MINERALS COUNCIL OF AUSTRALIA

REFORM OF PART IIIA (ACCESS REGIME) OF THE TRADE PRACTICES ACT

Submission to the Senate Standing Committee on Economics into the Trade Practices Amendment (Infrastructure Access) Bill

DECEMBER 2009

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EXECUTIVE SUMMARY

Part IIIA of the Trade Practices Act - the access regime - has run its course in its present form.

While there will always be scope for some regulation to ensure there is competition in contestable markets, the specific Part IIIA provisions governing third party access were born of an economic time and designed for a specific purpose now largely passed. The Part IIIA statutes were an attempt to reflect the intentions of the Hilmer Report which recommended the introduction of a system of statutory access rights in Australia, which, *inter alia*, assiduously recommended the criteria under which one business should be required by law to make its private facilities available to another business. They were designed for specific circumstances where the privatisation of government enterprise would manifestly reduce competition. With a few exceptions the tasks envisaged by the legislators have been completed. Instead, there is a real danger that policy will fall victim to "mission creep" – increased regulatory intervention driven by the institutions charged with its administration.

The economic investment challenge facing Australia is large. During the last growth phase, from 2002 to 2007 Australia lost market share in five major commodities despite strong growth in production. Capacity constraints were the main cause of that missed opportunity. In its latest assessment of minerals sector projects, the Australian Bureau of Agricultural and Resource Economics listed $40 billion of advanced projects and $101 billion other potential projects on the books (out of a total of $238 billion including oil and gas). Realising these projects and ensuring Australia grows its market share over the coming decade will depend on the confidence of investors.

The access regime in its present form is a "chill" on investment. The uncertainty created by the ability of a competitor to seek access to a developer's infrastructure in the future hinders decisions made today. As the recently retired Chair of BHP Billiton, Don Argus AO, said in October 2009, "*mandated third party access deters investment by under rewarding infrastructure owners for the risk they endure*". The upside to the investor is curtailed and the down side remains the same because access to infrastructure is only sought in good times and because the access seeker may decide to renew or not renew the access contract, he said, and then concluded:

> *Since regulators in Australia typically use the 'building block approach' based on net present value and the weighted average cost of capital, one could see a scenario where investors will defer investment and wait for an opportunity with a higher expected return. That means infrastructure investment will be delayed.*
>
> *Mandated access to infrastructure may help to achieve economies of scale where costs have already been sunk into infrastructure and there is plenty of spare capacity. However, in the resources sector, where expansion and growth remain a priority, mandated access works against our ability to achieve much needed scale in export oriented bulk commodities in particular.*[1]

The Productivity Commission has noted that third party access and the resulting benefits to service users were only possible "*if there is continuing investment in the essential infrastructure services themselves*". While there were costs from monopoly pricing, "*such behaviour cannot threaten the continued availability of the services concerned*".

> *This asymmetry in potential outcomes highlights the priority that access regulation must give to ensuring that there are appropriate incentives for efficient investment.*[2]

The mining industry is a capital intensive, globally mobile, technologically intensive, competitive industry. It is characterised by often very large exploration outlays, longer term capital investment (including in infrastructure) and volatile market conditions.

Market risk can be high. 'Sovereign risk' can be a major additional concern. Indeed, actual and perceived 'sovereign risk' has increased in Australia as a result of recent decisions by governments at all levels.

For these reasons, *investment certainty* is a requisite feature of the mining industry's investment environment. As a major contributor to the nation's economic growth and budgetary stability, the mining industry needs Governments to understand these concerns and foster predictable policy climates for investment: Sovereign risk is "king".

The Bill now before the Senate, *The Trade Practices Amendment (Infrastructure Access) Bill*, tinkers at the edges rather than addressing fundamental issues. Under the guise of expediting third party access approvals, it limits the rights of owners

1 Chairman of BHP Billiton, Don Argus AO, Melbourne Mining Club, October 22, 2009, p14..

2 Productivity Commission, Review of the National Access Regime, 2001, p xix.

of economic infrastructure. It will, perversely, create the potential for even longer delays (by forcing parties to run the gauntlet of the entire administrative structure before substantive arguments on the efficiency of declaration can be heard) and create further disincentives to investment (by entrenching the requirement to establish access arrangements on private infrastructure).

Therefore, the MCA argues:

- this amendment Bill be modified; and
- additional changes are required to the existing Part IIIA provisions.

Amending the proposed Bill

The Bill before the Senate seeks to expedite the access regime process by:

- imposing mandatory and arbitrary time limits on the National Competition Council and the Australian Competition and Consumer Commission;
- limiting the evidence that can be brought to a merits review by the Australian Competition Tribunal to existing material; and
- limiting alternative consideration to State Access Regimes certified by the National Competition Council as opposed to a case by case consideration as applies at present.

The Bill makes other changes, *viz*.:

- altering the process of Ministerial intervention. If the Treasurer makes no comment on a National Competition Council (NCC) determination within 60 days, the decision will be deemed as approved. At present the reverse applies which means a reason for a decision to reject need not be stated; and
- attempting to give more security to investors by allowing a developer to lock in access regime conditions for 20 years at the beginning of a project, though the terms are reviewable by the National Competition Council on its own initiative.

While changes were presented by the Federal Government as going to process rather than substance, the MCA argues the changes **stand to diminish transparency, restrict accountability and undermine due and proper regulatory process, increasing the sovereign risk related to private investment in economic infrastructure.**

In particular, the MCA is concerned about:

- the restriction of the review powers of the Australian Competition Tribunal; and
- the reversal of requirement for the Treasurer to explain a decision to accept a declaration recommendation.

The restriction of review will severely limit the role and effectiveness of the Tribunal. The Tribunal is an essential forum for testing facts and the regulatory process. The restriction will mean a genuine consideration of how granting access will materially reduce the efficiency of the infrastructure owner cannot take place until the Australian Competition and Consumer Commission is asked to arbitrate an outcome.

As such, the changes proposed will manifestly increase the risk of an ill-founded and therefore incorrect decision that the criteria for declarations under Part IIIA have been met.

This will significantly increase sovereign risk in private investment in economic infrastructure in Australia - the risk having been increased from an environment where Part IIIA existed with reasonable safeguards to ensure the criteria were met, to one where it will be virtually impossible to address a flawed administrative decision.

The reversal of requirements on the Treasurer to explain a decision to accept a declaration runs contrary to the principles of transparency and accountability.

In addition, the MCA is concerned that the 20 year "holiday" is more symbolic than practical. It remains open for the National Competition Council to revisit matters if it adjudges there is "material" change in arrangements. Material change is not defined. All projects have variations during construction and implementation and thus the security offered by these proposed provisions may be illusory. The process of applying, makings submissions and meeting with the NCC would add at least 12 months bureaucratic delay. Also, the NCC is likely to adopt a "compromise" approach to assessing applications – where the regulator will weigh up *potential* claims and thus a developer will not be able to lock in operational exclusivity to their own investment.

