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26 August 2020

Richard York
Executive Director
National Competition Council
GPO Box 250
MELBOURNE VIC 3001

Dear Mr York

**Re: NSW Minerals Council application for declaration at the Port of Newcastle**

Thank you for the opportunity to submit to the National Competition Council's (NCC) consideration of whether to recommend that the designated Minister declare the shipping channel service at the Port of Newcastle (the Port).

The attached submission considers the reasons the NCC recommended that declaration of the shipping channel service should be revoked, and provides additional information and analysis to help inform the NCC's consideration of the present matter. The ACCC believes that there are a number of points which, if approached differently, may result in a different outcome.

The response attached outlines crucial elements to the assessment of criterion (a) and criterion (d) that did not receive sufficient attention as part of the NCC's recommendation to revoke declaration.

Regarding criterion (a), the NCC should not disregard the inefficiencies, and the resulting cost to the community, caused by PNO's ability and incentive to earn monopoly profits, and the effect this inefficiency will have on competition in related markets. When the detriment caused by monopoly pricing is taken into consideration, the ACCC contends that criterion (a) is satisfied.

Regarding criterion (d), The ACCC considers the increased investment and efficiency benefits realised from declaration are likely to outweigh any positive longer-term marginal administrative and compliance costs. Therefore, declaration of the Service would be in the public interest, and criterion (d) is satisfied.

We note that on Monday 24 August, the Federal Court handed down its judgment on its judicial review of the Australian Competition Tribunal's arbitrated terms and conditions of access to the Port. We are currently reviewing the reasons for judgment and may shortly make a brief supplementary submission on any matter arising from it.

If you would like to discuss this letter or any issues contained in the attached submission, please contact Matthew Schroder, General Manager, Infrastructure and Transport – Access and Pricing, on (03) 9290 6924, or Justin Martyn, Director, Regulated Access – Rail, on (08) 8456 3536.

Yours sincerely

Rod Sims
Chair

# Introduction

This submission sets out the ACCC's views on a number of matters the National Competition Council (**NCC**) should take into consideration in assessing the New South Wales Minerals Council's (**NSWMC**) application for declaration of certain services (**the Service**) at the Port of Newcastle (**the Port**).

The foundation of Part IIIA is the promotion of economic efficiency in markets characterised by natural monopoly infrastructure service providers. Owners of monopoly infrastructure services have the potential to exercise market power in a way that prevents effective competition in related markets, such as preventing access, charging monopoly prices for services or imposing unreasonable terms and conditions. Part IIIA seeks to address this problem of monopoly market power by the promotion of economic efficiency in markets characterised by natural monopoly infrastructure service providers.[1] Therefore, underlying Part IIIA is the notion that monopolies require some level of economic regulation to address the market failure problem.

The ACCC notes that the declaration criteria, now under section 44CA of the *Competition and Consumer Act* (**the Act**), were amended in 2017 and subsequently applied once by the NCC in its consideration of an application by Port of Newcastle Operations (**PNO**) to revoke declaration of the Service at the Port. In that instance, the NCC was not satisfied that declaration of the Service at the Port satisfied criteria (a) and (d). Therefore it recommended to the Minister that declaration of the Service should be revoked.[2]

In considering whether or not to declare the Service, under subsection 44F(2)(b) of the Act, the NCC is required to have regard to the objects of Part IIIA. Specifically, the ACCC considers the NCC's previous interpretation and application of the amended criteria (a) and (d) to be inconsistent with the first object, which is to promote the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting competition.[3]

This submission addresses criteria (a) and (d). Regarding criterion (a), the ACCC contends that competition in dependent markets is best enabled by the promotion of economic efficiency in the market for PNO's services. The NCC should not disregard the inefficiencies, and the resulting cost to the community, caused by PNO's ability and incentive to earn monopoly profits, and the effect this inefficiency will have on competition in related markets. When the detriment caused by monopoly pricing is taken into consideration, the ACCC contends that criterion (a) is satisfied.

