the power to decide whether criterion (f) is satisfied "is consistent with legislative recognition of the great breadth of matters that can be encompassed by an inquiry into what is or is not in the public interest and with legislative recognition that the inquiries are best suited to resolution by the holder of a political office".[48] The Tribunal would not be expected to lightly depart from a ministerial conclusion on the public interest; in particular, "if the Minister has not found that access would not be in the public interest, the Tribunal should ordinarily be slow to find to the contrary, and it is to be doubted that any such finding would be made, except in the clearest of cases, by reference to some overall balancing of costs and benefits".[49]

Notably, the High Court's decision concerns the law as it stood before amendments to Part IIIA were introduced in 2010. Among other things the amendments limited the materials before the Tribunal to the record which was before the Minister plus any additional information requested by the Tribunal by written notice being information it considered "reasonable and appropriate" to its task.[50]

As a result of the 2010 amendments, in future declaration cases parties will provide a significantly greater volume of information to the NCC (and Minister) than has typically been provided in the past. Any additional practical consequences of the High Court's decision for the conduct of Part IIIA declaration proceedings cannot be predicted.

[45] [2012] HCA 36 (14 September 2012).

[46] [2012] HCA 36 (14 September 2012) at [65].

[47] [2012] HCA 36 (14 September 2012) at [48].

[48] [2012] HCA 36 (14 September 2012) at [42].

[49] [2012] HCA 36 (14 September 2012) at [112].

[50] Section 44ZZOAAA of the CCA, amended by the *Trade Practices Amendment (Infrastructure Access) Act 2010* (Cth).

1.3 Related court proceedings

Two further court proceedings arose from FMG's declaration applications. The first concerned whether the first rail track access services FMG sought to have declared constituted the "use of a production process", such that they were excluded from the definition of "service" under Part IIIA (see s 44B). This issue was considered by the Federal Court, the Full Court of the Federal Court, and the High Court. The High Court held that the track access services did not comprise the "use of a production process", and so were "services" under Part IIIA. The second proceeding concerned FMG's definition of the Newman "service" in the Tribunal proceedings.

2. TECHNICAL ISSUES ARISING IN PART IIIA ACCESS CASES

2.1 Part IIIA declaration cases raise complex technical issues

Application of the declaration criteria to a specific service and facility, in the relevant industry context, will often require consideration of complex, industry-specific technical issues. These issues may be framed in terms of risk, rather than definitive outcomes, and will often be disputed. Box 13 provides examples of technical issues addressed in the Pilbara rail access proceedings.

Box 13 – Complex technical issues considered in the Pilbara rail access proceedings

The chemical, physical and metallurgical properties of iron ore	The different types of iron ore products, and the role of blending to produce iron ore products	The stages of mine development	How to measure the capacity of the relevant railways
Iron ore supply contracts and pricing	The steelmaking process, and customers' requirements concerning product quality, specifications and variability, and timely and reliable supply	Whether there would be "spare" capacity on the relevant railways	The process of planning and undertaking large-scale capital expansions
The geology and development of the Pilbara	The iron ore exploration process, including types of and the process for buying minerals tenements	The operation of the JORC code	Causes and impact of train failures
The significance of rail wagon loading for capacity	Scheduling a "run when ready" system	Shipping and tidal constraints at Port Hedland	The effect of third party access on "direct to ship loading"
Rail regulation in Western Australia	Environmental constraints on developing Pilbara rail infrastructure	The operational compatibility of FMG's trains with BHP Billiton's railways	The feasibility of trucking iron ore rather than using rail transport

2.2 Complex technical issues are likely to be disputed

The technical issues raised by Part IIIA declaration applications will often be disputed.

In the Pilbara rail access proceedings, numerous critical and complex issues were the subject of dispute between the parties and relevant industry experts. For example, disputed technical issues included:

- the operational compatibility of FMG's trains with BHP Billiton's railways and the extent to which the associated risks (such as derailments and rail track damage) could be managed by the adoption of operating procedures (see Box 14)*;*
- the capacity of the Newman railway, in particular the nature and effect of mine and port "end effects" in identifying practical capacity and the existence of "spare" capacity on the railway (see part 2.3 below); and
- the effect of third party access on BHP Billiton's ability to conduct "direct to ship loading" (ie to load iron ore on to ships without first stockpiling the ore).

