Minerals Council of Australia response to Productivity Commission Draft Report into the National Access Regime

The framework outlined by the Productivity Commission in its Draft Report into the National Access Regime represents an evolution in both policy and, potentially, in its implementation. While cautious in its approach, it nonetheless potentially changes the operation of the law.

Given that the Minerals Council of Australia (MCA) considers that the legislation *per se* is of less concern than its interpretation and application, the Productivity Commission's proposal, though theoretically innovative, fails to redress our underlying concerns. Indeed, the underlying premise to the Productivity Commission's conceptual model is flawed.

The Draft Report, in reviewing the existing law, adopts a conceptual approach founded in high level principles, rather than an accurate view of the historical genesis of the national access regime, and identified market failures as a legacy of policy failure, which have been the Productivity Commission's signature criterion for Government intervention in the form of regulation.

While there is arguably some theoretical merit in the analytical framework adopted by the Productivity Commission – although the case for why this new conceptual framework is indeed needed has not been explicitly made – for it to be of practical value requires redress to the inaccuracies in its foundation and the unintended consequences that would arise in its application.

This Productivity Commission's new framework is less grounded in the real world circumstances which gave rise to the original policy intervention twenty years ago. The MCA contends that it by looking at the actual operations a crucial distinction emerges. On the one hand, there are the circumstances where intervention is less likely to be justified – that is, in the case of privately-originated, privately-owned and operated infrastructure which operate within a highly-integrated, complex private supply chain. On the other hand there are those circumstances where it is wholly appropriate – that is, multi-user/multi owner infrastructure created from former government-owned monopolies.

The policy question before the Productivity Commission remains how to balance competition policy and practical application. This submission argues for more consideration of the practical situation.

The basis for regulation

The Minerals Council of Australia (MCA) considers that government regulation should only be used where it is *prima facie* demonstrably the most economically efficient way of addressing identified market failure and /or to achieve a specific social objective. The MCA adopts a four-fold approach to regulation:

- first policy choice – the primacy of the market: there should generally be a presumption that the free and unhindered operation of the market will lead to efficient outcomes;
- market failure alone is insufficient to justify Government intervention – there must be *prima facie* evidence that regulation can efficiently and effectively remedy market failure;
- where regulation is warranted, light-handed regulation should be applied in the first instance by the regulator; and
- more intrusive regulation should only be used where light-handed approaches and non-regulatory options have demonstrably failed.

Regulations should be employed to enhance rather than to impede the minerals industry's contribution to achieving an enduring balance between the financial viability of the industry, its environmental stewardship and its positive socio-economic contribution.

Practical application of access regimes

The MCA's submission to this inquiry clearly stipulates the industry's position on the original construct of the national access regime and its legislation on account of the *Independent Committee of Inquiry on National Competition Policy* chaired by Professor Fred Hilmer (the Hilmer Committee). For the purpose of this response, and with regard to our material concern that the Productivity Commission appears to be reinterpreting the original basis, we underscore the following arguments.

In its Draft Report the Productivity Commission states:

> *At the time that the Hilmer Committee report was delivered, the provision of major infrastructure services was typically the domain of public providers. While the Committee focused primarily on access to public infrastructure assets, the regime was nevertheless also intended to cover access to assets that were privately owned, built and operated.*

The MCA considers this to be a significant and profound reinterpretation of the foundation of the Hilmer Committee's consideration of third party access. In this, there lies considerable sovereign risk for those parties which have since invested in infrastructure on that historical premise, and which has been a matter of contest through numerous courts, including the High Court, appeal tribunals and ministerial determination.

The Hilmer Committee, in adopting and adapting the "*essential facilities*" doctrine (EFD) developed under United States jurisprudence, identified criteria to be adopted when it recommended the introduction of a system of statutory access rights in Australia. These were specifically designed to address the circumstances of the privatisation of government owned enterprises which could manifestly reduce competition.

The EFD requires the owner of an asset to provide third parties access to the facility, and on what terms, in order to ensure competition in a "*related market*", where the facilities are considered "*essential*". It must be physically impossible or prohibitively expensive to duplicate or otherwise construct substitute facilities; the asset constitutes a real "*bottleneck*"; the owner of an essential facility need not expand its own capacity or reduce its own output in order to provide access to a competitor; and the facility must be truly essential to competition.

The Hilmer Committee's recommendations were heavily qualified in that the facilities and industries most likely to meet the statutory requirements for third party access would be those in which there was "*traditional involvement of government in these industries, either as an owner or regulator*".[1]

[1] Independent Committee of Inquiry into Competition Policy in Australia, National Competition Policy, AGPS (1993). Hence forth described as Hilmer Report. P 251

The Hilmer Committee clearly recognised the economic costs and risks associated with third party access. The Committee also identified the considerable prospect of competitive benefits of third party access in the transition of public utilities to private monopolies.

