BHP Billiton
Submission to the Productivity Commission's Inquiry into the National Access Regime
12 July 2013

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1. EXECUTIVE SUMMARY

BHP Billiton welcomes the opportunity to respond to the Productivity Commission's Draft Report on the National Access Regime (**Regime**)[1].

The Commission's Draft Report makes an important contribution by clearly identifying those exceptional cases where access regulation may increase welfare, and other cases where access is unlikely to increase efficiency, and could reduce welfare.

However, the Commission has failed to conduct the first and most critical task referred for its inquiry: an analysis of the costs and benefits of infrastructure regulation. A rigorous, real world cost benefit analysis is vital to evaluating the Regime's impact on the national interest. Without it, the Commission cannot meaningfully address the overwhelming majority of its Terms of Reference (see Box 1), or propose reforms which would promote the national interest.

The Commission's failure to undertake this practical, evidence based evaluation is reflected in its theoretical analysis, and the inadequacy and impracticality of its key recommendations.

BHP Billiton urges the Commission to conduct a rigorous cost benefit analysis having regard to the actual, practical experience and evidence of the Regime's impact, before preparing its final report.

Failure to do so will be a missed opportunity to identify reforms that promote the national interest, and complete the critical review mandated by the Council of Australian Governments, and entrusted to the Commission.

2. OUTLINE OF SUBMISSION

This submission addresses the following matters.

- The Draft Report's valuable contribution to identifying when access may result in public benefits, and when it is unlikely to achieve any benefits.
- The critical importance of a full cost benefit analysis of access regulation.
- The information the Commission should have analysed more closely in conducting a cost benefit analysis, including information relevant to the Regime's impact on investment incentives.
- The Commission's failure to understand the practical reality and real world complexity of the impacts associated with infrastructure access, as shown in:
    - the Commission's proposal that declaration criterion (b) should be assessed using an entirely impractical and unsound "natural monopoly" test;
    - the Commission's inadequate analysis of whether the Regime should be amended to ensure that access declaration does not occur where access would impose extensive costs on tightly integrated and intensively utilised infrastructure;
    - the Commission's view that there is no need for overarching reform of the Part IIIA declaration process, even though Part IIIA decision makers currently lack the time, skills and resources to make well-founded decisions; and
    - the Commission's draft recommendation that the ACCC should have the intrusive and likely ineffective power to direct a provider to expand the capacity of its facility against its will.
- The Commission's specific questions about Part IIIA negotiation/arbitration.

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[1] Productivity Commission, National Access Regime: Draft report, May 2013 (**Draft Report**).

Box 1 – Fulfilling many of the Terms of Reference requires a cost benefit analysis

Terms of Reference[2]	Cost benefit analysis
"In reporting on the Regime and the CIRA, the Commission is to: 1. examine the rationale, role and objectives of the Regime, and Australia's overall framework of access regulation, and comment on: a) the full range of economic costs and benefits of infrastructure regulation, including contributions to economic growth and productivity;	**REQUIRED**
b) the operation of the Regime relative to other access regimes, including its consistency with those regimes and the effectiveness of the certification process; and	Not essential
c) the roles of the National Competition Council, the Australian Competition and Consumer Commission and the Australian Competition Tribunal in the administration of the Regime, and the Minister as decision maker, and the relationship between the institutions;	**REQUIRED**
2. assess the performance of the Regime in meeting its rationale and objectives, including: a) the effectiveness of enhancements made to the Regime and the regulatory reforms agreed under COAG's National Reform Agenda; and	**REQUIRED**
b) how the Regime has been variously applied by decision makers, but not so as to constitute a review or reconsideration of particular decisions;	**REQUIRED**
3. report on whether the implementation of the Regime adequately ensures that its economic efficiency objectives are met, including: a) whether the criteria for declaration strike an appropriate balance between promoting efficient investment in infrastructure and ensuring its efficient operation and use; and	**REQUIRED**
b) whether the criteria for declaration are sufficiently well drafted in the legislation to ensure that its objectives will be met;	**REQUIRED**
4. provide advice on ways to improve processes and decisions for facilitating third party access to essential infrastructure, including in relation to: a) promoting best-practice regulatory principles, such as those pertaining to regulatory certainty, transparency, accountability and effectiveness;	**REQUIRED**
b) measures to improve flexibility and reduce complexity, costs and time for all parties;	**REQUIRED**
c) options to ensure that, as far as possible, efficient investments in infrastructure are achieved; and	**REQUIRED**
d) 'greenfield' infrastructure projects and private sector infrastructure provision;	**REQUIRED**
5. review the effectiveness of the reforms outlined in the CIRA, and the actions and reforms undertaken by governments in giving effect to the CIRA; and	**REQUIRED**
6. comment on other relevant policy measures, including any non-legislative approaches, which would help ensure effective and responsive delivery of infrastructure services over both the short and long term."	**REQUIRED**

[2] Extracted from Draft Report, vi-vii.

3. THE DRAFT REPORT'S VALUABLE CONTRIBUTION

The Draft Report makes an important and insightful contribution by recognising that "only in exceptional cases should access to an infrastructure service be regulated"[3], and by identifying particular conditions under which access is not likely to promote welfare.

In particular, Draft Finding 3.1 states:

> 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.[4]

The Commission has also noted that "the potential benefits" from access regulation "come from addressing allocative inefficiencies for monopoly pricing or denial of access, and hence from facilitating lower prices for consumers."[5] Further, it has explained that "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".[6]

This is vitally important, as it confirms sound economic principles:

- Where competition is possible, allowing competition is likely to deliver better welfare outcomes than access regulation (put another way: access regulation can reduce welfare when applied in situations where competition is possible). This is consistent with the policy underlying critical provisions of the national competition law framework established under the *Competition and Consumer Act 2010* (Cth) (**CCA**) (see Box 2).

- The purpose of access regulation is to facilitate allocative efficiency, not short term productive efficiency (ie access regulation should not be applied simply because granting access would avoid or discourage the duplication of existing facilities, in circumstances where access would not achieve any improvement in allocative efficiency).

- Where a business operates infrastructure to produce export commodities or other products which are sold into a competitive market, and cannot affect prices in that market, access to that infrastructure is unlikely to achieve the "potential benefit" of increasing allocative efficiency. This is precisely the situation presented by the applications for access declaration of BHP Billiton's and Rio Tinto's Pilbara iron ore railways. The Commission's analysis suggests that access would not deliver efficiency benefits and should not be imposed in those contexts.

The Commission has also proposed some beneficial reforms to declaration criteria (a), (e) and (f) (see Box 8 in section 7.4). Further, its draft recommendation that the Tribunal's merits review function be retained is an important endorsement of the importance of merits review under Part IIIA.[7] However the Commission's draft recommendations concerning the declaration criteria and process do not go far enough (see 7.4 and 8 below).