Broader reforms

As the MCA contends, there is a strong case that the access regimes, which were created essentially to deal with the market power of privatised government monopolies, has run its course.

Export industries already work in a highly competitive global environment and need to attract investment. The intention of the Trade Practices Act is to foster competition, but in a global market can have no influence. The application of domestic competition paradigm on a globally competitive export market is questionable.

The 2005 Prime Ministerial Taskforce on Export Infrastructure called on the then Federal Government to consider an "efficiency override": a mechanism that would allow the NCC to limit the scope of access on the basis of efficiency (that is, the cost to the owner and disruption to its operation). At present, such assessments are undertaken by either the Australian Competition Tribunal or the Australian Competition and Consumer Commission *after* access has been granted and there is an arbitrated dispute over the charges for access.

The proposed Bill would remove the Tribunal's ability to make such an assessment.

"Efficiency" was added to the Objects clause of Part IIIA as a result of these recommendations, but not directly into the relevant sections of the Act. A genuine efficiency override would require the NCC take account of the cost of any access declaration during its initial deliberations.

Accordingly, the MCA recommends that reforms should be made to Part IIIA to more accurately reflect the intentions of the Hilmer Report in recommending the introduction of a system of statutory access rights in Australia which, *inter alia*, assiduously recommended the criteria under which one business should be required by law to make its private facilities available to another business, including a competitor.

The Act should be amended to ensure:

- competition be 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 be 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 be 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.

These policy principles should be realised in amendments to Part IIIA access regime. Such amendments would reduce the risk that a declaration results in outcomes that are costly and inefficient without a material increase in competition that would justify the regulatory intervention. Accordingly the MCA recommends that amendments be formulated such that Part IIIA:

- better reflects the substantial and nationally significant economic benefits that come from an intervention into privately-held infrastructure. The existing definition – known as criterion (a): that access or increased access to the service would promote competition in at least one market – should be amended to require that any improved competition would be both likely, substantial and occur in an important market.

  At present, even small or speculative improvements in competition are sufficient to justify declaration of a facility; even improvement in small or unimportant markets is sufficient to justify declaration of a facility.

- reflects the need for access to be essential rather than just convenient to a competitor. The existing definition – known as criterion(b): that it would be uneconomical for anyone to develop another facility to provide the service - should be amended to strictly limit the circumstances when a competitor may seek access to an infrastructure facility such that the facility is essential to competition or could not be developed in the absence of a declaration.

  At present third party access need not be "essential" for competition for a service to be declared.

- provides for the operation of modern, highly integrated and efficient export infrastructure chains. Such a 'production process exemption' should be an explicit threshold criterion for declaration, taking into account closely integrated infrastructure/facilities.

The scope of the production process exemption has been narrowed since its introduction so that most large infrastructure facilities are a risk of declaration, even in circumstances where they form part of what is plainly an integrated production process.

- provides scope for rigorous testing of the grounds for interventions. This would involve amending existing rules – known as criterion (f): that access or increased access to the service would not be contrary to the public interest - to require that declaration is demonstrably in the public interest and the explicit application and independent scrutiny of a public interest test.

  The public interest test, which requires a balanced overall assessment of the benefits and costs of declaration, effectively plays no role in the decision about whether to impose mandatory third party access.

Minerals Council of Australia

December, 2009.

INDUSTRY OVERVIEW

Meeting global demand

The market for resource commodities is one of the most dynamic and competitive in the world. Barriers to trade are generally lower than for other goods and services traded around the world. The international commodities market is growing at a rapid pace. The global population is expected to grow from 6.5 billion people today to 8 billion by 2030 with 97 per cent of the growth to come from developing countries. Demand from China and India is accelerating at a pace not seen before despite the interruption of the Global Financial Crisis in 2008/9. Economic consultants, Access Economics, describe it as a *"new global revolution"*.

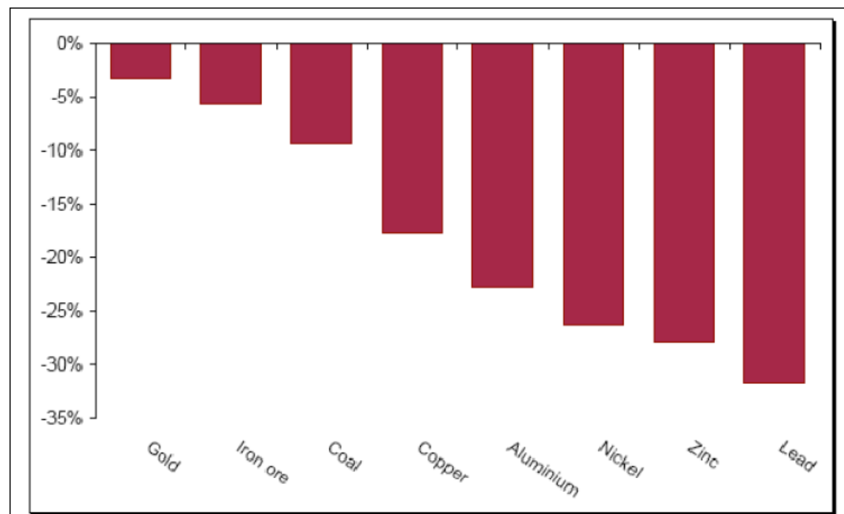
> *Half the world is having an industrial revolution. That is raising not merely global growth, but doing so in a particularly commodity hungry manner, as demand for industrial commodities grows fastest in the income range of $US 3-15,000 per head...*
>
> *By the time that process is complete [the world] will look back on the strongest period of sustained global growth since the industrialisation of the West. Moreover, that boom will have completely transformed the global demand for industrial commodities.*[3]

On projections calculated by Access Economics for the Minerals Council of Australia, global iron ore production will need to grow 54 per cent over 2006 levels to meet world demand in 2020. Coal production will need to increase 45 per cent and nickel production will have to more than double.

To fully capitalise on its minerals and energy endowment, Australia must, *inter alia*, address the shortcomings in the regulation of export infrastructure, poorly functioning markets for key domestic infrastructure and inadequate investment in social and physical infrastructure in remote and regional Australia.

While there was a marked increase in demand (and Australian supply) during the period of 2002 to 2007, Australia nonetheless lost global market share to competitor nations. Access Economics has estimated that if Australia had maintained its market share between 2002 and 2007 then – at today's prices – Australia would have earned another $17 billion in export income, the equivalent of 1.6 per cent of nominal national income in 2007. This missed opportunity was largely due to capacity constraints.