Box 14 – The need for compliance with complex operational specifications

Decision-makers in the Pilbara rail access proceedings needed to identify the costs and benefits that would arise as a result of access to BHP Billiton's railways. This question was relevant to the public interest analysis under criterion (f), which involved consideration of a third party's costs of complying with BHP Billiton's operating and technical standards.

To take one example: BHP Billiton grinds the wheels of its ore cars to match the profile of its rail lines, which is optimised over time. This brings many operational benefits, such as assisting in rail and ore car maintenance, and helping to avoid derailments. Unless an access seeker adopted and complied with BHP Billiton's rail management procedures, there would be an increased risk of rail track damage and rail accidents, a significant reduction in the life of the rail tracks, and a significant increase in operating and maintenance costs.

The fact that access seekers would need to adopt these procedures was relevant to considering the likely costs of access: if third parties were provided with access on terms that required compliance with these procedures, there would be a significant cost involved in achieving that compliance; if third parties did not comply, that non-compliance would give rise to significant costs, including in terms of maintenance, damage and derailments. Given the importance of these costs, BHP Billiton put relevant information regarding these costs before the NCC (in a statement from BHP Billiton's Superintendent of Railway Planning and Logistics) and the Tribunal (in affidavits from relevantly qualified industry and expert witnesses).

The questions of how the issue would be managed, and how the costs would actually be allocated, if access was granted, were questions that would have needed to be determined through negotiation or arbitration, had declaration occurred. However the *fact* that access would give rise to this significant cost, regardless of who bore that cost, was relevant to the public interest analysis at the declaration stage.

The Tribunal considered the parties' evidence on this highly technical point, in order to understand the relevance of the issue in its industry context, and to form its own, well-reasoned and well-informed view, on the significance of the issue to its decision. The Tribunal specifically acknowledged the relevance of this technical issue to its analysis.[51]

[51] *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2, at [1211,1216].

2.3 Case study: rail capacity in the Pilbara rail access proceedings

A critical issue in the Pilbara proceedings was the capacity of the Newman railway – specifically, what did "capacity" mean, how could it be measured, and would there be "spare" capacity to accommodate third parties?

The significance of rail capacity

Understanding what "capacity" meant in the context of a vertically integrated, single user system required extensive evidence on factors which affect the capacity of BHP Billiton's rail system, and in particular the impact of BHP Billiton's mine, port and train operations. This included evidence on, for example, BHP Billiton's "run when ready" rail operations, which do not follow a timetable. It also included evidence on how operational factors, such as train speeds, lengths and loads influence capacity, and how mine and port "end effects", including ship arrivals and tidal patterns at Port Hedland, affect capacity.

Decision-makers in the Pilbara rail access proceedings needed to understand what capacity meant, determine how it could best be measured, and assess the likely capacity of the railways they considered. Accordingly, BHP Billiton provided information to the NCC and the Tribunal on:

- the nature of and inputs into dynamic modelling methodology (which experts called by BHP Billiton, Rio Tinto and FMG ultimately agreed was the appropriate methodology for modelling capacity in the context of a vertically integrated system);
- why dynamic modelling provided a more reliable measure of system capacity than static modelling (for example, spreadsheet-based modelling); and
- how the results of such modelling could be analysed and understood.

The questions of what capacity would exist, and whether there would be "spare" capacity, were disputed.

The NCC

When considering FMG's application concerning the Newman railway, the NCC commissioned rail consultants to prepare a report on the capacity of the Newman line. However the limited time and resources available to the NCC significantly affected this process. For example, the rail consultants conducted static rather than dynamic capacity modelling and, contrary to their normal practice, did so with limited contemporary data about the relevant railway operations, and without the benefit of on-site observation and discussion with relevant rail personnel to formulate or test their analysis.[52] The NCC specified a period of under two weeks for the parties to respond to this modelling, and there was no opportunity for the rail consultants to meet with relevant operational personnel during that period. The NCC acknowledged that this timing was tight.