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[3] Draft Report, 2.

[4] Draft Report, 34.

[5] Draft Report, Box 2, 12.

[6] Draft Report, Box 2, 12.

[7] Draft Finding 9.1, Draft Report, 38. See also BHPB Submission, 8-12.

Box 2 - The preference for competition is well established in Australian law

The Commission's Draft Finding 3.1 reflects a well-established principle of Australian competition law and policy: that competition is to be preferred over monopoly, even when monopoly may be expected to achieve costs savings or other benefits.

This preference is highlighted by the prohibition of anticompetitive mergers and acquisitions under s 50 of the CCA.

In particular, a merger of two viable competitors[8] to create a monopoly is unlikely to be permitted under s 50, even if the merger would create a "natural monopoly", or would otherwise achieve cost reductions or other efficiencies that neither firm could achieve alone. Similarly, s 50 would be unlikely to permit creation of a monopoly even if the merged firm would be bound by court-enforceable undertakings to regulate the monopoly's ongoing conduct (ie, in a manner similar to regulated access terms).[9]

In reflecting this preference for competition over monopoly, the Commission's Draft Finding 3.1 interprets Part IIIA consistently with other critical elements of Australia's competition law framework.[10]

4. THE COMMISSION'S MOST IMPORTANT TASK: A FULL COST BENEFIT ANALYSIS

4.1 The Terms of Reference require a rigorous, fact based cost benefit analysis

The very first matter referred to the Commission requires the Commission to "examine the rationale, role and objectives of the Regime, and Australia's overall framework of access regulation", and comment on:

> 1(a) the full range of economic costs and benefits of infrastructure regulation, including contributions to economic growth and productivity.

Cost benefit analyses are critical to policy analysis, as recognised in the Commonwealth Government's Best Practice Regulation Handbook 2010,[11] and in Professor Allan Fels' submission to the Commission, which quotes the Commission's own statement that:

> In assessing the case for any regulation, the costs of intervention are an important consideration. Even if a regulation will have benefits, intervention will only be warranted if those benefits exceed the regulatory costs.[12]

The Commission appears to acknowledge as much: Box 1.2 in the Draft Report, which outlines general principles for assessing policy reforms, states: "the benefits of policy should outweigh the costs to the community as a whole", and "all effects of policy should be considered".[13] The Commission has also previously advocated cost benefit analyses: "appeals to nation building

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[8] In contrast, a merger to create a monopoly may potentially be permitted in the very special context of a "failing firm" – ACCC, Merger Guidelines, November 2008, [3.23].

[9] ACCC, Merger Guidelines, November 2008, Appendix 3, [20].

[10] The High Court has stated that "the primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute." (*Project Blue Sky Inc And Others v Australian Broadcasting Authority* (1998) 153 ALR 490, 509 [69]-[70] per McHugh, Gummow, Kirby and Hayne JJ). The object of the CCA is stated in s 2; that is, "to enhance the welfare of Australians through the promotion of competition and fair trading and consumer protection". Section 15AA of the *Acts Interpretation Act 1901* (Cth) states that in interpreting a provision of an Act "the interpretation that would best achieve the purpose or object of the Act (whether or not that purpose or object is expressly stated in the Act) is to be preferred to each other interpretation." It is entirely correct as a matter of law that Part IIIA should be interpreted consistently with s 50 of the CCA, as reflected in Draft Finding 3.1.

[11] Commonwealth Government, *Best practice regulation handbook*, June 2010, 26.

[12] Professor Allan Fels AO, *Submission to the Productivity Commission Inquiry into the National Access Regime*, March 2013, 38; Productivity Commission, *Review of the National Access Regime*, Inquiry Report No. 17, 28 September 2001, 59.

[13] Draft Report, 44 - 45. Also see the guidelines imposed on the Commission under the s 8(1)(c) of the *Productivity Commission Act* 1998: "In the performance of its functions, the Commission must have regard to the need… to encourage the development and growth of Australian industries that are efficient in their use of resources, enterprising, innovative and internationally competitive".

are no substitute for hard-headed analysis of benefits and costs".[14] The former Chairman of the Commission echoed this sentiment:

> Where private entities are considering investing large sums of money in infrastructure, their decisions will generally be based on a hard-headed assessment of the costs and revenue streams, and of the attendant risks. Yet … governments continue to base decisions on 'vision' or to achieve goals that are not subjected to rigorous, publicly tested analysis. [15]

A thorough, "hard-headed" cost benefit analysis should therefore properly underpin decision making about the future of the Regime.

4.2 The Commission has failed to conduct a cost benefit analysis

The Commission has acknowledged that "ideally, a rigorous cost-benefit analysis would be undertaken", and expressly quoted quantifiable evidence on the extensive costs of access (see Items 1-3 in Box 3). However the Commission described the task of undertaking a cost benefit analysis as "difficult", and did not attempt it.[16] Difficulty is no justification for omitting a cost benefit analysis.[17]

Box 3 – Quantifiable evidence on the costs of regulated access

1) A three month delay to Rio Tinto's iron ore expansions would result in costs in the order of $10 billion in lost export revenues and $4 – 6 billion in lost GDP. These delays could not be avoided by contractual or regulated terms, and average delays may be longer.[18] This conclusion by the Tribunal was based on extensive evidence from the three major Australian iron ore producers; it has not been questioned in the related legal appeals.
2) The rated capacity of the regulated Dalrymple Bay coal chain is 85 mtpa, but it has not delivered an annual outcome of above 64 mtpa.[19]
3) The ARTC's Hunter Valley rail network, which is regulated by a Part IIIA access undertaking, operates at 13 – 15% below contracted capacity.[20]
4) BHP Billiton has now also provided the Commission with evidence from the Pilbara rail access proceedings, given under affirmation by Mr Marcus Randolph, then Chief Executive, Ferrous and Coal for BHP Billiton. Mr Randolph testified that:
   a) the risk to BHP Billiton from third party access was the highest value item on BHP Billiton's internal risk register, and was valued at $7.9 billion.[21]
   b) BHP Billiton could "rebuild a completely independent railroad" for less than that amount, and had discussed spending $2 billion to do this, rather than incur the costs associated with access.[22]

[14] Productivity Commission, *Submission to Infrastructure Australia's National Infrastructure Audit*, September 2008, 9.

[15] Gary Banks, *Competition Policy's regulatory innovations: quo vadis?*, Address to the ACCC Regulatory Conference, Brisbane, 26 July 2012 and the Economists Conference Business Symposium, Melbourne, 12 July 2012, 10.

[16] Draft Report, 11.