Regarding criterion (d), the ACCC considers the increased investment and efficiency benefits realised from declaration are likely to outweigh any positive longer-term marginal administrative and compliance costs. Therefore, declaration of the Service would be in the public interest, and criterion (d) is satisfied.

Overall, the ACCC submits that the NCC should recommend that these criteria are satisfied with respect to NSWMC's application for declaration. The ACCC submits that declaration of the Service would promote economically efficient outcomes and enhanced competition and investment.

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[1] Petersen, Bull and Dermody, 2016, *Access Regulation in Australia*, p. 27.

[2] NCC revocation recommendation, 11.7.

[3] s 44AA(a) of the Act.

# Criterion (a)

## Introduction and background

In November 2017, declaration criterion (a) was amended to state:

> *Access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service.*[4]

The amendment changed the emphasis in the first part of criterion (a) from assessing the effects of access (or increased access) to assessing the effects of declaration. This has been referred to as a 'with and without declaration' test, as opposed to the previous 'with and without access' test.

In its recommendation to revoke the previous declaration, the NCC approached the assessment of criterion (a) by asking, in regard to the future with and future without declaration scenarios:

> *(a) Does the Council consider that the provider would have the ability and incentive to deny access to relevant service or restrict output and charge monopoly prices? Where a provider of a relevant service has this ability and incentive, it is more likely that it will be able to set terms and conditions of access that are less favourable than those that would be expected in a competitive market for the service;*
>
> *(b) If the provider has that ability and incentive, would such conduct materially affect competition in a dependent market?*[5]

Therefore, the NCC broke the assessment of criterion (a) into two limbs. Applying this approach, the NCC considered it is not enough to find that PNO has market power, or operates a bottleneck facility.[6] Even though the NCC found it is likely that charges for the Service would be higher in a future without declaration, it was not satisfied that criterion (a) was met.[7]

The ACCC disagrees with this framing and application of the assessment of criterion (a). The wording of criterion (a) should not be displaced with another test. Criterion (a) should be interpreted in a manner consistent with the objects of Part IIIA. In accordance with the first object, the focus of the criterion (a) assessment should be on whether declaration would promote economically efficient operation of, use of and investment in the infrastructure by which services are provided, *thereby* promoting a material increase in competition, rather than simply an assessment of the NCC's 'second limb' of whether a scenario without declaration materially affects competition in a dependent market.

However, if the NCC is minded to apply a similar two-stage assessment to the current application, the ACCC's views are set out below.

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[4] s 44CA(1)(a) of the Act.

[5] NCC revocation recommendation, 7.23

[6] NCC revocation recommendation, 1.6.

[7] NCC revocation recommendation, 7.168.

## Ability and incentives to exercise market power

The NCC's approach to the recommendation to revoke the declaration of the Service[8] at the Port considered a number of factors that go to PNO's ability and incentive to deny access to the Service on reasonable terms and conditions.[9] As part of this assessment, the NCC considered PNO's incentive and ability to restrict output and charge monopoly prices.[10]

The NCC reasoned that some level of constraint would apply on the 'pricing and output decision[s] of the Port [PNO] with respect to miners of export coal'.[11] Importantly, the Council considered that PNO would be constrained from maximising short-term profits as this may discourage investment in the Newcastle catchment and, in turn, reduce the longer-term profits of PNO as output reduced.[12]

The NCC considered that PNO has:

> *(a) little incentive to deny access to coal miners seeking to use the Service in order to export coal*
>
> *(b) a commercial incentive for dependent markets to be competitive in order to maximise demand for the Service. This is especially the case given export markets for coal are likely to be effectively competitive…and the Port is unlikely to face capacity constraints over the term of the existing declaration.*[13]

While the ACCC agrees that PNO has little incentive to deny access to the Service and that PNO benefits from increased demand for its services, the ACCC considers that PNO is ultimately driven by the goal of profit maximisation over the life of the investment. This goal is not equivalent to the goal of maximising the efficient use of the Port.

