National Access Regime Review –

Rio Tinto Iron Ore Submission in Reply to the

Productivity Commission Draft Report

5 July 2013

1. Introduction

1 Rio Tinto Iron Ore (***RTIO***) is the division of the Rio Tinto Group which has responsibility for Rio's global iron ore interests, including its iron ore mines and the rail and port infrastructure servicing these mines in the Pilbara, Western Australia.

2 RTIO previously made a submission addressing the Productivity Commission's Issues Paper of November 2012, focusing upon sections 44G(2)(b) and 44H(4)(b) of the *Competition and Consumer Act 2010* (***CCA***) (***criterion (b)***), and the role of the Australian Competition Tribunal (***the Tribunal***).

3 This submission responds to the Productivity Commission's Draft Report of May 2013 (***the Draft Report***). It addresses:

(i) the need to reinforce the production process exception, so that the exception can operate as an effective gate keeper against inappropriate applications;

(ii) the reasons why a private profitability test for criterion (b) is workable, conducive to productive efficiency gains, and most consistent with fostering competition;

(iii) the need to take all relevant costs into account under any natural monopoly interpretation of criterion (b);

(iv) the need to amend sections 44G(2)(a) and 44H(4)(a) of the CCA (***criterion (a)***) to clarify that access by declaration is focused upon the promotion of economic efficiency; and

(v) the reasons why existing safeguards in section s 44W of the CCA need to be maintained, particularly in light of any ACCC power to order expansions of infrastructure.

2. The production process exception

4 RTIO is well placed to comment upon the production process exception, as its Hamersley railway was the subject of a declaration application in August 1998 which was ultimately found to fall within the exception,[1] and RTIO intervened in proceedings concerning BHP Billiton Iron Ore (***BHPBIO***) rail facilities in 2008 which addressed the availability of the exception.[2]

5 Section 44B of the CCA defines the type of service that is capable of being declared open to third party access. It expressly carves out from the definition the use of a production process, except to the extent it is an integral but subsidiary part of the service in question.

6 'Production process' in this context has been interpreted to mean 'the creation or manufacture by a series of operations of some marketable commodity'.[3]

7 When the High Court considered the application of the production process exception to BHPBIO's Pilbara railways in 2008, it adopted a construction of section 44B which has effectively neutered the exception.

8 The High Court found that BHPBIO's use of its rail tracks and associated infrastructure was integral to the series of operations that constituted its production of iron ore stockpiles for sale.

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

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

[3] *BHPBIO v NCC* at [37].

Accordingly, it accepted that BHPBIO's use of its railway amounted to use of a production process within the meaning of the CCA.

9 However, the High Court concluded that Fortescue was not seeking to use a service that amounted to a production process *vis-à-vis Fortescue*, stating 'What Fortescue seeks is the use of a facility that BHPBIO uses for the purposes of its production process.'[4] The Court was influenced in this regard by the fact that Fortescue was only seeking access to the service constituted by the use of below rail infrastructure, and was not seeking use of BHPBIO's rolling stock or to add its iron ore to BHPBIO's trains.[5]

10 BHPBIO had argued that, as Fortescue was seeking access to the same service (use of rails, train control systems, signalling systems and communications systems) which BHPBIO provided to itself as part of its production process, this meant that Fortescue was effectively seeking access to a service that amounted to use of a production process. It contended that the fact Fortescue would be using the rail lines for its own purposes rather than for the purpose of conducting BHPBIO's production process was 'not relevant to the characterisation of the service.'[6]

11 The High Court observed that the construction advanced by BHPBIO was not 'untenable', but it preferred the more restrictive construction identified above on the basis that it was 'more appropriate to advancing the overall objectives of Part IIIA…'[7]

12 However, the impact of the distinction adopted by the High Court – that services that are used by the facility owner as a production process will not attract the exception unless access to the 'process' is sought (as distinct from access to the infrastructure used by the incumbent in its production process) – means that the exception is unlikely ever to apply.

13 This means that facility owners using infrastructure as part of their own integrated business operations are at risk of having third party use interposed, even where the facility is acknowledged to be an integral part of the owner's production process.

14 This defeats the purpose of having a production process exception. Moreover, such a construction does not align with the 'efficiency' objective identified in section 44AA, which was introduced in 2006 (but which was not considered by the High Court in the context of Fortescue's 2004 declaration application).

15 The inefficiencies that the exception seeks to avoid arise from interference in a firm's production process through third party use of infrastructure that is integral to an incumbent's production process. The exception needs to operate as an effective gate keeper to ensure that regulation does not unduly interfere with an incumbent's own means of production, given the high inefficiency costs and investment disincentives such interference causes.

