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# The far side of the Pilbara: Declarations for access to essential infrastructure – where to now?

The Australian Productivity Commission is currently reviewing the statutory regime that permits third-party access to private essential infrastructure via the declaration process contained in Australia's competition legislation.

This review has been precipitated as a result of the outcomes of the ongoing dispute for access to certain rail lines in the Pilbara region of Western Australia, which ended in the High Court of Australia. The Pilbara produces 95% of Australia's iron ore.

The dispute over access to those rail lines first began almost a decade ago. Whatever else the Productivity Commission finds, it is hoped that any legislative amendments speed up the process for resolving such disputes.

## Key issues

- The Australian High Court's decision in the Pilbara case is likely to have, as a practical matter, curtailed the operation of the provisions in Part IIIA of the CCA dealing with access to infrastructure
- This briefing note describes the almost ten-year litigation saga of the Pilbara case and the resulting practical operation of the access provisions in the CCA
- The Australian Productivity Commission is not assessing whether, in light of the Pilbara case, the CCA needs to be further amended to impose a different economic or social benefit test to assess access applications. It will also need to address the commercial timeliness and utility of a general access to infrastructure law, as opposed to sector specific access laws or regulations.

## Background

Third-party access to essential infrastructure in Australia may be obtained via the declaration mechanics in Part IIIA of the Competition and Consumer Act 2010 (Cth) (CCA).

Following an application by an access seeker to the infrastructure, the process requires the National Competition Council (NCC) to make a recommendation to the designated Minister (generally the Assistant Treasurer, as the Minister responsible for the Australian Competition and Consumer Commission (ACCC), but will be the relevant Premier or Chief Minister if the service provider is an Australian State or Territory body). The designated Minister will, in turn, make a determination as to whether to declare a particular service.

It is important to note that it is the service that it declared, not the actual facility. For example, in the case of a rail line, it is a particular use or uses of the rail line that is declared, which may not be all possible uses.

Once the declaration is made, the owner of the infrastructure is obliged to negotiate with third parties seeking access to the relevant services. If a negotiation is unsuccessful, the access seeker can require arbitration via the ACCC.

The NCC cannot make a recommendation to the designated Minister, and that Minister cannot make a declaration, unless the criteria in Part IIIA of the CCA are satisfied. In summary, the criteria are:

- that access (which in the following discussion also includes increased access) would promote a material increase in competition in one or more markets, domestically or internationally, other than the market for the service to be subject to the declaration;
- it would be uneconomical for anyone to develop another facility to provide the service;
- the facility is of national significance, considering its size, its importance to "constitutional trade or commerce" (being trade or commerce between Australian States, between Australia and places outside Australia, and between an Australian State and an Australian Territory or two Australian Territories) or its importance to the Australian economy;
- that access would not be contrary to the public interest; and
- an access regime under other provisions of the CCA is not in force (or, if in force, the NCC believes there are relevant extenuating factors).

Consideration must be given to whether it would be economical to develop another facility to provide part of the service.

**The fight in the Pilbara**

The Pilbara case (*The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36) was one stage of the ongoing dispute, which began in 2004, between Fortescue Metals (and its subsidiary, Pilbara Infrastructure) and Rio Tinto for access to certain rail lines in the Pilbara region of Australia, namely Rio Tinto's Hamersley and Robe River lines. BHP Billiton was initially involved in the dispute, as access was also sought to its Goldsworthy and Mount Newman rail lines.

In summary, the Treasurer had made a declaration regarding the rail lines, after receiving from the NCC a recommendation that he do so. On appeal in 2010 the Australian Competition Tribunal rejected Pilbara Infrastructure's claim for access to the Hamersley rail line and restricted the claim in relation to Robe River.

When this decision was in turn appealed to the Federal Court, the full court found for Rio Tinto. Of particular interest in that decision was the interpretation given to the "uneconomical" criteria (the second test referred to above). That test, according to the Full Federal Court, required consideration effectively from the perspective of an investor (excluding the owner of the existing facility), in other words whether that third-party investor could make a profit from developing an alternative facility. This was inconsistent with the approaches that had typically previously been taken of considering this test from a public perspective, which are described in greater detail below.

Pilbara Infrastructure then appealed to the High Court. The High Court considered three key issues:

- the "uneconomical" test;
- what matters can be taken into account in determining "public interest"; and
- whether there is a residual discretion for the Minister to not make a declaration if the criteria have all been satisfied.

**The "uneconomical" test**

In the view of the majority of the High Court, the "uneconomical" test required a consideration of whether it would be *unprofitable* for anyone, including the owner of the contested facility, to construct a competing facility. This was not to be considered from the perspective of an economist, but wholly from the perspective of an investor considering construction of the facility.

In reaching this conclusion the High Court rejected two alternative constructions, each based on an economics analysis of the term "uneconomical". The first rejected approach was the "net social benefit approach"; that is, whether, considering the reasonably foreseeable demand, it would be more efficient from the perspective of society as a whole for only one facility to provide the services. In looking at efficiencies, productive costs, "allocative efficiency" (that is, considering whether resources are allocated to their highest value use) and "dynamic efficiency" (that is, the need to respond to changes in consumer tastes and productive opportunities) would all be considered.