Orthodox economic theory is clear that monopolies will seek to maximise profits by charging above its efficient costs, even if this reduces volumes and/or the number of users utilising their service. Additionally, PNO's incentives, risks and future opportunities for revenue will change over time as industries evolve. Under certain circumstances, future revenues may be heavily discounted in favour of current (known) revenue.

The NCC found that PNO is likely to face some degree of competitive constraint from:

- its wariness of developing a reputation for "hold up" given it has signed a 98-year lease[14]
- prospective mining investors having options outside of the Newcastle catchment[15], and
- some limited regulatory constraints on PNO in the absence of regulation[16].

Despite these findings, the NCC appears to acknowledge these constraints to be minimal. The NCC considered it to be likely that:

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[8] Note that we refer again to 'the Service'. The current declaration application relates to the same service, from which declaration was revoked.

[9] NCC revocation recommendation, 7.83 – 7.86.

[10] NCC revocation recommendation, 7.83.

[11] NCC revocation recommendation, 7.91.

[12] NCC revocation recommendation, 7.93.

[13] NCC revocation recommendation, 7.120

[14] NCC revocation recommendation, p. 62.

[15] NCC revocation recommendation, p. 63.

[16] NCC revocation recommendation, p. 64.

*PNO would charge higher prices for the Service in a future without declaration of the Service than those likely to occur in a future with declaration. However, it is unclear precisely how much higher prices might be in a future without declaration of the Service…a price increase in a future without declaration of the Service may lead to small reductions in the volume of coal being exported through the Port…it might also mean some marginal mining opportunities that would be profitable in a future with declaration may not be profitable in a future without.*[17]

The NCC recognises that PNO is likely to charge higher prices for the Service in a future without declaration, which suggests that PNO does hold significant market power and it is likely to exercise its market power to earn monopoly profits. This in itself is an acknowledgement that PNO has the ability and incentive to exercise its market power to the detriment of dependent markets, and ultimately, community welfare. However, the NCC concluded that PNO does not have incentive to exercise that power.

To the contrary, the ACCC considers that monopoly providers, including PNO, will exercise market power when unconstrained by economic regulation, by setting unreasonable prices and terms of access to a service, to the detriment of economic efficiency (and the interests of users and the Australian economy).

Table 1 shows the change in Navigation Service Charge at the Port from 2014 to 2020. While there have been periods of relative stability in pricing, users have also experienced significant price shocks. For example, between 2014 and 2015, the NSC was increased by 60.8 per cent, and between 2019 and 2020, the NSC was increased by 33.4 per cent.

**Table 1 – Change in Navigation Service Charge over time**[18,19,20,21]

| Year | NSC ($/Gross tonne) | Percentage change (%) |
|---|---|---|
| **2014** | 0.4292 | |
| **2015** | 0.6900 | 60.8 |
| **2016** | 0.7169 | 3.9 |
| **2017** | 0.7305 | 1.9 |
| **2018** | 0.7553 | 3.4 |
| **2019** | 0.7809 | 3.4 |
| **2020** | 1.0420 | 33.4 |

It is noted that large price shocks increase risk and uncertainty for customers. While these impacts are discussed in greater detail below, in the ACCC's view, this clearly demonstrates that PNO has the ability and incentive to exercise market power.

[17] NCC revocation recommendation, 7.168.

[18] 2014 NSC: $0.4292 per gross tonne for the first 50,000 gross tonnes, increasing to $0.9656 for every subsequent gross tonne; NSWMC, *Application for a declaration recommendation in relation to the Port of Newcastle*, July 2020, p. 16.

[19] 2015 to 2018 NSC: PNO, *Application for revocation of declaration*, p. 18.

[20] 2019 NSC: PNO, *2019 Schedule of Service Charges*, p. 3.

[21] 2020 NSC: PNO, *2020 Schedule of Service Charges*, p. 3.

## Promoting a material increase in competition in dependent markets

### The NCC's assessment

While the NCC acknowledged that PNO is likely to charge higher prices in a future without declaration, it did not consider that this results in a lessening of competition.

