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**21 July 2008**

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Dear Mr Feil

**Draft Recommendation – Goldsworthy Railway**

We refer to the Draft Recommendation published by the National Competition Council (**NCC**) in relation to the Application for declaration of a service provided by the Goldsworthy Railway dated 20 June 2008.

In response to the Draft Recommendation, we **enclose** the following documents:

- a submission on behalf of BHP Billiton Iron Ore Pty Ltd and BHP Billiton Minerals Pty Ltd (collectively **BHPBIO**); and
- five attachments to that submission.

To the extent that BHPBIO's submissions are relevant to the Council's consideration of the Hamersley Application and Robe River Application, we request that the Council take these submissions into account.

Yours sincerely

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# BHP BILLITON IRON ORE

# SUBMISSION IN RESPONSE TO THE DRAFT RECOMMENDATION OF THE NATIONAL COMPETITION COUNCIL

# APPLICATION FOR DECLARATION OF A SERVICE PROVIDED BY THE GOLDSWORTHY RAILWAY LINE

**21 JULY 2008**

bhpbilliton
resourcing the future

## 1. EXECUTIVE SUMMARY

### DRAFT RECOMMENDATION

1.1 In its Draft Recommendation, the NCC stated that it had reached a preliminary view that the Goldsworthy Application satisfies each of the declaration criteria set out in s44G(2) of the TPA and that it intends to recommend to the Treasurer that the Goldsworthy Service be declared for a period of 20 years.

1.2 In particular, the NCC indicated that its preliminary view was that:

(a) access to the Goldsworthy Service would promote a material increase in competition in the Pilbara-wide iron ore tenements market and the rail haulage services market;

(b) it would be uneconomical for anyone to develop another facility to provide the Goldsworthy Service; and

(c) access would not be contrary to the public interest.

1.3 BHPBIO submits that, in formulating its Draft Recommendation, the NCC has failed to properly consider or take into account the information and other matters contained in BHPBIO's submissions to the NCC dated 30 April 2008 and has made a number of critical errors of fact, law and reason.

1.4 Of particular concern is the willingness of the NCC to reach conclusions on technical matters without having any expertise in such matters, without consulting any relevant technical literature and without the benefit of opinions from appropriately qualified consultants. Despite having no such basis for its conclusions on various technical matters, the NCC rejects the opinions and submissions of BHPBIO and Rio Tinto, world leaders in the mining industry.

### ACCESS IS CONTRARY TO THE PUBLIC INTEREST

1.5 BHPBIO strongly believes that declaration of the Pilbara iron ore railways would be contrary to the national interest. The competitiveness, efficiency and growth of Australia's iron ore export industry will be seriously compromised by mandating third party use of Pilbara railway infrastructure. The magnitude of the potential loss of export sales will be many billions of dollars. As detailed below, the NCC's analysis of these critical issues has been superficial and completely inadequate.

| NCC Conclusion | The Reality |
|---|---|
| Third party access will not delay expansions to infrastructure in light of the safeguards provided for by Part IIIA. | Historical experience with the ACCC and other access regulators demonstrates that access and access regulation will cause delays to expansions. Access regulation is time consuming and generates uncertainty. The experience of the Queensland Competition Authority in relation to the regulation of access to the Dalrymple Bay Coal Terminal is illustrative. |
| The problems associated with multi-user systems on the east coast of Australia will not occur if third party access to the Goldsworthy Service is granted because Part IIIA provides safeguards that will ensure that those problems will not arise. | The NCC has made no attempt to analyse or understand the causes of the problems of multi-user systems on the east coast of Australia. Its conclusions on these issues have no solid foundation. Further, the fundamental premises on which the NCC relies in relation to regulatory safeguards are legally and factually incorrect. |

| NCC Conclusion | The Reality |
|---|---|
| Access to the Goldsworthy Service will result in capacity and efficiency losses but those losses will be capable of being reflected in access prices and terms. Any loss that is not capable of being ameliorated by access terms will not be near the level suggested by BHPBIO. | Capacity and efficiency losses will result in significant costs and diseconomies to the Australian public, regardless of whether they are reflected in access prices, and must be taken into account, in accordance with the NCC's previously established approach. The NCC has also failed to undertake any quantitative analysis of the costs resulting from losses in capacity and efficiency, either in relation to the supposedly ameliorated costs or the residual costs. |
| Access seekers will support the optimisation of rail operations and the introduction of new technologies because they have the economic incentives to do so. | The NCC's conclusion is unrealistic because third parties will have differing sales growth profiles and life of operations to BHPBIO. Where there are such differences, there will be opposition or delay to the introduction of new technologies and practices. |
| Investors in infrastructure can expect an appropriate rate of return under Part IIIA. | Experience in access regulation demonstrates that investors can expect exactly the opposite – a rate of return that results in a disincentive to invest in infrastructure. |
| Part IIIA has safeguards to avoid third party access seekers "gaming" the regulatory system. | The NCC adopts an unduly restrictive notion of "gaming" and accordingly does not take into account all of the costs likely to arise from misuse of the regulatory process. |
| Access will produce significant benefits by adding to Australia's iron ore exports through development of additional iron ore tenements. | The NCC has identified only one company, Atlas Iron, which has only two tenements in the vicinity of the Goldsworthy Railway. Atlas Iron has stated that rail access is not essential as it proposes to produce iron ore and transport it by road haulage regardless of whether the Goldsworthy Railway is declared. As the Finucane Island section of the Goldsworthy Railway is capacity constrained and difficult to expand, Atlas Iron is unlikely to be able to use that section of the Goldsworthy Railway in any event. There are no perceptible benefits which require declaration of the Goldsworthy Railway. |
| There are a number of categories of costs and benefits but it would be unrealistic and unhelpful to undertake a quantitative cost benefit analysis in determining whether access would be contrary to the public interest. The costs of access to the Goldsworthy Service would not be likely to outweigh the benefits of access. | There is no explanation in the Draft Recommendation as to how the NCC determined that the costs of access would be unlikely to outweigh the benefits of access. It did not disclose the quantum or the likelihood of these costs or benefits. The facts clearly demonstrate that the costs and diseconomies of third party access are significant and would dwarf the benefits (if any) of access. |

## ECONOMICAL TO DEVELOP ANOTHER FACILITY

1.6 There is no spare capacity on the Finucane Island section of the Goldsworthy Railway. There are significant impediments to duplicating the Finucane Island section and it is unclear whether duplication is feasible. Under the NCC's own test, this means that criterion (b) is not satisfied.

1.7 In any event, the ACCC does not have the power to order BHPBIO to duplicate the Finucane Island section in order to enable access. Further, the NCC has failed to take into account the costs and diseconomies of access, contrary to its previously established interpretation of this criterion.

| NCC Conclusion | The Reality |
|---|---|
| It will never be economical to develop another facility to provide a heavy haul railway service, such as the Goldsworthy Railway, unless the railway cannot be expanded. | The NCC's approach does not take into account the costs of diseconomies of access, even though it acknowledges that they exist. These costs and diseconomies are significant and must be taken into account, in accordance with the NCC's previously established approach. In the Draft Recommendation, however, the size of the diseconomies is ignored, which means that criterion (b) will always be met for a heavy haul railway that can be expanded. This is inconsistent with the express objectives of Part IIIA. |
| While there is little or no spare capacity on the Finucane Island section of the Goldsworthy Railway, the ACCC can order BHPBIO to expand the railway to enable access. | The ACCC does not have the power under Part IIIA to order an infrastructure owner to expand its facilities for the purpose of enabling access. Consequently, criterion (b) is not met and declaration would be futile. |
| It is feasible to expand the Finucane Island section of the Goldsworthy Railway. | As set out in BHPBIO's previous submission, there are significant impediments to duplicating the Finucane Island section such that it is unclear whether it is feasible. The NCC acknowledges this but then assumes that duplication is nevertheless possible. The NCC does not explain how it reached this conclusion despite the information presented by BHPBIO. |

## ACCESS WOULD NOT PROMOTE A MATERIAL INCREASE IN COMPETITION

1.8 The NCC has identified only one potential user of the Goldsworthy Railway – Atlas Iron. Atlas Iron has only two tenements in the vicinity of the Goldsworthy Railway which are only 75 km from Port Hedland. Atlas Iron has publicly stated that transportation of its ore by road is economically viable. In light of these facts, it is inconceivable that providing access to the Goldsworthy Service to Atlas Iron could have any material impact on competition in the Pilbara-wide market for iron ore tenements or any market for rail haulage services.

| NCC Conclusion | The Reality |
|---|---|
| Access to the Goldsworthy Service would promote a material increase in competition in a Pilbara-wide iron ore tenements market. | Access to the Goldsworthy Railway could only have an effect on competition for tenements in the vicinity of the Goldsworthy Railway. The NCC has identified only one company, Atlas Iron, with only two tenements in the vicinity of the Goldsworthy Railway. |
| Access to the Goldsworthy Railway would promote a material increase in competition in the haulage services market. | Atlas Iron is the only potential user of the Goldsworthy Service identified by the NCC. There is no spare capacity on the Finucane Island section of the Goldsworthy Railway and there are significant impediments to duplicating that section such that it is unclear whether it is feasible. In any event, the ACCC does not have the power under Part IIIA to order BHPBIO to duplicate the Finucane Island section to enable access. |

1.9 For the reasons set out above and as substantiated in this document, the Councillors of the NCC cannot be satisfied that:

(a) access to the Goldsworthy Service would promote a material increase in competition in the Pilbara-wide iron ore tenements market and the rail haulage services market;

(b) it would be uneconomical for anyone to develop another facility to provide the Goldsworthy Service; or

(c) access would not be contrary to the public interest.

1.10 Accordingly, the NCC is required by the legislation to recommend that the Goldsworthy Service should not be declared.

## 2. INTRODUCTION

### DRAFT RECOMMENDATION

2.1 On 20 June 2008, the NCC published its Draft Recommendation in relation to the Goldsworthy Application.

2.2 In its Draft Recommendation, the NCC stated that it had reached a preliminary view that the Goldsworthy Application satisfies each of the declaration criteria set out in s44G(2) of the TPA and that it intends to recommend to the Treasurer that the Goldsworthy Service be declared for a period of 20 years.

2.3 In particular, the NCC indicated that its preliminary view was that:

(a) access to the Goldsworthy Service would promote a material increase in competition in the Pilbara-wide iron ore tenements market and the rail haulage services market;

(b) it would be uneconomical for anyone to develop another facility to provide the Goldsworthy Service; and

(c) access would not be contrary to the public interest.

### RESPONSE

2.4 BHPBIO submits that, in formulating its Draft Recommendation, the NCC has failed to properly consider or take into account the information and other matters contained in BHPBIO's submissions to the NCC dated 30 April 2008 and has made a number of critical errors of fact, law and reasoning.

2.5 Of particular concern is the willingness of the NCC to reach conclusions on technical matters without having any expertise in such matters. It is clear from the Draft Recommendation that the NCC has not obtained any assistance from appropriately qualified consultants.[1] It has similarly not cited or relied upon any industry or other technical expertise. This is surprising and disappointing in view of the importance of the iron ore industry.

2.6 Despite having no such basis for its conclusions on various technical matters, the NCC rejects the opinions and submissions of BHPBIO and Rio Tinto, world leaders in the mining industry.

2.7 Details of these matters and BHPBIO's submissions in response are set out in this document.

2.8 This submission only responds to the principal issues raised by the NCC's Draft Recommendation. There are a number of other issues in relation to which BHPBIO strongly disagrees with the views of the NCC. In this regard, BHPBIO maintains its previous submissions to the NCC.

[1] Draft Recommendation, para 1.7.

## 3. CRITERION (f) – PUBLIC INTEREST

### BACKGROUND

3.1 In its Draft Recommendation, the NCC concluded that it was satisfied that access would not be contrary to the public interest.

3.2 In reaching this view, the NCC made a number of conclusions which are unsupported or contradicted by the facts.

### COSTS OF ACCESS

#### Delays to expansions

***NCC Conclusion***

***Third party access will not delay expansions to infrastructure in light of the safeguards provided for by Part IIIA.***

***The Reality***

***Historical experience with the ACCC and other access regulators demonstrates that access and access regulation will cause delays to expansions. Access regulation is time consuming and generates uncertainty. The experience of the Queensland Competition Authority in relation to the regulation of access to the Dalrymple Bay Coal Terminal is illustrative.***

***NCC Reasoning***

3.3 The NCC states:

> *"The Council considers that access under Part IIIA would be unlikely to [delay expansions] given the legislative scheme of Part IIIA. The Council considers the extent and impact of any such delays to have been over estimated by the service providers. To the extent that access disputes and the need for arbitration may require time to resolve, the Council notes that the TPA provides for arbitrations to be conducted within a six month period. . . . It seems clear that any access related issues can be dealt with in parallel with other activities and within overall planning timeframes so as to minimise delay."*[2]

3.4 The NCC also states:

> *"There is no requirement in Part IIIA for access terms set by ACCC determination to require the consent of third party users before expansions are conducted; there is no 'consent requirement'. Neither is there any requirement in Part IIIA for access terms to guarantee minimum access rights, nor anything preventing a determination that, for example, provides that access is subject to the expansion and optimisation plans of the service provider notified to third party users."*[3]

3.5 The NCC refers to the period of time taken for BHPBIO's expansion approval process and reasons:

> *"Given these time frames, the Council considers it feasible for parties negotiating in good faith to resolve issues relating to the impact of any third party access on expansion and*

[2] Draft Recommendation, para 9.121.

[3] Draft Recommendation, para 9.122.

> *optimisation plans before the commencement of those plans is delayed, or at least, that Rio Tinto Iron Ore's and BHP Billiton Iron Ore's estimates of the extent of any delays to expansions are overestimated.*"[4]

3.6 The NCC also reasons:

> *"More generally unless and until an access seeker has achieved agreement with the service provider, or has received an ACCC determination or court order in its favour, the service provider is free to do what it chooses with the service and the facility.*"[5]

3.7 The NCC concludes:

> *"The Council does not consider that access under Part IIIA on appropriate conditions would necessarily delay expansion or optimisation outcomes if the process is managed appropriately.*"[6]

***Reality***

3.8 The NCC's conclusion that delays to expansions are unlikely to occur as result of the safeguards in Part IIIA is inconsistent with its own reasoning, lacks critical analysis and is based upon flawed assumptions.