The Tribunal

The Tribunal also considered these capacity issues. Under cross examination, all parties agreed that dynamic modelling was strongly preferred to static modelling. Further, the Tribunal commissioned its own dynamic modelling of the relevant railways on the basis of its own assumptions (on which it sought the parties' comment before the modelling commenced), which was undertaken by modellers who had significant experience modelling BHP Billiton's and Rio Tinto's systems. This was conducted at BHP Billiton's and Rio Tinto's expense. The Tribunal then had the opportunity to question the modellers about the results of their modelling.

[52] Report prepared by G13 & Associates Pty Ltd and APR Pty Ltd for the NCC, Questions for rail experts re BHP & FMG, 26 February 2006, page 1.

This meant that the Tribunal:

- received rigorous and commercially realistic information on one of the key issues relevant to its task, so that it was able to understand the relevant concepts and could reach a well-informed view on the modelling task required for its decision;
- obtained the information it required for its decision in a manner which the parties agreed would produce meaningful results, having regard to the relevant industry context;
- obtained the benefit of the parties' and the modellers' specific industry expertise in the conduct of that task; and
- could question and test the modelling results and related information before it, including by questioning the witnesses who provided that information.

The Tribunal's process ultimately produced the information it required in a manner which was rigorous and meaningful in the specific industry context. The process required to achieve this outcome was factually, technically and intellectually complex, as well as time and resource-intensive. Nonetheless, this type of inquiry is vital in order to correctly resolve the difficult questions at issue in declaration applications.

2.4 Complex technical issues in other declaration applications

The need for Part IIIA decision-makers to understand and resolve complex technical issues is not unique to the Pilbara rail access proceedings. Rather, complex technical issues have also been raised in other declaration cases, such as applications concerning access to airport and sewerage services.

- Virgin Blue Pty Limited's application for declaration of airside services provided by runways, taxiways, parking aprons and other associated facilities at Sydney Airport required decision-makers to consider industry practice concerning the processes, equipment and facilities involved in delivery of such airside services, the regulatory and pricing history of Australian airports, and the industry drivers for, and implications of, a change in the structure of tariffs at Sydney Airport. [53]
- Australian Cargo Terminal Operators Pty Ltd's applications for declaration of certain airport services provided by aprons, hardstands and airport space at Sydney and Melbourne International Airports required consideration of the operations and transactions involved in the handling of air freight. This included analysis of on-airport and off-airport cargo terminal operations, as well as management of limited air space, capacity planning and the potential for and effect of traffic-way congestion.[54]
- In Services Sydney Pty Ltd's application for declaration of transmission and interconnection services provided by Sydney Water Corporation Ltd's sewage reticulation network, the NCC and the Tribunal considered the processing requirements of sewage, pollution load characteristics and the need for dilution of higher toxicity effluent, and the management and accommodation of wet weather flows and overflows. Decision-makers also required an understanding of the related processes of sewer mining (being the extraction of raw effluent from a sewage reticulation network, to treat and hence use the treated sewage).[55]

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[53] NCC, *Application by Virgin Blue for declaration of airside services at Sydney Airport: final recommendation*, November 2003 [4.5,4.24], [6.210-6.226] and Virgin Blue Airlines Pty Limited [2005] ACompT 5 at [18], [88-123] and [167-295].

[54] Numerous uses of the facilities were specified by the Australian Cargo Terminal Operators Pty Ltd, which may have been required to operate their business of providing ramp and cargo terminal operations services. See NCC, *Application for declaration of certain airport services at Sydney and Melbourne International Airports: reasons for decision*, 8 May 1997 ("**NCC recommendation – SIA**"), 11. References for this paragraph are NCC recommendation – SIA 12-13, 34-35, 45-46 and 50-51; Sydney International Airport [2000] ACompT 1 at [23-37], [44-45], [63] and [151-168]. The Tribunal noted that certain matters it considered "*could give rise to differing perspectives among knowledgeable and experienced witnesses*" at [155].