16 In the Draft Report, the Productivity Commission observes that the production process exception 'provides a useful initial filter for the obvious cases where coordination costs will exceed any competition benefits'.[8] However, the exception currently does not provide this filter.

17 The Productivity Commission also observes in the Draft Report that amendment to the exception is not necessary because coordination costs can be assessed under criterion (b), on the assumption that modifications suggested by the Commission to criterion (b) are adopted.

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[4] *BHPBIO v NCC* at [41].

[5] *BHPBIO v NCC* at [40].

[6] *BHPBIO v NCC* at [38].

[7] *BHPBIO v NCC* at [42].

[8] Draft Report, p.150.

This is not a compelling reason to avoid changes to the exception so that it achieves what was originally intended. Even if the Commission's suggested amendments to criterion (b) are accepted, it is still important that the production process exception works effectively to exclude inappropriate applications at the outset and to avoid wasted time and resources arising from unnecessary analysis of the declaration criteria. Further, if the Commission's suggested amendments to criterion (b) are not accepted (with the additional requirement that *all* costs be addressed under criterion (b), as discussed below), then consideration of all of the diseconomies and costs flowing from the use of a facility that is integral to the incumbent's production process may not be adequately provided for anywhere in the regime.

18 In light of the High Court's interpretation of the production process exception, it is necessary to amend the exception to make it clear that 'service' excludes the use of infrastructure, or a significant part of infrastructure, which is '*used as an integral part of a production process by the facility owner or access provider*.'

3. A private profitability test for criterion (b) is workable, conducive to productive efficiency gains, and most consistent with fostering competition

19 In the Draft Report, the Productivity Commission suggests that the private profitability test, recently endorsed by the High Court as the appropriate test for criterion (b), would be difficult to apply because it involves decision-makers having to estimate uncertain measures such as costs, prices, demand, capacity, and required rates of return.[9]

20 Such difficulties are overstated. These kinds of assessments, including assessments about future prices, are routinely made when a private sector entity makes an investment decision. As the High Court observed, the question of whether it would be economically feasible to develop an alternative facility, involving as it does the making of forecasts and the application of judgment, is '*a question that bankers and investors must ask and answer in relation to any investment in infrastructure. Indeed, it may properly be described as the question that lies at the heart of every decision to invest in infrastructure, whether that decision is to be made by the entrepreneur or a financier of the venture*'.[10]

21 Indeed, forecasts of many of these factors – costs, demand and capacity – are inevitably involved in the application of the proposed alternative natural monopoly test as well.

22 Furthermore, it is much less likely that there will be occasions where market evidence is readily available to demonstrate whether or not the natural monopoly test is made out, compared to the private profitability test where public announcements, internal company assessments, external reports, and actual construction, are routine and readily available to provide real world indicators of whether the private profitability test can be satisfied.

23 The Productivity Commission also expresses a view in the Draft Report that the private profitability test is less likely to result in productivity efficiency gains than a form of natural monopoly test.[11]

24 This concern appears to be based on the premise that, where a facility is privately profitable to duplicate, the market cannot be relied upon to ensure access is granted where that would be a lower cost option than having a duplicate facility built.

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[9] Draft Report, p.163.

[10] *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* (2012) 246 CLR 379 (***TPI v Australian Competition Tribunal***) at [106].

[11] Draft Report, p.158.

25 This premise is erroneous. As was pointed out during the Pilbara rail access proceedings by Professor Willig, Professor of Economics and Public Affairs at Princeton University, the purpose of the private profitability test is not to decide whether there should be one facility or two, it is to decide how the decision of sharing or duplication will be made – via private negotiation or regulatory intervention. Where duplication is feasible, the parties will have the incentive to reach the least cost arrangement, and the parties are far better placed to make this assessment than a regulator.[12]

26 Where privately feasible entry is possible, the facility owner and the access seeker will both have an incentive to find the solution that is least cost to them. The facility owner will assess whether it is less costly for it to provide access and offset some of its potential losses raised by new entry through access fees, or to face the threat of an alternative facility being constructed that may have technological and other efficiency and cost advantages over it. The access seeker will assess whether it is less costly for it to utilise the incumbent's facility at the access fees that can be agreed, or to construct (or have constructed) its own facility which it can control and may possibly be able to use to more effectively compete with the incumbent. These market participants have superior information to a regulator, they are far better placed to assess the costs to themselves of sharing versus duplication than a regulator would be in a declaration process.