The second rejected approach is described as the "natural monopoly test", which would look at whether the existing facility is able to satisfy the reasonably foreseeable demand for the services at a total lower cost than would be the case if there were two or more facilities.

Not all commentators support the High Court's approach, but the "unprofitable" test is an

understandable interpretation. As pointed out in the majority decision, the wording in the section itself points to this construction. The High Court was also of the view that this interpretation is most consistent with the primary legislative intent of Part IIIA, which is to promote economic efficiency.

For example, although the adoption of the unprofitable test would mean that there would be certain circumstances where a declaration would not be made in relation to a natural monopoly, this was still an economically efficient outcome – as the potential alternative facility would still need to be demonstrated to be profitable. The High Court was also concerned that if the natural monopoly test was used, a facility that was not a natural monopoly could not be declared, even though there would be no profit incentive for any alternative facility to be developed, leading to economic inefficiencies.

Finally, the High Court was persuaded by the greater degree of certainty that the "unprofitable" test provides, commenting that essentially this is the test that entrepreneurs and financiers apply all the time in determining whether to make infrastructure investments – in contrast, the other two tests were very difficult to apply.

Whether "anyone", as referred to in this test, should include or exclude the incumbent owner seems to be an irrelevant question. The High Court, disagreeing with the conclusion of the Federal Court, determined that "anyone" should include the incumbent owner. This has been criticised on the basis that if only the incumbent owner could satisfy the test, a situation could arise where the incumbent would be able to profitably build a second facility but chooses not to do so. However, given that the test the High Court prescribed did not depend on the identity of the person considering the alternative facility, it seems more likely that the High Court was not suggesting that the specific characteristics of the incumbent could be taken into consideration, but simply that there is no need to specifically exclude a person in the position of the incumbent.

**"Public interest"**

Turning to the requirement that the access to the service would not be contrary to the public interest, although in early matters involving Part IIIA more social policy matters had been considered, prior to Pilbara this criteria had been seen to generally be limited to economic matters. But, based on Pilbara, any matter not extraneous to the scope and object of Part IIIA may be considered. No exhaustive list is possible. This is a discretionary value judgement primarily of the designated Minister (given the nature of this criteria, the NCC would be seen to be less focused on this). Effectively, anything relevant to determine the appropriate balance between promoting competition in related markets and not de-incentivising investment may be considered.

**Residual discretion?**

Finally, the High Court held that there is no residual discretion, if the criteria are satisfied, for either the NCC to refuse to recommend the declaration or for the designated Minister to determine not to declare a service. This though would not serve as a significant limitation of the rights of the relevant Minister. Given the broad range of matters that the designated Minister can consider in determining the public interest issue, if a determination is made that the declaration will not be contrary to the public interest, the circumstances in which the Minister would wish to exercise a residual discretion would presumably be rare.

## After the High Court decision

As a result of the High Court decision, the matter was sent back to the Australian Competition Tribunal. Unfortunately for Fortescue Metals, the decision of the Tribunal, handed down in February 2013, did not change the outcome. Access to the rail infrastructure was still denied. This outcome was reached approximately nine years after access to rail lines in the Pilbara was first sought. Fortescue Metals has determined not to appeal this decision.

In light of Pilbara, updated NCC Guidelines were released in February 2013. These Guidelines are not binding but do provide an indication of the likely approach of the NCC. Of most interest in the updated Guidelines are the amendments made to reflect the position of the High Court on the "uneconomical" test.

The Guidelines now, unsurprisingly, provide that this criteria will require an analysis similar to a business case for infrastructure development, including capital expenditure and operating costs, projected revenues (including by reference to likely usage given competition with the existing facility), required return on debt and equity and the like. Assumptions and forecasts will need to be disclosed so that the NCC may test these. The relevant time period for consideration will need to be at least the time period for which the declaration is sought but may in fact be longer, most likely referable to the useful life of the

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facility. As the owner of the existing facility is a potential developer of the new facility, in considering whether it would be profitable for that person to develop the new facility, consideration would be given to whether there is instead a prospect of providing additional capacity through an extension of the existing facility.

The High Court in Pilbara was very clear in its views on the relevant requirements of Part IIIA. To the extent that, politically, the High Court's views are not agreed, it will be necessary to amend the CCA. To this end, the Productivity Commission has been asked by the federal government to review the access regime. The 12-month review commenced in October 2012 and is due to report by October 2013. The key areas to be considered by the Productivity Commission include:

- an assessment of the performance of the national access regime in meeting its performance and objectives;
- whether the implementation of the regime is sufficient to ensure that its "economic efficiency" objectives are met.

Interested parties have made submissions to the Productivity Commission, with its draft report due in May 2013. It will be interesting to see what view is taken of the Pilbara approach. Whatever else the Commission comments on, it is hoped that sensible suggestions are made for streamlining the application process to ensure that decisions cannot be debated for the long period the Pilbara dispute continued. If nothing else, that long period of dispute is surely not economically efficient.

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