The ACCC contends that denial of access is not the only way in which a monopolist can drive inefficient outcomes. Charging monopoly prices also results in inefficiencies and reduced investment and competition in related markets. This in turn undermines the productivity of the Australian economy and the international competitiveness of the Australian economy, and reduces community welfare. In considering the effect of higher prices on competition in the tenements market, the NCC states that it:

> *…does not believe that setting the same higher charges for all miners or investors for a particular tenement opportunity would necessarily amount to a lessening of competition in the market(s) for tenements in the Newcastle catchment…That is, while higher charges for the Service in a future without declaration may reduce the net present value of a mining project to which a tenement relates, this does not mean it would reduce the ability of individual miners to compete against each other for that tenement on their merits.*[22]

The underlying argument is that, provided that miners each face the same inefficient monopoly pricing in making their investment decisions, there is no adverse impact on competition and efficiency in the tenements market. In support of this view, the NCC refers to a report it commissioned from NERA Consulting, which states that:

> *…a competitive tenements market is one in which the tenements are allocated to the most efficient miners/explorers. Even if the value of tenements was reduced because of PNO's pricing, the tenements are likely to be allocated to the most efficient miners/explorers.*[23]

The ACCC disagrees with these conclusions and addresses the efficiency impacts of monopoly pricing in related markets below.

### Economic inefficiency resulting from the exercise of market power cannot be disregarded

The ACCC contends that disregarding the economic inefficiencies caused by monopoly pricing is inconsistent with and undermines the objects of Part IIIA, which are to:

> *(a) 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; and*[24] *[emphasis added]*
>
> *(b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.*[25]

Paragraph (a) of the objects is clear. Effective competition in related markets is promoted by promoting the economically efficient operation of, use of and investment in the infrastructure by which services are provided.

[22] NCC revocation recommendation, 7.330-7.331.

[23] NCC revocation recommendation, 7.335.

[24] s 44AA(a) of the Act.

[25] s 44AA(b) of the Act.

Declaration criterion (a) should be interpreted in a way that best promotes the objects of Part IIIA and, as such, the economic inefficiencies caused by monopoly pricing cannot be disregarded. A failure to give proper weight to the promotion of economically efficient use of monopoly infrastructure is to substantially read down the scope of the regime and materially impairs its ability to have any operation outside of a pure denial of access.

The Hilmer Report considered that economic efficiency comprises three components:

> *Technical or productive efficiency, which is achieved where individual firms produce the goods and services that they offer to consumers at least cost. Competition can enhance technical efficiency by, for example, stimulating improvements in managerial performance, work practices, and the use of material inputs.*
>
> *Allocative efficiency is achieved where the resources employed to produce a set of goods or services are allocated to their highest valued uses (that is, those that provide the greatest benefit relative to costs). Competition tends to increase allocative efficiency, because firms that can use particular resources more productively can afford to bid those resources away from firms that cannot achieve the same level of returns.*
>
> *Dynamic efficiency reflects the need for industries to make timely changes to technology and products in response to changes in consumer tastes and in production opportunities. Competition in markets for goods and services provides incentives to undertake research and development, effect innovation in product design, reform management structures and strategies and create new products and production processes.*[26]

The ACCC considers that promoting effective competition in markets is the best way to maximise economic efficiency. However, competition cannot maximise economic efficiency in markets under a monopoly. The foundation of Part IIIA is the promotion of economic efficiency in markets characterised by natural monopoly infrastructure service providers. The promotion of effective competition in dependent markets relies on the promotion of economic efficiency in the operation of, use of and investment in PNO's infrastructure.

Without declaration, the ACCC considers PNO has the ability and incentive to exercise its market power to the detriment of the economic efficiency and the productivity of the Australian economy. Some of the ways in which this is likely to occur are discussed below.

### *Declaration would result in an increase in allocative efficiency*

In a future without declaration and with monopoly pricing, there will be a reduction in allocative efficiency because PNO's prices will exceed its marginal cost of production. Allocative inefficiency results in a 'deadweight loss', reflecting the distortion of users' behaviour and the subsequent misallocation of resources as a result of the relative price change. This deadweight loss results in a reduction in community welfare.

