INFRA SHARE
DELIVERING SHARED-USE INFRASTRUCTURE

Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

17 November 2014

Dear Sirs,

Comments on Draft Report of the Harper Panel

We are writing to comment on those aspects of the draft report of the Harper Panel (Draft Report) that relate to the National Access Regime. Specifically, our comments are focused on the implications of the Panel's recommendations for the sharing of rail, port and other infrastructure facilities associated with mining operations.

InfraShare Partners is engaged in advising governments around the world on how they can facilitate the sharing of infrastructure facilities, particularly those tied to mining, oil & gas and other resource projects, in order to ensure rational and efficient development of their natural resources and, where possible, promote broad-based economic development. We believe that we have a global perspective on this issue, which we have considered in a number of developed and frontier countries.

In our view, Australia's experience over the last three decades with access to mining infrastructure includes both the best (e.g., the Queensland coal network) and the worst (Pilbara iron ore infrastructure) that has been observed within the global mining industry. We routinely advise governments (particularly in frontier countries) that are approaching this issue for the first time to draw heavily from the positive experience in Queensland, and to be certain to avoid the Pilbara scenario.

It is, of course, possible for Australia's policy-makers to address, and correct, those situations where the effective and efficient sharing of infrastructure is not being achieved. We are concerned that the Panel's recommendations will not achieve this and, indeed, may actually make matters worse. If the goal of open and fair access to mining infrastructure in the Pilbara (for example) is not ultimately met, we fear that this will have profoundly negative long-term consequences for the development of mining projects and/or infrastructure corridors in the affected regions, and could adversely affect competition in related or dependent markets.

With respect to the National Access Regime, the Panel's main recommendations include the following:

- preserve (for the most part) an existing court-developed interpretation of a key condition (the "not economical to develop…" test) contained within the National Access Regime; such interpretation has, in our view, unduly narrowed the application of the National Access Regime and done so in a way that is inconsistent with the original intent of its framers; and

- tighten another condition (the "public policy" test) by putting a positive onus on an access seeker to show that declaring infrastructure for access would have a positive community benefit.

While access regimes always involve a tension between promoting competition, on the one hand, and maintaining incentives for investment, on the other hand, we consider that the Panel's recommendations do not strike the correct balance. The Panel's recommendations suggest, in our view, that it is overly focused on not discouraging private investment in infrastructure rather than on realising the economical rationale of the National Access Regime. In our view, investment in infrastructure will not be discouraged by this, or any other, access regime if, and so long as any successful access seeker is obliged to pay access charges that are fully-cost reflective. If this is the case, an affected infrastructure owner is fully and fairly compensated for his incremental operating costs and for an appropriate portion of his cost of capital associated with investment in the infrastructure (including any required expansion). In most instances, the owners' average costs will decrease upon introduction of an additional infrastructure user thereby improving his economic returns.

Arguments against requiring the owner of critical infrastructure to grant access to third parties based upon respect for private property rights (or variations on this theme) are heard routinely, and can often appear compelling. However, for more than 100 years, and in various sectors including railways, telecommunications and information technology, courts and legislators in developed countries have consistently held that private rights should not trump the overriding need to prevent an infrastructure owner from abusing his monopoly position in a way that damages competition (including by leveraging his position to gain an unfair advantage in a related or dependent market).

In the case of mining infrastructure, clear, comprehensive, workable and economically rational access regimes are needed to facilitate fair and effective competition in:

- the market for acquiring and developing mineral rights (something the government of every mineral-rich country, including Australia, has a keen interest in promoting);

- the market for providing haulage services to mining and other companies wishing to move bulk commodities quickly and efficiently to market (the cost of such services being a key success factor in terms of competitiveness); and

- the market for supplying bulk commodities such as iron ore, coal and bauxite (which, in the case of iron ore, is relatively concentrated among only three low-cost global miners).

Critical rail and port facilities are very difficult to replicate in terms of finding suitable land and obtaining necessary approvals and permits. Moreover, the cumulative adverse environmental and social impacts associated with duplicating infrastructure facilities generally cannot be justified in circumstances where unutilized capacity (or potential expansion capacity) exists within existing facilities. Economically, it is rarely the case that multiple upstream mineral reserves are of a scale to justify capital expenditure associated with new and independent infrastructure, while they can contribute meaningfully as part of a resource region.

Put simply, it is a waste of society's economic resources for a major investment in new infrastructure to be made before it is strictly needed. Where such unnecessary investments are effectively required due to the absence of effective competition regulations, there can be a very clear and direct adverse economic impact. For example, a greenfield mine might never be developed, a mine's development might be unnecessarily delayed and/or a mine's profitability might be significantly reduced (with a related adverse impact on shareholder returns and royalty/profit tax receipts by host government(s)). Furthermore, there are economic costs associated with being reliant on one or a small number of dominant players, rather than achieving a more balanced, competitive environment.