[55] See NCC, *Application by Services Sydney for declaration of sewage transmission and interconnection services provided by Sydney Water – final recommendation*, 1 December 2004 ("**NCC recommendation – Services Sydney**") at [1.4]. References for this paragraph are Application by

3. COMMERCIAL ISSUES ARISING IN PART IIIA ACCESS CASES

3.1 The costs of access can be large

The Tribunal found that the need for BHP Billiton and Rio Tinto to consult with a third party would delay or deter BHP Billiton and Rio Tinto from investing in operational and technological improvements in, and would delay expansions of, their respective iron ore businesses. It noted that the relevant delays may well be longer than three months' duration.[56] The Tribunal considered that the consequence of these delays would be to delay the increased production facilitated by these investments and expansions. It made particular reference to evidence that a three month delay to Rio Tinto's iron ore expansion would result in lost export revenue of approximately $10 billion[57] and lost GDP of between $4 - 6 billion.[58]

3.2 The risk of access is a disincentive to investment

Even the prospect of regulated access risks delaying and/or deterring infrastructure investment (see Box 15).

Box 15 – The impact of access on investment incentives

An infrastructure owner's investment incentives

The most important issue facing any investment decision is: What do I get for my money? In the case of third party access this means understanding what capacity the infrastructure provider will control assuming the investment is approved. An infrastructure owner facing the prospect of third party access does not know:

- how much capacity will be allocated to third parties;
- the size of the reduction in system capacity caused by regulated multi-user operations; or
- what the access terms will be, or how they will impact on the infrastructure owner's business (For example: Will protection of the third party's confidential information require the owner to separate its rail operations from the rest of its business? What impact will access have on the owner's ability to undertake technological and operational improvements?).

This uncertainty over the capacity which will be available to the infrastructure provider discourages and defers infrastructure investment; if access is granted, it may cause investments to be cancelled rather than simply deferred.

A third party's investment incentives

The availability of access may also inefficiently deter access seekers from investing in their own infrastructure (when costs of access are high, for example) if access is, or is anticipated to be, available on regulated tariffs which do not accurately reflect the full costs of providing access.

3.3 Providing access can impose extensive costs

Granting access to highly utilised, sole user infrastructure in an operationally complex business is likely to impose the following costs.

- **Loss of capacity:** the need to schedule and otherwise coordinate multiple users significantly reduces system capacity. For example, this is reflected in the fact that efforts

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Services Sydney Pty Limited [2005] ACompT 7 at [26-31]. [45], [82], [127-129] and NCC Recommendation – Services Sydney at [4.10,]. [5.10], [6.22–6.25], [6.31] and [6.109].

[56] [2010] ACompT 2 (30 June 2010) at [1298].

[57] Dollar figures are Australian dollar estimates as at 2009.

[58] [2010] ACompT 2 (30 June 2010) at [1296,1298].

to increase the capacity of the Hunter Valley and Goonyella coal chains have focussed on increasing coordination between the various elements of those chains.

- **Loss of flexibility:** access unavoidably decreases operational flexibility, since the infrastructure owner must effectively "sterilise capacity" to accommodate a third party. This loss could be reduced but not eliminated if a third party adopted flexible operating practices. However, in a highly complex and flexible system, it may often be uneconomic for a third party to operate in such a manner. That is, the third party would have to accept terms which effectively subordinate the third party's requirements to the provider's requirements in order to minimise the third party's impact on the provider's operational flexibility. Further, were a "flexible" approach to be adopted, it would be likely to result in a significant number of disputes and potentially court proceedings, since it would be extremely difficult to determine and monitor the measures required to reduce the third party's impact on the provider's operational flexibility.