If PNO were able to perfectly price discriminate, the adverse consequences on allocative efficiency would be reduced. However, in practice, given information limitations and the administrative costs of charging different customers different prices, perfect price discrimination is extremely difficult.

Even if the NCC considers demand for the Service to be relatively inelastic in the short-run such that the increase in price will have little effect on the volume of goods shipped through the Port, the expropriation of resource rents could reduce investment and induce marginal

[26] Hilmer Report, Independent Committee of Inquiry 1993, p. 4.

mines to prematurely close. Therefore, over the long-run, PNO's exercise of market power will materially reduce allocative efficiency. Further, over the long-run, when all factors of production are flexible, the elasticity of demand will increase, giving rise to a greater resource change and therefore greater allocative inefficiency.

Moreover, the added input price uncertainty faced by users as a result of PNO's exercise of monopoly power would likely increase the likelihood of delays in mining investments, resulting in a decrease in future mining throughput at the Port. Again, in the long-run, the reduced throughput resulting from PNO's exercise of market power will materially reduce allocative efficiency.

### *Declaration would result in an increase in productive efficiency*

The NCC also failed to consider the findings of the mainstream economics literature[27] that monopoly rents result in productive inefficiency.

Productive inefficiency occurs even if PNO is not X-inefficient[28] and could mitigate allocative inefficiency through price discrimination. While price discrimination is permitted under section 44ZZCA(b)(i), as observed by the NCC, it is only permitted when it aids efficiency. Price discrimination where revenues exceed the standalone cost of a service or subset of services gives rise to productive inefficiency.

A natural monopoly exists where total cost of production is minimised when one firm supplies services. However, if PNO engages in any pricing strategy – one which discriminates between customers or not – with the effect that revenues exceeds the standalone cost of any service or subset of services provided, there is productive inefficiency. Productive inefficiency arises because in a contestable market, revenues that exceed the standalone cost of a service or any subset of services, encourage entry and wasteful duplication of the fixed and common costs of bringing those services into production. The result is that the total cost of supplying port services exceeds the efficient total cost. That is, society devotes more resources to obtain these services than the opportunity cost of bringing these services into production.

The productive (in)efficiency argument made above was also observed by the Australian Competition Tribunal (**the Tribunal**) in *Application by Port of Newcastle Operations Pty Ltd*[29] as being 'usually part of the rationale for regulatory oversight'.[30] The Tribunal provided the following explanation of the rationale behind the [standalone] cost test:[31]

> *If prices for a group of services yield revenues in excess of standalone cost', entry occurs, 'inefficiently causing the total costs of production of all services to rise.*[32]

[27] Perhaps one of the seminal papers on this matter is by Faulhaber (1975) who couched the issue in game theoretic terms. If there are economies of joint production, a single supplier of the service is the most (socially) efficient production arrangement. However, if any one consumer or group of consumers is charged above the standalone cost of the service, it is rational for these consumers to 'go it alone' and supply the service themselves, 'leading to a globally less efficient supply arrangement'. Faulhaber's seminal contribution, including related research into cost allocation games (efficient pricing within the core) and the sustainability of natural monopoly is found in standard regulatory economic texts including Berg and Tschirhart (1988), Brown and Sibley (1989), Courcoubetis and Weber (2003) and Spulber (1989). Gerald Faulhaber (1975), 'Cross-subsidization: Pricing in Public Enterprises', *American Economic Review*, 65(5), pp. 966-977; Sandford Berg and John Tschirhart (1988), *Natural monopoly regulation: Principles and practice*, Cambridge; Stephen Brown and David Sibley (1989), *The theory of public utility pricing*, Cambridge University Press; Costas Courcoubetis and Richard Weber (2003), *Pricing Communications Networks: Economics, Technology and Modelling*, John Wiley and Sons; Daniel Spulber (1989), *Regulation and markets*, The MIT Press.