Change in Australia's Global Market Share, 2002 versus 2007.



Source: Access Economics

For Australia simply to maintain its market share of this expanding commodity trade, substantial new investment in minerals operations and supporting infrastructure will be necessary. To meet expected global demand in 2020, Australia will need to lift annual coal and iron ore volumes by 211 million tonnes and 328 million tonnes respectively over and above their 2007 levels. That is more than three times the matching lift in tonnages achieved across the period 2002 to 2007. For aluminium, the matching jump is almost five times that achieved from 2002 to 2007.

[3] Access Economics, Global commodity demand scenarios, May 2008, Executive Summary, p i.

Yet the experience of the growth in demand from 2002 to 2007 revealed critical shortfalls in Australia's export capacity. In response, the MCA commissioned the Vision 2020 Project – a long-term research endeavour designed to shape the policies that will overcome systemic capacity constraints and ultimately help to increase Australia's market share as a premium supplier of minerals. The endeavour was to ensure that both as a nation and industry we do not repeat the mistakes of the past which have ill-equipped Australia to respond to burgeoning global demand for minerals products.

Phase One of the project – modelling on global demand and Australian supply in 2020, cited above – was released at Minerals Week in 2008. It showed Australia had lost market share 8 key commodities, including coal and iron from 2002 to 2007, despite an increase in supply. Indeed, to maintain market share, production of iron and coal would have to increase three times as much by 2020 as it had increased from 2002 to 2007. Some of that needed expansion has been underway although its progress has been disrupted this year by financial and economic events.

A companion study of labour, also released at Minerals Week 2008, suggested an additional 86,000 workers would be required.

Using the Phase One results as a baseline, the MCA embarked on an infrastructure audit of 21 minerals regions, to identify the impediments to achieving the growth to maintain or increase market share by 2020.

The report highlighted a "cancer of neglect" across much of regional Australia fuelled, in part by governments abrogating their duties to citizens and presuming that industry would act as a surrogate for the public sector. Impediments to growth varied across the regions, with physical infrastructure - such as ports, rail and energy - deficient in some while social infrastructure - housing, health and education - was lacking in others. Planning across the whole of the supply chain was generally poor. The report confirmed that:

- minerals and energy producing regions are suffering a patchwork of neglected industrial and community infrastructure;
- investment by the private sector has not been matched by the public sector;
- in other areas, the required private investment has been constrained by poor planning or regulatory barriers;
- while there are different priorities in the 21 regions, common themes included:
    - rail and port stock remains insufficient,
    - energy supply is inadequate,
    - water availability and supply will become an increasing challenge,
    - broadband capability will be critical, and
    - social infrastructure and services lag behind industrial development and in some cases need urgent attention by government.

While there was scope for governments to restore a contribution to regional communities and economic development that had been left wanting for many years, consistently across the audit, the need for regulatory reforms – planning and environmental approvals, duplication and inconsistency across a range of areas and competition and markets reform – were seen as key gap in Australia's export infrastructure policy.

Summary of MCA Vision 2020 report – gaps and impediments to growth

Infrastructure	2020 Vision
Ports	Overall Vision: Expansion of port facilities in Queensland, Victoria, South Australia (Spencer Gulf), WA (South West, Mid West, and Kimberley and Darwin). Consolidation of port reforms in NSW and WA.
	Fourth deepwater port in Queensland; expansion of existing facilities. Increase in existing ports capacity (Abbot Point, Wiggins Island, Dalrymple Bay etc.) from 150Mtpa in 2008 to potential 300Mtpa by 2020. Accelerated development of Abbot Point State Development area.
	NSW: Hunter Valley expansion to 250Mtpa, consolidation of Port Kembla to 18Mtpa.
	Hastings on Westernport Bay in Victoria.
	Port Bonython/Whyalla Expansion – Upper Spencer Gulf. Eyre Peninsula (lower Spencer Gulf) port.
	Mid-West: Additional port capacity from 12 Mt to 25Mtpa at Geraldton and 80Mtpa at Oakajee from 5 operations.
	Pilbara: Expanded iron ore facilities at existing sites; two new iron ore ports, expanded facilities for minerals concentrates, supply bases for offshore developments. Potential iron ore supply of from 500Mt to 600 Mtpa.
	Darwin: North West Arm.
Rail	Overall Vision: On the east coast, government ownership structures can feed capacity constraint, through monopolistic tendencies. Reforms need to more effectively and efficiently align interests of producers, terminals and shipping under commercial arrangements. On the west coast, regulatory and planning delays and duplication, together with the shadow of access regime legislation constrain private investment. Potential of Northern Territory, and potential spur line to Mt Isa, dependent on other developments.
	Goonyella Abbot Point Expansion (northern missing link) Completion of the Jilalan railyards.
	Great Northern Rail line expansion by 165 per cent by 2013.
	Galillee Basin rail line – new rail lines, increase in QR capacity to Wiggins Island.
	Surat rail line.
	Hunter Valley: increase capacity to 200Mtpa. Port Kembla: increase in freight capacity separate to passenger network.
	Gippsland: Create dedicated freightlink to export port.
Roads	Steady program of supporting roads to ensure investments. Northern Queensland, North-west WA priorities.
Airports	Upgrade of regional airport and Perth hub. Upgrade of Darwin airport. Gladstone and Prosperine airport expansions in Queensland.
Energy	Overall: Ambitious plans for energy generation and distribution essential for the expansion of the industry. Distribution networks are presently geared to coastal regions and close to existing generation capacity. Renewable and alternative energy sources face their own problems of accessing networks (which may distort investment decisions for expansion of distribution).
	Queensland Northern Economic Triangle: New base load power station and transmission infrastructure to port development region.

