Submission to the Productivity Commission

Review of the National Access Regime in light of the Draft Report

Anglo American Metallurgical Coal Pty Ltd

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1 Executive summary

Anglo American Metallurgical Coal Pty Ltd (***Anglo American***) welcomes the opportunity to make a submission to the Productivity Commission (***Commission***) in respect of the Commission's Draft Report on the National Access Regime released in May 2013 (***Draft Report***).

Anglo American is supportive of the recommendations contained in the Draft Report.

Anglo American supports the need for separate consideration to be given to the appropriateness of regulation, and the form of regulation, for different forms of ownership structures. For example, each of the following requires different consideration:

(a) the vertically integrated railways of the Pilbara;

(b) Government-owned natural monopoly facilities which were often operated on the basis of open access which transfer into private ownership (sometimes in circumstances where the private owner is vertically integrated into competitive markets); and

(c) greenfield facilities which are developed as privately funded multi-user facilities (for example, Wiggins Island Coal Export Terminal in Queensland).

The Commission stated that facility-based access arrangements should only be applied in appropriate cases and that there should be a transparent and robust process in making the decision to use a facility-based access arrangement. Anglo American accepts this view, however, it notes that in its experience some of the facility – based access arrangements have been the most successful and affective access arrangements. For example, Anglo American believes that the arrangements in place at PWCS and NCIG have been successful and effective arrangements in governing third party access to the facilities, despite the fact that the terminals are not subject to legislated access regimes.

In respect of the recommendations contained in the Draft Report, Anglo American submits that:

(d) In light of the recent public commentary in respect of the privatisation of government infrastructure, Anglo American supports the recommendation of the Commission that it is important that appropriate access arrangements are in place prior to any such privatisation. This is particularly important in respect of privatisation of critical export infrastructure such as railways and ports and also in respect of domestic infrastructure such as electricity networks and water infrastructure;

(e) Although Anglo American understands the statements made by the Commission in respect of the difficulties of imposing prescriptive mechanisms in complex negotiating environments such as the funding of expansion capacity, Anglo American believes that without the intervention of appropriate regulatory mechanisms there is a significant incentive for natural monopolists to engage in 'economic hold-up' or 'investment hold-up'. This is an issue which should be dealt with in third party access arrangements, despite its complexities. Therefore, regulators should have the power to require capacity expansions and extensions, whether or not that power is frequently relied on, in order to prevent this form of 'economic hold-up' by infrastructure owners;

(f) While vertically integrated monopolists present the most significant risk for users, there is still a risk that non-vertically integrated owners can exploit market power arising from a natural monopoly. Due to this, regulation should be maintained on non-vertically integrated infrastructure as, to date, there is no evidence that there is an effective alternative form of intervention (such as price surveillance);

(g) Anglo American strongly supports the recommendation of the Commission that legislative reform is necessary to clarify that the most appropriate test for determining criterion (b) is the 'natural monopoly' test;

(h) Operational or disruption costs should not prevent an access declaration unless the cost of access to the infrastructure owner outweighs the potential benefit to the public in every possible access scenario. There may be some access scenarios where the costs outweigh the potential benefits and other scenarios where the costs may not outweigh the potential benefit. The assessment of whether the operational or disruption costs outweigh access should be addressed in the context of a specific request for access (ie, the facility should be declared and the ACCC should assess the costs and benefits in the 'arbitration stage'); and

(i) The public interest test in criterion (f) should remain phrased in the negative as this reflects the economic policy that the promotion of competition is in the public interest and there should be a specific finding that access is not in the public interest as apposed to placing the burden on the applicant to prove that access is in the public interest.

2 Regulation is increasingly important with government privatisations

The Commission has acknowledged in the Draft Report that privatisation of infrastructure has been an increasing trend for governments over recent years. Further, the Commission outlined that a number of governments have made public statements indicating that further privatisations will occur.