27 Accordingly, the private profitability test is a more reliable indicator of whether duplication is feasible (and hence a deal will be done if it is lower cost than duplication, or a deal will not be done and duplication will result with ensuing facilities-based competition), or whether duplication is not feasible and so market forces cannot be relied upon to produce the most efficient outcome. It is only in circumstances where market forces cannot be relied upon to ensure the most efficient outcome that regulatory intervention is justified.

28 RTIO therefore believes that the private profitability test is in fact preferable from a productive efficiency point of view to the alternative constructions, because it relies upon the better informed market players rather than regulators to assess the true costs of access versus duplication.

29 Finally, RTIO endorses draft finding 3.1, in which the Productivity Commission articulates a key principle underpinning the design of access regulation:

> In markets where two or more infrastructure service providers are able to provide the same service (or an effective substitute service), allowing competition between providers will generally be preferable to access regulation because regulation in such markets could reduce welfare.
>
> Access regulation is most likely to provide net benefits to the community where there is monopoly provision of infrastructure services.[13]

30 Of the various alternative interpretations put forward for criterion (b), the private profitability test best reflects this principle.

31 The Productivity Commission has sought to formulate a version of the natural monopoly test that is also consistent with this principle, explaining: 'By taking into account total market demand, criterion (b) could preclude declaration of services that face meaningful competition from other facilities – effective duopolies or oligopolies. …allowing competition between two or more competing infrastructure service providers will generally be preferable to access regulation.'[14]

[12] See oral testimony of Professor Robert Willig during the Pilbara rail access proceedings before the Tribunal, 3 November 2009.

[13] Draft Report, p.80.

[14] Draft Report, p.167.

32 However, even taking all market demand into account, a natural monopoly formulation still allows for the possibility that criterion (b) can be satisfied, potentially leading to regulatory intervention, where there is actual duplication of infrastructure and facilities-based competition is occurring. Only the private profitability test ensures that competition between providers will be given preference over regulation, by enabling - where it exists - real world evidence of actual competition between providers to be taken into account.

33 Further, in terms of potential duplication, the private profitability test ensures that where the development of an alternative is viable, the incentives set by Part IIIA will facilitate the development of facilities-based competition. By contrast, a natural monopoly type test sets disincentives to profitable duplication, encouraging potential new entrants to instead 'roll the regulatory dice' to see if a favourable deal will be mandated.

34 RTIO therefore urges the Productivity Commission to reconsider its proposed move away from the private profitability test.

4. All relevant costs need to be taken into account under any natural monopoly test for criterion (b)

35 In the Draft Report, the Productivity Commission has suggested an alternative construction of criterion (b) to the various interpretations adopted by the NCC, the Tribunal and the courts since Part IIIA's introduction. RTIO believes that the current private profitability test is the correct construction for criterion (b). However, if a natural monopoly test of the kind currently contemplated by the Productivity Commission is ultimately to be recommended, RTIO believes it should take into account *all* of the costs associated with meeting market demand using one facility.

36 An inclusive approach to costs is supported by economic principle, and is also far easier to apply as a matter of practice.

37 The Productivity Commission's proposed test relies upon categorising the costs that arise from mandated sharing of infrastructure said to include costs under the following headings:

- 'Additional maintenance costs';
- 'Costs arising from reduced operational flexibility': including scheduling costs from increased use of infrastructure, associated loss of flexibility in the management of the facility owing to the contractual rights held by a third party, and coordination problems between different users of the infrastructure – for example, in relation to the scheduling of train paths;
- 'Costs arising from problems with coordinating investments': covering investments aimed at improving the operation, or expanding the capacity, of infrastructure, including investments or innovations that are unexploited, delayed, mistimed or otherwise sub-optimal.[15]

38 In terms of economic principle, the proposal to exclude costs associated with coordinating investments from consideration under criterion (b) on the basis that these costs are 'dynamic in nature and while potentially significant, are unlikely to relate to a given level of foreseeable demand, which is what a natural monopoly test is focused on',[16] is misconceived.

[15] Draft Report, pp.108-109.

[16] Draft Report, p.168.