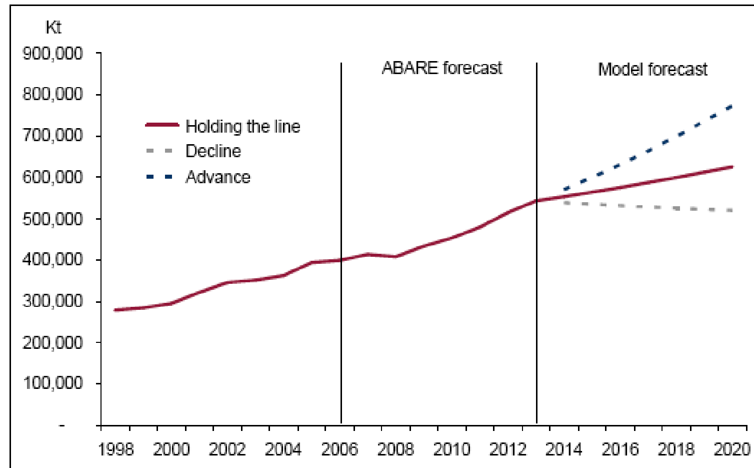
	Central West NSW: generation and transmission requirements need to be expanded from 2013.
	Western Victoria: Distribution networks failing to keep pace with growth.
	Tasmania: Gas pipelines infrastructure to fuel north-west growth
	WA: Mid-West, Pilbara Kimberly. Major new capacity in generation and transmission needed. Dampier to Bunbury and other domestic gas pipelines needed.
Social Infrastructure	Largely uncharted capacity constraint that needs urgent attention. Key part of the Crown's contribution to the joint venture of minerals production. Regional citizens entitled to service available to others. In remote WA and NT re-engineer health and education system to match local needs. In Queensland and Pilbara, there is a need for social infrastructure for families.
Water	Greater certainty in water markets to provide investment framework that will attract additional capital needed for infrastructure. In WA, need for region-wide integrated water strategy. Water pipeline projects in North Queensland (eg further extension to Moranbah pipeline in Bowen Basin) and SA. Recycling and re-use projects across the country. Desalination may be required on Eyre Peninsula (SA).
Broadband	Broadband inadequate or highly costly in many regional areas, particularly non-remote. Need to develop competition in broadband and mobile telecommunications across the region and in "backhaul" connections between regions – across north-west WA, central west NSW and to Tasmania.

There has been significant investment in export infrastructure over the past three years. Total capital investment in the mining sector has continued to grow from $32 billion in 2006/ to $37 billion in 2008/9. Investment has slowed through the beginning of 2009/10 but is expected to recover - checked but not compromised by the Global Financial Crisis. For example, in coal there is now increased capacity in Queensland ports (Dalrymple Bay, Abbot Point), rail (the Jilalan rail yards in Queensland, and the Hunter Valley in NSW) as well as commitments for more (the Goonyella to Abbot Point rail expansion, further upgrades in the Hunter Valley, approval for the expansion of Wiggins Island facilities in Queensland and reform of terminal access rules at Newcastle). These expansions, however, will simply maintain Australia's (now lower) global market share through to 2013.

Conversely, if Australia is unable to rebuild market share over the next decade, the opportunity costs will be substantial. Modelling by Access Economics has shown that if Australia's market share dips between 2013 and 2020 like it dipped between 2002 and 2007, then the costs will be significant. Under this *"decline"* scenario, Australia would be more than $91 billion worse off in 2020 alone compared to a "holding the line" scenario.

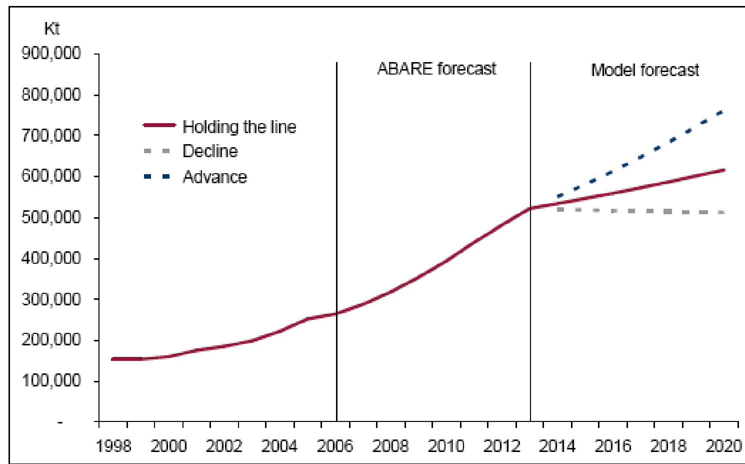
If Australia can lift its performance, the rewards will be great. If Australia can recover and retain market share over the next decade, Australia's national income will be almost $129 billion higher in 2020 than under the *"holding the line"* scenario. That is equivalent to around 12 per cent of today's national income.

Australian Coal Production Under Different Supply Scenarios – 2007



Note: This is all coal – both thermal (typically 46 per cent) and metallurgical (54 per cent)

Australian Iron Ore Production Under Different Supply Scenarios

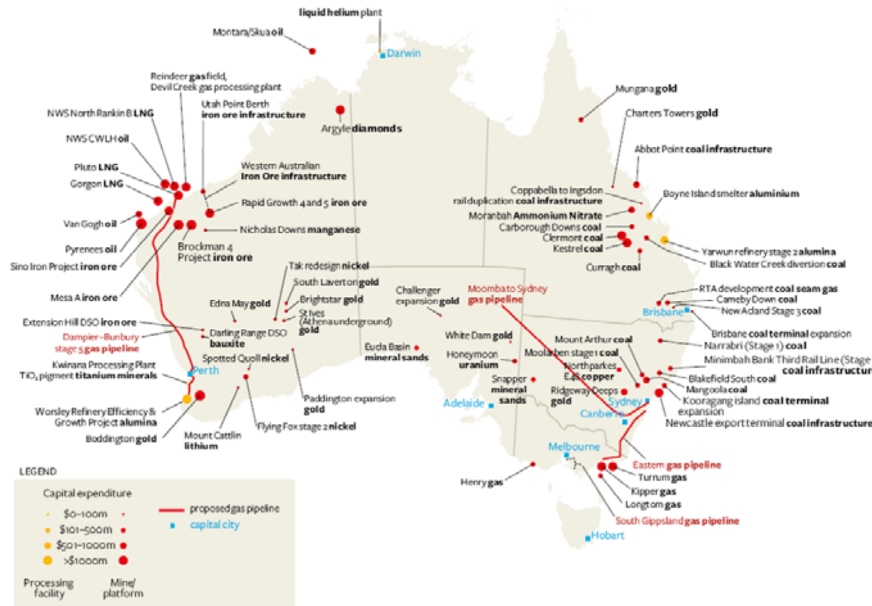


Investment

Investment will be the key to meeting this challenge. On paper, the prospects are strong, but realising that investment will ultimately depend on the confidence of investors that they will be able to secure projected returns. The scale of the task ahead is ultimately one that goes beyond the budgets of government **– it is an issue of regulatory reform.**

In its latest assessment of minerals projects, the Australian Bureau of Agricultural and Resource Economics listed $40 billion of advanced projects and $101 billion other potential projects on the books (out of a total of $101 billion advanced projects and $238 billion potential projects, including oil and gas). Realising these projects and ensuring Australia grows its market share over the coming decade will depend on the confidence of investors.