Specific Comments

Economic efficiency

In the Draft Report, the Panel states:

> "The National Access Regime was originally established to enable third-party access to identified bottleneck infrastructure where it was apparent that economic efficiency would be enhanced by promoting competition in markets that were dependent upon access to that infrastructure."

This is not strictly correct. The National Access Regime was introduced:

> "to promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets" (emphasis added) - *Letter (a), Section 44AA of the National Access Regime*

The regime's framers wanted, therefore, to see infrastructure being operated, used and invested in in an economically efficient manner, expecting that this would, in turn, promote effective competition in associated markets. We consider that the Panel's recommendations threaten to dispense with the goal of achieving economically efficient use of infrastructure, in order to avoid the practical (but certainly not insurmountable) challenges associated with determining what is, or is not, economically efficient.

If the needs of an access seeker can be met through unutilized infrastructure capacity on terms that fully and fairly compensate the owner of such infrastructure,

this will almost always be more economically efficient than having such infrastructure duplicated prematurely. Where additional capacity is required, this can generally be achieved more efficiently by having an access seeker contribute, directly or indirectly, to the capital cost of expanding existing facilities rather than funding the construction of completely new ones.

National Access Regime vs. Other Regimes

In the Draft Report, it is noted that:

> "The bottleneck infrastructure cited by the Hilmer Review is now subject to a range of access regimes. Those regimes appear to be achieving the original policy goals identified by the Hilmer Review. Today, Part IIIA has only a limited role in the regulation of that bottleneck infrastructure."

Access to rail and port infrastructure used by mining companies in Australia has, indeed, largely been achieved courtesy of State-level access codes and undertakings. These regulations have worked well in the case of infrastructure held by independent infrastructure companies (e.g., the Queensland Coal network/Aurizon). Where infrastructure is owned privately, there are signs of progress but also some worrying developments (for example, Fortescue Metals is currently fighting an access application by Brockman Mining).

The Draft Report does not, but should, address or consider why the National Access Regime has failed to support the achievement of the Hilmer policy goals. In our view, the reason is clear. The National Access Regime, as interpreted by the courts, is not fit for its original purpose and needs to be strengthened - not weakened or further marginalised. Uncertainties in the regime's original drafting opened the door to extensive legal manoeuvrings by incumbent infrastructure owners, the best example of which is the infamous Pilbara rail case – a dispute that resulted in staggering legal bills and clear value destruction.

In our view, strong and effective State-level access regimes have arisen, and exist, in Australia because the national regime has never fulfilled its original purpose. However, there remains a real need for an "omnibus" national access regime – one that is as effective as the best State-level regimes and provides a safety net to catch situations not otherwise addressed at the State level.

Identifying Infrastructure

The Draft Report states:

> "The question that arises today is: what are the infrastructure facilities for which access regulation will be required under Part IIIA in the future? Unless it is possible to identify those facilities or categories of facilities, it is difficult to reach a conclusion that the regulatory burden and costs imposed by Part IIIA on Australian businesses is outweighed by economic benefits, or that the benefits can only be achieved through the Part IIIA framework."
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> [...]
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> "The Panel agrees that, if the Regime is to be retained, the scope of the Regime should be confined because of the potential costs of regulation."

We are concerned about this statement. The National Access Regime was designed to address a point of principle, namely that where bottleneck infrastructure (of whatever type) could be efficiently used by others there should be a mechanism by which sharing can occur on fair and reasonable terms. This flexibility should be preserved. Early 20th century courts in the United States, when they required monopoly owners of a rail terminal to grant access to third parties, surely had no idea that their decision (the genesis of the "essential facilities" doctrine) would, more than 50 years later, be applied to require access to telecommunications infrastructure, and almost 100 years later, be applied to open up access to elements of Microsoft's market-leading operating system.

Furthermore, it is unclear to us what specific "regulatory burden and costs" the Panel is referring to in the quoted paragraph above. The enormous legal costs generated by the National Access Regime could, we suggest, be eliminated through greater clarity of drafting. Other costs of regulation will, in our experience, normally be outweighed by the benefits associated with achieving economically efficient infrastructure sharing. In the case of rail and port facilities, for example, the costs of constructing "greenfield" facilities often run into the billions of dollars; the costs of achieving equivalent capacity through the expansion of existing facilities are often a small fraction of the greenfield figure.

"Uneconomical for anyone to develop"

In the Draft Report, the Panel explains its decision to reject the Productivity Commission's preferred recommendation in relation to the critical "uneconomical for anyone to develop…" test in favour of the Commission's "alternative" suggestion as follows:

> "The alternative recommendation for criterion (b) essentially maintains it in its current form, while clarifying that duplication of the facility by the owner of the existing facility is not a relevant consideration. As recently interpreted by the High Court in the Pilbara rail access case, the current form of criterion (b) asks a practical question whether it would be profitable for another facility to be developed — if it would, the facility is not a bottleneck. The Panel considers that this test can be more easily applied than the alternative test proposed by the PC, which would require predictions of total market demand over the proposed period of declaration and an assessment of production costs rising from third-party access to the facility."