[28] X-inefficiency occurs when a firm lacks the incentive to control costs causing the average cost of production to be higher than necessary.

[29] Application by Port of Newcastle Operations Pty Ltd [2019] ACompT

[30] Ibid at [552]

[31] Ibid at [550]

[32] Ibid at [552]

When read in context as an explanation of the standalone cost test, the ACCC agrees with this view.

Productive inefficiency may take the form of socially wasteful duplication in a real way. Monopoly rents can give rise to either pressure or the actuality – and in any case an expenditure of real resources – of miners seeking to replicate any activity of PNO if this meant a lower resource cost incurred by the miners in doing so. Any current or future actions of miners as a result of these incentives constitutes a social waste and must be set against the monopoly rents of PNO.

Productive inefficiency may take other forms. Miners may seek to bypass PNO's exercise of monopoly power and monopoly rents by repeatedly seeking declaration. The monopoly rents therefore cannot be conceived as a benign transfer, since expenditure of real resources undertaken to mitigate or eliminate these rents includes social waste and must be set against the monopoly rents of PNO. The social waste arises in the above instances because the resources expended to mitigate or eliminate the monopoly rents could be otherwise spent on productive activities.

Moreover, since any form of price discrimination is unlikely to increase throughput at the Port to competitive levels, a further consideration of PNO's productive inefficiency arises from the inefficient scale and scope of its operations. The supply of Port services is characterised by a natural monopoly. Therefore, even if PNO just broke even in supplying less than competitive (contestable) levels, it will be productively inefficient. This is because, in a contestable market, such charges would encourage entry since the Service can be bought and sold at a lower unit cost. Entry, and the resulting duplication of costs, has the effect of inefficiently increasing the total cost of producing all Port services, which means society must expend more real resources to obtain the services of the Port than the opportunity cost of bringing those services into production.

### *Declaration would result in an increase in dynamic efficiency*

In a future without declaration, PNO's rational strategy would be to increase prices and restrict the volume of services, which may also lead to dynamic inefficiency. Restricting the volume of services results in the employment of fewer capital, labour and intermediate inputs to production. Economic regulation mimics the effects of the competitive market by encouraging socially optimal behaviour of the regulated business. In mimicking these effects, such as pricing discipline and cost minimisation, the regulated business also has an incentive to be dynamically efficient. In this context, declaration would provide the incentive for PNO to increase its volume of services, resulting in the employment of more production inputs, using a cost-minimising input mix to meet this expansion in volume. This would increase the scope for introducing new technology and incurring a lower resource cost of supplying the service. Therefore, declaration would likely result in an increase in the dynamic efficiency of the market.

### *Declaration would promote investment in dependent markets*

In a future without declaration, users will face higher levels of uncertainty with respect to the future path of access prices. This substantially increases the risk associated with making investments in related markets, such as the exploration stage tenements market. As the ACCC stated in its submission to the Productivity Commission's 2013 review of the National Access Regime:

> *Mining exploration is inherently risky as many prospects will be found not to be viable after substantial exploration and initial development expenditures have been incurred. The economic rents made on commercially viable mines allow miners to recover losses on prospects that prove unviable and to achieve at least a*

> *commercially-acceptable risk-adjusted rate of return across their entire operations (including losses on unviable prospects). Expropriation of these economic rents may discourage investments in prospecting for, and developing, new mines - with negative implications for allocative and dynamic efficiency, productivity and export earnings, and in turn, for community welfare.*[33]

Further, the increased risk associated with investing in new mines increases the borrowing costs to finance new investment, which increases the return miners require on investments. This elevated uncertainty also increases the likelihood that miners will delay their investments until the uncertainty is resolved. Therefore the uncertainty caused by PNO's unfettered market power can also distort decisions on otherwise efficient investments, which undermines the productivity of the Australian economy.