Advanced Minerals Projects – October 2009



Potential projects – October listing 2009

Commodity	NSW	Vic	Qld	WA	SA	Tas	NT	Aust	potential capital expenditure ($m)
Mining - energy projects									
Black coal	24	0	42	1	0	0	0	67	38 085
Coal seam gas	4	0	1	0	0	0	0	5	565
Petroleum	4	4	10	11	0	0	8	37	129 686
Uranium	0	0	2	3	4	0	3	12	1 780
Sub-total	32	4	55	15	4	0	11	121	170 116
Mining - minerals projects									
Bauxite	0	0	3	1	0	0	0	4	2 355
Copper	1	0	5	0	8	0	0	14	1 516
Gold	6	0	3	14	1	0	1	25	3 146
Iron ore	0	0	0	31	6	0	1	38	29 026
Lead-zinc-silver	6	0	2	3	1	0	1	13	3 177
Mineral sands	2	2	0	3	0	0	0	7	375
Nickel	0	0	5	11	0	1	0	17	15 471
Rare earths	0	0	0	1	0	0	1	2	1 122
Tin	0	0	1	0	0	2	0	3	674
Vanadium	0	0	0	2	0	0	0	2	879
Other commodities	3	0	2	5	0	1	2	13	3 291
Sub-total	18	2	21	71	16	4	6	138	60 832
Mineral processing									
Alumina	0	0	2	2	0	0	0	4	6 507
Copper	0	0	0	0	1	0	0	1	na
Crude iron and steel	0	0	1	0	0	0	0	1	542
Magnesium	0	1	0	0	0	0	0	1	20
Titanium minerals	0	0	0	1	0	0	0	1	120
Sub-total	0	1	3	3	1	0	0	8	7 189
Total	50	7	79	89	21	4	17	267	238 337

Source: ABARE

As noted above, there has been significant investment in export infrastructure over recent times, slowed but not checked by the Global Financial Crisis. These expansions, however, will simply maintain global market share through to 2013.

The mining industry is a capital intensive, globally mobile, technologically intensive, competitive industry. It is characterised by often very large exploration outlays, longer term capital investment (including in infrastructure) and volatile market conditions.

Market risk can be high. 'Sovereign risk' can be a major additional concern. Indeed, actual and perceived 'sovereign risk' has increased in Australia as a result of recent decisions by governments at all levels.

For these reasons, *investment certainty* is a requisite feature of the mining industry's investment environment. As a major contributor to the nation's economic growth and budgetary stability, the mining industry needs Governments to understand these concerns and foster predictable policy climates for investment.

Economic infrastructure policy

To overcome capacity constraints over the next decade, governments and industry have different but indispensable roles: Governments must identify the key infrastructure requirements needed in key growth corridors and meet its responsibility to citizens wherever people live; Industry can then seize its opportunities and be able to finance project expansions confident in the certainty of the regulatory environment - and ultimately deliver shareholder returns and sustainable development.

These two responsibilities are part of an integrated, holistic approach to the infrastructure challenge. Fixing bottlenecks at the ports won't be enough if there are too few skilled mine managers, truck drivers, welders or community relations staff to operate mines. Addressing these challenges won't be enough if industry does not have enough water and energy. Addressing these challenges won't be enough if there is not a viable, sustainable community in which to house and service the mine operations.

The MCA is concerned to ensure a balance is achieved between the needs of today and the demands of tomorrow. Mining is a dynamic, global, entrepreneurial exercise, physically and financially large in its scale and lengthy in its planning and operation. It therefore approaches issues of infrastructure differently from other sectors. The infrastructure required is both as a supplier of energy products and a consumer of energy necessary for its operations.

For the resources sector infrastructure development falls within three classes:

- project infrastructure (plant and equipment, water pipelines, energy generation, haul roads, landing strips, railways and ports);
- multi-user infrastructure (such as dams, power stations, transmission lines and public roads, railways and ports); and
- social infrastructure (including housing, town water supply, health and education services, law enforcement, basic community transport and community welfare).

Improving and streamlining regulation will free infrastructure development from the constraints that have developed over the decades. The following policy imperatives should underpin Australia's infrastructure policy:

- Export infrastructure
  - A strategic policy framework to guide the reform and development of multi-user, multi-owner infrastructure. This includes whole of system master planning in supply chains and commercial arrangement including commercial drivers in regulation, particularly for regulating access to the extent required.
  - Policy settings that respect and reward investment, and particularly high risk investment, in integrated export infrastructure. In practical terms, this means changing trade practices and other laws to better reflect modern vertically integrated production chains operating against increasing international competition.
- Effective markets in key domestic infrastructure
  - The efficient and timely development of an integrated National Energy Market (NEM) that improves reliability of supply, promotes greater interstate competition and trade, delivers effective customer choice and strengthens investor and community confidence in the market.
  - Water policy reform that creates a true price for water and ensures water allocations to users and the environment are based on sound science.. These arrangements should also ensure that water entitlements for cultural heritage values are recognised as distinct and separate to environmental flows, and where appropriate, can be traded in the market. (In this case, the National Water Initiative should be implemented in full).
- Rebuilding social and physical infrastructure in regional and remote Australia
  - Governments meeting their responsibilities in providing sustained investment in education, health, housing, transport and communications services in regional and remote regions of Australia.
  - A strategic framework for regional development, underpinned by a formal partnership between the Federal, State and Territory Governments to ensure that key policies and programs are effectively delivered in a coordinated sense at the community level, and support communities to access opportunities to improve their socio-economic livelihoods.

The money involved is beyond the scope of government budgets. This is not an issue where governments can intervene to meet the need it must and should be met by the private sector. This, in turn, means establishing a regulatory framework that gives investors confidence. Access regimes are a crucial part of this framework.

INVESTMENT AND ACCESS REGIMES

Investment rules

The minerals sector requires stable, transparent and efficient rules to ensure it can invest in the infrastructure required to produce. Essential to that stable environment are rules on access regimes to private infrastructure that reduce rather than increase sovereign risk.

As a supplier of minerals energy products, the MCA argues that it is imperative that the current rules applying to Part IIIA of the Trade Practices Act (access regime) be changed.

The MCA submits that over the long term, mandated third party access:

- chills the incentive to invest in facilities that might subsequently be declared; and
- reduces or entirely eliminates the incentive to invest on the part of the access seeker who can gain by 'free-riding' on the access providers' investment.

As the recently retired Chair of BHP Billiton, Don Argus AO, said in his final address to the Melbourne Mining Club, "*mandated third party access deters investment by under rewarding infrastructure owners for the risk they endure*". The upside to the investor is curtailed and the down side remains the same because access to infrastructure is only sought in good times and because the access seeker may decide to renew or not renew the access contract. Mr Argus concluded:

> *Since regulators in Australian typically use the 'building block approach' based on net present value and the weighted average cost of capital, one could see a scenario where investors will defer investment and wait for an opportunity with a higher expected return. That means infrastructure investment will be delayed.*
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> *Mandated access to infrastructure may help to achieve economies of scale where costs have already been sunk into infrastructure and there is plenty of spare capacity. However, in the resources sector, where expansion and growth remain a priority, mandated access works against our ability to achieve much needed scale in export oriented bulk commodities in particular.*

The infrastructure imperative is about encouraging as much development as possible rather than cannabalising what already exists. If major Australian iron ore or coal producers fail to expand their production capacity quickly enough they will permanently lose market share to low cost overseas producers.[4] Expanding capacity is not achieved by an access regime that both increases the scope for disruption and dissuades the owners of that infrastructure from expanding related operations. It is economically inefficient and shortsighted to seek to limit infrastructure development at a time when a fundamental structural shift in global demand has opened up the opportunity for strong and sustained growth in Australia's iron ore and coal exports.