As the Hilmer Committee and the Draft Report have recognised, there are significant efficiency benefits that privatisation can bring but that 'privatisation without appropriate regulation may entrench the anti-competitive structure of the former public monopolies'.

Prior to the trend of privatisations many investments were made by mining companies on the understanding that access to export facilities was guaranteed, or at least that the government entity operating the export facilities would allow for access on a non-discriminatory basis at relatively reasonable prices. This belief was founded on the understanding that governments had an interest in maximising throughput of the export facilities as higher throughput contributed to the economy (including through royalties) and generated regional growth and jobs.

Privatisations can, and have, resulted in ownership of significant natural monopoly infrastructure being controlled by vertically integrated companies such as Aurizon Limited. These vertically integrated companies who may have an incentive to refuse access, to provide access on unfavourable terms or to place unreasonable conditions on expansions. Without government regulation, access to critical export infrastructure could be restricted or prevented and drastically affect the ability of Australian miners to remain competitive in the dynamic global industry.

If government owned infrastructure is privatised without appropriate access arrangements in place then it is very difficult for this to be rectified after the privatisation. The reasons include:

(a) privatisation clearly decreases the involvement of the government or minister, reducing the level of scrutiny over the privatised operator;

(b) Section 46 of the *Competition and Consumer Act 2010* (Cth) (***CCA***) does not prohibit monopoly pricing per se (ie, an infrastructure owner who engages in monopoly pricing but no vertical foreclosure or discrimination amongst users is unlikely to be in breach of the prohibition on misuse of market power) and is generally considered to be ineffective in facilitating third party access to infrastructure; and

(c) once an asset has been privatised without access arrangements it is difficult for a government to make the asset subject to third party access regulation as it raises difficult issues of sovereign and regulatory risk.

Therefore, a privatised asset which did not have appropriate access arrangements put in place prior to the privatisation is unlikely to be the subject of effective scrutiny post-privatisation.

Rather than attempting to regulate and constrain privatised operators after the infrastructure has been sold by the relevant government, the Commission highlighted that it is vitally important for appropriate access arrangements to be constructed and implemented before infrastructure is privatised.

Anglo American fully supports this finding. This is particularly important in respect of the privatisation of critical export infrastructure such as railways and ports, but also in respect of essential domestic infrastructure such as electricity networks and water infrastructure. It is noted that for governments contemplating privatisations there is a potential conflict between implementing appropriate regulatory settings and maximising the value of the asset.

An interesting case study can be made of the operation of Queensland ports. Table 1 sets out the Queensland coal export terminals in terms of ownership structure, name plate and the status of third party access. The table contains a column which categorises each port into one of the following:

(a) Legislated access – where the terminal is subject to regulation under a statutory third party access regime;[1]

(b) Contractual access – where the terminal owner/operator is subject to a third party access regime which has been imposed upon it under contractual obligations (for example, under a clause in a lease between the relevant government and the infrastructure owner/operator); or

(c) No regime – where the terminal is not subject to either a legislated or contractual third party access regime. This does not necessarily mean that there is no third party who has obtained access. There is a separate column which identifies whether the owner/operator of the facilities has given third party access.

Table 1: Coal Export Terminals in Queensland

Terminal and Nameplate	Ownership	Legislated or contractual access?	Third party access	Comments
Abbot Point Coal Terminal (APCT) (50 mtpa)	Privatised (Adani)	No regime	There are currently a number of users who have access under contracts entered into prior to the privatisation	The pricing provisions of the contract are subject to arbitration
Hay Point Coal Terminal (44 mtpa)	Private (BMA)	No regime	No	No contracted capacity has ever been granted
DBCT (85 mtpa)	Privatised – 99 year lease from Queensland Government	Legislated access under the QCA Act	Yes	Legislated regulation was a requirement of privatisation
Wiggins Island Coal Export	Private – multi-owners by coal	Contractual	Will be granted under the Wiggins Island	WITAP required by Government in

[1] For the purposes of this table legislated access does not include the circumstances where the facility might be the subject of a declaration under Part 5 of the QCA Act. It only includes facilities which are currently regulated under legislation. This exclusion has been made because the High Court's adoption of the private profitability test has introduced a high level of uncertainty as to which assets may be the subject of a declaration.