Finally, the ACCC contends that PNO's market power increases the 'hold-up' risk of miners' investments. This risk arises when one party makes long-lived investments that are both 'sunk' and are specific to transactions with another party. In these instances, the investing party is locked into a relationship with the second party, and the risk arises that the second party will behave opportunistically to expropriate the value of the first party's sunk investment. Given that miners make significant long-term, location-specific investments that require PNO's service to reach the market, the market dynamics are conducive to the hold-up problem. As above, the perceived risk associated with the hold-up problem increases the risk associated with investments, which increases the rate of return required on otherwise efficient investments which reduces investment in the industry. This ultimately undermines the productivity and competitiveness of the Australian economy and reduces community welfare.

## Conclusion: Criterion (a)

The National Access Regime is built on the principle of promoting the economically efficient operation, use of and investment in the infrastructure by which services are provided. This is reflected in the objects of Part IIIA. Competition in dependent markets is best enabled by the promotion of economic efficiency in the market for PNO's services. The ACCC considers that the NCC should not disregard the inefficiencies, and the resulting cost to the community, caused by PNO's ability and incentive to earn monopoly profits and the effects this inefficiency will have on competition and investment in related markets.

# Criterion (d)

The ACCC considers that the efficiency gains from declaration of this nationally significant infrastructure are likely to outweigh the long-term marginal increase in administrative and compliance costs. Therefore, the ACCC contends that declaring the Service would be in the public interest.

## Introduction and background

Criterion (d) is a positive requirement that, in making its recommendation to the Minister, the NCC be satisfied:

> *That access (or increased access) to the service, on reasonable terms and conditions, as a result of a declaration of the service would promote the public interest.*[34]

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[33] ACCC submission to Productivity Commission Review of the National Access Regime, February 2013, p. 77.

[34] s 44CA(1)(d) of the Act.

As part of its assessment of criterion (d), the NCC must have regard to:

> *(a) the effect that declaring the service would have on investment in:*
>
> > *i. infrastructure services; and*
> >
> > *ii. markets that depend on access to the service; and*
>
> *(b) the administrative and compliance costs that would be incurred by the provider of the service if the service is declared.*[35]

In its final recommendation to revoke declaration, the NCC considered:

> *that access (or increased access) to the service, on reasonable terms and conditions, as a result of declaration:*
>
> - *is unlikely to significantly [a]ffect investment in the infrastructure necessary to provide the Service*
> - *has the potential to improve efficient levels of investment in dependent markets; however, it is unlikely that any such consequence of declaration would be material*
> - *is likely to result in material administrative and compliance costs.*[36]

Further the NCC considered that in the event that the removal of declaration did lead to higher prices and that if the increased prices led to a reduction in usage of the Port, this would result in a reduction in allocative efficiency. However the NCC was not convinced that this consequence was certain, or likely to be significant.[37]

While the NCC could not quantify the respective costs and benefits relating to criterion (d) so as to determine whether or not they establish that declaration promotes the public interest, it concluded that the Minister could reasonably form the view that criterion (d) was not satisfied.[38]

## ACCC position

The ACCC considers that an assessment which properly takes into account all relevant considerations and latest information will indicate that access (or increased access) to the Service, on reasonable terms and conditions, as a result of declaration would promote the public interest. The ACCC contends that declaration is likely to result in:

- an increase in investment in PNO's facility
- an increase in investment in related markets, and
- an immaterial increase in long-run *marginal* administrative and compliance costs.

Further the ACCC contends that the administrative and compliance costs of declaration must not only be set against the allocative efficiency improvements from declaration, but also the productive and dynamic efficiency improvements.

[35] s 44CA(3) of the Act

[36] NCC revocation recommendation, 10.103.

[37] NCC revocation recommendation, 10.105.

[38] NCC revocation recommendation, 10.107-10.108.

## Declaration is likely to result in an increase in investment in PNO's facility and in related markets

The ACCC considers, and the NCC has recognised, that prices will likely be higher in a future without declaration.[39] If it is accepted that prices are likely to be lower in a future with declaration, the lower prices will elicit a demand response from users of the facility through an increase in mining throughput. This improvement in mining investment and the expansion in use of PNO's services under declaration will result in an increase in the demand for labour inputs, increasing employment across the region.