The nature of the demand challenge explains why companies have sought to build integrated production processes that incorporate rail networks. The volumes that will be expected to maintain the nation's market share are certainly considerable. But, in addition, the demands of customers for different varieties and grades of product and the need for both more flexibility and certainty in delivery, places greater pressure on suppliers to operate effectively and efficiently. Certainty of investment in those production processes – from the pit-face to the customer – will be essential in convincing companies to invest in that extra capacity. Factors that increase uncertainty may lead minerals companies to invest in production facilities – vertically integrated mines, railways and ports – in other competing nations.

As the MCA has argued in National Competition Council hearings on access applications for the Pilbara railways under the existing Part IIIA provisions, the experience of the east coast coal infrastructure systems compared with the west coast iron producers is telling. During the recent growth phase, 2002 to 2007, the iron ore sector has increased its throughput at the ports by much more than the coal sector. Over the period 1998 to 2006 the world seaborne coal trade grew 68.1 per cent, yet over the same period Australia's coal exports grew by 38.4 per cent. Over the same period, the seaborne trade for iron ore grew 76.1 per cent, while Australia's grew by 81.4 per cent.

The result for market share was obvious: coal slipped from 36.1 per cent of world market share to 30.7 per cent. Iron ore maintained its overall share against increased competition just below 40 per cent (39.6 per cent compared with 38.5 per cent).

The former Executive Director of the Australian Bureau of Agricultural and Resources Economics and Chairman of the 2005

[4] Port Jackson Partners, Economic Evaluation of the Impact of Lost Iron Ore Production and Share, April 2008, p12-13.

Prime Minister's Taskforce on Exports and Infrastructure, Dr Brian Fisher, in his submission to the NCC on behalf of Rio Tinto Ltd, is unequivocal that transport arrangements are the key factor in the difference in performance.

> *Indeed the fundamental difference in this respect between the coal and iron ore industries in Australia is that coal exporters rely on multi-user, regulated infrastructure whereas the major iron ore exporters utilize single-user, owner operated integrated infrastructure.*
>
> *Although it is the case that there are several variants within multi-user systems, for example with respect to independent or joint user ownership, the common denominator is that these facilities have not been expanded as rapidly as the single user facilities to meet the surge in global commodity demand.*[5]

Dr Fisher rightly argues that multi-user regulated infrastructure is clearly associated with a disaggregation of interests compared with the single user model. This disaggregation is a fundamental flaw in the multi-user systems because the parties invariably look after their own welfare even if it is against the interest of the industry/facility as a whole.

> *Whilst there may be some difference in the ways in which the Pilbara and east coast coal transport and handling systems would work in a multi-user environment if access were to be granted to the Pilbara single user systems the most important element leading to delay would be introduced – namely, multiple players with different aims and constraints would be required to negotiate an agreed outcome before any significant changes to the facility (whether capital or operation nature) could be implemented. This will inevitably lead to delays in taking such decisions similar to those that have been observed in the east coast coal facilities.*[6]

As Dr Fisher correctly concludes the granting of ex-post access would not only reduce the efficiency of the system for individual users but it would also "lead to the loss of real option values and the crowding out of low cost exports thus resulting in a further reduction in economic welfare for Australia as a whole".

Origins and interpretations of Part IIIA

The origins of Part IIIA lie in the Hilmer Report which recommended the introduction of a system of statutory access rights in Australia. The reason for this was that the Hilmer Report considered that there was significant uncertainty in relation to whether the interpretation of other provisions of the TPA by Australian courts would establish an access doctrine akin to the "essential facilities doctrine" (EFD) established in US jurisprudence. The "essential facilities doctrine" requires the owner of a monopoly asset to allow third parties access to the facility in order to improve competition in a "related", for instance, a downstream, market.

EFD overrides the property rights of the access provider imposing on the access provider transactions that it would not voluntarily have entered into, that is, it denies the owner/investor the fundamental premise that they may choose with whom to enter into commercial enterprise. Under the EFD, facilities are considered "essential" if:

- it constitutes a natural monopoly where it was physically impossible or prohibitively expensive to duplicate or otherwise construct substitute facilities – there must be no actual or possible sources of alternative supply;
- it 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 – it is not sufficient that the facility merely improves competition.

The Hilmer Report invoked the concepts behind the essential facilities doctrine in making the case for a national access regime, arguing that:

> *Some economic activities exhibit natural monopoly characteristics in the sense that they cannot be duplicated economically … Some facilities that exhibit these characteristics occupy strategic positions in an industry, and are thus 'essential facilities' in the sense that access to the facility is required if a business is to be able to compete effectively …*

5 Brian Fisher, Economic Evaluation of the Relative Efficiencies of Multi-user and Single User Rail and Port Facilities, April 2008, p 11.

6 ibid, p15.

The access provisions of the Hilmer Reforms[7] were informed by the *"essential facilities"* doctrine developed under United States jurisprudence[8]. The US practice supports the view that access may be granted if it improves competition. However, from an economic point of view, competition is only a means to an end. The end is economic efficiency. Hilmer noted that in some cases the doctrine had been interpreted too widely in situations ranging *"from local telephone networks to football and basketball stadiums"*[9].

Conscious of the dangers of over-riding property rights, Hilmer had a number of qualifications on any access regime to be created in Australia. The qualifications included:

- 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".[10]
- the need for access should be "essential" to permit effective competition in a downstream or upstream market. [11]
- Noting that the facilities and industries most likely to meet these requirement would be those where there was "traditional involvement of government in these industries, either as an owner or regulator".[12]
- Noting 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"*.[13]

The Hilmer Review understood the need to limit the scope of any national access regime. As the MCA argued in its previous submission, while there were differences between the final form of Part IIIA and the Hilmer recommendations, it retained the emphasis on imposing substantive hurdles on the granting of access.

While the final form of Part IIIA differed in important respects from the Hilmer recommendations, it retained the emphasis on imposing substantive hurdles on the granting of access – the substantive character of the gateway being most obvious in the need to meet all of the hurdles before a facility can be declared.