*Inconsistent reasoning*

3.9 The NCC's finding that BHPBIO has overestimated the delays to expansions that are likely to result from third party access is not supported by any factual or economic analysis. The NCC's view implicitly acknowledges that such delays would, in fact, occur. The NCC then fails to undertake any analysis of the potential extent and impact of such delays, but claims that they have been overestimated by BHPBIO and Rio Tinto.

*Flawed assumptions regarding consent requirement*

3.10 The NCC's reasoning that there is no requirement in Part IIIA for access terms set by ACCC determinations to require the consent of third parties is, at best, misleading.

3.11 While technically the terms of Part IIIA do not require third party consent, this is merely because that level of detail is not reached by the provisions of Part IIIA. As a matter of practicality (and third party contract, where applicable), BHPBIO would need to advise and obtain the agreement of the ACCC, and any third party, to any plans to expand or change its operating practices. This applies whether or not a third party has yet formally applied for access.

3.12 The practical requirement to communicate and coordinate with third parties also results in an extra layer of regulatory cost. This has not been taken into account by the NCC at all in determining the costs of access. Such an approach is inconsistent with the NCC's own Guide which states:

> *"The Council recognises the inherent regulatory burdens, costs and inefficiencies associated with declaration, and in applying the public interest test, it considers whether the costs of declaration outweigh the benefits.*

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[4] Draft Recommendation, para 9.123.

[5] Draft Recommendation, para 9.148.

[6] Draft Recommendation, para 9.125.

> *Direct regulatory costs that may follow declaration include the costs of negotiating access with third parties or arbitrating an access dispute.*"[7]

*Flawed assumptions regarding arbitrations*

3.13 The NCC's apparent assumption that all arbitrations will be resolved without delay because "the TPA provides for arbitrations to be conducted within a six month period"[8] and its express assumption that access issues can be dealt with in parallel with expansion planning and implementation, are fanciful.

3.14 First, even though the TPA stipulates a time period for arbitrations, this is only an indicative or target time limit. In such circumstances, the NCC's reliance on the six month target to support its conclusion that delays to expansion will not result from third party access is disingenuous. This is particularly clear when one considers that in relation to the Goldsworthy Application the NCC itself will take twice the prescribed time period to provide its Final Recommendation to the Treasurer. The NCC does not explain why the ACCC would also not require additional time given the importance and complexities of the issues involved. The NCC further disregards the time involved through the appeal processes that are available under Part IIIA in relation to arbitrations decisions.

3.15 Second, the NCC's conclusion that access issues can be dealt with in parallel to expansion plans fundamentally misunderstands the planning and investment process.

3.16 A party involved in an arbitration is unlikely to proceed with progressing expansion planning and implementation in the environment of uncertainty that will be created by an arbitration about the terms of access. This will, of course, particularly be the case where the access arbitration concerns the terms of the expansion itself.

*Flawed assumptions regarding Part IIIA and the ACCC*

3.17 The NCC's conclusion that the ACCC can order that "access is subject to the expansion and optimisation plans of the service provider notified to third party users" is similarly disingenuous. No regulator is likely to arbitrate access terms that enables the service provider to unilaterally implement expansion or optimisation plans as notified to the third party as this may effectively enable the service provider to prevent the third party from accessing the facility.

3.18 The NCC's conclusion is also completely inconsistent with actual regulatory practice and the established position of the ACCC with regard to access undertakings. All of the major access undertakings governing rail and port infrastructure require infrastructure owners to engage in a consultation process with access seekers ahead of undertaking capacity expansion or making significant changes to operating practices. This includes the Australian Rail Track Corporation Access Undertaking, the Queensland Rail Access Undertaking, the New South Wales RailCorp Access Undertaking and the Dalrymple Bay Coal Terminal Access Undertaking. Details of these requirements are set out in **Attachment 1**.

3.19 It is particularly significant that in relation to the Australian Rail Track Corporation Access Undertaking the inclusion of a third party consent requirement was at the insistence of the ACCC in the process of its approval of the Access Undertaking. After reviewing the Access Undertaking submitted by the Australian Rail Track Corporation, the ACCC stated that the Undertaking would benefit from:

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[7] NCC Guide, Part B, paras 9.16 – 9.17.

[8] Draft Recommendation, para 9.121.

> *"…building an obligation into the Undertaking for transparent consultation on ARTC's capital expenditure program*"[9]

3.20 Consequently, the ACCC recommended that the Access Undertaking include the following clause:

> *"6.5 Industry Consultation*
>
> *In regard to Additional Capacity sought in accordance with clauses 6.2 and 6.3, ARTC must:*
>
> > *(i) provide above Operators with a reasonable opportunity to present their views to it regarding Additional Capacity sought by either an Applicant or by it;*
> >
> > *(ii) circulate a summary of the results of consultation to stakeholders including reasons for disagreeing with Operators' views (where applicable)…"*[10]

3.21 Further, the NCC's conclusion that access under Part IIIA on appropriate conditions would not delay expansion or optimisation outcomes if the process were to be managed appropriately is completely unrealistic.

3.22 Regulatory transactions, even with best practice regulation, are not instantaneous. Eminent commentators have recognised this fact:

> "*The difficulty of agreeing on a set of numbers to be used in rate-of-return calculations often leads to delays in regulatory response to changes in cost and other market conditions (not to mention long and expensive regulatory hearings). The major beneficiaries are usually lawyers, accountants, and, occasionally, economic consultants. The net result is* ***regulatory lag*** *– the delays of a year or more usually entailed in changing regulated prices*."[11] [emphasis in original]

3.23 In the Australian context it is clear that the requirement to obtain third party and regulatory consent to expansion has added significantly to the time taken to expand the Dalrymple Bay Coal Terminal. For instance, it took the Queensland Competition Authority approximately 22 months from the time of lodgement of the draft access undertaking to provide its decision not to approve that undertaking and it was a further 14 months before the revised access undertaking was approved.

3.24 In addition, a number of challenges to ACCC determinations on access pricing have resulted in substantial delays. **Attachment 2** sets out a summary of some of these cases.

3.25 More generally, as reflected in the chart which is **Attachment 3**, regulated ports on the east coast of Australia have been slower to expand than unregulated ports. This was explained in BHPBIO's previous submission but has been completely ignored by the NCC.

3.26 The recent conclusions of the Reserve Bank of Australia also clearly demonstrate this point. The Reserve Bank states:

> *"Capacity constraints in transport infrastructure have been an ongoing impediment to growth in bulk resources export volumes. In 2005, the Bank produced a survey of existing coal and iron ore supply chains, including estimates of the likely scale of rail and port expansions by 2007. . . . While actual transport capacity for iron ore increased by 27 per cent relative to*

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[9] ACCC, Draft ARTC Determination, p 213.

[10] ACCC, Draft ARTC Determination, p 213.

[11] Pindyck RS, and Rubinfeld DL, "Microeconomics" (6th Ed) at page 364.

> *an anticipated rise of 15 per cent, the increase in coal transport capacity was below expectation, rising by 8 per cent compared with an expectation of 13 per cent.*
>
> *One reason why supply chain expansions have been particularly difficult in the coal industry is that the fragmented ownership structure has complicated attempts to co-ordinate simultaneous investments, in contrast to the iron ore industry where the supply chains of large producers tend to be vertically integrated.*
>
> *. . .*
>
> *While coal capacity is estimated to expand by 17 per cent by 2009, further improvements in co-ordination between producers, infrastructure operators and governments are still necessary. Meanwhile, iron ore transport capacity is anticipated to rise by a further 36 per cent between 2007 and 2009.*"[12]

3.27 The opportunity costs of these delays represent billions of dollars per annum of foregone revenue.

[12] Reserve Bank of Australia, "Australian Exports and Developing Asia" Bulletin (June 2008), pages 9 - 10.

### Problems of multi-user systems

***NCC Conclusion***

***The problems associated with multi-user systems on the east coast of Australia will not occur if third party access to the Goldsworthy Service is granted because Part IIIA provides safeguards that will ensure that those problems will not arise.***

***The Reality***

***The NCC has made no attempt to analyse or understand the causes of the problems of multi-user systems on the east coast of Australia. Its conclusions on these issues have no solid foundation. Further, the fundamental premises on which the NCC relies in relation to regulatory safeguards are legally and factually incorrect.***

***NCC Reasoning***

3.28 The NCC states:

> *"The reasons for the problems in Australia's east coast coal export chain are varied and complex and there is no single reason for the apparently poor performance of the east coast coal industry in responding to a sudden unexpected increase in demand. There are some common features of this industry and the Pilbara iron ore industry - for example they both involve relatively complex logistics - but there are a range of differences including ownership structures, public sector involvement, planning arrangements and the form of regulation. Notably no part of the east coast coal supply chain is regulated under Part IIIA.*
>
> *The Council has considered the views of the service providers and their consultants that access to Pilbara railways under Part IIIA would transfer the problems of the east coast coal industry to the Pilbara iron ore industry. However, the Council fundamentally disagrees, and considers these arguments are based upon simplistic assumptions and are unconvincing.*
>
> *In this case, no party arguing against declaration acknowledged or considered the safeguards for service providers in Part IIIA, or explained how the costs alleged to arise from Part IIIA access could occur despite those safeguards."*[13]

3.29 The NCC concludes:

> *"In the absence of evidence as to why these safeguards are generally ineffective or would be ineffective in this particular situation the Council must accept that the TPA will operate as intended and that the ACCC in undertaking arbitrations and making access determinations (and the Tribunal in conducting reviews and 're-arbitrating' disputes) will act in accordance with these provisions."*[14]

3.30 In response to BHPBIO's submission that third party access to the Goldsworthy Service would result in the type of delays to expansion experienced in multi-user systems on the east coast of Australia, the NCC states:

> *"These arguments are premised on a particular view as to the differences between, on the one hand, a situation where a single party is involved in a decision and, on the other hand, a situation where multiple parties are involved in the decision and 'axiomatically', the outcome of the decision is delayed. This view ignores the fact that expansion decisions currently*

[13] Draft Recommendation, paras 9.113 - 9.115.

[14] Draft Recommendation, para 9.118.

> *made by the service providers necessarily take place over substantial time periods and already involve a number of parties, both those within the service provider groups who have competing internal priorities, and outside the service providers, such as planning, safety and environmental regulatory agencies.*"[15]

3.31 In dismissing evidence submitted by BHPBIO that changing its single-user, single-operator system to a multi-user, multi-operator system would effectively result in a 10-20% reduction in capacity, the NCC states:

> *"Mr O'Donnell's evidence is not that Part IIIA access to the Goldsworthy Service, or to single user railways, would result in a 10 to 20 per cent impact on throughput, but that this impact may result from 'rigid timetables' that 'usually' exist in a multi-user system.*
>
> *. . .*
>
> *In Mr O'Donnell's opinion, flexible scheduling arrangements are possible, but would be difficult and complex to implement. The Council notes that, if access rights are granted through negotiation or arbitration, it is entirely possible, given the protections provided to the service provider and the conditions prevailing in the Pilbara iron ore chains, that arrangements for access could require the access seeker to accept flexible scheduling arrangements under the overall control of the service provider. Such arrangements may be more complicated but given the sophistication with which BHP Billiton Iron Ore and Rio Tinto Iron Ore operate the Council considers it is entirely possible that such arrangements could be implemented and access seekers may have to operate within such an environment or risk access being unavailable in a particular situation.*"[16]

***Reality***

3.32 The NCC's conclusion that third party access to the Goldsworthy Railway would not result in the problems experienced in relation to coal supply chains on the east coast of Australia is naïve and misguided. It is also inconsistent with the NCC's approach to other declaration criteria.

*Failure to undertake proper analysis*

3.33 The NCC concludes that access to the Goldsworthy Railway would not result in inevitable efficiency losses as experienced in multi-user, multi-operator systems because:

(a) there is no single reason for the poor performance of the east coast coal industry;

(b) there are a range of differences between the Pilbara railways and the east coast supply chains; and

(c) the east coast coal supply chains are not regulated under Part IIIA.

3.34 The NCC, however, fails to make any attempt to analyse or understand the reasons behind the poor performance of coal supply chains or whether those reasons would apply to the Pilbara railways if third party access were mandated under Part IIIA.

3.35 Further, the NCC's position ignores the fact that the Prime Minister's Export and Infrastructure Taskforce, ABARE and the Reserve Bank of Australia have all drawn

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[15] Draft Recommendation, para 9.125.

[16] Draft Recommendation, paras 9.132 - 9.133.

comparisons between the east coast coal supply chains and the Pilbara iron ore supply chains.

3.36 The Prime Minister's Export and Infrastructure Taskforce found that:

> *"Where Australia's logistics chains are vertically integrated and are subject to much less economic regulation, the response to increased global demand has been timely, effective and efficient. In contrast, in those parts of the economy where economic regulation sits between investors in export related infrastructure and users, lengthy delays have been widespread, as infrastructure owners, users and regulators focus more on shifting slices of the pie than on ensuring that the pie expands to meet competing demands."*[17]

3.37 With respect to the NCC's Draft Recommendation in relation to the Mt Newman Application, ABARE stated that:

> *"It is of concern that the NCC made a recommendation without conducting an economywide* [sic] *benefit–cost analysis to determine whether declaration would be in the national interest. Given the inefficiencies and delays that have arisen in the operation and expansion of multi-user infrastructure in the Australian coal export chain, it is likely that the application of such a test would demonstrate that declaration of the Mount Newman rail line would impose considerably more costs on the Australian economy than any benefits it may confer.*
>
> *. . .*
>
> *Among Australia's export facilities, the Pilbara iron ore export chains stand out for the way that mine production, transport, cargo assembly and blending, loading and shipping are integrated. Relative to an integrated logistics chain with one owner, market processes with multiple owners of various parts of the chain often involve efficiency losses as a result of less effective coordination, particularly in those chains for bulk commodities. For many of Australia's exports involving high value, low bulk goods it is not evident that there is a problem. . . . For some major bulk commodities, such as grain and particularly coal, however, there are evident losses from lack of coordination under current structures."*[18]

3.38 As discussed above, the Reserve Bank of Australia has concluded that:

> *"One reason why supply chain expansions have been particularly difficult in the coal industry is that the fragmented ownership structure has complicated attempts to co-ordinate simultaneous investments, in contrast to the iron ore industry where the supply chains of large producers tend to be vertically integrated."*[19]

3.39 Notwithstanding that the NCC has no relevant technical expertise and has not obtained any expert advice on this issue, it nevertheless dismissed the views of Stephen O'Donnell, an acknowledged expert in this field who was appointed by the Queensland Government to undertake a review of the serious problems occurring in the Goonyella coal supply chain. Mr O'Donnell considered that changing its single-user, single operator system to a multi-user, multi-operator system would effectively result in a 10-20% reduction in capacity.

