25 November 2004

Mr J Hall
CEO
Queensland Competition Authority
GPO Box 2257
BRISBANE QLD 4001

Dear Mr Hall

Dalyrmple Bay Coal Terminal – Draft Access Undertaking

The Australian Council for Infrastructure Development (AusCID) appreciates the opportunity to offer comments and observations on the Authority's Draft Decision on the above matter.

AusCID is the principal industry association representing the interests of companies and organisations owning, operating, building, financing, designing and otherwise providing advisory services to private investment in Australian public infrastructure.

The Council formed in 1993 and currently has 84 members, drawn comprehensively from all economic infrastructure sectors including electricity generation, transmission and distribution, gas transmission and distribution, roads, rail, telecommunications, water, airports and ports.

As a result of its membership base, AusCID is in a unique position to consider the views of infrastructure owners, equity investors and debt financiers and combine them with the views of infrastructure operators.

AusCID's fundamental regulatory proposition is that regulation should only be applied where there are strong grounds to believe that, left unregulated, the service in question will be priced and delivered in a way that damages economic efficiency. In other words, regulation must have an efficiency rather than distributional focus, especially in those cases where intermediate industrial services are involved, such as airports and seaports.

When regulation is applied, it should be done so with great care with an emphasis on ensuring that commercial conduct in the relevant markets is as normal as possible. Regulatory decision making should not lead to perverse behaviour, especially in relation to ongoing investment.

Over the last few years, AusCID and its members have played a very active role in promoting the need for reform of Australia's regulatory arrangements both in relation to ensuring that regulation is only applied where needed and that, when applied, the form and outcome of the regulation is appropriate.

AusCID has made a number of submissions to reviews undertaken by the Productivity Commission and strongly supports the general policy thrust adopted by both that organisation and the Commonwealth Government.

Consequently AusCID is very disappointed with the approach that the Authority has recommended in relation to this matter. The approach proposed seeks to remove all incentive for DBCT Management to actively work with its customer group and, perhaps more importantly, new customers to expand the facility and its services. Indeed, the structure proposed by the Authority creates a mechanism by which incumbents may be able to frustrate expansion and ultimately restrict competition in related markets. Such an outcome is directly contrary to the policy purpose of access regulation.

The adoption of a revenue cap has the effect of removing any incentive for DBCT management to grow their business, especially given that the WACC being proposed by the Authority is so low as to deter future investment. In addition to the obvious impacts on DBCT Management's shareholders, the long term consequences of this situation are likely to be:

- There will be little incentive for DBCT Management to innovate, thus largely neutralising one of the primary purposes of the privatisation;
- Competition in related markets is likely be choked by the creation of a bottleneck in the supply chain; and
- In the event that there is a slackening in demand, supply chain costs are likely to increase under a revenue cap thus impairing overall industry competitiveness.

By requiring future investment to be subject to future regulatory scrutiny, irrespective of the return, significant difficulties will be encountered.

The Productivity Commission, when reviewing similar arrangements that applied to major airports in the period 1997-2002 (the so called "necessary new investment" arrangements), found among other things that they create a bias towards users seeking regulatory rather than commercial outcomes and "regulatory risk due to uncertainty and delays introduced by the need to have every investment-related price increase vetted by the regulator"[1].
A number of submitters to that inquiry, including the ACCC, drew attention to the fact that these types of arrangements can lead to anticompetitive gaming by incumbents[2]. AusCID understands that the DBCT User Group is by no means unanimous in its view and that this sort of gaming may in fact be occurring in relation to this matter.

The need for these types of arrangements arises fundamentally because the price level is below the long run incremental cost of new capacity (usually because the cost of capital or the valuation of existing assets is too low). What the Authority proposes, rather than ensuring that prices reflect long run efficient incremental costs (a set of prices which it could reasonably expect DBCT management to profitably invest at), seeks to restrain prices and introduce further regulatory risk.

This form of regulation was actively abandoned by the Commonwealth in relation to airports and AusCID urges the Authority to follow the Commonwealth's lead.

---

[1] Productivity Commission (2002) *Price Regulation of Airport Services*, Inquiry Report, p245.
[2] Ibid pp234-236.

As the peak representative body for Australian infrastructure investors, AusCID considers the level of return proposed by the Authority for current and future investment to be below that at which new investment will occur. It appears the structure of the price control arrangement is in part determining the estimate of returns – the argument being that much of the risk of volume is being eliminated.

Notwithstanding the theoretical inadequacies of the Authority's approach, we would also observe that when the ACCC was been faced with "low risk" investments in the airport sector, it considered an asset beta of 0.46 to be appropriate[3].

We are aware of the technical arguments DBCT Management has developed in relation to the Authority's approach on return on capital and support them. For the sake of brevity we shall not revisit them here in detail

It must be stressed, however, that a comparator group of three can in no sense constitute a statistically robust sample. Further, the comparators used are either of barely passing relevance (such as the Port of Tauranga) or totally irrelevant (MIG and Macquarie Office Trust). In the case of MIG and the Macquarie Office trust, not only are the assets in those investment vehicles involved in businesses totally unrelated to DBCT, the partial diversification that those vehicles provide to investors will tend to suppress asset betas relative to stand-alone assets such as DBCT.

AusCID urges the Authority to undertake a fundamental review of its approach in this matter as it represents a major reversal of regulatory practice that has developed in recent times. This review is especially important as Queensland law does not appear to provide for a full merit review of the Authority's decision, a characteristic of regulatory regimes that all parties to the regulation debate agree is a core component of a best practice regulatory system.

If this decision were to stand, it will go a long way towards reversing much of the progress that has been made in regulatory policy by the Productivity Commission and a number of forward-looking regulators, such as the Essential Services Commissions of Victoria and South Australia.

Such a reversal would send a powerful message to all infrastructure investors that they remain exposed to opportunistic regulatory behaviour at a time when the nation's, and especially Queensland's, infrastructure is in desperate need of expansion and renewal.

Further, the fundamental revisiting of the parameters of the privatisation which are embedded in this Draft Decision raise sovereign risk issues in Queensland in the same way that the regulation of the Dampier-Bunbury Natural Gas Pipeline did in Western Australia and the sale Freight Australia did in Victoria

If you wish to discuss these issues any further, please do not hesitate to contact me on 02 9247 2022 or Dr Warren Mundy on 0409 911 554.

Yours sincerely

Dennis O'Neill
Chief Executive Officer

---

[3] See http://www.accc.gov.au/content/index.phtml/itemId/364795 for further details