Terminal and Nameplate	Ownership	Legislated or contractual access?	Third party access	Comments
Terminal (WICET) (27 mtpa under construction)	producers	access regime	Terminal Policy (WITAP)	approvals and is binding on owner/operator by contract. There is a process of Deed of Assumption which allows third parties to directly enforce the WITAP against the owner/operator
RG Tanna Coal Terminal (68 mtpa)	Government owned (Gladstone Ports Corporation)	No regime	Yes	The pricing structure is complex and based on NPV valuations
Barney Point Coal Terminal (BPTC) (8 mtpa)	Government owned (Gladstone Ports Corporation)	No regime	Yes	The terminal will be closed in 2015

In putting third party access arrangements in place prior to privatisation a government fundamentally has two options:

(a) making the facility subject to a facility-specific access regime under legislation; or

(b) imposing contractual obligations upon the owner/operator of the facility to ensure third party access.

In its Draft Report the Commission referred to these types of arrangement as facility-based access arrangements. The next section of this submission deals specifically with facility-based access arrangements.

Anglo American was, and remains, strongly supportive of the fact that the Queensland Government required full access and price regulation of DBCT prior to granting the 99 year lease (currently held by Brookfield). The continued access by Anglo American to DBCT at reasonable rates has been essential to Anglo American in exporting coal from Queensland. However, Anglo American believes that there are some lessons which can be learnt through the privatisation of DBCT in that the regulation of DBCT put in place at the time of privatisation was not entirely sufficient as it did not deal specifically with the following issues:

(a) A subsequent request by users to expand the port infrastructure led to very lengthy delays and regulatory processes in determining who should invest and at what return; and

(b) There was insufficient coordination and master planning between the rail and port to ensure maximisation of the throughput of the overall system. This led to a situation where the 'system capacity' was lower than the nameplate capacity of DBCT and coal producers had contracted for 85 mtpa of port capacity but the system (ie, rail and port) could not deliver 85 mtpa. Those coal producers were still paying 100% take or pay for capacity at the port even though the system could not deliver the capacity.

The privatisation of the APCT shows that even though a terminal may be fully contracted at the time of privatisation, disputes in respect of pricing may still arise. The fact that the port was sold to an aspiring coal mining company also raises the question of whether third party access will be available to the APCT in the future.

Although Part IIIA has been, in part, effective in facilitating a certain level of consistency between State and Commonwealth third party access regimes, the clause 6 principles are not sufficiently detailed to ensure that access regimes are effective in terms of ensuring open and transparent access to capacity (including expansion capacity). In Anglo American's view any access regime developed for critical export facilities prior to privatisation should address the following key principles:

(a) **Clear and non-discriminatory access rules to current capacity**: access should be provided to existing users on a non-discriminatory basis under transparent and clear standard access agreements;

(b) **Prohibition on over-contracting:** there should either be an outright prohibition on over-contracting capacity or financial penalties for the owner doing so as consequences for early users can be significant;

(c) **Expansions**: there should be clearly defined rules in respect of the expansion of the terminal, including circumstances when expansions should be undertaken to create access to the expansion capacity by existing and new users and clear rules in respect of the return on the capital cost for the expansion;

(d) **Coal chain master planning**: to ensure the maximisation of the throughput of the rail and port supply chains, it is essential to have an appropriate framework in place in respect of the coordination of the systems and centralised planning. This may need to be facilitated by government as centralised coordination will not occur where there is separate ownership of the rail and port because incentives are not sufficiently aligned to ensure coordination; and

(e) **Pricing**: as railways and ports do exhibit natural monopoly characteristics, one of the significant issues is whether pricing is economically efficient. Prices should be based on either direct pass through costs with a return (where owned by industry) or an efficient weighted averaged cost of capital (***WACC***) established by an independent regulator.