3.40 The NCC argued that while "flexible scheduling arrangements . . . would be difficult and complex to implement . . . **it is entirely possible** . . . that arrangements for access could

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[17] Exports and Infrastructure Taskforce 2005, *Australia's Export Infrastructure*, Report to the Prime Minister, Canberra, May 2005 at page 2.

[18] ABARE, "Export Infrastructure and Access" *Australian Commodities*, Volume 13, No 2 (June quarter 2006) at pages 369 and 372.

[19] Reserve Bank of Australia, "Australian Exports and Developing Asia" Bulletin, (June 2008) at pages 9 – 10.

require the access seeker to accept flexible scheduling arrangements [and] that such arrangements could be implemented and access seekers may have to operate within such an environment . . " [emphasis added]. This statement lacks any support or analysis and is a mere supposition on the part of the NCC.

*Flawed understanding of multi-user, multi-operator systems*

3.41 The NCC puts the view that because expansion plans involve substantial time periods and numbers of internal competing interests, there will be no delay to expansions if BHPBIO is required to change from an unregulated single-user, single-operator system to a regulated multi-user, multi-operator system.

3.42 This point is nonsensical. Even though there may be a number of internal parties whose input is required in making investment and expansion decisions, all of those internal parties are quite unlike third party access seekers because they are within the direct control of BHPBIO.

3.43 Moreover, there is no basis for concluding that any of the consultations and transactions with external parties can be undertaken in parallel with any internal processes. Intuitively, the internal processes must be undertaken and internal decisions made before external consultations can occur and agreements entered into with external parties. For example, the scope of construction contracts must be well-defined before they can even be tendered.

3.44 The proposition that construction can commence before agreement is reached with other users and operators in the system is manifestly untenable.

*Inconsistent approach*

3.45 In its Review of the National Access Regime, the Productivity Commission considered whether the ACCC ought to have the express power under Part IIIA to require an access provider to "extend" a facility or "expand the capacity" of a facility. In this context, "extend" means only to increase the length of a thing between two points. "Expand" includes within its meaning an increase in length, but it also includes an increase in other characteristics such as capacity or functionality.

3.46 The Productivity Commission recognised the practical differences between "extensions" and "expansions" and recommended that the ACCC retain its power under s44V to require extensions but that an express power to require "expansions" was not warranted in Part IIIA.[20] The Productivity Commission observed that it was not clear whether s44V empowered the ACCC to require expansions.

3.47 In its Draft Recommendation, the Council concludes:

> *"Under the provisions of Part IIIA, where a facility needs to be expanded to meet demand for a declared service, access seekers must negotiate with the service provider for the required capacity expansion. The access seekers are required to fund that expansion."*[21]

3.48 This conclusion, however, is inconsistent with the NCC's previously established approach and its submission to the Productivity Commission in relation to its Review of the National Access Regime. In that submission, the NCC stated:

> *"The Council considers that it would not be appropriate for the restrictions in s.44W that relate to requiring the infrastructure owner to pay for extension to be applied to*

[20] Productivity Commission 2001, *Review of the National Access Regime*, Report no. 17, AusInfo, Canberra, at page 224.

[21] Draft Recommendation, para 5.86.

> *determinations that relate to expansions. The issues surrounding the question of ensuring the infrastructure owner is recompensed for expansions are likely to be more complex than those for extensions. These matters are best left to the discretion of the regulator to determine on a case by case basis. The current provisions in ss.44V and 44W already do this.*"[22]

*Misunderstanding of ACCC powers*

3.49 The NCC reasons that the problems experienced in relation to multi-user, multi-operator systems on the east coast of Australia will not arise if third party access to the Goldsworthy Railway is granted because Part IIIA provides adequate safeguards to avoid such problems.

3.50 In particular, the NCC concludes that the ACCC will have the power under Part IIIA to make determinations requiring BHPBIO to:

(a) effectively duplicate all or parts of the Goldsworthy Railway;[23]

(b) expand or modify infrastructure facilities that are not a part of the Goldsworthy Railway;[24] and

(c) construct and use alternative facilities (at the cost of a third party) while at the same time allowing the third party to use the Goldsworthy Railway.[25]

3.51 This is completely unrealistic and assumes an unprecedented exercise of powers by the ACCC under Part IIIA. Mr Allan Myers QC and Mr Michael O'Bryan have provided a written opinion to BHPBIO that the ACCC does not have such powers under Part IIIA. A copy of that opinion is **Attachment 4** to this submission.

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[22] NCC, Submission in response to the Productivity Commission's position paper, July 2001, pages 43-44.

[23] Draft Recommendation, paras 5.86 – 5.88.

[24] Draft Recommendation, para 5.93.

[25] Draft Recommendation, para 5.85.

### Loss of efficiency and capacity

***NCC Conclusion***

***Access to the Goldsworthy Service will result in capacity and efficiency losses but those losses will be capable of being reflected in access prices and terms. Any loss that is not capable of being ameliorated by access terms will not be near the level suggested by BHPBIO.***

***The Reality***

***Capacity and efficiency losses will result in significant costs and diseconomies to the Australian public, regardless of whether they are reflected in access prices, and must be taken into account, in accordance with the NCC's previously established approach. The NCC has also failed to undertake any quantitative analysis of the costs resulting from losses in capacity and efficiency, either in relation to the supposedly ameliorated costs or the residual costs.***

***NCC Reasoning***

3.52 The NCC states:

> *"The Council accepts that access to a railway by third parties is likely to result in some costs to the service providers in the form of lost system capacity and other diseconomies. These costs will be incorporated in likely charges either as a result of negotiated terms of access or if needs be an arbitration. If these costs are large, then it is likely that the costs of access will be correspondingly high and the demand for access lower. In some cases the costs and hence access charges may be so large that access will not occur."*[26]

3.53 The NCC reasons that where costs and diseconomies can be reflected in access pricing and terms, they are not be considered in the assessment of the costs of access under criterion (f):

> *"There may be some residual risk of capacity and efficiency losses that would result from access to the Goldsworthy Service that access terms and pricing cannot entirely anticipate or ameliorate, and the Council has considered this cost in assessing criterion (f). However, the Council does not accept that the extent of these costs is likely to be near the quantum argued by the service providers."*[27]

3.54 Further, the NCC reasons:

> *"The Council considers that generally the costs to the service provider resulting from lost system capacity and diseconomies of scope that would occur as a result of a particular third party's access to the Goldsworthy Service are capable of being anticipated and compensated through access pricing. It further considers that third party access seekers can be incentivised to minimise their impact on the service provider through access terms, which, to take a hypothetical example, could provide for penalty payments where a train breaks down and the third party fails to clear it within periods currently achieved by the service provider."*[28]

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[26] Draft Recommendation, para 9.130.

[27] Draft Recommendation, para 9.135.

[28] Draft Recommendation, para 9.134.

***Reality***

3.55 The NCC recognises that, as a matter of established principle, all regulatory and other costs that arise from declaration must be taken into account:

> *"As the Tribunal has noted, criterion (f) 'enables consideration of the overall costs and benefits likely to result from declaration and the consideration of other public interest issues which do not fall within criteria (a) – (e)' (Re Services Sydney Pty Limited at [192]). The Council considers that this must include consideration of any regulatory or other costs that flow from declaration of a particular service."*[29]

3.56 In its Final Recommendation in relation to the Mt Newman Application, the NCC noted that the costs of providing access to an existing facility include "interface costs, or 'diseconomies of scope' from sharing the facility".[30] This approach is also reflected in the NCC's own Guide to Part IIIA.[31]

3.57 The previously established approach of the NCC as outlined above is inconsistent with the NCC's conclusions in its Draft Recommendation. In particular, the NCC reasons that where capacity and efficiency losses can be reflected in access prices and terms, such losses are not to be taken into account in assessing the costs of access under criterion (f). This approach, however, fails to recognise that these losses will nevertheless result in significant costs and diseconomies to the Australian public. Such losses must be taken into account, in accordance with the NCC's previously established approach, in the evaluation of costs and benefits under criterion (f).

3.58 The NCC's acceptance that there may be "capacity losses" is also inconsistent with its conclusion that access will increase iron ore exports. There is no indication in the NCC's reasoning as to how this inconsistency can be reconciled.

3.59 The NCC also fails to:

(a) explain how the loss of efficiency is consistent with the objects of Part IIIA;

(b) attempt to quantify this loss of capacity and efficiency; and

(c) determine the impact of the loss on the Australian public.

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[29] Draft Recommendation, para 9.11.

[30] Mt Newman Final Recommendation, para 6.164.

[31] NCC Guide to Part IIIA, Part B, paras 9.16 – 9.19.

### Rail optimisation and new technologies

***NCC Conclusion***

***Access seekers will support the optimisation of rail operations and the introduction of new technologies because they have the economic incentives to do so.***

***The Reality***

***The NCC's conclusion is unrealistic because third parties will have differing sales growth profiles and life of operations to BHPBIO. Where there are such differences, there will be opposition or delay to the introduction of new technologies and practices.***

***NCC Reasoning***

3.60 The NCC states:

> *"The Council does not accept BHP Billiton Iron Ore's argument that Part IIIA access to Pilbara railways is likely to deter or delay the optimisation of rail operations and investment in new forms of technology. It is not true that third parties with smaller operations than the service providers would have no incentive to make investments in new technologies or innovative operating practices. All users of the railways are likely to have some incentive to maximise the quantity of ore they carry and minimise the cost of doing so, or at least to minimise the costs of their gaining access and hence the access charges they face. This is likely to provide access seekers with incentives to support operational optimisations and technological advances."*[32]

***Reality***

3.61 The NCC's conclusion that third parties would have significant commercial incentives to support the introduction of new technologies or innovative operating practices that incrementally increase system capacity and/or reduce operating costs is completely unrealistic because third parties will have differing sales growth profiles and life of operations to BHPBIO. In these circumstances, the NCC ignores the fact that the financial analysis of these improvement projects will result in significantly different outcomes. It also does not address the issue of whether a smaller third party will in fact have the financial resources to contribute to inherently risky investments in new technologies or operating practices, such as a new rail signalling system.

3.62 Where there are such different incentives, there will be opposition or delay to the introduction of new technologies and practices. Over time, failure or delay in implementing optimisation and improvement projects will lead to a significant reduction in system performance.

[32] Draft Recommendation, para 9.149.

### Rate of return on investment in infrastructure

***NCC Conclusion***

***Investors in infrastructure can expect an appropriate rate of return under Part IIIA.***

***The Reality***

***Experience in access regulation demonstrates that investors can expect exactly the opposite – a rate of return that results in a disincentive to invest in infrastructure.***

***NCC Reasoning***

3.63 The NCC states:

> *"Part IIIA provides for service providers to receive a risk-adjusted commercial return on declared infrastructure. Investors in infrastructure can therefore expect that if infrastructure is declared and a third party access seeker successfully seeks mandated access through arbitration, they will receive an appropriate return on their investment."*[33]

***Reality***

3.64 Experience under access regimes demonstrates that there are considerable problems in determining access prices such that the interests of the service provider are properly compensated. A number of ACCC and QCA access determinations have been reversed or overturned on the grounds of incorrect access prices and inadequate rates of return. **Attachment 2** sets out a summary of some of the cases in which the ACCC's decision on access prices has been overturned by a tribunal or court.

3.65 This is largely caused by the current regulatory approach to access prices. The NCC's conclusion ignores the fact that the current regulatory approach to access pricing is inappropriate and does not properly address the loss of real options that the service provider has in choosing to delay or accelerate an expansion.

3.66 The inadequacy of rates of return under current regulatory practice and the consequent disincentive to investment were discussed in the report of Professor Jerry Hausman, MacDonald Professor of Economics, MIT, which was provided with BHPBIO's previous submission to the NCC. A copy of that report is included in the report entitled "Regulation for the Future of Australia's Natural Resources Sector" dated April 2008 which is **Attachment 5**.[34] The NCC has failed to address these reports and the important issues they raise.

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[33] Draft Recommendation, para 9.137.

[34] See in particular, Appendix B at pages 13-21.

### Misuse of the regulatory process

***NCC Conclusion***

***Part IIIA has safeguards to avoid third party access seekers "gaming" the regulatory system.***

***The Reality***

***The NCC adopts an unduly restrictive notion of "gaming" and accordingly does not take into account all of the costs likely to arise from misuse of the regulatory process.***

***NCC Reasoning***

3.67 The NCC states:

> *"BHP Billiton Iron Ore submitted that regulatory costs are potentially very high given, among other things, 'the opportunity to "game" the system' system'* [sic] *(BHPBIO, Sub 1 at [13.6]). In this regard the Council notes there is provision to limit the costs of unnecessary or repeated arbitrations. The ACCC has the ability under section 44Y of the TPA to terminate arbitrations where the access seeker has not negotiated in good faith, where the request for arbitration is vexatious, misconceived or lacking in substance, or where the access sought has already been considered by the ACCC or is governed by an existing agreement."*[35]

***Reality***

3.68 The NCC adopts an unduly restrictive approach to "gaming" by suggesting that it is constituted only by vexatious, unnecessary or repeated arbitrations.

3.69 "Gaming" in the broad sense, however, can occur in any interaction or part of the regulatory process. In particular, it can occur where a delayed approval is used by a third party to attempt to secure uncommercial access prices. Consequently, "gaming" often results in additional delay.

3.70 This outcome is inefficient and results in regulatory costs. The NCC, however, does not take this into account in its consideration of the costs of access. This is inconsistent with the NCC's approach to regulatory costs as articulated in its own Guide (see paragraph 3.12 above).

3.71 In light of the above, the NCC's conclusion that Part IIIA has safeguards to avoid third party access seekers gaming the system is misconceived.

