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Richard Home
Executive Director
National Competition Council
GPO Box 250
Melbourne VIC 3001

By email: pon@ncc.gov.au

Dear ~~Mr Home~~ Richard

Possible NCC recommendation to revoke 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 revoke the declaration of the shipping channel service at the Port of Newcastle (Revocation Recommendation).

The attached submission sets out the ACCC's view on matters that it considers the NCC should take into account in the NCC's interpretation of section 44CA(1)(a) (criterion (a)) of the *Competition and Consumer Act 2010* (Cth) (CCA). The ACCC has limited its comments to criterion (a) at this stage.

The proper construction and application of criterion (a) is of considerable public importance. The ACCC is able to provide assistance on this issue as an independent statutory authority with national competition and regulatory functions under the CCA.

The ACCC makes this submission in light of the long history of contentious Part IIIA declaration matters where controversy over the interpretation of the declaration criteria has led to drawn out proceedings and potentially undermined the effectiveness of the regime as a whole.

Careful consideration of the criteria is particularly important now given that the Revocation Recommendation represents the first consideration of the amended declaration criteria by the NCC since passage of the *Competition and Consumer Amendment (Competition Policy Review) Act 2017* (Cth), which came into effect on 6 November 2017.

The NCC would also be aware that the ACCC was notified in 2016 of an access dispute between Glencore and the Port of Newcastle in relation to access to the shipping channel service. I am advised by the Commissioners conducting the arbitration that the ACCC's consideration of the access dispute is well-advanced.

The outcomes of that consideration may be relevant to the NCC's assessment of the effects of declaration of the shipping channel service. The ACCC may well need to put in further submissions to the NCC on the Revocation Recommendation at the conclusion of the arbitration process.

If you would like to discuss this letter or any issues contained in the attached document, please contact Michael Cosgrave, Executive General Manager, Infrastructure Regulation Division on (03) 9290 1914 or Michael Eady on (03) 9290 1945.

Yours sincerely

Rod Sims
Chair

Introduction

Declaration criterion (a) was amended on 6 November 2017. The revised criterion is that:

> *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*

This revised formulation of the criterion needs to be carefully considered by the NCC in considering the Revocation Recommendation and other declaration assessments.

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

After the amendment, declaration under Part IIIA may now be less likely where a bottleneck facility owner is already providing some level of access without declaration. Absent declaration, access seekers may be able to access the service and compete in related markets but a facility owner with market power can determine the terms and conditions of that access with little constraint. That is, the terms and conditions applied may not be 'reasonable terms and conditions' of access.

In this context, it is especially important that the second part of criterion (a) is properly interpreted and applied, having regard to economic principles. Whether access seekers would be able to obtain declaration will depend on how the promotion of 'a material increase in competition in at least one market… other than the market for the service' is considered under each scenario.

The ACCC is of the view that a proper consideration of whether declaration would promote competition in a dependent market requires:

- a forward-looking analysis
- assessment over the medium to long term
- consideration and comparison of the competitive conditions and environment likely to arise in the future with and without declaration, including considering the likely incentives of a monopoly service provider.

A proper assessment also requires more than just considering the level of production likely to arise in the dependent market in the future with and without declaration. Narrowly focussing on the level of services offered (rather than the prices and terms, and whether they could be considered 'reasonable') does not give appropriate consideration to the possible economic and competitive outcomes.

If the NCC does not conduct a proper application of the legal test of whether declaration 'would promote … competition' in a dependent market in the interpretation of criterion (a), this will have the effect of raising the declaration threshold. This may in turn reduce infrastructure owners' incentives to negotiate in good faith and provide access on reasonable terms and conditions to avoid declaration.

Legal principles relevant to the proper construction of criterion (a)

Competition, in the context of the CCA, is a process, rather than a static state of affairs, and refers to the nature and extent of rivalry in a given market.[1] In considering the meaning of competition, there is a distinction between, on the one hand, the *process* of competition and, on the other, the *extent* of competition, which is the outcome of that process.[2]

Relevantly, competition as a *process* relates to behaviour that may affect the price, quality or conditions of sale of goods or services exchanged in the relevant market. Hence competition may be described as rivalry that amounts to a process that leads to an increase in economic efficiency. The *extent* or state of competition in a market is the result of internal and external factors which bear upon the nature and extent of the rivalry.[3]

The concept of "promoting" competition in the criterion does not correspond to measuring quantifiable increases in competition or the state of competition, but expresses a more flexible idea of creating the **conditions or environment for improving competition** from what it would be otherwise.[4] In the ACCC's view, it is not confined to measuring quantifiable increases in competition or the state of competition.

The criterion is also **forward looking**,[5] involving a comparison of the future state of competition in each of two scenarios – sometimes described as the 'with or without' test, or the "factual" and the "counterfactual". The assessment requires a consideration of the competition in dependent markets under a scenario where the service is declared and there is potential recourse to arbitration by the ACCC, as compared to a situation where there is no potential recourse.

The existing conditions and environment for competition in the dependant markets may be relevant to establishing the likely future conditions and environment for competition with or without declaration. Significantly, however, this is not always the case as the necessary enquiry must be forward looking.

In making judgments about the future conditions and environment for competition, the enquiries required by Part IIIA (including criterion (a)) necessarily look to the **medium to long term**. The decision to declare a service under Part IIIA must hold good for the whole of the period of the declaration.