3 Facility-based access arrangements

Anglo American supports the need for separate consideration to be given to the appropriateness of regulation, and the form of regulation, for different forms of ownership structures. For example, each of the following requires different consideration:

(a) the vertically integrated railways of the Pilbara;

(b) Government-owned natural monopoly facilities (predominantly multi-user) which were often operated on the basis of open access which transfer into private ownership (sometimes in circumstances where the private owner is vertically integrated into competitive markets); and

(c) greenfield facilities which are developed as privately funded multi-user facilities (for example, Wiggins Island Coal Export Terminal in Queensland).

The Commission concluded that facility-based access arrangements can impose a net cost on the community if they are inconsistently or incorrectly applied and should be limited to where there is a clear need to tailor access arrangements for a specific facility.

Whilst Anglo American agrees that inappropriate facility-based access arrangements could be inefficient and impose a cost on the community, it notes that in its experience some facility-based access arrangements have been the most successful and effective access arrangements. For example, Anglo American believes that the arrangements in place for PWCS and NCIG have been effective arrangements in governing third party access to the facilities, despite the fact that the terminals are not directly subject to legislated access regimes.

In circumstances where the interpretation and application of important declaration criteria (such as criterion (b)) are not settled, Anglo American believes that facility-based access arrangements are critical to ensuring the international cost competitiveness of Australian miners accessing multi-user facilities. Anglo American sees that policy makers have two options in terms of introducing third party access to a facility, particularly prior to its privatisation:

(a) making the facility subject to a legislated third party access regime (for example DBCT); or

(b) requiring by contract that the owner/operator of the facility operate the facility on an 'open access basis'.

In determining which approach is most appropriate, governments should take into account whether the facility is part of an integrated supply chain and whether open access is in the public interest through the maximisation of throughput and support of the international cost competitiveness of mining companies.

4 Government intervention is essential to prevent 'economic hold-up'

Anglo American agrees with the recommendations of the Commission that the ACCC should have a clear power to direct capacity expansions and the recommendation that the ACCC provide guidance in respect of the exercise of the power to direct expansions.

The Commission stated in the Draft Report (at page 5):

> *Other participants raised the difficulties in securing agreement between infrastructure providers and access seekers to expand capacity within multi-user commodity supply chains as an issue that access regulation should address. However, these difficulties are not intrinsically the result of third party access problems. Rather, they reflect the challenge of coordinating and financing large-scale infrastructure investments that provide benefits to multiple parties. Governments should be wary of imposing prescriptive mechanisms in complex negotiation environments, as the optimal approach will largely depend on the circumstances at hand.*

Whilst Anglo American agrees that commercially negotiated agreements are preferable to regulated outcomes, it believes that sometimes it is necessary to impose a prescriptive regime even when the negotiation environment and the issues involved are complex. The example given by the Commission (and set out in the above quote) of negotiating expansion capacity within multi-user commodity supply chains is, in fact, an example of when prescriptive mechanisms may be necessary.

A case study is the negotiation of expansions and extensions in Queensland between coal producers and Aurizon Network. As outlined in Anglo American's previous submission, where parties' interests are not aligned, relying on voluntary commercial agreements between the parties to facilitate expansions causes conflict and subsequent delays. There is an incentive for the owner to engage in tactical delays to any voluntarily agreed expansion project in order to force more favourable access conditions from the user or users. This represents a particular risk to miners when commitments have already been made to mine expansion projects. This may include access prices significantly higher than the market price. The examples given by Anglo American of regulated assets not being expanded until users agreed to returns above the regulated returns (in circumstances where there was little or no evidence that the owner faced higher risks than on the brownfield assets) included:

(a) the Goonyella to Abbot Point Expansion (***GAPE***) on the Aurizon Network; and

(b) the Wiggins Island Rail Project (***WIRP***) also on the Aurizon Network.