- **Delays to investment in improvements and expansions:** an infrastructure owner planning to trial or introduce new technologies or operational practices, or to expand any part of the business, will need to negotiate with the third party to manage the associated impact on the third party. For example, if BHP Billiton sought to use a greater number of smaller trains in its iron ore business, it would need to negotiate with a third party to determine whether and how that trial would affect the third party's use of the railway. If BHP Billiton sought to make capital investments to expand its iron ore business, it would need to negotiate with a third party to manage the impact of that expansion on the third party, including the impact of associated construction works, operational changes, and ramp up periods. Those negotiations are likely to be technically complex, and involve large amounts of money and significant potential for disputes. Compared to the situation where BHP Billiton is the sole user and controller of the relevant infrastructure, the need to conduct these negotiations and any subsequent dispute resolution would be likely, at best, to significantly delay BHP Billiton's investment in and expansion of its iron ore business. Ultimately, delays result in lost iron ore production, the costs of which can be significant (as noted in part 3.1 above).

3.4 **Providing access raises further complex issues which are difficult and costly to address**

Introducing a third party user into single user infrastructure may create complex issues about how costs and benefits associated with infrastructure operations are allocated, which simply do not exist when infrastructure is operated on a single user basis. It is highly unlikely that any of these issues could be resolved without imposing significant costs on the infrastructure owner.

- **Responsibility for disruptions:** In a single user system, the infrastructure owner bears the full impact of disruptions caused by its own errors, and this significantly disciplines the owner's behaviour. For example, if BHP Billiton experiences a train derailment in its iron ore business, it bears full responsibility for the consequences, regardless of whether the derailment was caused by conduct in its mine, rail or port operations. This discipline does not exist, and is extremely difficult to replicate by contract, in a multi-user system. Even if all users in a multi-user system accept liability for consequential loss caused by their actions, there are significant challenges to identifying and attributing responsibility for errors and disruptions, especially in highly complex systems with many interdependent users. These challenges are exacerbated by the large costs at stake (for example, where disruptions result in foregone production), and the likelihood of disputes arising, which could potentially lead to complex and protracted litigation. Even the process of identifying whether and the extent to which a third party was required to compensate the owner for disruptions would be likely to be impose significant costs on an infrastructure owner.

- **Expansion pathways:** An owner of single user infrastructure can carefully plan how and in what order they expand their infrastructure. For example, faced with a choice about how to increase its rail capacity, BHP Billiton might choose to pursue a "cheaper" option (such as installing a rail siding) rather than a more "expensive" option (such as triple tracking a section of the railway). The position is more complex where third parties are involved. Suppose, for example, that a third party uses the additional capacity created by

the rail siding mentioned above; is the third party required to compensate BHP Billiton for the fact that BHP Billiton will need to undertake the more expensive expansion option when it next seeks to expand, since the cheaper expansion is no longer available?

- **Cost allocation where there is a mutual benefit:** BHP Billiton invests in improvements to its integrated mine, rail and port operations in the Pilbara across the whole of those operations, so as to improve efficiency and output and reduce total costs. Further, BHP Billiton trials operational and technological changes to its iron ore operations on an ongoing basis; a particular trial may or may not ultimately be adopted on BHP Billiton's system. These factors raise difficult questions in the context of third party access. Suppose BHP Billiton constructs additional marshalling yards at its port facilities which are not used by the third party but which have the effect of increasing the practical capacity of the rail system and enabling both BHP Billiton and the third party to transport more iron ore. Should the third party be required to contribute to the cost of the marshalling yards at BHP Billiton's port facilities?

- **Misaligned incentives:** BHP Billiton and the third party will naturally face inherently conflicting incentives – ie to maximise their own iron ore production. This gives rise to extensive potential for gaming and strategic conduct. For example, a third party will have every incentive to minimise their contribution to and maximise their benefit from any investment or expansion undertaken by the infrastructure owner, potentially with the result that the owner funds a benefit to the third party. Similarly a third party which expects that arbitrated access terms would be more favourable than negotiated terms will have every incentive to ensure that contractual terms are resolved by arbitration rather than negotiation.

3.5 In some cases there is no known regulatory solution to these costs

It is not possible to develop regulated terms which prevent or "solve" some of the costs caused by access. For example:

- There is no "solution" as to how capacity on an unscheduled railway can be allocated to a third party under Part IIIA, with sufficient certainty to enable the third party to conduct its business, but sufficient flexibility to maintain pre-existing system efficiency.