In this context, barriers to entry connote the existence of market power because significant barriers to entry afford an opportunity for a firm to sustainably raise prices without losing customers.

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[1] *Re Queensland Co-operative Milling Association Ltd* (1976) 25 FLR 169 at 189-90; *Re Virgin Blue Airlines PtyLtd* (2005) 195 FLR 242 at [145]; *Adamson v. West Perth Football Club (Incorporated)* (1979) 39 FLR 199 at 224-5; *Outboard Marine Australia Pty Ltd v. Hecar Investments No. 6 Pty Ltd* (1982) 66 FLR 120 at 123-4 per Bowen CJ and Fisher J; *Universal Music Australia Pty Ltd v. Australian Competition and Consumer Commission* (2003) 131 FCR 529 at [242] per Wilcox, French and Gyles JJ; *Australian Competition and Consumer Commission v. Cement Australia Pty Ltd* (2013) 310 ALR 165 at [3013].

[2] *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136 at [1049].

[3] *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136 at [1050-51].

[4] *Re Sydney Airports Corporation Ltd* (2000) 156 FLR 10 at [106]-[107]; *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) 162 FLR 1 at [75]; *Re Services Sydney Pty Ltd* (2005) 227 ALR 140 at [132]; *Re Virgin Blue Airlines Pty Ltd* (2005) 195 FLR 242 at [146]; *Telstra Corporation Ltd v. Australian Competition Tribunal* (2009) 175 FCR 201 at [224]-[225]; *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136 at [1060].

[5] *Re Sydney Airports Corporation Ltd* (2000) 156 FLR 10 at [108]; *Re Fortescue Metals Group Ltd* (2010) 242 FLR 136 at [1048].

Economic Principles relevant to the proper application of criterion (a)

When considering the promotion of competition under criterion (a), the NCC should conduct a full assessment that properly examines the effect on the conditions or environment for improving competition in the dependent market(s). This requires analysis of how a monopolist would be able and incentivised to act in relation to access to its infrastructure. As the NCC is aware, this requires consideration of a number of economic factors. The ACCC expands on a couple of particularly relevant points below.

The primary economic concern arises in a situation where, absent regulated access, there appear to be few limits on the ability of an owner of monopoly infrastructure to raise the charge for services, or otherwise impose terms and conditions of access that are other than 'reasonable'.

This has two main potential effects. Firstly, increases in prices, or unreasonable terms, may mean that production in dependent markets decreases as firms are unable to absorb increases in costs, in both the short and long term. As prices increase, firms may exit the market.

Secondly, without any pricing restraint, users of the monopoly service face a problem: any investments they make are subject to the threat of hold-up – the threat that once an investment is made, the monopoly service provider will seek to change the terms and conditions, including price, in its favour. Fearing this outcome, customers will be reluctant to invest, or will make less desirable investments. The harm to the competitive environment in dependent markets from the exercise of market power is the potential dampening or chilling effect on future investment by customers who are dependent upon a service provided by a firm with market power.

Where a monopoly service provider has an incentive to exercise its market power, the NCC should take as a relevant consideration the view that declaration would enhance the conditions or environment for improving competition in dependent markets. This is because commercial negotiations would then be conducted with the knowledge that, in default of agreement, arbitration is available. Declaration will require a monopoly service provider to "behave as it would if its activities were carried out in a competitive marketplace".[6] It is more likely that 'reasonable terms and conditions' for using the service would be offered and agreed to in such a scenario.

Short run effect on production

The NCC's assessment should not focus primarily on short term static quantitative effects of monopoly pricing on volumes of production in dependant markets as an indicator of changes in competition. While part of the effect of monopoly pricing, the competitive impact of a price rise for a monopoly service is not the same as the short term impact on dependant market production. To take this approach restricts the 'with or without' test to an inappropriate short-term quantitative assessment only, downplaying or ignoring qualitative judgments about long-run effects and disincentives to invest.

Instead, the correct interpretation of criterion (a) would use a 'with or without' test to consider the potential qualitative and quantitative impacts of dampened incentives to invest in the medium to long term, including the dynamic adverse consequence on competition of blunting investment in expanded production capacity. This is in addition to considering the short and longer term quantitative effects on production levels.

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[6] *Re Virgin Blue Airlines Pty Ltd* [2005] ACompt 5 at [155]

As such, the NCC should take into account the ability of a monopoly service provider to increase charges in the future by conducting a 'with or without' test comparing the two future scenarios in the relevant dependent markets. While future price increases or other changes to terms and conditions may be uncertain, the 'with and without' test should be conducted with reference to whether increased access to the monopoly service as a consequence of declaration would reduce or remove that uncertainty, and with consideration as to whether such a reduction or removal would create or enhance the conditions or environment for improving competition.

The incentive not to reduce production

Even if a charge for a monopoly service is currently small as a proportion of the total supply chain costs, there is no guarantee that it will remain small in the future.

The ACCC considers it would be inappropriate for the NCC to assume, absent access to independent arbitration, that a monopoly service provider's incentive to maximise the flow of product through its facility would constrain it from increasing prices. This is because a monopolist may be able to increase prices in a way that harms the conditions or environment for competition, notwithstanding that production levels do not immediately fall. This may be because a monopolist has the ability to price discriminate in its pricing for its service, or because increases in the prices for products in dependant end-markets allow for the monopolist to increase prices to users without affecting throughput.