In an attempt to create an alternate funding mechanism and reduce the risk of 'economic hold-up' by Aurizon Network the coal producers sought the inclusion of a user funding regime in the access regime. The Access Undertaking required Aurizon Network to submit for approval a standard agreement known as the Standard User Funding Agreement (***SUFA***). SUFA has been the subject of negotiations between the coal producers and Aurizon Network for more than 2 years.

Anglo American acknowledges that the issues involved in SUFA are very complex and that some issues will depend on the particular expansion/extension being funded. However, Anglo American believes that the time and effort spent in establishing a standard form of contract upfront will significantly decrease the number of issues in contention when a particular transaction does present itself. The alternative to the prescriptive mechanism contained in SUFA is a general negotiation/arbitration form of regulation. In the view of Anglo American, a negotiate/arbitrate form of regulation would have been ineffective as the negotiation would have taken years and been unsuccessful and any arbitration would have taken a further considerable period of time. A process of 3 or 4 years to negotiate and arbitrate a particular expansion process is unworkable. The advantage of SUFA is that all issues other than transaction-specific issues have already been negotiated between the coal producers. Therefore, Anglo American reiterates that there are circumstances where government intervention by way of prescriptive mechanisms is necessary to ensure that owners of monopoly infrastructure cannot engage in 'economic hold-up' of expansion and extension projects.

Anglo American supports the Commission's finding that the ACCC should publish guidelines on how it will use its powers. However, Anglo American does believe that the ACCC should also be given the power to require a mandatory access undertaking in respect of a service which has been declared. This allows for the pro-active management of issues rather than leaving issues to a negotiate/arbitrate process which may take years to resolved.

5 Non-vertically integrated infrastructure should remain regulated

Anglo American submits that any instance of monopoly pricing poses a risk to economic efficiency and productivity.

An infrastructure owner's incentive to engage in monopoly pricing is not necessarily affected by whether it is vertically or non-vertically integrated. A vertically integrated monopolist may use prices to alter upstream or downstream competition which might increase its incentive, but this does not mean that non-vertically integrated monopolists do not have incentives to engage in monopoly pricing.

While Anglo American strongly supports the Commission's finding that Part IIIA of the CCA should continue to apply to non-vertically integrated infrastructure, it cautions against restricting or altering the standard form of regulation. The Commission outlined that where 'competition is not disrupted but monopoly pricing exists, it may be the case that a different form of intervention is justified, such as an industry-specific regime, or other provisions of the CCA'.

Anglo American does not believe that regulation as important for international competitiveness, and efficiency and productivity should be left to fall within general regulation such as section 46 of the CCA or prices surveillance laws.

Section 46 of the CCA proven to be ineffective in dealing with third party access issues and general prices surveillance rules do not usually allow for full price regulation (as they are generally considered to be a light handed form of price regulation).

Anglo American submits that entities should not be allowed to fall within weaker regulation purely because they are not vertically integrated. Economic loss to users, and subsequently consumers, can occur without vertical integration and so must be covered by strong and capable regulation.

The economic loss from monopoly pricing is not merely a monopoly rent transfer issue with no practical effect; it feeds directly into the international competitiveness of the Australian mining companies.

6 Adopting the 'natural monopoly' test for criterion (b)

Anglo American strongly supports the Commission's recommendation that the appropriate test for criterion (b) is the natural monopoly test. While Anglo American agrees that the test should be properly outlined within the Regime, it believes that this will be a relatively simple task with industry consultation and recent decisions of the Australian Competition and Consumer Tribunal.

Anglo American supports the natural monopoly test as outlined by the Commission; ie, 'it would be uneconomical to develop another facility if the facility in question could provide society's reasonably foreseeable demand for the services at a lower total cost than if it were to be met by two or more facilities.'