39 It is no answer to say that some of the costs that arise from sharing of infrastructure should be excluded because natural monopoly tests have not traditionally included such categories of cost. Natural monopoly tests do not traditionally focus upon the question of competitors sharing a facility *at all*. Natural monopoly tests arise in the context of an industry or market, focusing upon whether *one firm* can meet total market demand at a lower cost than two or more firms.[17] Assessing whether or not an industry is a natural monopoly is determined by assessing whether or not the cost function of supply across the industry is subadditive. As Professor Willig, Professor of Economics and Public Affairs at Princeton University, has observed, the classic natural monopoly test is 'not about a sharing arrangement.'[18]

40 If an adaptation of the classic economic test for natural monopoly is to be applied to address the distinct scenario of whether a facility owned by a firm can be shared with other firms to meet all demand at less cost than multiple firms using multiple facilities, the adapted test needs to reflect the circumstances of this different scenario – namely that multiple firms sharing a single facility will give rise to a range of costs.

41 The question of what categories costs should be taken into account under a natural monopoly type test adapted to criterion (b) was examined at length by the economic experts in the Pilbara rail access proceedings.

42 Professor Ordover provided the following opinion:

> “engineering” costs generally will underestimate the costs that will have to be incurred by the incumbent firm if it is required to provide access. That is, the costs of moving a particular quantity of iron ore (for example) produced in the incumbent’s mines to the incumbent’s storage and processing facilities will differ materially from the costs of moving the same aggregate tonnage that originates partly from the mines of the incumbent and partly from the mines of the access-seeker (or a third party). In particular, line sharing may result in loss of effective capacity on the line due to inefficiencies resulting from the need to coordinate shipments from different users. There may also be additional costs – such as unplanned congestion and delays – that cannot be fully accounted by each party but which nevertheless are “real” and which impose a burden on the incumbent firm (but also on the access-seeker). And there will be costs incurred by the managements of both firms in designing contracts, coordinating schedules, resolving disputes, and so on. …. **If a natural monopoly test is to be applied, it is essential that these costs are taken into account (as well as the direct engineering type costs)** when assessing whether it is cheaper to have one facility, rather than two facilities, service the foreseeable demand.[19] (emphasis added)

43 Professor Gans, Professor of Management (Information Economics) at the University of Melbourne, who appeared on behalf of the access seeker in the proceedings, also provided an expert opinion that a broad range of costs should be taken into account. Professor Gans opined that a facility will be uneconomic to duplicate if the revenue of access seekers from using the provider's facility less the full cost of access (*including coordination costs, opportunity costs and additional capital costs*), is greater than the revenue of access seekers from using the other facility less the costs of using and developing that facility.[20]

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[17] See, for example, Kahn, A, *The Economics of Regulation: Principles and Institutions*, Volume II (1988) 119; Sharkey, W, *The Theory of Natural Monopoly* (1982) 54; Posner, R, *Natural Monopoly and its Regulation*, (1999), p.1; Panzar, J, 'Technological Determinants of Firm Structure and Industry Structure' in Shmalensee, R and Willig, RD (ed), *Handbook of Industrial Organization*, Volume 1 (1989)3, 24. See also *Re Services Sydney Pty Limited* [2005] ACompT 7 at [102].

[18] Oral testimony of Professor Robert Willig during the Pilbara rail access proceedings before the Tribunal, 3 November 2009.

[19] Expert report of Professor Janusz Ordover, provided during the Pilbara rail access proceedings before the Tribunal, 3 July 2009 at p.7.

[20] Second expert report of Professor Joshua Gans, provided during the Pilbara rail access proceedings before the Tribunal, 21 August 2009 at [50].

44 When the Tribunal explicitly asked whether a natural monopoly test under criterion (b) should be confined to a limited range of costs and should exclude the diseconomy and inefficiency costs that arise from sharing, all of the economic experts to whom the question was put rejected such an approach. For example, Dr Williams, Executive Chairman of Frontier Economics Pty Ltd, observed:

> If you put things together you have extra costs, like coordination costs, then they are relevant to the test of natural monopoly, because natural monopoly is defined as when the function over its length is sub-additive, that is, when it's cheaper to do it all together than – than the sum of them when they're separate. So it seems to me quite improper not to take into account anything that makes it more expensive or less expensive when you do it all together than the sum of the costs when you do it separately.[21]

45 Similar discussions followed between the Tribunal and various of the other economic experts, such that when the Tribunal posited a version of the natural monopoly test that hived off the diseconomy costs of sharing to criterion (f), each of the economists to whom the proposal was put rejected it.[22]

46 In summary, there is no basis for recommending that all the types of additional costs that flow as a result of adapting the natural monopoly concept to a shared facility should not be taken into account. It would be artificial, and distort the purpose of the exercise, to include only some of the costs that arise from sharing in the cost comparison under criterion (b), but not others.