- Similarly, there is no precedent for determining how to compensate the owner of a vertically integrated mine, rail and port system for the costs to overall system efficiency caused by a third party's rail service.

- The issue of mandating an infrastructure owner to expand its facility to accommodate access seekers is equally difficult, from the perspective both of an access seeker and an infrastructure provider. (See Boxes 8 and 11).

Nor are these issues likely to be resolved by contract: when faced with issues of such technical complexity and high value, and involving such inherently conflicting interests, some terms are simply not contractible.

Accordingly, any attempt to apply Part IIIA to a vertically integrated, single user mine, rail and port system and devise access terms to address these issues would necessarily involve a significant regulatory experiment, to the almost certain ultimate detriment of the public interest.

ANNEXURE C

DECLARATION CRITERION (B)

1. WHY IS THE EXISTENCE OF A PRIVATELY PROFITABLE ALTERNATIVE TO ACCESS RELEVANT TO PART IIIA DECLARATION DECISIONS?

Where it is clearly privately profitable to develop an alternative facility, a Part IIIA decision-maker applying the private test could not be satisfied of criterion (b), and therefore declaration would not occur. This outcome is consistent with the objects of Part IIIA for the following reasons.

- Where it is privately profitable to develop another facility to provide the service, the incumbent infrastructure provider is likely to face a competitive constraint. If the incumbent does not provide access, the access seeker may develop the alternative facility, or sponsor or promote its profitable development by others, and use the alternative facility to compete in the dependent market. This possibility constrains the incumbent's incentive to engage in anti-competitive behaviour regarding the price or other terms on which it may offer use of its facility to others in the first place.

- If the incumbent can readily provide a service from the existing facility at lower total cost than is achievable by the access seeker from a profitable alternative facility, the incumbent will increase its profits by offering a service at a price higher than the incumbent's costs of doing so, but lower than the access seeker's costs of developing, sponsoring and/or using another facility.

- In any downstream market(s), the competitive consequences of the incumbent providing access, on the one hand, or the access seeker developing or using another facility, on the other, will be similar.[59] Declaration and access to the incumbent's facility are unlikely to promote competition where it is privately profitable to develop another facility, because the incumbent will face (increased) competition in the downstream markets in any event, regardless of whether it provides access to its own facility.

In each of these cases, the incumbent is constrained by the options and market behaviour of other industry participants – which is clearly to be preferred, in BHP Billiton's view, to regulatory oversight over long periods of time.

Conversely, where it is not likely to be privately profitable to develop an alternative facility:

- the incumbent may not face any competitive constraint on its pricing or other behaviour concerning terms of access to the service;

- there may be no other "route to market" for potential competitors of the incumbent, such that declaration and access may promote competition in dependent markets; and

- it cannot be assumed that there is a comparably efficient alternative to access, and hence access may also promote efficiency.

In these circumstances, declaration (and subsequent access to the service) may be consistent with the objects of Part IIIA, and criterion (b) will be satisfied under the privately profitable test.

[59] On one view, it is likely that the access seeker will be a more vigorous competitor downstream if it has sunk its resources into developing another facility and then has powerful incentives to maximise its return on that capital investment. Thus, erring in favour of greater incentives for the development of alternative facilities may be the better policy approach.

2. COMPARISON – DECISION-MAKING UNDER THE PRIVATELY PROFITABLE TEST AND THE NATURAL MONOPOLY TEST

2.1 Introduction

Accepting any one interpretation of criterion (b) does not mean that declaration will be available more or less often than under an alternative test. Rather, it means that declaration will be available in different circumstances, depending on which test is applied. The question of which test is preferable should be answered by asking "in circumstances where the tests produce different outcomes, which test achieves the better outcome?"

This is a vital question. Answering this question should involve a thorough and rigorous consideration of the circumstances in which the tests produce different results, and an evaluation of which test produces the more desirable result in those circumstances.

The analysis below focuses on the natural monopoly test; however an equivalent analysis and equivalent outcomes apply in relation to the net social benefit test.