In his second reading speech implementing the changes to the TPA in 1995, then assistant Treasurer George Gear, emphasised that access provisions were geared towards essential facilities in general and former government owned assets, in particular. Ultimately, he said, the ability of the economy to grow and provide jobs and an improved standard of living depends on how well the productive potential of the economy is employed and enhanced. The changes would help the nation's governments implement structural reform of monopolies including

> *access to services provided by means of essential facilities and elimination of net competitive advantages enjoyed by government businesses where they compete with the private sector.*[14]

In the debate that followed, Mr Gear gave a salutary warning:

> *As I said in my second reading speech, we are not introducing competition for competition's sake; we are introducing competition where it is for the public benefit.*[15]

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7 Independent Committee of Inquiry into Competition Policy in Australia, National Competition Policy, AGPS (1993). Hence forth described as Hilmer Report.

8 Hilmer Report, p 241.

9 Ibid. p 244.

10 Ibid. p 248.

11 Ibid. p 251.

12 Ibid.

13 ibid. p 256.

14 Commonwealth Parliament of Australia, Hansard, 30 June 2005, p 2793.

15 Hansard, ibid, p 2819.

Australia however, has not applied the principles underpinning Part IIIA in its interpretation of Part IIIA – that is, the interpretation of relevant tests under Part IIIA is not undertaken with the same degree of rigour and warning foreshadowed by the Hilmer Report. Through the NCC, the Australian Competition Tribunal (ACT) and court interpretation, the test for declaration has been substantially diluted. Broadly speaking, facilities in Australia can now be declared in circumstances where there is only a small probability that declaration will enhance competition.

In addition, and as Part IIIA has been interpreted, little or no weight is given to the adverse efficiency implications of third party access on the access provider, or to incentives to invest in the longer term. Accordingly, it is critical that the NCC and the Tribunal properly recognise the importance of the objects clause in Part IIIA and apply it with the rigour sought by the Hilmer Report.

The implication of these interpretations of Part IIIA is that a very small or speculative increase in competition is deemed to outweigh the costs of declaration, in terms of their effect on overall efficiency, including the costs of the associated regulatory regime in terms of deterred investment and innovation. As a result the law is tilted against the private infrastructure owner and may create a "chill" on investment in the future.

The MCA remains concerned that the NCC decisions under the existing Part IIIA provisions reinforce a trend that economic reform is assisted simply by opening the doors to competition without proper consideration of the broader implications. A decade and a half after the Hilmer reforms there is a danger that the view of "competition for competition sake" appears to be gaining currency.

Amendments to the TPA in 2006 reinforced the need for caution. The creation of a new objects clause and the material impacts test recognised the submission made by the Productivity Commission to the then Treasurer Peter Costello in its 2001 review of the Act.

The Productivity Commission noted the potential 'chilling' effect of access regulation on investment in essential infrastructure services was the main concern. Investment, it said, may be deterred for two reasons.

- Potential exposure to access regulation is likely to increase the general level of risk attaching to investment in essential facilities. The inevitable regulatory discretion involved in the implementation of such regulation, and perceptions that regulatory decisions are likely to be biased in favour of service users, are among the factors that contribute to regulatory risk. These sorts of risks attach to investment in any regulated activity. However, the scale of investment in essential infrastructure, and the fact that, once in place, the assets are 'sunk' with few alternative uses, mean that regulatory risk can be a more critical factor in the investment decision and may sometimes deter projects.
- Investments in essential infrastructure will also be deterred if regulated terms and conditions are not expected to provide a sufficient return. A particular problem here is that the possibility of earning higher than normal profits if a project proves to be very successful may be required to balance the possibility that the project will fail. However, once a facility is operating, it will generally be impossible for regulators to delineate any upside returns from genuine monopoly rent — that is, returns in excess of those necessary to justify the investment. Regulatory pricing arrangements that (inadvertently) appropriate upside returns (so called 'regulatory *truncation') can be a significant source of inefficiency arising from access regulation.*[16]

The Productivity Commission noted that third party access and the resulting benefits to service users were only possible *"if there is continuing investment in the essential infrastructure services themselves"*. While there were costs from monopoly pricing, *"such behaviour cannot threaten the continued availability of the services concerned"*.

> *This asymmetry in potential outcomes highlights the priority that access regulation must give to ensuring that there are appropriate incentives for efficient investment.*[17]

Material harm…

The MCA maintains that "efficiency" is a prime economic factor to be considered in assessing any intervention by the State into privately held infrastructure.

The Prime Minister's 2005 Exports and Infrastructure Taskforce recommended that there should be a means to exempt integrated facilities from the operation of Part IIIA of the TPA, and specifically:

16 Productivity Commission, Review of the National Access Regime, 2001, p xix.

17 Ibid.

- that there should be an *"efficiency override"* for applications for declaration of export related facilities under Part IIIA or its associated regimes; and

- that the *"production process exemption"* should be amended so as to make it *"clear that the purpose of the exemption is to prevent the imposing of third party access in vertically integrated, tightly managed, logistics chains, especially those related to our export industries".*

Accordingly, based on the above, the MCA holds as a matter of principle that:

- competition be 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 be 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 be 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.

Trade Practice Amendment (Infrastructure Access) Bill

The Bill now before the Senate, *The Trade Practices Amendment (Infrastructure Access) Bill*, does not tackle fundamental reform. Under the guise of quickening approval processes it limits the rights of investors. It will, perversely, create the potential for even longer delays (by forcing parties to run the gauntlet of the entire administrative structure before substantive arguments on the efficiency of declaration can be heard) and create further disincentives to investment (by entrenching the requirement to establish access arrangement on private infrastructure).

Therefore, the MCA argues that:

- this amendment Bill be modified; and
- additional changes are required to the existing Part IIIA provisions.

Amending the proposed Bill

The proposed changes stand to diminish transparency, restrict accountability, and undermine due and proper regulatory process, increasing the sovereign risk related to private investment in economic infrastructure, already perceptibly high on account of the confusion and uncertainty created by the application of Part IIIA.

There are, arguably, few industries better positioned to reach this conclusion given the extent of the minerals industry's involvement in the application of Part IIIA in relation to the question of mandating third party access to purpose built, privately owned and operated iron ore railways of the Pilbara, in Western Australia, within a closely integrated minerals production process.

The Bill before the Senate seeks to expedite the access regime process by:

- imposing mandatory and arbitrary time limits on the National Competition Council and the Australian Competition and Consumer Commission;
- limiting the evidence that can be brought to a merits review by the Australian Competition Tribunal to existing material; and
- limiting alternative consideration to State Access Regimes certified by the National Competition Council as opposed to a case by case consideration as applies at present.