47 As a practical matter, drawing a distinction between broadly described categories of cost that arise from sharing of the facility that can be taken into account under criterion (b), and a broadly described category of costs that also arises from mandated sharing but is instead required to be assessed as part of the public interest under criterion (f), raises significant issues. Such an unnecessarily complex approach is likely to lead to confusion and give rise to protracted debate (and litigation) over categorisation of costs and the criteria under which they should be considered. This would distract from the important issues requiring analysis in declaration applications and result in unnecessary disputes and delay.

48 A large range of costs likely to arise from mandated sharing were identified in the Pilbara rail access proceedings, including:

- loss of flexibility in, and efficiency of, operations;
- coordination costs;
- loss of throughput;
- delays to technological developments;
- delays to changes to operational methodologies;
- delays to expansion which will necessarily arise as a result of consultation, negotiation and coordination with multiple users;
- disincentives to invest optimally;
- high likelihood of disputes;
- loss of facilities-based competition.

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[21] Oral testimony of Dr Philip Williams during the Pilbara rail access proceedings before the Tribunal, 5 November 2009.

[22] For example, the oral testimony of Professor Joshua Gans during the Pilbara rail access proceedings before the Tribunal, 3 November 2009; oral testimony of Dr Vincent Fitzgerald during the Pilbara rail access proceedings before the Tribunal, 3 November 2009; oral testimony of Dr Philip Williams during the Pilbara rail access proceedings before the Tribunal, 5 November 2009. In principle, Dr Aleksandr Sundakov's evidence was also that he would take all social costs into account, e.g. Expert report of Dr Aleksandr Sundakov, provided during the Pilbara rail access proceedings before the Tribunal, 7 August 2009 at [42.2].

49 Various economic experts gave evidence about the types of costs likely to arise from mandated sharing of the railway lines, including Professor Willig who identified the following costs:

- the costs of building the physical access or interface to the facility;
- conflicts and disagreements over priorities for expansions and changes in facilities operation;
- administration and regulatory costs of access sharing;
- litigation, regulatory compliance and adjudication costs associated with any conflicts that may arise from shared access;
- reduction in investment, maintenance and upkeep of a facility as a result of mandated facility sharing;
- costs of diminished output capacity and diminished optimization of facility operations;
- misallocation of resources attributable to mandated access as opposed to allocation based on market prices and supply/demand conditions;
- loss of potential competition between facilities if an access seeker built its own facility in the absence of mandated sharing;
- dynamic inefficiencies from reduced incentives to build new facilities or invest in new technologies.[23]

50 Professor Gans also identified the following broad range of costs as likely to be incurred:

- technical costs;
- costs caused by access to a shared facility that will not arise in duplication such as augmentation costs and coordination costs where there is insufficient capacity;
- economic costs such as lost profits to the incumbent where their demand is displaced by the access seeker;
- investment costs;
- loss of efficiency costs; and
- operational costs.[24]

51 Within this range, it is evident that there is ample scope for dispute about which category any particular cost will fall into.

52 For example, interpretation issues will almost certainly arise in trying to categorise costs of the additional infrastructure needed to redress diminished output capacity. In the Pilbara rail access proceedings, there was evidence of very significant infrastructure costs that would need to be incurred to accommodate multiple users on the railway lines for any given level of tonnage. For example, for additional third party tonnage of ≤10 million tonnes per annum (***mtpa***) on RTIO's railway lines, an additional 1 to 2 third party train sets (known as 'consists') would be required, and an additional RTIO consist might also be required compared with the position if there were two independent rail lines (which would naturally be less congested). For additional third party tonnage of 20 mtpa, an additional 2 to 3 third party

[23] Expert report of Professor Robert Willig, provided during the Pilbara rail access proceedings before the Tribunal, 30 June 2009 at [42].

[24] Oral testimony of Professor Joshua Gans during the Pilbara rail access proceedings before the Tribunal, 3 November 2009 and second expert report of Professor Joshua Gans, provided during the Pilbara rail access proceedings before the Tribunal, 21 August 2009 at [50].

consists would be required and for the Hamersley line (though not the Robe line), an additional 1 to 2 RTIO consists would be required. As consists cost in the region of $56 million to $105 million each,[25] the costs of additional consists alone (i.e. over and above the consists required if there were separate facilities) would be in the hundreds of millions of dollars.