2.2 When do the private test and the natural monopoly test achieve different outcomes?

The consequences of the different interpretations are shown conceptually in the following table.

<table>
<tr><th colspan="4">Comparing outcomes: the privately profitable test and the natural monopoly test</th></tr>
<tr><td rowspan="2">Is the facility a natural monopoly?</td><td>YES</td><td>Scenario A: facility is a natural monopoly, and is profitable to duplicate
DIFFERENT RESULT – only a natural monopoly test will allow declaration</td><td>Scenario B: facility is a natural monopoly, and is not profitable to duplicate
SAME RESULT – allow declaration</td></tr>
<tr><td>NO</td><td>Scenario C: facility is not a natural monopoly, and is profitable to duplicate
SAME RESULT – no declaration</td><td>Scenario D: facility is not a natural monopoly, and is not profitable to duplicate
DIFFERENT RESULT – only a private test will allow declaration</td></tr>
<tr><td></td><td></td><td>YES</td><td>NO</td></tr>
<tr><td></td><td></td><td colspan="2">Is it privately profitable to develop another facility?</td></tr>
</table>

Table 1 shows that there are two scenarios where the application of the private profitability test and the natural monopoly test achieve the same outcome (Scenarios B and C), and two scenarios where they achieve different outcomes (Scenarios A and D).

Scenario A: only the natural monopoly test allows declaration of a natural monopoly facility when it is privately profitable to develop another facility

In Scenario A, the facility is a natural monopoly and it is privately profitable to develop an alternative. For example, this scenario could occur where an incumbent railway is dedicated to carrying a high value mineral commodity, and it is privately profitable to develop an alternative railway, notwithstanding that the incumbent may have lower capital and operating costs than the alternative railway. In this scenario, the service may be declared under the natural monopoly test but not under the private profitability test.

Regardless of whether declaration occurs, the existence of the privately profitable alternative constrains the incumbent from engaging in anticompetitive pricing or other behaviour, and facilitates competition in dependent markets (ie the incumbent cannot prevent entry into those markets). Accordingly, the incumbent and the third party may reach a commercial agreement to share the incumbent facility, or the third party may develop the alternative facility. The parties are likely to reach a commercial arrangement if the costs to the incumbent of sharing the facility are sufficiently low that the incumbent and third party can reach a price and terms which are more advantageous to the third party than developing the alternative facility. This outcome is unlikely to occur when the costs of sharing the incumbent facility are high. In short, the declaration outcome produced by the natural monopoly test in this scenario does not promote the objects of Part IIIA compared to the situation which would prevail if declaration did not occur.

Scenario D: only the private test allows declaration of a service provided by a natural monopoly facility when it is not privately profitable to develop another facility

In Scenario D, the facility is not a natural monopoly and it is not privately profitable to develop an alternative. This scenario could occur where an incumbent railway is dedicated to carrying a relatively low value agricultural commodity, and could accommodate some but not all reasonably foreseeable demand at lower cost than using an alternative facility, in circumstances where it would not be privately profitable to develop an alternative facility.[60] In this scenario, the service may be declared under the private profitability test but not under the natural monopoly test.

It is clear that declaration could promote the objects of Part IIIA in this scenario: absent declaration, the incumbent could behave anticompetitively in relation to the price and terms (if any) on which it offered access, and prevent entry into a dependent market. Although the incumbent facility could not accommodate all reasonably foreseeable demand at lower cost than if the hypothesised alternative facility was developed, declaration would nonetheless promote the objects of Part IIIA by allowing access to the unused and low cost capacity on the incumbent's railway, thereby enabling competition to occur in the dependent market. It cannot be assumed that the amount of capacity the incumbent could accommodate would be small – under the natural monopoly test, this situation could arise where, for example, the incumbent could accommodate 90% of reasonably foreseeable demand at lower operating and capital cost than multiple facilities. Further, it cannot be assumed that this would be merely a transitory or temporal issue – such situations could persist for as long as the incumbent was free of competitive constraint concerning the price and terms (if any) on which it made use of its facility available.