[17] See, in another context, the Commonwealth Government *Best Practice Regulation Handbook*, 2010, 11:

> "If the benefits are difficult to value does the [Regulatory Impact Statement] still need to have a cost-benefit analysis?
>
> Yes – even though it can be very difficult to place a monetary value on some factors, including environmental and social impacts. The cost-benefit analysis should recognise this and include a qualitative discussion of these impacts so that they can be compared with other impacts that can be more easily quantified."

[18] *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2, [1265-1267,1296,1298]. Noted in Draft Report, 238.

[19] See BHP Billiton, *Submission to the Productivity Commission Inquiry into the National Access Regime*, 15 February 2013 (**BHPB Submission**), 4; Draft Report, 238.

[20] BHPB Submission, 21; Draft Report, 326.

[21] Transcript of oral evidence before the Australian Competition Tribunal, 17 November 2009, Mr Marcus Randolph, 2285.

[22] Transcript of oral evidence before the Australian Competition Tribunal, 17 November 2009, Mr Marcus Randolph, 2305.

4.3 The Commission cannot usefully address its other Terms of Reference without understanding the full costs and benefits of the Regime

Without a practical, real world evaluation of the evidence on the impact of access regulation, it is impossible for the Commission to respond meaningfully to other critical Terms of Reference, including Terms of Reference 2, 3, 4 and 6 (see Box 1).

4.4 The Commission proposes that other Part IIIA decision makers should do this type of analysis, but provides no guidance on how to conduct this analysis

Some of the Commission's key draft recommendations about the declaration criteria propose that Part IIIA decision makers should carefully estimate and evaluate the costs associated with access. This would require the NCC and Minister to consider additional maintenance costs and reduced operational flexibility caused by access, compliance and administrative costs associated with access, and "the effect of declaration on investment in markets for infrastructure services and dependent markets" (see Box 8).

The Commission has missed a vital opportunity to provide guidance to these decision makers about assessing the costs of access as required by the Commission's own draft recommendations, even though the Commission has had more time to do this analysis than Part IIIA decision makers would have when considering a declaration application in practice.

5. THE COMMISSION HAS NOT EVALUATED ONE OF THE MOST CRITICAL COSTS OF ACCESS: INVESTMENT DISINCENTIVES

5.1 The Commission's basis for not evaluating investment disincentives

Investment disincentives are a critical and well-recognised cost of access regulation. The Terms of Reference require the Commission to advise on how to "ensure that, as far as possible, efficient investments in infrastructure are achieved."[23] The Commission cannot address this requirement unless it understands how the Regime affects investment in practice. However, the Commission has not meaningfully evaluated this issue. It did acknowledge that access can affect investment incentives positively and negatively,[24] but then declined further evaluation on the ground that it lacked "conclusive empirical evidence".[25] In taking this approach, the Commission set the bar unrealistically high (ie "conclusive empirical evidence"), and declined to do the analysis because the evidence failed this artificial standard. In doing so, the Commission has given too little attention to the significance of the evidence before it (see Box 3), and relied too uncritically on untested and unproven assertions that regulation can "minimise" economic distortions and "promote" efficient investment (see Box 4).

The Commission is the pre-eminent body charged with assessing such matters. Its role is *precisely* to evaluate these issues, as reflected by the Terms of Reference and the former Chairman:

> … the very fact of exposure to price regulation — and the uncertainties this creates — can in itself deter investment. … The Commission has previously argued that the efficiency losses from setting regulated prices too low could generally be expected to be higher than from setting them too high. … That said, the proposition that there is an asymmetry in investment cost impacts has been contested **and the Commission will need to revisit this in its forthcoming review of Part IIIA**.[26] [emphasis added]

The Commission's choice not to address these issues rigorously, on the basis of the available evidence and its considerable expertise, seriously undermines the Draft Report.

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[23] Term of Reference 4(c), Draft Report, vii.

[24] Draft Report, 254. See also Table 3.1, Draft Report, 107.

[25] Draft Report, 15, 241-242 and 260.

[26] Gary Banks, *Competition Policy's regulatory innovations: quo vadis?*, Address to the ACCC Regulatory Conference, Brisbane, 26 July 2012 and the Economists Conference Business Symposium, Melbourne, 12 July 2012, 14 – 15.

Box 4 - The evidence suggests that regulation cannot "minimise" the costs of access

The Australian experience suggests that access regulation does not minimise or avoid the costs associated with access. Professor Allan Fels, who has spent his career dealing firsthand with the benefits and shortcomings of regulation, made this point in a submission to the Commission.[27]

The Commission has acknowledged the existence of access costs and regulatory error …

The Draft Report acknowledges the evidence in points 1-3 of Box 3.[28] It also describes an experience concerning ARTC in the Hunter Valley,[29] where:

- ARTC considered that regulated prices determined by the ACCC provided an insufficient return to justify expenditure for a planned expansion;
- users voluntarily agreed to arrangements with ARTC which provided a higher return; and
- as a result, the investment proceeded because the parties abandoned regulated prices.

… but also appears to assume these costs and errors away.

However the Commission also makes statements which dismiss the experience with access – for example, it states that economic distortions from access "can be minimised" by regulation[30] and that "well designed and implemented access regulation can promote efficient investment".[31]

These statements are, at best, aspirational. They are not supported by the experience to date.

The Commission ought to address the clear quantitative evidence about the shortcomings of regulation, rather than relying on untested and unsubstantiated qualitative assertions

5.2 What does the evidence suggest about investment disincentives?

The fundamental question for a prospective investor is: "What do I get for my money?" For an investor in infrastructure, this means "How much can I *use* (or sell the use of) the facility?" For an investor in infrastructure associated with a mining project, this means "How much can I *produce* using the facility?" The value of an infrastructure investment is critically determined by the investor's ability to make productive use of the investment over its lifetime.

The prospect of access prevents an investor from answering this fundamental question with any certainty. The evidence before the Commission suggests that access delays expansions and results in capacity shortfalls (see Box 3) – ie, that access *reduces* investors' ability to make productive use of their investment. As explained in BHP Billiton's previous submission:

> 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.[32]

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[27] Professor Allan Fels AO, *Submission to the Productivity Commission Inquiry into the National Access Regime*, March 2013, Part 3 generally; see also BHP Billiton Submission, Annexure B, Part 3.5; and *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2, [1242, 1265-1267].

[28] Draft Report, 238 and 326.

[29] Draft Report, 232.

[30] Draft Report, 234.

[31] Draft Report, 242.

[32] BHPB Submission, 29.

This uncertainty introduces an additional risk to the project, making the investment "more expensive". This will inevitably weigh on an investor's decision about whether and how much to invest in infrastructure. The Commission does not cite any evidence to suggest that access regulation can occur without giving rise to such uncertainty.