53 However, this above rail solution of running extra trains is only one way to address the issue of displaced tonnages; below rail expansions or modifications could also be made to reduce the impact on throughput. For example the interconnection mode could be by way of fly overs, which could cost in the hundreds of millions of dollars, but result in much less disruption than would flow from a classic junction system. The Tribunal found that adding extra consists would increase congestion, and accordingly there would be diminishing marginal returns from adopting the 'extra consist' approach as the sole means of reducing the effect on throughput. When a rail line reaches economic capacity, the marginal return of adding a consist would be less than the marginal cost, and so the Tribunal found that at this point it would then be necessary to undertake below rail expansions to increase throughput in addition to adding consists.[26]

54 Clearly it would be unworkable in this scenario to try to distinguish between costs that might be characterised as 'problems with coordinating investments' (on the basis that they involve a below rail solution of improvements to operations or expansions), which the Commission suggests be considered under criterion (f), from costs which might be regarded as 'additional maintenance costs' or 'reduced operational flexibility' (if above rail solutions are implemented by way of additional consists and scheduling). Absurdly, where a combined above rail and below rail solution is assessed, if the Commission's approach were adopted, part of the costs would be considered under criterion (b), whilst part of the costs would be carved off to criterion (f), whereas if a purely above rail solution was considered, all costs could be brought within criterion (b). That is, whether or not criterion (b) is satisfied could be arbitrarily dependent upon the view the NCC, designated Minister, or Tribunal takes as to how an infrastructure owner should elect to address displaced throughput in any given scenario.

55 It is also evident that a number of the costs identified in the Pilbara rail context (for example, loss of facilities-based competition) do not fit neatly into the categories posited by the Productivity Commission, leaving scope for protracted debate over where such costs should be taken into account.

56 Moreover, the wide range of costs identified in the context of the Pilbara's rail infrastructure will not be the same costs that arise from mandated sharing of other types of infrastructure with different forms of ownership and use. It is impossible to envisage every type of cost that may arise from mandated sharing across the universe of infrastructure that may be brought within Part IIIA, let alone to ensure specific categories of costs are sufficiently described to enable a clear view to be taken of which category each cost falls into and under which criterion they should be considered.

57 An additional issue that arises from the proposed natural monopoly test's narrow approach is that costs that clearly arise from mandated sharing could be subject to very different levels of assessment, depending upon whether they are to be considered under criterion (b) or criterion (f).

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[25] In the Pilbara rail access proceedings, Fortescue estimated that a consist would cost $56 million. RTIO estimated that the cost of an additional consist would be $105 million, comprising $65 million for the consist, $20 million for additional operating costs and $20 million for extra maintenance.

[26] *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2 (30 June 2010) (***Fortescue***) at [971]-[972].

58 In light of the High Court's finding that the Tribunal cannot 'lightly depart' from a designated Minister's assessment of the public interest under criterion (f),[27] the consequences of the suggested division of costs is that the relatively technical assessment of coordination costs of investment will be largely placed in the hands of the designated Minister. There will be the potential opportunity for some costs of sharing to be assessed in a detailed manner by technical experts in the Tribunal, whereas other costs that arise from sharing would only be subject to a detailed assessment by the Minister, who lacks the expertise and experience of the Tribunal, and has limited time to consider the matter and limited ability to call for clarifying material. There is no justification for introducing different treatment and a different level of scrutiny in respect of the various categories of cost that arise from sharing a facility.

59 It makes far more sense, both in terms of principle and practical application, to have technical matters like the true economic costs of providing access (including costs of coordination of investment) assessed together under criterion (b).

60 This division would still leave significant work for criterion (f), as consideration of broader public interest factors – such as environmental issues, security concerns etc. – not just the costs imposed by sharing a facility, would appropriately be considered here.

5. Criterion (a) should include an explicit efficiency test

61 As noted in the Draft Report, and as the Productivity Commission previously flagged in its 2001 review of the national access regime, the current formulation and interpretation of criterion (a) has the potential to set an inappropriate threshold for the grant of declaration.

62 RTIO agrees with the Productivity Commission's view that 'competition' in the context of criterion (a) is intended to be a proxy for more efficient outcomes. It also endorses the Commission's observation that 'competition can be an imprecise proxy for efficiency in some circumstances'.[28]

63 RTIO supports the Productivity Commission's proposed amendment to criterion (a), so that an assessment of whether this criterion is met is undertaken by comparing the status quo and declaration (rather than access). This comparison ensures that the test for whether regulatory intervention is needed is based on reality, and removes the artificial abstraction introduced by the Full Federal Court in 2006[29]. However, RTIO believes that this amendment alone is insufficient.