Further, the increase in throughput at the Port would increase the demand for factors of production to service the increase in demand for the Service. This would include an increase in investment in capital inputs.

While the ACCC agrees with the NCC in that declaration is likely to result in an increase in investment in related markets, it disagrees with the notion that this increase is likely be immaterial. As already described under the criterion (a) section of this submission, without declaration, users of the Service are subject to increased uncertainty associated with the future path of access prices, and increased hold-up risk. This increased risk increases the value of the real option to delay investment. The increase in risk can also filter through into an increase in borrowing costs to finance new investment.

Therefore the ACCC considers that, overall, declaration is likely to have a material positive impact on investment in PNO's facility and in related markets.

## Over the long-term declaration will have a relatively immaterial impact on administrative and compliance costs

Previously, the NCC contended that declaration will result in a material increase in administrative and compliance costs caused by the costs of negotiating and arbitrating access disputes. The NCC draws on the example of the Glencore-PNO access dispute to make the point that these proceedings can be very costly. While the NCC acknowledges that any future access disputes would likely be relatively less costly than the Glencore-PNO access dispute, it considers that a series of bilateral access disputes may add significant administrative and compliance costs associated with declaration of the Service.

The ACCC considers the NCC's predictions of declaration resulting in costly access disputes to be purely speculative. It is also possible that declaration will result in a shift in negotiating behaviour such that access disputes are avoided, resulting in no increase in administrative and compliance costs. It is not possible for the NCC to predict with any certainty the magnitude of the change in administrative and compliance cost, let alone make a judgement that declaration will result in a material increase in such costs.

Further, the ACCC contends that the NCC should take a long-term view when considering the administrative and compliance costs of declaration. If an access dispute does arise following declaration, this will result in an increase in administrative and compliance costs in the short-run. However, over the long-run, once the initial terms and conditions of access are resolved, the administrative and compliance costs are likely to be immaterial in proportion to the size of the industry.

Moreover, in assessing administrative and compliance costs, the ACCC considers that the NCC should examine the *marginal* administrative and compliance costs. That is, just as the 'with declaration' scenario has such costs, so does the 'without declaration' scenario. While

[39] NCC revocation recommendation, 7.168.

the service remains without regulatory oversight, PNO's exercise of market power will encourage users to continue to devote resources to seek declaration and any subsequent appeals, which can also be costly. Therefore, it is possible that the *marginal* long-run administration and compliance costs of declaration are low or even negative.

The ACCC considers that, over the *long-term*, any positive *marginal* increase in administrative and compliance costs is likely to be relatively immaterial when compared with the likely efficiency gains to a nationally significant supply chain.

### The NCC must also consider productive and dynamic efficiency

In its concluding remarks on its previous assessment of criterion (d), the NCC states that revocation of declaration:

> *could result in a loss in allocative efficiency. If so, it establishes a factor in the public interest that weighs in favour of declaration. The Council is unconvinced that a loss in allocative efficiency is certain, or likely to be significant.*[40]

The ACCC contends that the administrative and compliance costs of declaration must not only be set against the allocative efficiency improvements, but must be set against productive and dynamic efficiency improvements of declaration. Under the criterion (a) section of this submission, we have set out different ways in which PNO's exercise of market power undermines the efficiency of the related markets. This includes:

- the long-run reduction in allocative efficiency
- the reduced productive efficiency arising from PNO earning revenue exceeding standalone cost
- the reduced dynamic efficiency arising from higher prices and lower throughput
- the greater risk to investment in related markets caused by the uncertain future path of access prices
- the greater hold-up risk of investing in related markets.

The ACCC contends that all of these impacts must be considered when assessing whether declaration of the Service would promote the public interest.

## Conclusion: Criterion (d)

The ACCC considers the increased investment and efficiency benefits realised from declaration are likely to outweigh any positive longer-term marginal administrative and compliance costs. Therefore, declaration of the Service would be in the public interest, and criterion (d) is satisfied.

[40] NCC revocation recommendation, 10.107.