Box 5 – The impact of access on incentives to invest in infrastructure which may be declared

An investor is considering whether to invest $2 billion to build a single user railway which would initially transport 50 mtpa of iron ore. The $2 billion investment is designed so that it could be expanded to transport 60 mtpa in 5 years' time for minimal additional expenditure.

The investment is profitable, and the best use of the investor's funds, if the railway remains a single user facility.

The investor attempts to consider the impact of access on its investment, assuming:

- *that track access is declared 4 years after the railway is completed; and*
- *(optimistically) that access will result in a 15% capacity shortfall and delay the 10 mtpa expansion by 3 months.*

	What production would the $2 billion investment deliver?	
	Never declared	**Declared from year 4**
Year 1	50 mt	50 mt
Year 2	50 mt	50 mt
Year 3	50 mt	50 mt
Year 4	50 mt	42.5 mt[33]
Year 5	60 mt	48.9 mt[34]
Years 6 - 20	60 mtpa	51 mtpa
Total	1160 mt	1006mt
Investment cost per tonne delivered	$1.72	$1.99

Box 5 presents a highly simplified example of how risks associated with access can impact on an investment decision. In this example, the investor makes assumptions about the impact of access, in an attempt to answer the question "What do I get for my money?" The results show that the investor can invest $2 billion to achieve 1160mt production (at a cost of $1.72 per delivered tonne) if the facility is not declared, or 1006 mt (at a cost of $1.99 per delivered tonne) if it is declared. In other words, if declaration occurs, the investor will have "paid more to get less" than if the facility remained a single user facility.

In practice, this could affect the investor's decision in the following ways:

- If the access-adjusted investment case (ie lower production, higher costs per delivered tonne) shows the investment is profitable and is the investor's best use of funds: **investment proceeds, but at higher cost and lower return**.

- If the access-adjusted investment case shows the investment is profitable but is no longer the investor's best use of funds: **no investment** (the investor may pursue another option, which may not involve infrastructure, or be based in Australia).

- If the access-adjusted investment case shows the investment is not profitable: **no investment**.

[33] Figures reflect a 15% capacity shortfall each year from year 4 (when declaration occurs).

[34] We have not included the minimal additional cost of the expansion in year 5 in the costings in this table; this is appropriate given the assumption that the expansion costs are significantly borne in the initial $2 billion investment, with small incremental cost in year 5. These figures reflect the assumption that the expansion to 60 mtpa is delayed by 3 months, so that expanded production scheduled for Q1 of year 5 is not achieved until Q2 of year 5; it also reflects the assumed 15% capacity shortfall, resulting in production of 10.625 mt in Q1 (ie (85% x 50 mtpa)/4) and of 12.75 mt in Q2, 3, and 4 (ie (85% x 60 mtpa)/4), producing a total of 38.25 + 10.625 = 48.875 mt.

- Even if the investment proceeds, the investor may seek to:
    - limit the declaration risk – eg, by reducing the size of the investment or cancelling the expansion, to avoid having "spare" capacity for access; or
    - postpone investing until the access risk is better understood – eg, by deferring the expansion until the declaration application is determined.

The best outcome is that the access risk increases the cost and lowers the return on investment, but the investment proceeds nonetheless; the other alternatives are that the investment is cancelled, deferred or reduced.

In practice, the investment decision in Box 5 would be further complicated, and the investor would be further deterred from investing, if the ACCC exercised a power to order the investor to expand their infrastructure to accommodate an access seeker. To take a simplified example, suppose the ACCC ordered the investor to expand capacity by 10 mtpa in year 4. In this situation:

- The provider would find itself in the midst of construction works to accommodate its competitor at precisely the time it intended to be expanding for its own business.
- The need to undertake expansion works in accordance with the ACCC's direction would delay the provider's own expansion, thereby further reducing the return (ie delivering fewer tonnes) on the provider's investment. This delay would be an inevitable consequence of the provider needing to negotiate/arbitrate with the access seeker about the complex issues raised by a mandated expansion (see Box 10 below), and address issues concerning the interaction of the mandated expansion with the investor's own expansion and operations.
- The provider may be required to construct the investment it had intended to use for its own purposes in order to accommodate its competitor. If this occurred, the competitor could effectively free ride on the investor's upfront investment, and make use of a "cheap" expansion option, forcing the investor to consider a more expensive expansion option instead. This could fundamentally change the economics of the investor's investment, and may deter or delay the investor's own expansion.

The practical issues associated with mandated extensions and expansions are addressed in Box 10 below.

6. THE "NATURAL MONOPOLY" TEST FOR CRITERION (B) IS UNWORKABLE IN PRACTICE AND UNSOUND IN PRINCIPLE

6.1 The Commission's Draft Recommendation 8.1

Declaration criterion (b) provides that a service can only be declared if "it would be uneconomical for anyone to develop another facility to provide the service". The High Court held that this test requires assessment of whether it is "privately profitable" to develop another facility.[35] However the Commission has made a draft recommendation that this criterion should be amended:[36]

> … such that criterion (b) is met where total market demand could be met at least cost by the facility. Total market demand should include the demand for the service under application as well as the demand for any substitute services provided by facilities serving that market. The assessment of costs under criterion (b) should include an estimate of the costs associated with additional maintenance and reduced operational flexibility imposed on the infrastructure service provider from coordinating multiple users of its facility.

6.2 The natural monopoly test is impractical

The Commission's proposed natural monopoly test would be highly impractical to apply and would create significant uncertainty about declaration outcomes.

The proposed test is not practical. A practical approach would be clear and straightforward to apply, and would rely on information and analysis which is used and understood by access seekers and infrastructure owners alike. The natural monopoly test does not meet that standard. The Draft Report does not even begin to answer the challenging questions that would need to be addressed in order to apply the natural monopoly test in practice (see Box 6). In contrast, the private test applies a "hard-headed", well-understood:

> question that bankers and investors must ask and answer in relation to any investment in infrastructure … *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.[37]

The proposed test does not provide certainty about declaration outcomes. The unanswered questions about how the natural monopoly test could be applied in practice (see Box 6), and the absence of any established industry analytical techniques to apply it, mean that the test confers a substantial discretion on regulatory decision makers. No access seeker could reliably predict whether this test will be satisfied (and hence whether the facility could be declared), since it requires a detailed understanding of the cost structure of the provider's facility, which will not be known to access seekers. An unpredictable test, based on a regulator's discretion and techniques and information which are unavailable to critical stakeholders, hardly provides certainty to those most affected by its application.

In contrast, the private test can be applied using information and techniques familiar to market participants. Predicting the outcome of the private test does not require hypothetical, abstract or unfamiliar analysis, or regulatory fact-finding. The private test asks precisely the question access seekers will typically consider when deciding whether to build infrastructure or seek access, and industry participants can readily predict the answer to that question.

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[35] *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (14 September 2012) at [159].