In this situation, the outcome achieved by the private profitability test is clearly preferable to the outcome achieved by the natural monopoly test: allowing declaration would impose a competitive constraint, and enable access seekers to use the facility to compete in a dependent market, in circumstances where there was no other feasible "route to market". This is a clear example of the failings of the natural monopoly test: faced with a "classic" situation of market power capable of suppressing competition in a related market, the private test would allow declaration, and the natural monopoly test would not.

The High Court's analysis of the scenarios in which the private test and the natural monopoly test achieve different outcomes

The High Court considered these two scenarios in the following terms:

> "If criterion (b) is read as a privately profitable test, there may be cases where there would be a duplication of a natural monopoly [this is Scenario A, above]. But duplication would occur only if it were profitable for another to develop an alternative facility to provide the services (despite the fact that total market output could be supplied at lowest cost by one facility). It *would* be profitable for another to develop an alternative facility if the new facility is more efficient than the existing facility, for example, because of some form of cost or technological advantage. And if the new facility is not

[60] For example, it might not be privately profitable to develop an alternative facility to cater for the whole of reasonably foreseeable demand not satisfied by the incumbent facility in circumstances where there was uncertainty about whether commodity prices would justify investment on the scale required to build the alternative facility; the same uncertainty might not prevent an access seeker using low cost spare capacity on the incumbent facility.

> more efficient than the existing facility, it is to be doubted that development of the new facility in competition with a natural monopoly would be profitable. Especially would that be so where, as here, the capital costs of establishing the new facility would necessarily be very large.
>
> By contrast, if criterion (b) is read as a natural monopoly test, a facility that is *not* a natural monopoly cannot be declared even if there is no (profit) incentive to duplicate it [this is Scenario D, above]. In that case, the sole supplier would be left in control of the field with the attendant risks of abuse of market power and, no less importantly, with no incentive to price and produce efficiently. An outcome of that kind does not sit easily with the requirement that criterion (b) be understood in a way that will "promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets."[61]

BHP Billiton respectfully agrees with the High Court's analysis on these points.

2.3 Which test achieves preferable outcomes?

In summary: in the only situations where the private test achieves different outcomes to the natural monopoly test, only the private test rules out declaration when it is not required to promote the objects of Part IIIA, and rules in declaration where declaration could promote the objects of Part IIIA.

3. THE PRIVATE PROFITABILITY TEST AND "ANYONE"

The High Court found that, "in criterion (b), "anyone" includes existing and possible future market participants".[62] In doing so, it rejected the finding of the Full Federal Court of Australia that "anyone" should be read as not including the incumbent owner of the facility to which access is sought.

Thus the law on the meaning of "anyone" is currently as follows:

- it includes "existing and possible future market participants"; and
- an incumbent owner of the facility to which access is sought may fall within the definition of "anyone" – the rule adopted by the Full Federal Court that the incumbent is always to be excluded has been rejected.

It remains to be seen what effect the High Court's decision will have in practice.

If a case emerges where criterion (b) may not be satisfied due to the commercial incentives of the incumbent alone, further judicial refinement of the construction of the phrase "uneconomical for anyone to develop another facility to provide the service" may be required so as to achieve the "overall objective of statutory construction, [namely] to give effect to the purpose of parliament as expressed in the statutory provisions".[63]

However, factual circumstances which would give rise to such a case are likely to be rare. In particular, in order to determine that it would be privately profitable to develop an alternative facility, the incumbent would need to determine that it could earn an adequate rate of return on both its existing facility and a new facility. This would appear less likely to occur if, for example, an incumbent facility had significant spare capacity.

For now, the High Court has advanced the proper construction of criterion (b) very substantially. This construction is consistent with and gives effect to the purpose of parliament as expressed in the objects of Part IIIA.

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[61] [2012] HCA 36 (14 September 2012) at [101-102].

[62] [2012] HCA 36 (14 September 2012) at [105].

[63] The Hon. Michael Kirby CMG, "Statutory Interpretation: The meaning of meaning", 13 August 2009, RMIT University, Melbourne.