[35] Draft Recommendation, para 9.147.

## ALLEGED BENEFITS OF ACCESS

### Supposed benefits from promotion of competition

***NCC Conclusion***

***Access will produce significant benefits by adding to Australia's iron ore exports through development of additional iron ore tenements.***

***The Reality***

***The NCC has identified only one company, Atlas Iron, which has only two tenements in the vicinity of the Goldsworthy Railway. Atlas Iron has stated that rail access is not essential as it proposes to produce iron ore and transport it by road haulage regardless of whether the Goldsworthy Railway is declared. As the Finucane Island section of the Goldsworthy Railway is capacity constrained and difficult to expand, Atlas Iron is unlikely to be able to use that section of the Goldsworthy Railway in any event. There are no perceptible benefits which require declaration of the Goldsworthy Railway.***

***NCC Reasoning***

3.72 The NCC reasons that access to the Goldsworthy Service would play a role "in accelerating development of mines and adding to Australia's iron ore exports …".[36] BHPBIO considers that this is correct to the extent that, for access to provide any material benefit for Australia, it must deliver an increase in iron ore exports.

3.73 The NCC considers that access is required to achieve this outcome because it is necessary for the development of tenements in the vicinity of the Goldsworthy Railway. The NCC states:

> *"Arguably the benefits flowing from enhanced competition in relation to these tenements may be small. However . . . there are significant numbers of tenements for which access to existing rail infrastructure is essential for competition and will produce significant benefits."*[37]

3.74 The NCC concludes:

> *"*[T]*he Council considers it likely that new deposits could be efficiently exploited via access to the Goldsworthy Service, at prices and on terms that include compensation to the Goldsworthy Service Providers for diseconomy costs, in a manner that involves less overall cost to the Australian economy than would be the case without access. This is a public interest benefit to the Australian economy."*[38]

3.75 The NCC concludes that rail access is necessary for the development of some of these deposits because road haulage is only viable in certain situations:

> *"The Council accepts that in some limited situations there may be alternatives to access to the Pilbara railways to enable some currently stranded iron ore reserves to be exploited, such as road transport or the construction of alternative railways. However, the Council notes that rail transport is a considerably more efficient and socially preferable option for transporting iron ore than road transport. The Council also notes that in respect of some*

[36] Draft Recommendation, para 9.96.

[37] Draft Recommendation, para 9.94.

[38] Draft Recommendation, para 9.103.

> *iron ore reserves in the vicinity of the Goldsworthy Railway road will not be a viable option. Therefore, the Council considers that access to those railways* [sic] *would create a material public interest benefit by enabling exploitation of a greater range of stranded ore reserves."*[39]

***Reality***

3.76 The conclusions of the NCC as set out in paragraphs 3.73 and 3.74 above contrast starkly with the conclusion earlier in its Draft Recommendation that:

> *"The Council is able to identify only two projects – Atlas Iron's Pardoo and Ridley projects – which represent potential drivers of demand for the Goldsworthy Service over this time period."* [5 to 10 years][40]

3.77 The NCC's reasoning also fails to take into account the following facts which are accepted, or not refuted, by the NCC:

(a) the two tenements which Atlas Iron is developing which could use the Goldsworthy Railway are only 75 km from Port Hedland;

(b) Atlas Iron has stated that road transportation is economically viable for those tenements; and

(c) Atlas Iron has stated that it is "not constrained by needing a rail agreement."[41]

3.78 Further, Atlas Iron would not, in any event, be able to use the Goldsworthy Railway because there is no spare capacity on the Finucane Island section of the Goldsworthy Railway and there is not likely to be any spare capacity on the Goldsworthy Railway for the foreseeable future.

3.79 Further, as set out in BHPBIO's previous submission to the Council, there are significant impediments to duplication of the Finucane Island section, including proximity to the township of South Hedland, environmental and hydrological challenges and lack of physical space.

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[39] Draft Recommendation, para 9.102.

[40] Draft Recommendation, paras 5.72 and 5.74.

[41] Atlas ASX Announcement, "Open Briefing – Atlas Iron", dated 25 February 2008.

## COST-BENEFIT ANALYSIS

***NCC Conclusion***

***There are a number of categories of costs and benefits but it would be unrealistic and unhelpful to undertake a quantitative cost benefit analysis in determining whether access would be contrary to the public interest. The costs of access to the Goldsworthy Service would not be likely to outweigh the benefits of access.***

***The Reality***

***There is no explanation in the Draft Recommendation as to how the NCC determined that the costs of access would be unlikely to outweigh the benefits of access. It did not disclose the quantum or the likelihood of these costs or benefits. The facts clearly demonstrate that the costs and diseconomies of third party access are significant and would dwarf the benefits (if any) of access.***

***NCC Reasoning***

3.80 With respect to the need for a quantitative cost benefit analysis, the NCC states:

> *"The Council also notes the proposition that the consideration of criterion (f) requires a quantitative cost benefit analysis. In the Council's view this is unrealistic. Quantitative information and estimates may assist in assessments of the type that the Council is required to undertake under criterion (f), but in practice many important cost and benefit factors that need to be considered do not lend themselves to quantification. In such situations attempts to provide quantification require assumptions to be made in relation to key issues and judgments. An excessive focus on quantification can lead to complex and largely irrelevant arguments about the numbers while the substantive issues are overlooked."*[42]

3.81 In relation to the benefits of access, the NCC concludes:

> *"While most of these forms of benefit will only arise in relation to a relatively small but significant component of the Pilbara iron ore industry, given that the two largest participants (BHP Billiton Iron Ore and Rio Tinto Iron Ore) already have access to their own railways, the Council considers the benefits from access are significant."*[43]

3.82 In relation to the costs of access, the NCC states:

> *"In the Council's view a number of the costs put forward are unlikely to result from access to the Goldsworthy Service as they are precluded from arising by provisions of the TPA that specifically address the concerns raised. Other costs are overstated or are based on unrealistic assumptions.*
>
> *The Council considers that access to the Goldsworthy Service will give rise to some costs in complying with regulatory requirements and participating in regulatory processes that follow from declaration and/or access to the service.*
>
> *When proper consideration is given to the safeguards against adverse outcomes from access in specific situations provided for in Part IIIA, the Council considers the costs of*

[42] Draft Recommendation, para 9.15.

[43] Draft Recommendation, para 9.155.

> *access that are not adequately dealt with through the arbitration process are likely to be low.*"[44]

3.83 The NCC accordingly concludes that:

> *"The Council considers that the likely benefits of access to the Goldsworthy Service will outweigh the likely costs…*"[45]

***Reality***

3.84 In the absence of any quantitative analysis it is unclear how the NCC could have reached any conclusion about the balance between the costs and benefits of third party access. This is surprising and disappointing in view of the importance of the iron ore industry to the national interest.

3.85 The approach of the NCC in its Draft Recommendation contrasts with the approach the NCC took in the Final Recommendation in relation to the Mt Newman Application where it concluded that:

> *"While the Council acknowledges that congestions, delays and flexibility issues may result in costs, such costs are theoretical and unforeseen at this time and therefore impossible to quantify. It is therefore impossible to conclude any correlation between these diseconomies of scope and lost revenue resulting from foregone sales.*"[46]

3.86 Although the reasons are different, in both cases the NCC has failed to undertake a quantitative cost benefit analysis. Without such an analysis it is difficult to understand how the NCC can be satisfied, as the legislation requires, that the benefits of access outweigh the costs.

3.87 The facts as demonstrated above in this submission clearly establish that the costs and diseconomies of third party access are significant and would dwarf the benefits (if any) of access.

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[44] Draft Recommendation, paras 9.157 – 9.161.

[45] Draft Recommendation, para 9.162.

[46] Mt Newman Final Recommendation, para 6.255.

## 4. CRITERION (b) – UNECONOMICAL TO DEVELOP ANOTHER FACILITY

### BACKGROUND

4.1 In its Draft Recommendation, the NCC concluded that it was satisfied that it would be uneconomical to develop another facility to provide the service.

4.2 The NCC identified the following issues as determinative of the application of criterion (b) to the Goldsworthy Application:

(a) whether there are any alternative facilities that could provide the Goldsworthy Service;

(b) whether heavy haul railways such as the Pilbara railways exhibit natural monopoly characteristics;

(c) the likely current and forecast demand for the Goldsworthy Service;

(d) whether foreseeable demand can be met within the capacity (current and planned) of the Goldsworthy Railway; and

(e) where access is likely to result in demand exceeding capacity, comparing the likely costs of expanding the Goldsworthy Railway to meet the excess demand with the costs of constructing an alternative facility to meet the extra demand of access seekers.

4.3 In its consideration of each of these issues, the NCC makes a number of conclusions which are incorrect because they are unsupported or contradicted by the facts.

### CONSIDERATION OF ISSUES

#### Costs and diseconomies of access

***NCC Conclusion***

***It will never be economical to develop another facility to provide a heavy haul railway service, such as the Goldsworthy Railway, unless the railway cannot be expanded.***

***The Reality***

***The NCC's approach does not take into account the costs of diseconomies of access, even though it acknowledges that they exist. These costs and diseconomies are significant and must be taken into account, in accordance with the NCC's previously established approach. In the Draft Recommendation, however, the size of the diseconomies is ignored, which means that criterion (b) will always be met for a heavy haul railway that can be expanded. This is inconsistent with the express objectives of Part IIIA.***

***NCC Reasoning***

4.4 The NCC adopts a 'social cost' test in relation to criterion (b) and notes that:

> *"In this context the assessment of criterion (b) centres on identifying whether a facility exhibits natural monopoly characteristics such that a single facility is capable of meeting likely demand at lower cost than two or more facilities such that it is uneconomical to*

> *duplicate the facility and society's resources are most efficiently used and costs minimised if additional facilities are not developed.*"[47]

4.5 The NCC goes on to observe that:

> *"The key characteristics of a natural monopoly relate to the presence of significant economies of scale and/or economies of scope in the production of the service or services the facility provides, the existence of substantial fixed (or capital) costs and relatively low variable (or operating) costs, and large and lumpy investment costs.*"[48]

4.6 The NCC ultimately concludes that:

> *"These features of heavy haul railways suggest that the Goldsworthy Railway is likely to be a natural monopoly – such that a single below rail operator is likely to be able to deliver services at lower cost than two or more track operators over a wide range of demand levels and that it is only when the use of a railway approaches the maximum scope of its potential capacity that it would become economical to develop another facility.*"[49]

***Reality***

4.7 The social cost test propounded by the NCC (and the Australian Competition Tribunal) requires an assessment of all of the costs of access.

4.8 In its Final Recommendation in relation to the Mt Newman Application, the NCC indicated that criterion (b) required an assessment of "interface costs, or 'diseconomies of scope' from sharing the facility".[50]

4.9 In its Draft Recommendation, the NCC accepts that access to the Goldsworthy Service is likely to result in lost system capacity and other diseconomies:

> *"The Council accepts that access to a railway by third parties is likely to result in some costs to the service providers in the form of lost system capacity and other diseconomies. These costs will be incorporated in likely charges either as a result of negotiated terms of access or if needs be an arbitration. If these costs are large, then it is likely that the costs of access will be correspondingly high and the demand for access lower. In some cases the costs and hence access charges may be so large that access will not occur.*"[51]

4.10 It is therefore very surprising that the NCC fails to include any consideration of diseconomies in its assessment of the costs of access for the purposes of applying criterion (b).

4.11 If diseconomies are not taken into account in the consideration of whether criterion (b) is satisfied, as the NCC has done in its Draft Recommendation, then criterion (b) will always be satisfied with respect to an expandable heavy haul railway. This approach is inconsistent with the previously established interpretation of criterion (b).

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[47] Draft Recommendation, para 5.3.

[48] Draft Recommendation, para 5.4.

[49] Draft Recommendation, para 5.61.

[50] Mt Newman Final Recommendation, paras 6.163, 6.164.

[51] Draft Recommendation, para 9.130.

4.12 Further, the NCC fails to take into account the precedent set by FMG in constructing another railway. If sufficient iron ore deposits are found to exist near the Goldsworthy Railway, it would be economical for anyone to construct another railway as FMG has done.

**ACCC powers under Part IIIA**

***NCC Conclusion***

***While there is little or no spare capacity on the Finucane Island section of the Goldsworthy Railway, the ACCC can order BHPBIO to expand the railway to enable access.***

***The Reality***

***The ACCC does not have the power under Part IIIA to order an infrastructure owner to expand its facilities for the purpose of enabling access. Consequently, criterion (b) is not met and declaration would be futile.***

***NCC Reasoning***

4.13 The operation of the Goldsworthy Railway is effectively divided into two sections – the Yarrie section and the Finucane Island section. BHPBIO is currently using all of the capacity on the Finucane Island section and will use all of the capacity for the foreseeable future.

4.14 The NCC accepts that there is "little or no spare capacity on the Finucane Island section of the railway as currently configured or as the result of currently planned expansions."[52]

4.15 Accordingly, the NCC notes that where "likely demand outstrips installed capacity, Part IIIA envisages that it may be necessary for a facility to be expanded to meet demand for a service arising from access".[53] The NCC then observes that if necessary, "the ACCC can determine that a service provider should expand a facility and that access seekers must meet the costs of this expansion."[54]

***Reality***

4.16 As stated above at paragraph 3.51, this is completely unrealistic and assumes an unprecedented exercise of powers by the ACCC. Mr Allan Myers QC and Mr Michael O'Bryan have provided a written opinion to BHPBIO that the ACCC does not have the power under Part IIIA to order BHPBIO to expand its facilities, such as the Goldsworthy Railway. A copy of that opinion is **Attachment 4** to this submission.

4.17 In their opinion, counsel conclude:

> *"We believe that the ACCC is not empowered by section 44V(2) to require BHP Billiton to expand the Goldsworthy Railway.*
>
> *. . .*
>
> *The exercise by the ACCC of a power to require the expansion of the Goldsworthy Railway would give rise to various practical difficulties including:*

[52] Draft Recommendation, paras 5.85, 5.97.

[53] Draft Recommendation, para 5.86.

[54] Draft Recommendation, para 5.88.