[36] Draft Recommendation 8.1, Draft Report, 36.

[37] Decision of the High Court of Australia in *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (14 September 2012) at [106].

Box 6: The natural monopoly test is unworkable in practice

There are critical questions about how the natural monopoly test could be applied in practice.

Essential issues	Questions unanswered by the Draft Report

What options are relevant to determine whether "total market demand" could "be met"?	The Draft Report **does not** provide any guidance on this point.
	• Does the test assess the capacity of the existing facility, or the capacity of the facility following potential expansions?
	• If the test assesses expansions, what options are assessed?
	  ○ Capital investment in the facility (eg duplicating a section of rail)?
	  ○ Operational changes to expand the facility (eg longer operating hours)?
	  ○ Capital investment in infrastructure other than the facility, which expands the facility's capacity (eg faster train loading or unloading equipment)?
	  ○ Only the "cheapest" expansion options (eg double tracking a flat section of track), or also more expensive options (eg building a new bridge)?

Does "cost" mean "actual cost"?	The Draft Report **does not** explain whether "cost" refers to the *actual* cost to the provider of accommodating demand in accordance with its standard practice. For example: • Does the test measure actual cost, or an alternative regulatory concept such as "efficient" costs? • In either case, does the test measure the cost of accommodating demand in accordance with the provider's design standards, or with the access seeker's standards? What if the provider's standards are necessary and efficient for the provider's operations, but more expensive than the access seeker requires?
What categories of "costs" are assessed?	The test requires an assessment of "least cost", including "the costs associated with additional maintenance and reduced operational flexibility." The Draft Report **does not** identify what time period is used to assess costs, or what other types costs must be assessed. For example, does the test consider: • A return on historical capital costs? A return on capital costs associated with expansions? If so, how will capital cost be converted to an "operating cost" to allow the natural monopoly test to be applied? • Opportunity costs? (If a "cheap" expansion option is used to accommodate demand, does the test assume the provider is compensated for having to use a more expensive option for its own needs in future, and assess that cost?) • Consequential loss? (If expansion works temporarily close part of the provider's facility and so delay or reduce production, does the test assume the provider is compensated for this loss and assess that cost?) • Inefficiency costs? (Mandated expansions will be less efficient than voluntary expansions – see Box 10 below. Does the test recognise or ignore these inefficiency costs?) • Social costs? (If the natural monopoly test is not the same as the "social test", which, if any, social costs are assessed under the natural monopoly test?)
What information and techniques can be used to assess costs?	The Draft Report **does not** explain what information or techniques can (or would) be used. • The test assesses costs as a function of quantity produced. Businesspeople routinely consider how costs change over time, but not how costs change with quantity *and* time. How does the test assess these variations? What about other cost variations (eg cost increases associated with "hot" market conditions)? • The Commission itself has not evaluated critical costs of access (eg lost flexibility and additional maintenance) – how would Part IIIA decision makers do this under the natural monopoly test?

6.3 The natural monopoly test is unsound in principle

Even aside from its impracticality, the natural monopoly test is flawed as a matter of principle.

The Commission's Draft Finding 3.1 rightly identifies that:[38]

> 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.

Accordingly, Draft Finding 3.1 suggests that the critical question to identify whether access regulation "could reduce welfare" or is "likely to provide net benefits" is: are ***"two or more infrastructure service providers … able to provide the same service (or an effective substitute service)?"*** The private test, not the natural monopoly test, best asks and answers this question consistently with the Commission's own draft finding. The natural monopoly test produces results which are inconsistent with this draft finding.

BHP Billiton refers the Commission to its previous submission[39] and the economic analysis in Rio Tinto Iron Ore's previous submission,[40] on this point.

7. THE COMMISSION HAS NOT SOUGHT TO PREVENT THE EXTENSIVE COSTS OF IMPOSING ACCESS ON INTENSIVELY USED, TIGHTLY INTEGRATED INFRASTRUCTURE

7.1 The national interest imperative

A full cost benefit analysis would have revealed the clear national interest imperative of ensuring that intensively used, tightly integrated infrastructure is not declared for third party access. The Pilbara iron ore railways are the prime example of how Part IIIA has been applied to such infrastructure to date; as outlined above, this experience suggests that the costs from declaring these facilities could extend to $10 billion in lost export revenues and $4 – 6 billion in lost GDP (see Box 3). The Commission has barely considered, and has not proposed, any reforms that would promote the national interest by ensuring that such facilities are not declared.

These reforms are particularly important given that the High Court has limited the scope for the Tribunal to conduct a merits review, and in particular to review the Minister's decision on the public interest under declaration criterion (f). Previously, only the Tribunal had the time, resources and skill to undertake, and in fact undertook, the complex and rigorous cost benefit analysis which ensured that intensively used, tightly integrated infrastructure was not declared where the extensive costs of access were likely to outweigh any benefits. Now that the Tribunal's review powers on criterion (f) are more narrowly understood, it is imperative that the Commission identifies how Part IIIA will ensure that such infrastructure is not declared in future.

7.2 The Commission should recommend amending the definition of "service"

The Commission should further consider limiting the "services" which may be declared under Part IIIA. The Draft Report gives little consideration to this issue: it only cursorily considers the "production process" exception in s 44B, and does not consider other possible amendments.

There are serious shortcomings with the production process exception (see Box 7). However the Draft Report simply notes that the production process exception is "a useful initial filter for

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[38] Draft Finding 3.1, Draft Report, 34.

[39] BHPB Submission, Annexure C, 32-36.

[40] Rio Tinto Iron Ore, *Submission to the Productivity Commission's National Access Regime Review*, February 2013, 6-10.

the obvious cases where coordination costs will exceed any competition benefits", and is often associated with manufacturing.[41] It does not identify any evidence to support its assertion that there have ever been "obvious cases", or identify any cases where it considers that the exception has been useful in practice. The Commission does not analyse or propose reforms to address the shortcomings of this exception. It simply concludes that "it is difficult to define a broad exception".[42]

BHP Billiton submits that the production process exception would work more effectively if it simply applied to the use of any infrastructure which is operated as a material part of a production process, regardless of whether the declaration application concerns use of all or part of that particular *process*. The Commission does not appear to have considered this possibility.

Box 7: Shortcomings of the production process exception

- The definition of the "services" which can be declared under Part IIIA specifically excludes the "use of a production process", except to the extent that that use is an integral but subsidiary part of the service sought to be declared (s 44B).
- The High Court has found that this exception did not prevent Fortescue from seeking declaration of a service comprising Fortescue's use of a railway track that BHP Billiton operated as part of its own production process.
- As a result, this exception has no useful application: the use of infrastructure which is part of the provider's production process may be declared, as long as an access seeker identifies a "service" with reference to a subset of production process infrastructure, rather than to the use of the provider's production process.
- The production process exception did not prevent declaration of the Newman and Hamersley iron ore railways, even though they were acknowledged to be "part of" a production process, and the Tribunal expected that access would cause billions of dollars in lost exports and GDP. Had this exception applied, significant time and cost associated with the Pilbara proceedings could have been avoided.