The Bill makes other changes, *viz.*:

- altering the process of Ministerial intervention. If the Treasurer makes no comment on a National Competition Council (NCC) determination within 60 days, the decision will be deemed as approved. At present the reverse applies which means a reason for a decision to reject need not be stated; and
- attempting to give more security to investors by allowing a developer to lock in access regime conditions for 20 years at the beginning of a project, though the terms are reviewable by the National Competition Council on its own initiative.

While changes were presented by the Federal Government as going to process rather than substance, the MCA argues the changes **stand to diminish transparency, restrict accountability and undermine due and proper regulatory process, increasing the sovereign risk related to private investment in economic infrastructure.**

In particular, the MCA is concerned about:

- the restriction of the review powers of the Australian Competition Tribunal; and
- the reversal of requirement for the Treasurer to explain a decision to accept a declaration recommendation.

The proposed reforms will have quite the opposite effect than intended by severely restricting and undermining due and proper and effective regulatory process. This is counter to the Rudd Government's commitment to transparency and accountability in the administration of Government, its' institutions and regulation. The proposed reforms will severely limit the critical role and effectiveness of the Tribunal. The Tribunal is an essential forum for review and testing of the facts and the regulatory process. It is the only forum where assertions made by interested parties can be tested through a primary evidentiary process and properly informed and considered findings of fact can then be made on whether the necessary criteria are met. Such a process does not and cannot be undertaken by the Council which does not conduct a public hearing where evidence is tested – instead, it acts upon untested and competing submissions from interested parties.

The process now undertaken by the Tribunal cannot effectively be undertaken in a six month time period (as has been recognised by the Tribunal in the Pilbara cases by virtue of its extension of the period to about 15 months). The reforms would leave the only effective avenue for appeal to the Courts on legal grounds, which restricts the scope for reasonable contest (especially in respect of key factual findings).

The Bill does seek to give more security to investors by allowing a developer to lock in access regime conditions for 20 years at the beginning of a project. The MCA is concerned that the 20 year "holiday" is more symbolic than practical. It remains open for the National Competition Council to revisit matters if it adjudges there is "material" change in arrangements. Material change is not defined. All projects have variations during construction and implementation and thus the security offered by the provisions may be illusory. Also, the NCC is likely to adopt a "compromise" approach to assessing applications – where the regulator will weigh up *potential* claims and thus a developer will not be able to lock in exclusivity to their own investment.

As such, the changes proposed will manifestly increase the risk of an ill-founded and therefore incorrect decision that the criteria for declarations under Part IIIA have been met.

This will significantly increase sovereign risk in private investment in economic infrastructure in Australia (the risk having been increased from an environment where Part IIIA existed with reasonable safeguards to ensure the criteria were met, to one where it will be virtually impossible to address a flawed administrative decision).

The restriction of review will severely limit the role and effectiveness of the Tribunal. The Tribunal is an essential forum for testing facts and the regulatory process. The restriction will mean a genuine consideration of how granting access will materially reduce the efficiency of the infrastructure owner cannot take place until the Australian Competition and Consumer Commission is asked to arbitrate an outcome.

The reversal of requirements on the Treasurer to explain a decision to accept a declaration runs contrary to the principles of transparency and accountability.

Broader reforms

As the MCA contends, there is a strong case that the access regime, which was created to essentially deal with the market power of privatised government monopolies, has run its course.

The 2005 Prime Ministerial Taskforce on Export Infrastructure called on the then Federal Government to consider an "efficiency override": a mechanism that would allow the NCC to limit the scope of access on the basis of efficiency (that is, cost to the owner and disruption to its operation). At present such assessments are undertaken by either the Australian Competition Tribunal or the Australian Competition and Consumer Commission *after* access has been granted and there is an arbitrated dispute over the charges for access.

(As noted above, the proposed Bill would remove the Tribunal's ability to make such an assessment.)

"Efficiency" was added to the Objects clause of Part IIIA as a result of these recommendations, but not directly into the relevant sections of the Act. A genuine efficiency override would require the NCC take account of the cost of any access declaration during its initial deliberations.

Accordingly, the MCA recommends that reforms should be made to Part IIIA (access regime) of the Trade Practices Act to more accurately reflect the intentions of the Hilmer Report in recommending the introduction of a system of statutory access rights in Australia which, *inter alia*, assiduously recommended the criteria under which one business should be required by law to make its private facilities available to another business, including a competitor.

As noted above the MCA holds that:

- competition be 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 be 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 be 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.

These policy principles should be realised in amendments to Part IIIA. Such amendments would reduce the risk that declaration results in outcomes that are costly and inefficient without a material increase in competition justifies the regulatory intervention. Accordingly the MCA recommends that amendments be formulated such that Part IIIA:

- Amend criterion (a) – that access (or increased access) to the services would promote competition in at least one market – to require that any improved competition would be both likely, substantial and occur in an important market.

  At present even small or speculative improvements in competition are sufficient to justify declaration of a facility; even improvement in small or unimportant markets is sufficient to justify declaration of a facility.

  Decision makers at present have wide latitude which means that the mere possibility rather than likelihood of an improvement means that small improvements can justify a decision. It has also means that relevant 'markets' have been defined to include trivial and unimportant markets.

- Amend criterion (b) – that it would be uneconomical for anyone to develop another facility to provide the services – to strictly limit the circumstances when a competitor may seek access to an infrastructure facility such that the facility is essential to competition or could not be developed in the absence of a declaration.

  At present, third party access need not be "essential" for competition for a service to be declared.

  There is no requirement at present that access to a facility be 'essential' in the sense that it represents a 'bottleneck' without which competition cannot take place. Instead the law as stands holds that access to a competitor's facilities need only be 'convenient', in the sense that the access seeker would avoid some costs as a result of the declaration.

- Formulate the 'production process exemption' as an explicit threshold criterion for declaration, taking into account closely integrated infrastructure/facilities.

  The scope of the production process exemption has been narrowed since its introduction so that most large infrastructure facilities are a risk of declaration, even in circumstances where they form part of what is plainly an integrated process production.

  As presently drafted, the production process exemption appears incidental to the declaration process under Part IIIA - rather than forming an explicit declaration criterion, it is implicit in the definition of services. Also the exemption in is formulated in terms of the type of service in question (such as roads and railways), rather than with reference to the economic characteristics of a facility, in terms of risks and disruptions and lost efficiencies to tightly integrated supply processes.

- Amend criterion (f) – that access or increased access to the service would not be contrary to the public interest – to require that declaration is demonstrably in the public interest and the explicit application and independent scrutiny of a public interest test.

  The public interest test, which requires a balanced overall assessment of the benefits and costs of declaration, effectively plays no role in the decision about whether to impose mandatory third party access.

  An amendment would insure that declaration is in the public interest rather than merely not harmful to the public interest.

Minerals Council of Australia
December, 2009