*(a) interfering with the efficient manner of operation of the Railway;*

*(b) the diversion of human and capital resources away from other productive activities in order to undertake the expansion; and*

*(c) securing the capital and maintenance cost of the expansion."*

4.18 Therefore, where a facility has no spare capacity, criterion (b) cannot be met (under the test applied by the NCC) and in any event, for practical purposes, declaration would be futile.

**Significant impediments to expansion**

***NCC Conclusion***

***It is feasible to expand the Finucane Island section of the Goldsworthy Railway.***

***The Reality***

***As set out in BHPBIO's previous submission, there are significant impediments to duplicating the Finucane Island section such that it is unclear whether it is feasible. The NCC acknowledges this but then assumes that duplication is nevertheless possible. The NCC does not explain how it reached this conclusion despite the information presented by BHPBIO.***

***NCC Reasoning***

4.19 In relation to the expansion of the Finucane Island section, the NCC observes:

> *"There appears to be greater difficulty in expanding this section of the track than the Yarrie section, given its location relative to the town of Port Hedland and related facilities, environmental and hydrological challenges and possible community objections to further development of the area. These locational and related factors may limit the amount and nature of access available to the Finucane Island section of the Goldsworthy Railway."*[55]

***Reality***

4.20 In BHPBIO's previous submission to the NCC, BHPBIO advised that, even though the Goldsworthy Railway Line operates in two distinct sections, it is very unlikely that a third party mining company would seek access to the Yarrie section without access to the Finucane Island section. This is because it would be impractical and uneconomic for a third party to exit the Goldsworthy Railway Line from the Yarrie section given the added cost of unloading the ore at the end of the Yarrie section and then reloading the ore for transportation by road to port facilities.

4.21 BHPBIO also advised that:

(a) there are significant impediments to duplication of the Finucane Island section, including proximity to the township of South Hedland, environmental and hydrological challenges and the lack of physical space;

(b) it is not clear whether duplication of the Finucane Island section is feasible; and

[55] Draft Recommendation, para 5.97.

(c) BHPBIO has no plans to duplicate the Finucane Island section.

4.22 The NCC has chosen to ignore these issues and it has not pointed to any other information or evidence in support of its conclusion. Accordingly, the NCC's above conclusion is not supported by any fact and the NCC has not attempted to provide any reasoning for its conclusion.

4.23 If the Finucane Island section has no spare capacity and cannot, for practical reasons, be expanded, then criterion (b) cannot be met (under the test applied by the NCC) and in any event, for practical purposes, declaration would be futile. As there is no basis for the NCC's conclusion that the Finucane Island section can be duplicated, the NCC cannot be satisfied that criterion (b) is met with respect to the Goldsworthy Railway.

## 5. CRITERION (a) - MATERIAL INCREASE IN COMPETITION

### BACKGROUND

5.1 In relation to criterion (a), the NCC states:

> "*The issue is whether access would improve the opportunities and environment for competition in dependent markets such as to promote materially more competitive outcomes.*"[56]

5.2 In relation to dependent markets, the NCC concludes:

> "*The Council considers that the most relevant dependent markets for the Goldsworthy Application are:*
>
> - *The market for haulage services for iron ore on the Goldsworthy Railway in the vicinity of the Goldsworthy Railway (**the haulage services market**) and*
> - *The market for tenements that contain iron ore in the Pilbara (**the iron ore tenements market**).*"[57]

5.3 The NCC ultimately concludes that it was satisfied that access to the Goldsworthy Service would promote a material increase in competition in the Pilbara-wide iron ore tenements and the rail haulage services markets.

### CONSIDERATION OF ISSUES

#### Competition in the Pilbara-wide iron ore tenements market

***NCC Conclusion***

***Access to the Goldsworthy Service would promote a material increase in competition in a Pilbara-wide iron ore tenements market.***

***The Reality***

***Access to the Goldsworthy Railway could only have an effect on competition for tenements in the vicinity of the Goldsworthy Railway. The NCC has identified only one company, Atlas Iron, with only two tenements in the vicinity of the Goldsworthy Railway.***

***NCC Reasoning***

5.4 The NCC defines the iron ore tenements market, in relation to which it finds that access would promote a material increase in competition, as Pilbara-wide:

> *"The Council considers that the geographic dimension of the market for tenements containing iron ore is Pilbara wide.*"[58]

5.5 In relation to this market, the NCC concludes:

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[56] Draft Recommendation, para 4.1.

[57] Draft Recommendation, para 4.31.

[58] Draft Recommendation, para 4.73.

> *"Tenements containing large ore bodies, or those which might economically use road transport, represent collectively a relatively small proportion of total iron ore reserves and mining interests in the Pilbara. There are significant numbers of smaller independently-owned tenements that will remain stranded without access to existing rail infrastructure."*[59]

***Reality***

5.6 In identifying the potential users of haulage services on the Goldsworthy Railway, the NCC concludes:

> *" . . .the Council notes that the Applicant identified the likely purchasers of haulage services on the Goldsworthy Railway as those companies with announced tenements located within a distance of about 50km of the Goldsworthy Railway (Goldsworthy Application Part 2, at [6.13]). The Council considers that this is a reasonable indicator of the likely geographic dimension of the market for haulage services."*[60]

5.7 If the only potential users of haulage services on the Goldsworthy Railway are tenements within 50km of the Goldsworthy Railway, it is inconceivable that declaration of the Goldsworthy Service would promote a material increase in competition in a Pilbara-wide tenements market.

5.8 Moreover, as noted above, in relation to potential demand for the Goldsworthy Service, the NCC concludes that:

> *"The Council is able to identify only two projects – Atlas Iron's Pardoo and Ridley projects – which represent potential drivers of demand for the Goldsworthy Service over this time period."* [5 to 10 years][61]

5.9 Further, the Council fails to explain why the Pilbara-wide market for iron ore tenements is not already effectively competitive given the existence of other railway lines in the Pilbara, such as the FMG Chichester Railway.

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[59] Draft Recommendation, para 4.93.

[60] Draft Recommendation, para 4.44.

[61] Draft Recommendation, paras 5.72 and 5.74.

### Competition in the rail haulage services market

***NCC Conclusion***

***Access to the Goldsworthy Railway would promote a material increase in competition in the haulage services market.***

***The Reality***

***Atlas Iron is the only potential user of the Goldsworthy Service identified by the NCC. There is no spare capacity on the Finucane Island section of the Goldsworthy Railway and there are significant impediments to duplicating that section such that it is unclear whether it is feasible. In any event, the ACCC does not have the power under Part IIIA to order BHPBIO to duplicate the Finucane Island section to enable access.***

***NCC Reasoning***

5.10 The NCC concludes:

> *"The Council concludes that access to the Goldsworthy Service would promote a material increase in competition in both the market for haulage services for iron ore on the Goldsworthy Railway and the market for iron ore tenements in the Pilbara ….*"[62]

***Reality***

5.11 The NCC's conclusion is inconsistent with the following facts, which have been set out earlier in this submission:

(a) Atlas Iron is the only potential user of the Goldsworthy Service;

(b) there is no spare capacity on the Finucane Island section of the Goldsworthy Railway;

(c) the ACCC does not have the power under Part IIIA to order BHPBIO to duplicate the Finucane Island section; and

(d) it is unclear whether it feasible to duplicate the Finucane Island section.

[62] Draft Recommendation, para 4.96.

## ATTACHMENT 1

### INTRODUCTION

1. This paper reviews the requirements of access undertakings accepted by Australian regulators in relation to whether the owner of infrastructure is required to consult with access seekers and/or the regulator in proposing to undertake capacity expansions or making significant operational changes.

2. The paper considers the "consent requirements" of the following access undertakings:

   (a) the access undertaking provided by the Australian Rail Track Corporation (**ARTC**) to the Australian Competition and Consumer Commission (**ACCC**) under Part IIIA of the *Trade Practices Act 1974* (**TPA**) in relation to ARTC's interstate rail network in South Australia, Victoria, Western Australia and New South Wales and in relation to which the ACCC has issued a draft determination;

   (b) the access undertaking provided by Queensland Rail (**QR**) to the Queensland Competition Authority (**QCA**) under the *Queensland Competition Authority Act 1997* (**QCA Act**) in relation to specified rail infrastructure in Queensland;

   (c) the access undertaking provided by the Rail Infrastructure Corporation, RailCorp and the ARTC (collectively, **the NSW Rail Providers**)[1] to the Independent Pricing and Regulatory Tribunal under the *Transport Administration Act 1988* in relation to those parts of the New South Wales rail network owned by the NSW Rail Providers; and

   (d) the access undertaking provided by BBI (DBCT) Management Pty Ltd (**DBCT Management**) to the QCA under the QCA Act in relation to the Dalrymple Bay Coal Terminal (**DBCT**).

### EXECUTIVE SUMMARY

3. A review of the access undertakings provided by each of the ARTC, QR, the NSW Rail Providers and DBCT Management demonstrates that:

   (a) each access regime requires, or will require, the owner of infrastructure to engage in a consultation process with access seekers ahead of undertaking a capacity expansion;

   (b) approval is required from the regulator to include the cost of capacity expansions in the regulated asset base;

   (c) the regulator will take account of the interests of access seekers in determining whether to approve a capacity expansion, and there is often explicit provision for the regulator to have regard to the consultation process described above in making this assessment; and

   (d) in some instances (i.e. the Queensland access regimes), the capacity expansion approval processes make provision for a specified percentage of access seekers (calculated by contracted tonnage) to approve a proposed expansion.

[1] The Rail Infrastructure Corporation controls some regional networks, RailCorp controls metropolitan track and the ARTC controls the Hunter Valley Coal Network.

## ACCESS UNDERTAKINGS

### The ARTC's Rail Network (South Australia, Victoria, Western Australia and New South Wales)

#### *Proposed access undertaking*

4. On 20 December 2007, the ARTC submitted a new access undertaking to the ACCC to replace an existing access undertaking that was due to expire.

5. The new access undertaking is similar to the previous undertaking, but the ARTC included the following additions to the access regime:

   (a) the ARTC's planned expansion program is to be included in its regulated asset base, subject to ACCC approval (see clause 2.4 and Schedule H);

   (b) clause 4.4 requires ACCC approval for any increase in capital expenditure exceeding 20% of capital expenditure on the network in a single year; and

   (c) clause 6.3 provides that, on application to the ACCC, the ARTC may expand the capacity of its network of its own volition and/or adjust access charges to take account of any such expansions.

#### *ACCC position on third party consent requirements*

6. On 29 April 2008, the ACCC issued its draft determination in relation to the ARTC's access undertaking (**Draft Determination**). The Draft Determination recommended that an additional clause be added to the access undertaking that would require the ARTC to undertake an industry consultation process (i.e. consult with third party users) in the event that it is proposing to add additional capacity to its network.

7. The recommended clause is as follows:

   *"6.5 Industry Consultation*

   *In regard to Additional Capacity sought in accordance with clauses 6.2 and 6.3, ARTC must:*

   *(i) provide above Operators with a reasonable opportunity to present their views to it regarding Additional Capacity sought by either an Applicant or by it;*

   *(ii) circulate a summary of the results of consultation to stakeholders including reasons for disagreeing with Operators' views (where applicable)".*

8. The ACCC is currently in the process of receiving submissions on the Draft ARTC Determination.

#### *ACCC position on regulatory consent requirements*

9. Apart from the explicit requirement to undertake industry consultation, the necessity to involve third party access seekers in expansion decisions also arises in the context of the ARTC seeking ACCC approval for capacity expansions.

10. For example, the ACCC stated that:

(a) in assessing what was a reasonable and prudent amount of capital expenditure, it was necessary to have regard to whether the proposed expansion had been subject to an effective industry consultation process[2];

(b) in assessing an application by the ARTC to expand the capacity of its network under clause 6.3, the ACCC will have regard to, amongst other things, the interests of access seekers[3]; and

(c) the requirements on the ARTC to seek its approval for capacity expansions under clause 6.3 merely codify processes that would exist in any event (i.e., within Part IIIA and the access undertaking itself).[4]

**QR's Rail Network (Queensland)**

11. While clause 7.4.1 of the QR access undertaking enables QR to expand the capacity of the railway without consulting third parties, the inclusion of capital expenditure into the regulatory asset base used in the calculation of access tariffs requires third party and regulator involvement.

12. There are two processes for the acceptance of capital expenditure into the regulatory asset base – post approval and pre-approval.

13. In relation to post approval, the access undertaking provides that the QCA will approve the inclusion of prudent capital expenditure in the regulatory asset base.[5]

14. In relation to pre-approval, there are three circumstances in which QR can obtain prior approval for capital expenditure to be rolled into the asset base:[6]

(a) where proposed expenditure over the regulatory period is consistent with QR's Network Management Plan;[7]

(b) where the scope of expenditure has been approved by customers in accordance with the Master Plan Process (explained below); or

(c) where the expenditure is customer specific expenditure on a spur line that has been approved by the relevant customer.

15. The Master Plan Process requires QR to convene a Coal System Master Planning Forum (**Forum**) comprised of customers, access right holders, facility owners, the QCA and the Queensland Resources Council.[8]

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[2] Page 202, Draft Determination.

[3] Page 222, Draft Determination.

[4] Page 223, Draft Determination.

[5] Clause 2.1(b), Schedule FB.

[6] Clause 2.2(a), Schedule FB.

[7] The Network Management Plan is QR's Strategic Asset Management Plan, as approved by the QCA: clause 2.1(e), Schedule FB.

[8] Clauses 2.2.1(g); 2.2.1(a), Schedule FB.

16. The Forum is to be actively involved in the development of a Coal System Master Plan (**Plan**).[9] The Plan is required to cover, *inter alia*, projects for which Customer Group approval is sought and customer specific spur projects.[10] The Customer Group includes all customers who will incur access charges based on the reference tariff or who will be affected by the inclusion of the expenditure in the asset base.[11] QR may seek Customer Group approval (and hence QCA pre-approval) for projects within the Plan.