7.3 The Commission should rigorously assess the other proposals before it

It is not clear what, if any, regard the Commission has given to other proposals which would help to ensure that intensively used, tightly integrated infrastructure is not declared.

For example, BHP Billiton previously proposed that Part IIIA be amended to introduce:

(a) a new "economic cost/benefit criterion", which would require that declaration could only occur if the decision maker was satisfied that the likely economic costs of access would not outweigh the likely economic benefits of access;[43] and

(b) a new "capacity criterion", which would require the decision maker to be satisfied that the facility would have or be likely to have capacity to provide the service before declaring or recommending declaration of the service.[44]

These proposals would help to ensure that Part IIIA declaration did not occur where the costs of access were likely to be so extensive as to render access contrary to the national interest. BHP Billiton urges the Commission to consider them in its final report.

[41] Draft Report, 150.

[42] Draft Report, 150.

[43] BHPB Submission, 14.

[44] BHPB Submission, 15.

7.4 The Commission's draft recommendations on the other declaration criteria do not address this concern

The Commission's draft recommendations concerning the other declaration criteria are sound in principle, but do not assist in preventing declaration of intensively used, tightly integrated infrastructure.

Box 8 – The Commission's other draft recommendations do not address the substantive issues

Criterion (a): that "access (or increased access) to 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"

- The Commission proposes amending criterion (a) to require "a comparison of competition with and without access on reasonable terms and conditions through declaration".[45]
- This may usefully prevent declaration based on an abstract competition benefit, or a benefit which is already being achieved via unregulated access. However, it does nothing to prevent declaration of intensively used, tightly integrated infrastructure.
- Further, while the Commission rightly acknowledges that access is unlikely to increase efficiency where the provider is an export producer who has no power to set prices in world commodities markets,[46] its proposed amendments do nothing to ensure that the declaration criteria exclude declaration in this scenario, or to ensure that declaration can only occur where access would achieve a competition benefit which is itself nationally significant, or at least meaningful in the context of the nationally significant infrastructure which is the subject of declaration.[47]

Criterion (e): effective access regime

- Under criterion (e), a service cannot be declared if it is already the subject of an effective access regime.
- The Commission has usefully recommended that this issue be tested as a threshold issue rather than being incorporated into a declaration criterion.[48]
- This proposal does not assist to prevent declaration of intensively used, tightly integrated infrastructure.

Criterion (f): that "access (or increased access) to the service would not be contrary to the public interest"

- The Commission proposes amending this criterion to provide that a service may not be declared unless declaration promotes the public interest, and require decision makers applying this criterion to have regard to the effect of declaration on investment in markets for infrastructure services and dependent markets, and compliance and administrative costs associated with access.
- Raising the public interest threshold and mandating consideration of particular access costs usefully reforms criterion (f) in principle; however in practice, the Minister who applies this criterion will not have the time to undertake this complex analysis, the NCC is manifestly under-resourced for this task, and the Tribunal has limited scope to review the Minister's decision. Accordingly, it is at best unclear whether this criterion will have any material impact in practice; it cannot be relied on to prevent declaration in inappropriate cases.

[45] Draft Recommendation 8.3, Draft Report, 38.

[46] Draft Report, Box 2, 12.

[47] See BHPB Submission, 13.

[48] Draft Recommendation 8.5, Draft Report, 36.

8. THE DRAFT RECOMMENDATIONS DO NOT ADDRESS THE SIGNIFICANT DEFICIENCIES IN THE PART IIIA DECLARATION PROCESS

Had the Commission undertaken a full analysis of the costs and benefits of access regulation, it may have been more concerned to ensure that Part IIIA decision makers were able and likely to make correct decisions on declaration applications.

In the absence of that analysis, the Commission has acknowledged but not addressed submissions[49] concerning the manifestly inadequate resourcing, skills and time available to Part IIIA decision makers (see Box 9). The Commission has not identified meaningful procedural or institutional reforms in response to the Terms of Reference which specifically require it to consider improvements to processes and decisions for access (for example, Term of Reference 4).[50] The Commission has done nothing to ensure that Part IIIA decision makers have the time, skills, and resources required to conduct a rigorous analysis of declaration applications, or to increase the likelihood that the Part IIIA process will produce correct declaration outcomes. BHP Billiton refers the Commission to BHP Billiton's previous submission on these matters.

Box 9 - BHP Billiton's previous submissions on the Part IIIA declaration process

Concerns identified[51]	Response in Draft Report
NCC	
Manifestly under-resourced; insufficient finances and expertise; cannot conduct the rigorous substantive analysis previously conducted by Tribunal	NCC should retain its current role – identifies but does not address NCC's inadequate resources.[52] Only suggested reforms: NCC staff secondments and lower quorum for NCC decisions.[53]
Insufficient time for parties to prepare necessary information	Nil
Minister	
Rigorous analysis is impossible within the Minister's 60 day time limit As a result, the Minister is not able to make a substantive and independent contribution to the declaration decision, and in practice is likely to rely on the NCC's fact finding and analysis	Nil change to time limit. Minister should be deemed to adopt NCC's recommendation if he/she does not make a decision in the 60 day time limit[54] - this would *increase* the influence of the NCC's fact finding and analysis on the declaration outcome
Tribunal	
Merits review is essential, but the Tribunal will provide a much narrower quality check on the NCC/Minister's analysis following 2010 legislative amendments and 2012 High Court decision[55]	"On balance", the status quo, including merits review, "should contribute to sound decision making".[56]

[49] See extracted submissions of BHP Billiton (Draft Report, 283), Rio Tinto (Draft Report, 284), the Law Council of Australia (Draft Report, 290), the Institute of Public Affairs (Draft Report, 283).

[50] Term of Reference 4, Draft Report, vii.

[51] BHPB Submission, 5–7, and 12.

[52] Draft Report, 286.

[53] Draft Report, 287.

[54] Draft Recommendation 9.1, Draft Report, 296.

[55] In 2010 amendments to Part IIIA were introduced which 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 (Section 44ZZOAAA of the CCA, amended by the *Trade Practices Amendment (Infrastructure Access) Act 2010* (Cth)). In 2012 the High Court held (in relation to the law as it stood before the 2010 amendments) that 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) ([2012] HCA 36 (14 September 2012) at [65]).

[56] Draft Report, 307.