64 To ensure criterion (a) is focused upon improvements in economic efficiency, RTIO believes it should be amended to read: *'(a) declaration of the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service, and thereby result in an overall material improvement in economic efficiency.'*

65 There is little down side to being more explicit about the efficiency aims of criterion (a), and, rather than leading to 'interpretation issues' as the Productivity Commission suggests, this clarification would guard against possible misinterpretation by future decision-makers who are generally unwilling to read into a statute concepts that are not explicitly stated in the text (e.g. 'access' as meaning regulated access or declaration, the confusion over the meaning of 'uneconomical', the contrary interpretations of 'reconsideration'). A clear efficiency focus in

[27] *TPI v Australian Competition Tribunal* at [112].

[28] Draft Report, pp.169 and 177.

[29] See *Sydney Airport Corporation Limited v Australian Competition Tribunal* [2006] FCAFC 146.

criterion (a) would contribute to greater certainty around how the criterion will be interpreted by various decision-makers.

66 Moreover, linking the promotion of competition in a dependent market to an overall material improvement in economic efficiency would enable decision-makers to disregard improvements in a purported market which has been identified by an applicant but which is minor or theoretical, where this impact would be outweighed by the inefficiencies generated by declaration in terms of higher prices and/or lower output in the dependent markets that are the actual focus of the declaration application. This resolves the problem that can arise where narrow, technical markets are artificially construed for the purposes of showing an improvement in competition in a purported field of rivalry, which thereby satisfies criterion (a), even though overall economic efficiency will not be materially enhanced by access through declaration in the field of actual competitive behaviour, which is the real focus of the application.

67 RTIO agrees with the views expressed by the Productivity Commission in Box 2 of the Draft Report, noting the following key observation in particular:

> Access regulation is unlikely to increase efficiency where the incumbent owner of infrastructure has no ability to affect prices — for example in downstream markets where prices are set by world commodity markets. In these circumstances, the incumbent owner would have a strong incentive (through the sharing of its fixed costs) to provide access to any capacity that will be unused for the foreseeable future, provided the access charges recover the full costs of use by the third party.
>
> ….
>
> In this example of a vertically integrated price taker, intervention to require access risks lowering efficiency and, in the long term, reducing investment in infrastructure.[30]

68 However, RTIO considers that the current regime risks allowing regulatory intervention in precisely these circumstances where access will in fact lower efficiency, because of the possibility of an applicant being able to construct a market where rivalrous behaviour will be promoted, regardless of how insignificant that market is overall and without any evidence that it will lead to lower prices or higher output.

69 By way of example, in the Pilbara rail access proceedings, the applicant put forward a market for haulage services for iron ore on each of RTIO's railway lines in the vicinity of the railway line as a relevant dependent market. The Tribunal found that, notwithstanding that declaration would have no impact on the market which was at the heart of the application – the global market for iron ore – criterion (a) was satisfied because potential consumers would benefit from being able to use RTIO's railway lines, and hence there was a promotion of a material increase in competition in those rail haulage markets. No consideration was given under criterion (a) to how access would impact upon the conduct of the potential consumers, or how access would affect overall industry performance or efficiency.[31]

70 The Productivity Commission asserts that a criterion (a) test focusing upon 'declaration' rather than 'access' would obviate the need for an efficiency override, as a 'declaration test' would not be satisfied where there is already effective competition in dependent markets. However, in the Pilbara rail access proceedings, while the Tribunal interpreted criterion (a) as incapable of satisfaction where effective competition already existed in a market, it nevertheless found criterion (a) was satisfied in respect of RTIO's railway lines because it would provide a benefit to potential consumers by way of more transportation choice in respect of a purported market for rail haulage.

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[30] Draft Report, pp.12-13.

[31] *Fortescue*, [1155]-[1159].

71 The history of criterion (a)'s interpretation by decision-makers demonstrates there can often be conflicting understandings of how the criteria should be applied and what thresholds they are intended to set, particularly where there is no express statutory language to make the aims of the criterion clear. If the Productivity Commission supports the view that the promotion of economic efficiency is the intended aim of criterion (a), it should recommend that the aim be made explicit to avoid further costly debate and misinterpretation.

6. Safeguards need to be maintained in respect of mandated expansions

72 Allowing the ACCC to order expansions of privately-owned infrastructure creates significant risks for facility owners, and will involve the ACCC making decisions for which it is ill equipped. The safeguards set out in section 44W to protect infrastructure owners' interests when their facilities are declared have always been recognised as an important and necessary aspect of the declaration regime, and take on a heightened significance where the regulator can mandate expansions.