17. To receive Customer Group approval, QR must provide the relevant customers with detailed information on the proposed expenditure and the effect on the customer's reference tariff.[12] Customers in the Customer Group have 6 weeks to object to the expenditure. The QCA will determine any objection. If a customer does not respond to the proposal, the customer will be deemed to have accepted the expenditure.[13] Customer acceptance will be deemed to have been received if 60% of the Customer Group accepts the proposal.[14]

**NSW Rail Providers' Rail Network (New South Wales)**

18. Schedule 3 to the access undertaking provides for the inclusion of new investment in the regulatory asset base.

19. In respect of the Hunter Valley Coal section of the network, there is provision for additional capital expenditure to be included in the regulatory asset base. However, this capital expenditure must be "prudently incurred", and, in determining this, the consultation process described below must be undertaken.[15]

20. Clause 3.3(a) provides that the NSW Rail Providers may undertake new investments for the purpose of facilitating access, either at their own instigation or at the request of an access seeker. The NSW Rail Provider will undertake the works, provided that they are not inconsistent with the implementation of their network management plan.[16]

21. Clause 3.4 of the Schedule provides for a capital expenditure consultation process. The NSW Rail Provider is required to:[17]

    (a) work with access seekers to identify and prioritise future network investments; and

    (b) evaluate future investments in consultation with access seekers.

22. This process requires the owner to provide access seekers with detailed information about future capital expenditure and develop a process for access seekers' input.[18]

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[9] Clause 2.2.1 (b), Schedule FB.

[10] Clause 2.2.1(d)(ii) and (iii), Schedule FB.

[11] Clause 2.2.1(e), Schedule FB.

[12] Clause 2.2.2(a), Schedule FB.

[13] Clause 2.2.2(b), Schedule FB.

[14] Clause 2.2.2(d), Schedule FB.

[15] Clause 3.2(b), Schedule 3.

[16] Clause 3.3(b), Schedule 3.

[17] Clause 3.4 (a), Schedule 3.

[18] Clause 3.4 (b), Schedule 3.

**DBCT Management's Dalrymple Bay Coal Terminal**

***Background***

23. The access undertaking submitted by the DBCT explicitly provides for consultation and approval processes for proposed capacity expansions.

24. The access undertaking also annexes a Standard Access Agreement that makes provision for consultation in respect of proposed capacity expansions and operational changes.

***Access undertaking***

25. Clause 12.2 of the DBCT access undertaking explicitly refers to "capacity expansion consultation". The clause provides that:

> *"DBCT Management will hold meetings with Access Holders not less than twice per Financial Year to consult with Access Holders in good faith upon the following issues:*
>
> *i. current Terminal Capacity;*
>
> *ii. constraints on current Terminal Capacity including the impact on Demurrage Costs and Access Holder transport costs;*
>
> *iii. future contracts/forecasts that may impact on Terminal Capacity;*
>
> *iv. significant issues relevant to Terminal Capacity;*
>
> *v. the timing and nature of the next Capacity Expansion (if any) and the impact on current capacity requirements, pricing and the Master Plan; and*
>
> *vi. any proposed changes to the Terminal Regulations.*
>
> *DBCT Management will distribute in a timely manner agendas, detailed briefing material and a copy of the minutes of each of these meetings to all Access Holders, DBCT Holdings and the QCA."*

26. DBCT Management is required to apply to the QCA prior to expanding the capacity of the DBCT during the term of the undertaking.[19] Clause 12.5 sets out an extremely detailed and prescriptive set of criteria by which the QCA assesses such an application, and whether the cost of the proposed expansion can be included in the regulated asset base.

27. Notably, in assessing a proposed capacity expansion under clause 12.5, the QCA must be satisfied that:

    (a) the scope of the proposed works is consistent with the current Master Plan (and any variations to the Master Plan) and applicable laws;[20]

    (b) DBCT Management has secured contracts from access seekers for 60% of the proposed capacity expansion;[21]

    (c) 60% of access seekers (calculated by contracted tonnage) do not oppose the capacity expansion, having been given notice of the proposed expansion;[22] and

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[19] Clause 12.5(a).

[20] Clause 12.5(f).

[21] Clause 12.5(h).

(d) the capital works are to be undertaken pursuant to a QCA approved tender and contract management processes. One of the factors to be taken into account by the QCA is the reasonable accommodation of requests from access seekers as to the sequencing of works so as to avoid disruption to their activities.[23]

***Standard Access Agreement***

28. Clause 10 of the Standard Access Agreement includes an obligation that before making any decision to expand the terminal, DBCT Management must:

(a) advise the user of the reasons for, extent, timing and estimated cost of any expansion under consideration;

(b) consult the user as to whether changes in the user's annual contract tonnage or the method of operation of the terminal, including the user's arrangements for shipping its coal, would avoid or delay the need for the expansion or reduce the extent or estimated cost of the expansion; and

(c) consider how to maximise the utilisation of the terminal.

[22] Clause 12.5(h).

[23] Clause 12.5(i).

**ATTACHMENT 2**

## INTRODUCTION

1. This paper sets out examples of cases where the ACCC has made a determination in relation to the access prices and terms which has subsequently been overturned by a tribunal or court on the basis that the approach taken by the ACCC was erroneous.

## EXECUTIVE SUMMARY

2. Three recent cases demonstrate the following:

   (a) there are substantial delays associated with resolving access pricing issues, for example in the East Australian Pipeline matter (below), it was three years before a final determination was made;

   (b) there is considerable uncertainty in the ACCC's ability to properly determine the access prices and terms; and

   (c) access regulation generates significant uncertainty for investors in infrastructure facilities given the divergent views of regulators and courts in setting access prices and terms.

## *Re East Australian Pipeline Limited* [2004] ACompT 8 (8 July 2004)

### *Relevant facts*

3. In 2004, the ACCC considered an access arrangement submitted by East Australian Pipeline Limited (**EAPL**) for the Moomba to Sydney pipeline system (**MSP**) pursuant to the National Third Party Access Code for Natural Gas Pipeline Systems (the **Code**).

4. The ACCC ultimately drafted and approved a revised version of the access arrangement pursuant to s 2.20(a) of the Code (the **Final Decision**).

5. EAPL sought a review of the ACCC's Final Decision in the Australian Competition Tribunal (**Tribunal**). Application to the Tribunal for review of the final Approval is limited by ss 39(2) and 39(5) of the *Gas Pipelines Access (South Australia) Act* 1997 (**Gas Law**). Under the Gas Law, an application may only be made on the grounds of an error in the regulator's finding of facts, or that the exercise of the relevant regulator's discretion was incorrect or unreasonable, or that the occasion for exercising the discretion did not arise.

### *Tribunal - findings*

6. The ACCC accepted EAPL's proposed ORC of $1055.6 million, save for a contingency factor of $82 million. In its Draft Decision, the ACCC determined DORC of $539.5 million based upon an asset life of 50 years and straight line depreciation. That conclusion was based in part upon the purchase price of the MSP paid by EAPL in 1994. The ACCC proposed an Initial Capital Base (**ICB**) of $502.081 million which was equivalent to its assessment of DORC of $539.5 million when other adjustments were taken into account.

7. EAPL criticised this approach on various bases and put forward various alternative proposals in the period leading up to the Final Decision. These included DORC of between $768 million and $972 million and a value of between $784 million and $998 million based upon its 'reasonable expectations' pursuant to s 8.10(g) of the Code.

8. In the Final Decision, the ACCC maintained the preference for straight line depreciation. It accepted that DORC should be the product of the expected useful life of the pipeline looking forward, which it accepted as 80 years. It calculated a DORC value of $715.1

million. However, it rejected DORC as the measure of value. It adopted a value for the ICB of $559 million based upon adjusting ORC according to the useful asset life assumed in the past (50 years) coupled with future depreciation on the current assumed life (80 years).

9. In each case straight line depreciation was utilised, but the overall result has been described as 'kinked'. The life of 50 years was principally based upon the financial accounts of EAPL.

10. The Tribunal held [at 25]:

> *"it was contended that it was a fundamental error in principle for the ACCC to put aside known valuation methodologies and devise a methodology of its own which adjusted ORC in a novel fashion. It was submitted that this had no support in the Code or the material on the subject received by the ACCC and is properly described as idiosyncratic. In our opinion that submission is correct."*

11. The Tribunal found [at 27]:

> *"it was incorrect and unreasonable to adopt a methodology which does not reflect the terms of the Code and which is not supportable in principle. We are satisfied that the ICB fixed by the Final Approval cannot stand and must be set aside".*

12. The Tribunal further found [at 28]:

> *"it is implicit in what we have said that we cannot see any reasonable basis upon which reference to s8.10(f) could justify the method of adjusting ORC that was chosen by the ACCC….there is no logical or rational link between the accounting treatment of depreciation in the past on the one hand and the true estimate of the life of the pipeline in relation to the forward looking deduction of DORC from ORC on the other."*

13. The Tribunal was critical of the ACCC's reasoning and found that there was "some substance in [the] submission" that "the conclusion of predetermination is supported by the reasoning of the ACCC on other aspects of the Final Decision, which was arbitrary and not in accordance with principle" [32].

14. The Tribunal held that "the ACCC was wrong and unreasonable in finding that the contingency included in Venton's estimate of ORC should be excluded *in toto*. We are of the view that it was appropriate to include a contingency factor in an estimate of ORC in this case to cover omissions" [51].

## *Australian Competition and Consumer Commission v Australian Competition Tribunal* [2006] FCAFC 83

### *Relevant facts*

15. The ACCC sought judicial review of the Tribunal's decision in *Re East Australian Pipeline Limited* (above).

16. The ACCC contended that the Tribunal had made errors of law in its construction of ss8.10 and 8.11 of the Code and its approach to its review function under s 39(5) of the Gas Law. Further, it contended that the Tribunal had relied on irrelevant considerations, failed to take into account relevant considerations, made findings on the basis of inadequate evidence and made unreasonable and improper findings.

17. The ACCC sought:

    (a) an order setting aside the Tribunal’s decision; or

(b) the issue of a writ of certiorari quashing the Tribunal's decision; or

(c) declarations as to the validity of the ACCC's calculation of the ICB in its Final Decision and Final Approval; and

(d) declarations that the Tribunal had acted ultra vires to s 44ZZOA of the TPA; and

(e) an order for mandamus compelling the Tribunal to deal with EAPL's application in accordance with law, or alternatively remitting the matter to the Tribunal for further determination in accordance with law.

***Full Court of Federal Court - findings***

18. The Court commented that the Tribunal:

> *"has not been given a purely substitutive function in relation to the review of the ACCC's discretion. That is to say, if the ACCC has exercised its discretion on correct principles and if the particular exercise of the discretion was open to it within the framework of the Code, the Tribunal is not empowered to set aside that decision simply because it thinks another decision would have been preferable."*

19. The Court considered that a decision is not unreasonable merely because a decision-maker could reasonably have reached a different view. The Court concluded that the ACCC had not adopted an unreasonable or incorrect methodology. Rather,

> *"[t]hat methodology was in conformity with the terms of the Code. The ACCC had a considerable discretion in determining or establishing the ICB for the pipeline, albeit a discretion circumscribed by the factors set out in s 8.10(a) to (k) of the Code… The error into which the Tribunal fell, in substance, was that it rejected the ACCC's determination of the ICB as an accepted or "known" valuation methodology… Presumably the Tribunal, consistently with s 39(2) of the Access Law, determined that this approach by the ACCC was an incorrect or unreasonable exercise of discretion."*

20. The Court set aside the determination of the Tribunal.

21. The Court considered that the ACCC had not erred in exercising its discretion to substitute its own access arrangement and in applying a novel method in calculating the ICB. Further, the Tribunal had erred in interpreting ss8.10 and 8.11and in concluding that the ACCC had miscarried in the exercise of its discretion.

## *East Australian Pipeline Pty Ltd v Australian Competition and Consumer Commission* [2007] HCA 44

***Relevant facts***

22. EAPL appealed the decision of the Full Federal Court in *Australian Competition and Consumer Commission v Australian Competition Tribunal* [2006] FCAFC 83 to the High Court.

23. It sought to have the Tribunal's findings on the construction of s 8.10 reinstated and contended that the Federal Court had misinterpreted the nature of the Tribunal's jurisdiction under s 39 of the Gas Law.

24. The majority (Gleeson CJ, Heydon and Crennan JJ) identified the relevant questions for determination, namely:

(a) what is the correct construction and application of s 8.10 of the Code when establishing the ICB of an existing pipeline; and

(b) what is the scope of the Tribunal's jurisdiction to review a decision of the ACCC under s 39 of the Gas Law?

***High Court - findings***

25. The ACCC had conceded that it had applied an "idiosyncratic" method in determining the ICB in its substitute access arrangement.

26. The majority commented that in calculating an ICB [51]:

> *"It is clear that a range of well recognised asset valuation methodologies can be considered and within that range a choice of value may be made. The discretion permitted is wide but limited. The reference to well recognised asset valuation methodologies emphasises that valuation, in this context, is a practical exercise. Idiosyncrasy in valuing an initial capital base is capable of distorting the proper calculation of a rate of return "commensurate with prevailing conditions in the market" for funds and the risk involved".*

27. The Court considered that there is nothing in s 8.10 to indicate that the regulator may ignore the factors in paragraphs 8.10(a) – (d) or give them only cursory consideration. Rather, [55]:

> "[w]*hilst it is true that in its entirety, s 8.10 does not mandate the establishment of an ICB by reference only to a value established by reference to well recognised asset valuation methodologies, it does… mandate reference to known valuation methodologies as the starting point for setting an ICB."*

28. This is a necessary conclusion if a service provider, or the public, are to have any certainty in the matters that will be taken into account in calculating an ICB. The majority found that the Tribunal was correct in its construction of s 8.10, which was consistent with the language and structure of the provision. Further, the Tribunal was correct in exercising its jurisdiction under s 39.

29. Justices Gummow and Hayne similarly found that [105]:

> "[t]*he Tribunal committed no jurisdictional error to attract the exercise of jurisdiction conferred on the Federal Court by s 39B(1) of the Judiciary Act. To the contrary, the Tribunal correctly found that the ACCC had misconstrued, and as a result misapplied, the Code."*

30. The appeal was allowed.

## *Re GasNet Australia (Operations) Pty Ltd* [2003] ACompT 6 (23 December 2003)

***Relevant facts***

31. GasNet owns and maintains natural gas transmission networks (the Principal Transmission System and the Western Transmission System) in Victoria and NSW (the GasNet System or **GNS**).