9. THE PROPOSAL TO ENTRENCH THE ACCC'S POWER TO DIRECT EXPANSIONS IS FUNDAMENTALLY MISCONCEIVED, AND WILL NOT WORK IN PRACTICE

Draft recommendation 8.7 proposes amending s 44V(2) of the CCA to confirm that the ACCC has the power, when arbitrating an access dispute, to require a provider to expand the capacity of and extend its facility.

Again, the Commission has not undertaken any cost benefit analysis associated with this intrusive power, or any substantive analysis of how it might operate in practice. Such analysis would have revealed that this power is likely to be completely unworkable, and will deter rather than facilitate infrastructure investment.

9.1 Commission's consideration of this issue

The Draft Report attempts to justify the power to direct expansions as being "in the interests of regulatory and investment certainty";[57] it notes that directing a provider to conduct expansion works to accommodate an access seeker "may be in the community's interests" where the provider is the most efficient party to do the required works,[58] and that this power may prevent a provider from foregoing or delaying expansion works required to accommodate access seekers in order to facilitate monopoly pricing, and/or forestall access.[59]

The Commission has acknowledged that this power "has the potential to increase regulatory risk", may undermine investment incentives, and "may require complex operational, commercial and legal considerations".[60] However the Commission has not thoroughly identified or evaluated those complex considerations, or considered whether any regulatory framework or the ACCC could possibly address them. Further, it has not meaningfully considered whether this power could be exercised without deterring investment, or whether it would in practice achieve the Commission's aim of preventing undersized investments.

The Commission has not foreshadowed that it will conduct this analysis; rather, it has simply made a draft recommendation that the ACCC should develop and publish guidelines on how it would exercise this power,[61] in the expectation that "greater transparency … would improve regulatory and investment certainty".[62]

The Commission has also observed that the power to order extensions/expansions "should be subject to robust and practical safeguards to protect the interests of all parties".[63] However, it has not yet attempted to identify what principles should underpin those safeguards, or what interests the safeguards should protect. Rather, it has called for further submissions, but provided no guidance on this point.

9.2 Any power to direct investment should be confined to a power to order a geographically limited interconnection to facilitate access

BHP Billiton recognises that the ACCC should have the power to direct the construction of a geographically limited interconnection of a provider's facility with an access seeker's infrastructure, in circumstances where access could not occur without that interconnection.

However any broader power, regardless of whether it is described with reference to an "extension" or an "expansion", will seriously interfere with the provider's business, will raise complex practical issues which will be incapable of resolution in the absence of agreement between the provider and access seeker, and is likely to be futile in practice.

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[57] Draft Report, 253.

[58] Draft Report, 134.

[59] Draft Report, 134.

[60] Draft Report, 136 and 253.

[61] Draft Report, Draft Finding 8.8, 37.

[62] Draft Report, 135.

[63] Draft Report, 136.

9.3 A broader power would seriously interfere with legitimate business conduct

The ACCC has expressed a preference, endorsed by the Commission, for extensions and expansions to be conducted by agreement rather than mandatory direction.[64] Accordingly, the extension/expansion power would only be exercised if the provider determined that it was not in its commercial interests (including the interests of its shareholders) to undertake the extension/expansion voluntarily. This could include, for example, circumstances where the provider's Board considered that the return from the expansion did not justify the associated risk (eg the disruption to the provider's own business, or the risk that the access seeker would not be able to fund the expansion to completion). Further issues would arise if the safeguard in s 44W(1)(e), which prevents the provider from being required to "bear some or all of the costs of extending the facility", was watered down. If that occurred, such that mandated expansions were financed using "take or pay" agreements, and the access seeker became insolvent before the expiry of such an agreement, the provider could be stranded with an asset which it did not want and which the access seeker had not fully funded.

Even more intrusive issues would arise where the provider was vertically integrated, only provided the service for its own purpose, and was not in any way involved in supplying the declared service or extension/expansion services to any other party. For example, where the provider was a vertically integrated producer of export commodities, an ACCC direction to expand would be tantamount to a government mandate that the provider become a supplier of construction and project management services, against its will, to the benefit of its competitors, notwithstanding that this formed no part of the provider's existing business.

The Commission's Draft Report has given scant consideration to these fundamental alterations to the rights of private firms and their shareholders.

9.4 The Commission has not considered the enormous practical challenges involved in exercising the ACCC's extension/expansion power

Compelling an individual or business to engage in ongoing behaviour which they would not otherwise pursue voluntarily raises extensive practical difficulties. This is well recognised as a matter of law, and reflected, for example, in the courts' general reluctance to grant and supervise mandatory injunctions.[65] It is similarly reflected in the ACCC's own informal merger clearance guidelines, which expressly prefer "structural" rather than "behavioural" merger remedies.[66] In the case of a provider being directed to conduct an expansion against its will, the associated legal, commercial, technical and operational considerations are likely to be intractable. The Commission's analysis of this issue identifies only a subset of the difficulties which are likely to arise (see Box 10).

The practical issues raised by a mandated extension/expansion may be able to be resolved by agreement where resolution is in both parties' commercial interests. They may also be able to be resolved effectively by arbitration where the value and complexity of the issues are low – this is the basis for BHP Billiton's submission that the ACCC should only have the power to direct the construction of geographically limited interconnections, and not a broader power (see 9.2 above). However, these complex issues are unlikely to be resolved where the value and/or complexity of the relevant issues is any more than minimal, and the parties do not judge it in their commercial interests to reach agreement on those issues.

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[64] See the comments of the ACCC and the Commission in the Draft Report at 139 and 253, respectively.

[65] See *J C Williamson Ltd v Lukey* (1931) 45 CLR 282 at 299, 300.

[66] ACCC, Merger Guidelines, November 2008, Appendix 3, [11, 20, 21].