Conscious of the dangers of over-riding property rights, the Hilmer Committee laid down a number of qualifications on any access regime to be created in Australia, specifically:

- the need to "*carefully limit the circumstances in which one business is required by law to make its facilities available to another*", because the "*failure to provide appropriate protection to the owners of such facilities has the potential to undermine incentives for investment*".[2]
- the need for access should be "*essential*" to permit effective competition in a downstream or upstream market. [3]
- that if applied to privately owned facilities "*it would be appropriate that an obligation to provide access does not unduly impede an owners right to use its own facilities, including any planned expansion of utilisation or capacity*".[4]

The MCA has previously underscored the importance of the Hilmer Committee's measured approach in respecting the investment of private companies in infrastructure forms part of a highly-integrated, complex private supply chains. In those circumstances, in order to ensure investor confidence, the application of the law should take account of whether:

- the barriers to entry, whether they be physical, commercial, and or regulatory, are high;
- competition is promoted in a market that is substantial and of national significance, other than the market in which the service is being provided, before the service is declared;
- the declared service is truly essential to competition in the market in which competition will be promoted, where essential means indispensable as a practical matter for participation in that market';
- the production process exemption prohibit or strictly limit access where doing so would disrupt a vertically integrated production process; and
- the decision-maker is satisfied that granting access is in the public interest and in so doing, that the decision-maker takes account of the costs and risk of regulatory error.

The MCA is disappointed that the Productivity Commission does not appear to have spent more time considering the fundamental tenet to the matters that have required consideration of tribunals and the High Court, namely, the argument that a highly-integrated, complex private supply chain might constitute part of a production process. While the MCA notes the Productivity Commission's observation that such a broad exception on the basis of facility type would be difficult, a closer examination of modern minerals operations would underscore the error in presuming that its transport infrastructure is always a vertically separate activity. The MCA does acknowledge, though, the Productivity Commission's remarks that there should be greater consideration of the costs of co-ordination.

The practical focus of reform

The Productivity Commission also notes that the Hilmer Committee recognised the need for "*right of access to essential facilities*" in the public interest and cautioned that "*privatisation without appropriate restructuring may entrench the anti-competitive structure of the former public monopolies, making structural reform even more important*".

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2 Ibid. p 248.

3 Ibid. p 251.

4 ibid. p 256.

This observation is vital in understanding the distinction the MCA seeks to emphasise in the application of access regimes.

The anti-competitive structure of former public monopolies may linger long after the act of privatisation. This would be more so in the potential case where a privatisation process might be inappropriately structured to maximise a sale price. The consequences of any poorly implemented privatisation means that the customers of services on multi-user/multi-owner infrastructure are placed at a significant disadvantage for some (potentially considerable) time.

Regulation should provide for an efficient price for both service providers and users; it should allow for operational issues managed by commercial contractual negotiation; there must be recognition of the investment contribution of existing users and owners; and there should be scope to invest in additional capacity. In the case of multi-user facilities, while there has been considerable reform centred on market based solutions, the main "regulatory failures" have surrounded inadequate commercial alignment of market incentives between the interests of owners and users.

Ultimately, owners and users need financial incentives to extend the facility to both build and deliver expanded services with a portion of revenue at risk based on the fulfilment of key business performance indicators. This means:

- Existing regulation of multi-user infrastructure services should not be revoked if a market failure was to result or if other policy considerations (particularly environmental or social) combined with the revocation would also lead to a market failure – this is not to argue that competition policy is being asked to make judgements of policy areas, only to recognise the interaction of policy.
- Where there is only one supplier of services to multiple users there is no market hence market forces cannot be relied upon to facilitate competition in mineral export supply markets.
    - Investments have been made in mines on the expectation that already regulated facilities will continue to be regulated. A significant change may render existing investments uneconomic or unable to compete internationally. Monopoly pricing would also lead to inefficient allocation of resources and a reduction of national export income.

In addition, the terms of access regimes for vertically separate multi-user/multi-owner infrastructure should be spelt out clearly from the outset of the approvals processes.

The MCA contends that the Productivity Commission's draft is too optimistic about the mutual incentive to increase capacity. It effectively argues that there is no incentive for the service provider not to respond to demand and that at issue is only the sharing of economic rent between the parties.

If that were the case, there should not be a policy problem. The evidence is, however, that the regulatory framework has led to delayed and asynchronous expansion of port and rail capacity, inefficient use of existing capacity and patchy regulation of infrastructure owners creating poor capacity utilization and missed opportunities. As cited in the previous submission, the Port Jackson Partners' study *Opportunity at risk: Regaining our competitive edge in minerals resources* shows that there has been a disjunction in the market and that optimising infrastructure requires deliberate action to improve the alignment between asset owners and users. Regulations should not impede the incentives that deliver mutually beneficial gains – that is income gains for operators through greater throughput and pricing gains for users through greater efficiencies of scale.

The MCA maintains that its *Strategic Framework for Sustainable Operation of Minerals Industry Multi-User/Multi-Owner Export Infrastructure* can provide a guide.

This framework is centred on market-based solutions but with the recognition of the particular needs to ensure efficiency in (primarily) east coast export coal supply chains through:

- the primacy of the market in the provision and operation of export infrastructure;
- where government intervention is only justified in cases of market failure and the demonstrable capacity to remedy;
- minimum effective, nationally consistent regulation implemented in a timely fashion;
- whole of system coordinated planning; and
- commercial arrangements that deliver capacity and efficiency, and provide certainty of access to export infrastructure.

The key is that the regulatory system should allow for robust commercial frameworks underpinned by contracts that align performance accountability with system capacity.

Minerals Council of Australia
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