32. The GNS by virtue of the *Gas Pipelines Access (Victoria) Act* 1998 (Vic) is a "covered pipeline" under the Code. The Code is applied as a law of Victoria, being part of the Gas Pipelines Access (Victoria) Law (the **Law**). The Law is as contained in Schedules 1 and 2 to the *Gas Pipelines Access (South Australia) Act* 1997 (SA).

33. Section 2.2 of the Code obliges GasNet to submit to the ACCC a proposed Access Arrangement (**AA**) for the GNS. In December 1998, the ACCC approved separate initial AAs for GasNet's two pipelines. GasNet submitted revisions of the AAs for approval by the ACCC but these were not acceptable to the ACCC. Following a draft decision, further submissions and a final decision, the ACCC pursuant to s 2.42 of the Code, determined that it was not satisfied that the amended revisions submitted by GasNet incorporated the amendments that it required in its final decision.

34. Accordingly, the ACCC drafted and approved its own revisions to the AA instead of the revisions proposed by GasNet.

35. GasNet applied for review of the ACCC's decision. Review was available under the Law on the limited grounds of an error in the regulator's finding of facts, or that the exercise of the relevant regulator's discretion was incorrect or unreasonable, or that the occasion for exercising the discretion did not arise. Under the Law, the available review was a review on the basis of the documents and material that were before the regulator at the time the decision under review was made.

36. GasNet submitted that the ACCC erred in the proper determination of the Reference Tariff applicable to GasNet's revised AA.

***Tribunal - findings***

37. The Tribunal held [at 29]:

> *"The application of the Reference Tariff Principles involves issues of judgment and degree. Different minds, acting reasonably, can be expected to make different choices within a range of possible choices which nonetheless remain consistent with the Reference Tariff Principles. Where the Reference Tariff Principles produce tension the Relevant Regulator has an overriding discretion to resolve the tensions in a way which best reflects the statutory objectives of the Law. However, where there are no conflicts or tensions in the application of the Reference Tariff Principles, and where the AA proposed by the Service Provider falls within the range of choice reasonably open and consistent with Reference Tariff Principles, it is beyond the power of the Relevant Regulator not to approve the proposed AA simply because it prefers a different AA which it believes would better achieve the Relevant Regulator's understanding of the statutory objectives of the Law."*

38. The Tribunal found that dispute between GasNet and the ACCC "lies in the choice of the risk-free rate used to calculate the WACC and in the choice of the inflation rate to be used to estimate the annual revenue requirements" [34].

39. The Tribunal found that the ACCC erred in determining for itself a Rate of Return for the purpose of s 8.30 in circumstances where GasNet's proposed Rate of Return using the CAPM was consistent with the objectives of s 8.1 of the Code. The Tribunal held that [at 47]:

> *"The ACCC erred in concluding that it was open to it to apply the CAPM in other than the conventional way to produce an outcome which it believed better achieved the objectives of s 8.1. In truth and reality, the use of different values for a risk free rate in the working out of a Rate of Return by the CAPM formula is neither true to the formula nor a conventional use of the CAPM. It is the use of another model based on the CAPM with adjustments made on a pragmatic basis to achieve an outcome which reflects an attempt to modify the model to one which operates by reference to the regulatory period of five years. The CAPM is not a model which is intended to operate in this way. The timescales are dictated by the relevant underlying facts in each case and for present purposes those include the life of the assets and the term of the investment."*

## *Re Epic Energy South Australia Pty Ltd* [2003] ACompT 5 (10 December 2003)

### *Relevant facts*

40. Epic Energy (**Epic**) is the owner and operator of the natural gas pipeline system known as the Moomba to Adelaide Pipeline System (**MAPS**).

41. By virtue of the *Gas Pipelines Access (South Australia) Act* 1997 (SA) (**Gas Law**), the MAPS is a "covered pipeline" under the Code. As the Service Provider, Epic was obliged by s 2.2 of the Code to submit to the ACCC a proposed Access Arrangement (**MAPS Arrangement**) together with and application for Access Arrangement Information (**MAPS Application**) for the MAPS.

42. The ACCC refused to approve Epic's proposed MAPS Arrangement, which included an estimate of the Initial Capital Base in Epic's MAPS Application and the application of the DORC in valuing the pipeline.

43. The ACCC drafted its own access arrangement (**ACCC Arrangement**) which included the cost of line pipe, one of the major input costs, obtained from a report by Microalloying (commissioned by the ACCC). The ACCC used the lower bound cost of $1053 per tonne in the estimated ORC in its Final Decision, however, the Final Decision contained no rationale for the selection of the lower bound price provided by Microalloying. The ACCC also commissioned cost modelling by SKM, which endorsed a line pipe cost of $1250 per tonne and agreed that it "generate[d] a 50th percentile estimate of replacement costs"[24].

### *Tribunal findings*

44. Epic sought to have the ACCC Arrangement reviewed. The review was limited by the Gas Law on the grounds that the exercise of the relevant regulator's discretion was incorrect or was unreasonable having regard to all the circumstances (s 39(2)).

45. The Tribunal found that there "is nothing in the context of the Law or in the statutory objects of the Law, to suggest that the legislature intended to prevent interference with the decision of the Regulator other than where the decision was wholly untenable in the public law Wednesbury sense" [13].[1]

46. The Tribunal held that "the concept of 'Wednesbury unreasonableness' involves a consideration of whether the exercise of decision-making was ultra vires because it was in excess of the statutory grant of power" [10].

47. The Tribunal found that the process followed by the ACCC (in selecting the lowest indicative price for line pipe for the determination of the ORC) was unreasonable in the circumstances. The process "was flawed and therefore was unreasonable, not the price chosen as such" [92]. The Tribunal found that the process followed by the ACCC was "not an exercise of discretion that a reasonable person would have made in all the circumstances. It falls beyond the boundaries of what a prudent commercial operator would objectively be expected to do in these forward-looking planning circumstances" [95].

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[1] In *Epic Energy South Australia Pty Ltd* [2002] ACompT 4, the Tribunal said: "for the purposes of the subsection, error is made out only if it is demonstrated that the exercise of the discretion was so unreasonable on the basis of the matters available to the decision maker that no reasonable decision maker could ever come to it: *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1947] EWCA Civ 1".

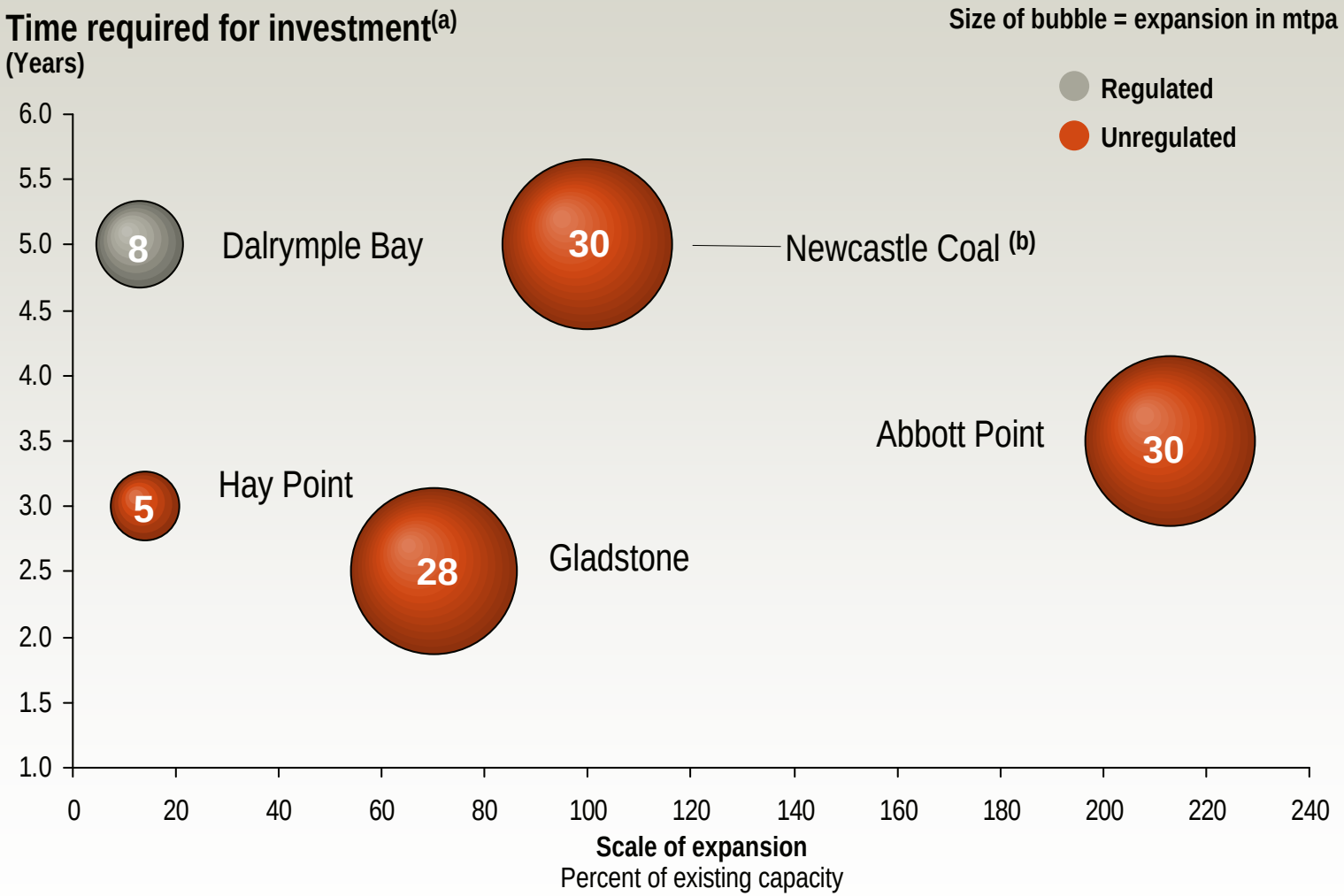
48. The Tribunal stated that the ACCC "treated the Microalloying figures with a degree of specificity and certainty that was inappropriate given the qualifications Microalloying put on its findings"[62]. The Tribunal criticised the ACCC's final decision in that [at 32]:

> *"…it contained no rationale for the selection of the lower bound price provided by Microalloying…the use of the lowest price from the Microalloying Report was defended by the ACCC on the grounds that the prices were observed and not estimated, because the prices were observed there was a reasonable degree of certainty, and a reasonable and prudent Service Provider would choose the lowest priced line pipe."*

49. The Tribunal also agreed with the submissions of counsel for Epic that the prices in the Microalloying Report provided [at 34]:

> *"…an indicative pricing level which may never be guaranteed at the relevant time. It's only indicative pricing. To take the lowest of those prices doesn't do justice to what is reasonable and substantiated for the purposes of developing an initial capital base which provides the service provider with an appropriate return on capital for its investment. That's really the point".*

# Less regulation of large scale export oriented infrastructure could assist in Australia growing supply




a) *Source: O'Donnell; BHP Billiton.*
b) *Newcastle Coal Infrastructure Group is a greenfield expansion.*

bhpbilliton
resourcing the future

**IN THE MATTER OF**
**BHP BILLITON IRON ORE PTY LTD**
**AND**
**APPLICATION FOR DECLARATION OF THE GOLDSWORTHY RAIL LINE**

# MEMORANDUM OF ADVICE

## Instructions

1. We have been instructed by BHP Billiton Iron Ore Pty Ltd (**BHP Billiton**) to advise in respect of the following questions:

   (a) Could the Australian Competition and Consumer Commission (**ACCC**) validly use the power granted to it under section 44V of the *Trade Practices Act* 1974 (Cth) (**the Act**) to direct BHP Billiton to expand substantially the capacity of the Goldsworthy Railway?

   (b) What limits are there on the exercise of the ACCC's power under section 44V?

   (c) What practical issues might arise if the ACCC were to require BHP Billiton to expand the Goldsworthy Railway pursuant to its powers under section 44V of the Act?

## Background

2. On 16 November 2007, The Pilbara Infrastructure Pty Ltd (**TPI**) applied to the National Competition Council (**NCC**) for a recommendation under Part IIIA of the Act that the service provided by a railway owned by the Mt Goldsworthy Joint Venture participants (**Goldsworthy Railway**) be declared for a period of 20 years.

3. On 20 June 2008, the NCC published a Draft Recommendation that the service provided by the Goldsworthy Railway be declared.

4. As described in the Draft Recommendation, the Goldsworthy Railway is a single track railway line (with passing loops) that extends from a location near Yarrie at its eastern end to a location near Finucane Island within the port of Port Hedland

at its western end.[1] The Goldsworthy Railway crosses the Mt Newman Railway at a point known as the Goldsworthy Junction, south of Port Hedland. The section from Yarrie to the Goldsworthy Junction (referred to in the Draft Recommendation as the Yarrie section) is 191 kilometres long and the section from the Goldsworthy Junction to Finucane Island (referred to in the Draft Recommendation as the Finucane Island section) is 17 kilometres long.[2]

5. BHP Billiton advised the NCC that the Finucane Island section of the Goldsworthy Railway is fully used because BHP Billiton effectively uses the section as a queuing yard for the trains before they are unloaded at its port operations at Finucane Island. BHP Billiton also advised the NCC that it does not currently propose to increase the capacity of the Finucane Island section by double tracking it, and it is unsure whether it would be feasible to double track that section given the environmental and hydrological challenges of additional train movements in that area and the lack of physical space. As a result, the Finucane Island section is and will be for the foreseeable future capacity constrained.[3]

6. BHP Billiton also advised the NCC that, if the service provided by the Goldsworthy Railway were declared, a railway connection would need to be established between the Finucane Island section and TPI's railway loop leading into its port facilities near Anderson Point. However, it is unlikely that such a connection would be viable given the lack of available land and environmental concerns.[4]

7. In the Draft Recommendation, the NCC acknowledged that there is little or no spare capacity on the Finucane Island section of the Goldsworthy Railway.[5] However, the NCC formed the view that this was not a reason not to recommend declaration of the service. The NCC reasoned as follows:

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[1] Paragraphs 2.7 and 2.8 of the Draft Recommendation.
[2] Paragraph 5.14 of the Draft Recommendation.
[3] Paragraphs 5.17 and 5.18 of the Draft Recommendation.
[4] Paragraph 5.19 of the Draft Recommendation.
[5] Paragraph 5.85 of the Draft Recommendation.