73 There are two safeguards in particular that RTIO wishes to comment upon.

74 First, RTIO believes it is vital that the requirement that the ACCC not make access determinations that would result in a third party becoming an owner of part of a facility or an extension of a facility, without consent, is retained.

75 Interference in the ownership of nationally significant infrastructure is likely to have a major impact upon Australia's productivity. Accordingly, incursion into the ownership structure of a facility should only be undertaken where it is absolutely necessary. RTIO does not consider that any arguments have been made to demonstrate that access seekers require ownership of part/s of an access provider's facility in order for Part IIIA to function effectively.

76 Interposing multi-party ownership into a privately-held facility will create complex management issues, investment disputes and delays, and operational, maintenance and financing risks. Rather than facilitating the efficiency aims of Part IIIA, access determinations which could impose multi-party ownership would create significant inefficiencies.

77 By way of example, even simple matters such as the scheduling of maintenance works on different parts of the infrastructure owned by different parties would necessarily involve consultation, negotiation and coordination, with the potential for delays and increased costs (and possibly safety concerns). Causation disputes may arise where damage or delay occurs and the various owners dispute who is liable for repair, leading to delays in remedying the issue and resultant loss in productivity. Or more significantly, the terms on which the infrastructure owner is able to acquire finance could be detrimentally impacted by the imposition of a third party access seeker with a lower credit rating.

78 Such a power may also involve an expropriation of property by the ACCC, where part of a facility that was originally owned by a private firm, including the right to use the land on which the facility is situated, becomes the property of a third party. This raises legal as well as practical issues.

79 Secondly, RTIO believes it is vital to retain the requirement that the ACCC not make access determinations that would require the provider to bear some or all of the costs of interconnections to the facility (or of extensions or expansions to the facility).

80 Company boards are the most appropriate body, and are best equipped, to determine whether a company undertakes potentially significant capital expenditure, not the ACCC. In making a decision about whether to invest capital, a board will need to consider, amongst other things:

- whether the company can afford to make a particular capital investment. Would such expenditure result in the company being unable to pay its debts as and when due?;
- whether a particular investment will generate an acceptable return for shareholders given the likely rate of return and risk; and/or
- whether there are better alternatives available for investment (which could include return of capital to shareholders).

81 Capital expenditure decisions generally involve consideration of a wide body of information, analysis of multiple factors, and the weighing up of risks governed by the company's particular investment risk profile. The ACCC does not have the time, experience or expertise to undertake this task. More fundamentally, allowing the ACCC to require a company to invest in an expansion for the benefit of third parties would require the ACCC to usurp the board's proper functions, and interpose the ACCC into the management of the infrastructure owner's business. Part IIIA was never intended to involve such statutory intrusion into Australian businesses.

82 If the service provider could be required to fund any part of works mandated by the ACCC, the ACCC could potentially require a company to make an investment even where the board's view is that there are better options available for investment of shareholder money. It could also require an investment to be made at a rate of return the board believes is inadequate given the risks involved (which may be high, given revenues will depend upon an access seeker remaining financially viable and paying future access charges). It could even require an investment where the board thinks it cannot afford the investment, or that it would be financially imprudent and/or raise insolvency risks to make the investment.

83 Providing for the ACCC to become so involved in a company's decisions not only exposes the infrastructure owner to potential risks, but also raises issues for the ACCC.

84 It is not appropriate for the ACCC to make decisions for shareholders of companies about how and where their money is invested.

85 The way costs are dealt with under the current regime is appropriate, particularly given that section 44X enables the ACCC to take into account the value to the provider of extensions (and expansions) or interconnections whose cost is borne by someone else. This provides a sufficient avenue to set off any windfall the service provider might otherwise obtain through access fees and other terms and conditions.

86 The safeguards included in the access determination provisions to protect the interests of infrastructure owners whose facilities are declared have always been recognised as important and necessary. The Hilmer Committee recognised the importance of having provisions to ensure access did not unduly impede an owner's right to use its own facility, including any planned expansion of utilisation or capacity.[32] Most recently, the High Court in the Pilbara rail access proceedings observed that concerns that the exercise of private proprietary rights not be 'lightly' overridden by the national access regime were addressed by the safeguards set out in sections 44W and 44X for service providers against whom access is granted.[33] RTIO believes that these safeguards, and particularly the ownership and payment protections discussed above, are even more important in light of an ACCC power to mandate expansions and must be retained.

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[32] *Report by the Independent Committee of Inquiry into Competition Policy* (August 1993) (***Hilmer Report***), p.256.

[33] *TPI v Australian Competition Tribunal* at [173]-[174].