Box 10 - Practical issues raised by the ACCC's extension/expansion power

Issue	Illustration
How will the extension/ expansion be designed?	The provider and access seeker may have different views on appropriate design standards (and hence costs), and there is not likely to be an "industry standard" the ACCC can rely on to resolve disputes. For example, an access seeker: • may use materially lighter weight rail sleepers for its railway than the provider uses (eg because it runs lighter trains); must the access seeker pay for heavier, more expensive sleepers, or must the provider compromise on its standards? • may use materially fewer sleepers per kilometre on its own railway than the provider uses (eg because it has a shorter investment horizon and designs for a 1 in 5 year flood event, whereas the provider has a longer horizon and designs for a 1 in 20 year flood event); must the access seeker adopt the provider's risk preferences? If not, must they compensate the provider for the increased incidence of flood damage over time?
How will the extension/ expansion works be contracted?	Mandated extension/expansion works will not be contracted as efficiently as if the provider was voluntarily extending/expanding. For example: • a provider might obtain long lead-time items in advance when planning its own expansion, but would not do this for an access seeker until the ACCC mandated the expansion and the access seeker provided full funding; • a provider would optimise its contracting strategy for voluntary extensions/ expansions, but would not incur cost or risk concerning a mandated extension/ expansion until it received the relevant funding – for example, if an access seeker provided funding in instalments, the provider would rationally conduct contracting and procurement in stages which matched those instalments. In both cases, an access seeker may object that the provider was proceeding less efficiently than if it was conducting works for itself; however a provider may justify its conduct as necessary to prevent it bearing any costs of the extension/expansion.
How will real time technical decisions be made while the extension/ expansion is built?	Extension and expansion works require ongoing discretionary decisions, on-site, in real time, based on an individual's skill and experience. Reasonable minds can differ on whether decisions are preferable, let alone optimal. For example: • a provider may identify that construction works should proceed more slowly than scheduled, to allow additional quality checks; the access seeker may resist the associated cost and delay if they think the checks are unnecessary; • an infrastructure owner makes many decisions as to the quality of work performed by contractors and sub-contractors when conducting extensions/expansions for its own purposes. At times it will approve work that is not strictly compliant with specifications, as the differences can likely be corrected at a later stage. There will be limited incentive for a provider to make these judgement calls in the context of a mandated extension/expansion, since an access seeker may seek to challenge the provider for not complying with design specifications. However, if the provider does not make those judgement calls, the access seeker may object to any resulting delays. In a mandated extension/expansion, where the provider and access seeker have no incentive to reach agreement, who will make these decisions?
How will cost and risk be allocated?	The "safeguards" in Part IIIA prevent the provider from being required to bear the cost of an extension/expansion.[67] What does "cost" mean? For example: • Does it require only that the provider be reimbursed for costs incurred, or that the provider not be out-of-pocket at any point in time during the conduct and use of the extension/expansion works? • If mandated extension/expansion works constrain or delay the provider's own operations or expansions, will the access seeker compensate the provider for the associated loss of export revenue and myriad other potential opportunity costs? What if the value of the loss is greater than the value of the access seeker's business? Who would make up this shortfall? • Will the provider be compensated for other associated opportunity costs – for example, the diversion of management time away from its own business, for the benefit of its competitor? If not, will the ACCC allow the provider to deploy its most talented executives to work on its own business, so that it can at least mitigate the opportunity cost associated with a mandated extension/expansion?

[67] CCA, ss 44W(1)(e), as to extensions, and (f), as to interconnections.

9.5 Power to order an expansion will be futile

Where an extension/expansion occurs by agreement, because market forces (rather than regulation) dictate that this is an efficient outcome, practical matters are likely to be managed and determined by an agreed decision maker. However, where a provider is directed to undertake an extension/expansion against its will, the interests of the provider and access seeker (often a competitor) will by definition not be aligned. Both parties will be incentivised either to "take every point" (ie refer all disputes to arbitration) or to "work to rule" to prevent disputes. Both alternatives are cumbersome and impractical and will lead to increased costs. The cost and risk associated with addressing the myriad likely disputes will at best make mandated extensions/expansions significantly less efficient than other, consensual alternatives. Further, providers will still be incentivised not to invest in "spare" capacity, knowing that the need for the ACCC to exercise the extension/expansion power and deal with the associated complexities will likely delay the provision of access.

This analysis holds regardless of whether Part IIIA protects the provider from bearing any cost associated with an expansion.[68] However if Part IIIA is interpreted or amended to allow for the provider to be required to bear any such costs (eg opportunity costs of foregone production), the prospect of being required to subsidise access would be a fundamental deterrent to efficient infrastructure investment. It would strengthen the disincentives for providers to invest in spare capacity, and the imperative for providers to "take every point" so as to avoid being compelled to provide access on uncommercial terms.

Accordingly, entrenching the ACCC's extension/expansion power is unlikely to solve the Commission's concern about infrastructure owners under-sizing their investments, to the detriment of Australian welfare. Entrenching this intrusive and costly power will only heighten concerns about the impact of access on the national interest.

10. COMMISSION'S REQUESTS FOR FURTHER INFORMATION ABOUT THE NEGOTIATION/ARBITRATION REGIME

The Commission has requested information on the following matters:[69]

(a) "The adequacy and workability" of the Part IIIA safeguards concerning the ACCC's power to direct a provider to extend its facility, including whether they "strike the right balance" between the interests of providers and access seekers, and whether changes are necessary to enable "effective funding arrangements" for extensions/expansions that a provider is directed to undertake against its will.

(b) "The safeguards for the access rights of the infrastructure service provider in access determinations", including the appropriateness of the protections in ss 44W and 44X of the Act, and the implications for other service users of strengthening those safeguards".

BHP Billiton submits that there is little if any utility in the Commission considering the matters addressed in these information requests until it has completed a rigorous, real world analysis of the costs and benefits of access, and the limited potential for regulation to limit or avoid those costs or to deliver those benefits. Absent any such analysis, the Commission's response risks being hypothetical rather than practical.

Nonetheless, BHP Billiton makes the following observations to assist the Commission's consideration of these matters.

(a) The evidence before the Commission, including as cited in this submission, suggests that access regulation does not, in practice, occur in a way which "minimises" access costs or promotes efficient investment. This increases the imperative to ensure that Part IIIA access declaration cannot occur where the costs of access are likely to be high.

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[68] CCA, ss 44W(1)(e).

[69] Information Request 4.1, Draft Report, 34.

(b) In cases where Part IIIA correctly identifies that declaration is consistent with the national interest, it is *essential* to ensure that the terms of access do not deter efficient investment in infrastructure. To this end, BHP Billiton:

(i) Endorses the strengthening of provider's priority to use the service.[70] The shortcomings of the current "protections" were clearly identified in the Tribunal's decision in the Pilbara rail access case, and BHP Billiton's previous submission.[71] Failing to address those shortcomings will deter rather than promote efficient infrastructure investment.

(ii) Submits that the Commission should recommend:

(A) strengthening the rule that providers cannot be required to bear the costs of an extension/expansion or interconnection to accommodate an access seeker,[72] to confirm that this prevents the provider from bearing any direct, indirect or opportunity cost concerning the extension/expansion or interconnection; and

(B) strengthening the protection of the "provider's legitimate business interests"[73] – promotion of efficient infrastructure investment requires that "legitimate business interests" be <u>protected</u>, not merely be one of the many matters which the ACCC must take into account.[74]

[70] CCA, ss 44W(1)(a) to (c).

[71] *In the matter of Fortescue Metals Group Limited* [2010] ACompT 2 (30 June 2010) at [597-603], and [1251–1254]; BHPB Submission, 18.

[72] CCA, ss 44W(1)(e), as to extensions, and (f), as to interconnections.

[73] CCA, s 44X(1)(a).

[74] [2010] ACompT 2 (30 June 2010) at [1173].