*"Where likely demand outstrips installed capacity, Part IIIA envisages that it may be necessary for a facility to be expanded to meet demand for a service arising from access. Under the provisions of Part IIIA, where a facility needs to be expanded to meet demand for a declared service, access seekers must negotiate with the service provider for the required capacity expansion. The access seekers are required to fund that expansion."*[6]

8. In a footnote, the NCC stated that: *"Section 44W(1)(e) of the TPA states that in determining an arbitration the ACCC must not require the provider to bear some or all of the costs of extending the facility or maintaining extensions of the facility. Section 44V(2)(c) states that the ACCC may specify terms and conditions of the third party's access to the service."*

9. The NCC further stated:

*"As with other terms relating to access, an inability for access seekers and service providers to reach a commercial arrangement for provision and funding of expansions may give rise to an access dispute that is subject to arbitration by the ACCC. If necessary the ACCC can determine that a service provider should expand a facility and that access seekers must meet the costs of this expansion."*[7]

10. In the Draft Recommendation, the NCC did not specify in any detail what it meant by expanding the capacity of the relevant facility (the Goldsworthy Railway). However, it gave the following indication of what it had in mind:

*"The alternative to constructing a new facility is to expand the existing Goldsworthy Railway to accommodate third party demand. Given the nature of iron ore operations in the Pilbara there are a range of options available for expanding capacity. The options include changes to below*

[6] Paragraph 5.86 of the Draft Recommendation.
[7] Paragraph 5.88 of the Draft Recommendation.

*and above rail to enhance capacity, as well as changes at the mine and port that have an impact on the railway network.*"[8]

11. We understand that when the NCC referred to the expansion of the Goldsworthy Railway or the expansion of the capacity of the Goldsworthy Railway, it was not referring to an extension to the length of the Goldsworthy Railway. Rather, the NCC was referring to capital works that would enable more trains to use the railway in a given period of time. Ordinarily, an expansion of that kind would require the construction of additional sidings or passing loops or perhaps the laying of a second railway track so that trains do not meet on the railway.

**Does the ACCC have power to direct the expansion of a facility?**

12. The NCC's reasoning is premised on the belief that the ACCC is empowered by section 44V of the Act to require an access provider to undertake capital works to expand the capacity of the relevant facility. In our view, the ACCC is not so empowered.

13. The effect of declaration of a service under Part IIIA is to enliven a right to seek access to the declared service in accordance with the provisions of Division 3 of Part IIIA. Specifically, if an access seeker is unable to agree with the provider of the declared service one or more aspects of access, either the access seeker or the provider may notify the ACCC that an access dispute exists (section 44S).

14. Under section 44V, the ACCC is empowered to make a determination on access to the declared service by the access seeker. Subsection 44V(2) provides as follows:

> "*A determination may deal with any matter relating to access by the third party to the service, including matters that were not the basis for notification of the dispute. By way of example, the determination may:*
>
> *(a) require the provider to provide access to the service by the third party;*
>
> *(b) require the third party to accept, and pay for, access to the service;*

[8] Paragraph 5.93 of the Draft Recommendation.

(c) *specify the terms and conditions of the third party's access to the service;*

(d) *require the provider to extend the facilities;*

(da) *require the provider to permit interconnection to the facility by the third party;*

(e) *specify the extent to which the determination overrides an earlier determination relating to access to the service by the third party*".

15. The power given to the ACCC under section 44V is expressly limited by section 44W. Subsection 44W(1) provides that:

"*The Commission must not make a determination that would have any of the following effects:*

(a) *preventing an existing user obtaining a sufficient amount of the service to be able to meet the user's reasonably anticipated requirements, measured at the time when the dispute was notified;*

(b) *preventing a person from obtaining, by the exercise of a pre-notification right, a sufficient amount of the service to be able to meet the person's actual requirements;*

(c) *depriving any person of a protected contractual right;*

(d) *resulting in the third party becoming the owner (or one of the owners) of any part of the facility, or of extensions of the facility, without the consent of the provider;*

(e) *requiring the provider to bear some or all of the costs of extending the facility or maintaining extensions of the facility;*

(f) *requiring the provider to bear some or all of the costs of interconnections to the facility or maintaining interconnections to the facility.*"

16. It can be observed that paragraph 44V(2)(d) expressly empowers the ACCC to require the provider to extend the facility. The subsection does not expressly empower the ACCC to expand the facility or expand the capacity of the facility.

17. The ordinary and dictionary meaning of the word "extend" is to increase the length of a thing between two points. The word "expand" includes within its meaning an increase in length, but it also includes an increase in other characteristics such as capacity or functionality. However, the word "extend" does not include an expansion of the capacity of a facility, unless the particular type of expansion that is contemplated is an increase to the length of the facility. In our view, a court is unlikely to conclude that the word "extend" in paragraph 44V(2)(d) includes an expansion of the capacity of a single track railway by laying a second track or adding additional sidings or passing loops.

18. The first sentence of subsection 44V(2) of the Act is broadly framed. It states that a determination by the ACCC may deal with any matter relating to access by an access seeker to the declared service. The subsection does not, however, empower the ACCC to require an access provider to undertake capital works to expand the capacity of the relevant facility. The words "relating to" denote that there must be a relevant connection between the subject matter of the determination and access to the declared service. An argument can be made that requiring the provider to expand the capacity of the facility may facilitate access to the service by the access seeker, and therefore expansion is a matter that relates to access. Conversely, a determination that requires an access provider to undertake capital works to construct a second rail track or additional sidings or passing loops is not a determination that truly relates to access to the declared service, being the use of the existing railway (and not an expanded railway).

19. In our view, it cannot be inferred from the express reference to extending a facility in paragraph 44V(2)(d) that Parliament intended to empower the ACCC to require the provider to expand the facility. As noted earlier, the word "extend" has a different meaning to the word "expand". It will usually be the case that an extension of a facility will involve less complex issues than an expansion. An

extension will not ordinarily involve any interference with the existing facility, apart from the interconnection of the extension with the existing facility. For that reason, it is reasonably straightforward to allocate the costs of an extension between the access provider and the access seeker; there is a clear delineation between the existing and the extended facility. The Act expressly provides that the access provider cannot be required to bear any of the costs of undertaking the extension or maintaining the extension (see paragraph 44W(1)(e)). In contrast, expansions interfere with the existing facility. There will be complex questions about how the expansion should occur. The allocation of the costs of an expansion will also give rise to complex questions, particularly if both the access provider and the access seeker benefit from the increased capacity resulting from the expansion. Unlike extensions, there is no express provision in the Act dealing with the costs of undertaking expansions or maintaining expansions.

20. The relevant extrinsic materials do not assist in determining whether Parliament intended to empower the ACCC to require an access provider to expand a facility.

21. In September 2001, the Productivity Commission published a report titled Review of the National Access Regime. The report discussed whether the ACCC ought to have the power to require an access provider to extend (geographically) a facility or expand the capacity of a facility. The Productivity Commission recognised the practical differences between extensions and expansions and recommended that the ACCC retain its power to require extensions.[9] The Productivity Commission observed that it was not clear that section 44V empowered the ACCC to require expansions. Further, it concluded that such a power is not warranted in Part IIIA. One of the reasons for that conclusion was that there are complex issues relating to the treatment of the costs of capacity expansions. The Commission observed that: "*...unlike geographic extension, capacity expansion is not necessarily incremental and easily hypothecated to particular users. Capacity expansions can*

[9] At page 224

*require discrete blocks of investment. As a result, in many circumstances, it may be difficult to attribute the costs to the individual users.*"[10]

22. Following the Productivity Commission's report, Part IIIA was further amended by the *Trade Practices Amendment (National Access Regime) Act* 2006 (Cth). The ACCC was not given the express power to require expansions of a facility.

23. Having regard to the foregoing considerations, we believe that the ACCC is not empowered by section 44V(2) to require an access provider to expand a facility.

24. For completeness, we note that the NCC stated in its Draft Recommendation that the potential options for expanding the capacity of the Goldsworthy Railway include changes to below and above rail to enhance capacity, as well as changes at the mine and port that have an impact on the railway network."[11] The reference to changes at the mine and port are unclear. The NCC may have been referring to those aspects of the Goldsworthy Railway that are located at the mine or port. If, though, the NCC was referring to BHP Billiton's mine and port facilities that do not comprise part of the Goldsworthy Railway, we believe that the NCC's view is erroneous. Although as noted earlier subsection 44V(2) is stated in broad terms, it is difficult to believe that Parliament intended to give the ACCC power to require an access provider to change facilities that are separate from the facility which is used to provide the declared service. Such a determination would not relate to access to the declared service because by definition the facilities are not used to supply the declared service. The exercise of such a power would give rise to many complex questions which are not addressed by the provisions of Part IIIA. Those questions include interference with separate production facilities and the efficient operation of separate production facilities.

25. Although we believe that the ACCC is not empowered by section 44V(2) to require an access provider to expand a facility, the remainder of this memorandum addresses the two further questions we have been asked on the assumption that the ACCC does have such power.

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[10] At page 225

[11] Paragraph 5.93 of the Draft Recommendation.

**What limits are there on the exercise of the ACCC's power under section 44V?**

26. Section 44W imposes limitations on the exercise of the ACCC's powers under section 44V.

27. The limit that is most relevant in the present context is paragraph 44W(1)(a): the ACCC must not make a determination that would have the effect of preventing BHP Billiton (being an existing user of the Goldsworthy Railway) from obtaining a sufficient amount of the use of the Goldsworthy Railway to be able to meet its reasonably anticipated requirements.

28. Usually, the limitation in paragraph 44W(1)(a) is considered in the context of a determination that requires an access provider to allow an access seeker to use the declared service, and the question arises whether access will deprive the provider (or another user) of a sufficient amount of the service to meet the provider's (or other user's) reasonably anticipated requirements.

29. However, there is no reason why the limitation would not also apply to a determination that required an access provider to expand a facility. Such a requirement has the potential to reduce the capacity of the facility during the period of the expansion by disrupting the use of the facility. In our view, paragraph 44W(1)(a) would prevent the ACCC from making such a determination if the expansion would have that effect. The limitations in paragraph 44W(1) are absolute and are not subject to any discretion on the part of the ACCC. Nor can the limitation be overcome by paying compensation to the access provider (or other affected user).

**What practical issues might arise from a requirement to expand a facility?**

30. In our view, there are three principal practical issues that might arise from a requirement to expand a facility.

31. The first issue concerns the efficient manner of operation of the facility. It will ordinarily be the case that an owner or operator of a facility will use the facility in a manner that attempts to maximise the efficiency of its operations. The efficient operation will depend on a particular configuration of the facility. If a facility such

as the Goldsworthy Railway is required to be expanded, the manner in which the facility is operated will necessarily change. For example, if additional passing loops or a second track are added, different processes would need to be developed for the operation of the facility. The new processes may undermine the efficiency of the original configuration.

32. The second issue concerns the deployment of resources to undertake the expansion. Ordinarily, we would expect that a facility owner would wish to undertake any expansion itself and not subcontract the task to others. This is to ensure that the expanded facility is of suitable quality and to minimise disruption to the owner's existing operations. However, undertaking the expansion may place a drain on the human and capital resources of the facility owner. Its human and capital resources may already be fully utilised in its existing operations. To undertake the expansion, the owner would have to divert those resources from other productive uses and that may impose a substantial economic cost on the owner.

33. The third issue concerns the capital and maintenance cost of the expansion. As observed earlier, the Act expressly provides that the access provider cannot be required to bear any of the costs of undertaking an extension or maintaining an extension (see paragraph 44W(1)(e)). No such express limitation applies in relation to an expansion. We note that, in the Draft Recommendation, the NCC asserted that access seekers are required to fund any expansion that is required by the ACCC.[12] In our view, that assertion is erroneous. It also contradicts a submission made by the NCC to the Productivity Commission in July 2001. In that submission, the NCC stated that:

> *"The Council considers that it would not be appropriate for the restrictions in s.44W that relate to requiring the infrastructure owner to pay for extension to be applied to determinations that relate to expansions. The issues surrounding the question of ensuring the infrastructure owner is recompensed for expansions are likely to be more complex than those*

[12] Paragraph 5.86 of the Draft Recommendation.

*for extensions. These matters are best left to the discretion of the regulator to determine on a case by case basis. The current provisions in ss.44V and 44W already do this."* [13]

34. Accordingly, the manner in which a facility owner would be compensated for the capital and maintenance costs of expansion would lie in the discretion of the ACCC, applying the principles set out in section 44X. It may be that the ACCC would require an access seeker to pay for all such costs, and indeed pay for the costs at the outset, or provide suitable security for those costs, to ensure that the facility owner is not encumbered with the risk of financial default by the access seeker. However, it is not certain that the ACCC would require this. The facility owner may ultimately be required to incur costs that are not recovered from the access seeker.

**Conclusion**

35. Our conclusions, as they apply to the Goldsworthy Railway, can be summarised as follows.

36. We believe that the ACCC is not empowered by section 44V(2) to require BHP Billiton to expand the Goldsworthy Railway.

37. If the ACCC was so empowered, paragraph 44W(1)(a) would impose a limitation on the exercise of that power such that the ACCC must not make a determination requiring BHP Billiton to expand the Goldsworthy Railway if the determination would have the effect of preventing BHP Billiton (being an existing user of the Goldsworthy Railway) from obtaining a sufficient amount of the use of the Goldsworthy Railway, during the period of the expansion, to be able to meet its reasonably anticipated requirements.

38. The exercise by the ACCC of a power to require the expansion of the Goldsworthy Railway would give rise to various practical difficulties including:

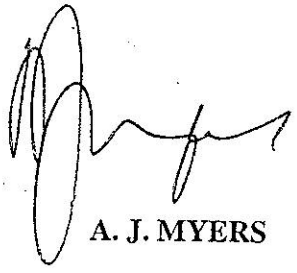
    (a) interfering with the efficient manner of operation of the Railway;

[13] NCC, Submission in response to the Productivity Commission's position paper, July 2001, pages 43-44

(b) the diversion of human and capital resources away from other productive activities in order to undertake the expansion; and

(c) securing the capital and maintenance cost of the expansion.

**Dated: 21 July 2008**



**A. J. MYERS**

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