In our view, the Panel should adopt the Productivity Commission's preferred recommendation for reforming the "uneconomical…" test. The Commission's proposal correctly (in our view) addresses the critical issue of "economic efficiency", and is surely consistent with the original intention of the framers of the National Access Regime.

Given the length and cost of the Pilbara rail case, we cannot agree with the Panel's preference for retaining the existing "uneconomical…" test based on its ease of application. The existing test (as interpreted by the court) requires, in effect, an applicant to expend significant resources (usually tens of millions of dollars, in the case of rail and port infrastructure) to conduct a feasibility study for a theoretical duplicate project. Often, the relevant data points are not available until extensive

negotiations have been held with third parties (e.g., landowners, etc.). This, surely, is a more complex and onerous requirement than establishing that there is available capacity within an existing rail or port facility (or that such capacity could be created through expansion) and that such capacity could meet the needs of foreseeable applicants.

Furthermore, even if it is economically viable for the developer of a mine to construct his own rail and port infrastructure, it may not be economically rational to do so. Duplication of infrastructure (prematurely) can involve significant and unnecessary value destruction, the implications of which are felt by shareholders of mine developers, government treasuries, and many others.

"Public interest"

In the Draft Report, the Panel states:

> "The Panel believes that declaration and third party access to infrastructure should only be mandated when it promotes the public interest. The onus of proof should lie with those seeking access to demonstrate that it would promote the public interest rather than on infrastructure owners to demonstrate it would be contrary to the public interest."

The owner of an integrated mining operation has a clear incentive to block access to infrastructure by its competitors, with a view to increasing its market power and limiting supply competition by ultimately acquiring the access seeker's mineral rights cheaply or extracting all available economic returns from an access-seeker's mining project. Furthermore, it is clear that there will generally be a significant "information asymmetry" between infrastructure owner and access seeker, including with respect to available capacity and the technical and commercial feasibility of accommodating the access seeker's application. In view of the foregoing, the Panel should be seeking to make it easier, not more difficult, for access seekers to have critical infrastructure declared. If bottleneck infrastructure has available unutilized capacity (or its capacity can be expanded) then, *prima facie*, it should be capable of declaration.

Significant economic decisions

The Panel points out in the Draft Report that:

> "Decisions to declare a service under Part IIIA, or determine terms and conditions of access, are very significant economic decisions where the costs of getting the decision wrong are likely to be high."

We think it is fair to note here that denials of third party access to essential infrastructure facilities are also very significant economic decisions, and that the opportunity costs to society of blocking or preventing access can be very material indeed.

On the other hand, we are unclear as to what "costs" are involved in permitting an access seeker to gain access to available infrastructure capacity on terms and conditions that are fair, reasonable and fully cost-reflective.

Specific Requests for Comments

The Panel has invited further comment on:

- the categories of infrastructure to which Part IIIA might be applied in the future, particularly in the mining sector, and the costs and benefits that would arise from access regulation of that infrastructure; and
- whether Part IIIA should be confined in its scope to the categories of bottleneck infrastructure cited by the Hilmer Review.

Categories of Infrastructure to Which National Access Regime Might Apply

As noted above, we believe that the National Access Regime should remain flexible ! in its potential application to different types of infrastructure. !

In the context of the mining industry, the regime could conceivably be applied to ! achieve economically rational sharing of excess capacity within the following types ! of infrastructure: !

- railways (including associated bridges and tunnels); !
- port facilities (harbours, deep sea channels – but usually not laydown areas); !
- power generation plant and equipment; !
- access and haulage roads; !
- airports; !
- desalination plant and equipment; and !
- water treatment facilities. !

Should the National Access Regime be Confined in its Scope?

For the reasons given above, we do not consider that the National Access Regime should be confined in its scope.

However, we do recommend that the regime be supplemented to create greater clarity concerning the fundamental principles that should be applied by the ACCC in the event that it is required to arbitrate following a failed access negotiation. Such principles, which should include access tariffs that are fully cost reflective, would inform and guide private negotiations (as the Surface Transportation Board's guidelines do within the US railway sector) and discourage gamesmanship by incumbent owners of infrastructure.

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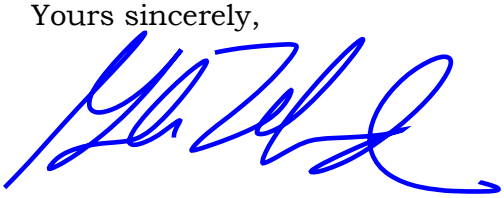
We appreciate the opportunity to provide these comments. Should you have any questions or require any further information, please do not hesitate to contact the undersigned on glen.ireland@infra-share.org or +44 7540 993 595.

Yours sincerely,



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