As previously submitted, Anglo American does not support the other two tests for economic feasibility. In particular, the 'private profitability' test is unnecessarily restrictive when deciding whether to grant an access declaration. Under the private profitability test the Minister must be satisfied that it is not economically feasible and privately profitable for any other entity (including the proponent) to construct further infrastructure. Further, as the Commission outlined, access will not be granted under the private profitability test even if the only entity that can construct further facilities is the owner of the current facilities. This arises because of the uncertain and extremely broad definition of 'anyone for whom it would be profitable'. Further development by the current infrastructure owner is not evidence of emerging competition, and yet it is enough to prevent an access declaration under the private profitability test. As acknowledged by the Commission, it would be very difficult to ever be satisfied that infrastructure is uneconomical to duplicate and this would restrict the ability to grant access to existing facilities. This interpretation focuses on what is uneconomical from an individual perspective as opposed to what will be most damaging to the interests of the Australian market and society.

Although infrastructure owners might suggest that access is too easily obtained under the natural monopoly test, Anglo American disagrees. There are still significant measures to protect owners from unnecessary access, including four other criteria that must be accepted before access can be granted.

As such, Anglo American submits that the appropriate access test is the natural monopoly test and that it must be clearly defined within the Regime. Without a clearer definition the risk of not declaring services where regulation could improve efficiency remains strong.

7 Disruption costs should not be considered at the declaration stage

Anglo American acknowledges that there might be coordination and disruption costs for the infrastructure owner involved in providing access to third parties. In particular, this could include administrative, maintenance and compliance costs or reduced operational flexibility of the owner's own services in order to deliver productivity to third parties. It might also cover the difficulties associated with coordinating investment in order to complete expansions and extensions if required, although Anglo American supports the Commission's finding that investment costs are more appropriately dealt with under criterion (f).

The Commission has suggested that it might be appropriate to consider coordination and disruption costs when deciding whether it is uneconomical to duplicate infrastructure; ie, in criterion (b). Anglo American submits, however, that a declaration should only be refused on grounds of disruption costs where both the National Competition Council and the relevant Minister are satisfied that the costs to the owner outweigh the benefits to productivity in **all**

possible access scenarios. The difficultly with taking disruption costs into account at the declaration stage is that the full extent of requested access will not be known until a declaration has been made and an access application made. For example, if there is a situation where one of the possible access seekers might only require an individual train path, and is flexible with the timing of that train path, the costs are very unlikely to be considered to outweigh the benefits. Otherwise a specific decision may refuse access where there really would have been minimal disruption to the supply chain and the owner would not have been affected.

Therefore, Anglo American does not believe that disruption costs should be considered a decisive factor in determining criterion (b), or indeed criterion (f). The most appropriate time to consider the implication of disruption costs on the supply chain is after access applications have been submitted and the exact effect is known. This will leave disruption costs to be considered in the negotiation / arbitration stage and the owner can either recoup disruption costs from the users or the arbitrator may refuse access if the disruption costs cannot be quantified or clearly outweigh the benefits of access.

As such, Anglo American submits that disruption costs should only form grounds for refusing to declare infrastructure where the circumstances show that the cost of disruption will outweigh the benefit of efficient access in every possible access scenario.

8 Criterion (f) is properly drafted in the negative

The Commission found that the public interest test contained in criterion (f) would be better drafted as a positive requirement on the access seeker. That means that the access seeker must specifically prove that access is in the best interests of the public, rather than the current test which requires the access provider to prove that access is not in the best interests of the public.

Anglo American strongly disagrees with this suggestion. The negative drafting of the public interest test reflects the economic position that the promotion of competition and efficient investment in infrastructure is considered to be in the public interest. It follows that if criteria (a) and (b) are satisfied then access is in the public interest unless the access provider can prove that there is some other public interest which overrides this conclusion.

This issue is not merely an issue of semantics but effectively shifts the onus of proof from the access provider to the access seeker.