IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY

No. M156 of 2011

BETWEEN

THE PILBARA INFRASTRUCTURE PTY LTD (ACN 103 096 340) & ANOR

Appellants

and

AUSTRALIAN COMPETITION TRIBUNAL & ORS

Respondents

No. M157 of 2011

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Appellants

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APPELLANTS' SUBMISSIONS IN REPLY

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1 It is useful to restate the central points where the parties are together or apart.

Criterion (a)

2 As to criterion (a), there is no challenge to the Tribunal's finding that access to the relevant service, being the use of the facility of a railway line between A and B (currently the only line being Rio's), would promote a material increase in competition in a separate market, namely the market for the provision of rail haulage services from A to B in the vicinity of that line: see T 1132-1159, especially 1146. This is the promotion of effective competition in a downstream market spoken of in the objects provision s 44AA(a).

Criterion (b)

3 As to criterion (b), the approach of Fortescue (and the NCC) is that the decision maker enquires whether if anyone were to develop a second facility (here railway line) to provide that same service (here the use of the line) the resultant two facility world would be uneconomical. Put simply this involves whether the total foreseeable demand for the service could be met at a lower cost by the existing facility as opposed to if the second facility were developed. This is the promotion of economically efficient operation of, use of and investment in the infrastructure by which the service is provided within the objects provision s 44AA(a).

4 This also provides an answer about the structure of the market in which the service is provided, one expressed for convenience by the label "natural monopoly". It is "natural" as opposed to "artificial" to see a single firm meet all of the demand in such a market because of this relationship between demand for the service and the cost function. (By contrast, a patent would be an example of an "artificial" monopoly.)

5 Because it is "natural" in this sense, one might often see only a single firm in the market. If there is a single firm, this would give rise to the risk of the exercise of monopoly power, in the present case by denying access to the service (use of the railway line) to persons (such as Fortescue) who wish to compete with the incumbent in a downstream market (here the haulage market). Hence the need for regulatory intervention reflected in criterion (b).

6 However as Posner correctly points out, the fact that a market is characterised by a natural monopoly structure does not dictate the number of firms who may seek to enter, or ultimately survive in, the market. Nor does the number of firms from time to time in the market necessarily reflect what is efficient. Posner states:[1]

> *If the entire demand within a relevant market can be satisfied at lowest cost by one firm rather than by two or more, the market is a natural monopoly, whatever the actual number of firms in it. If such a market contains more than one firm, either the firms will quickly shake down to one through mergers or failures, or production will continue to consume more resources than necessary. In the first case competition is shortlived and in the second it produces inefficient results.*
>
> *Competition is thus not a viable regulatory mechanism under conditions of natural monopoly.*

[1] In a passage endorsed by the Tribunal in *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) 162 FLR 1 at [62].

7 The critical difference between the parties is that Rio/BHP urge that criterion (b) is not satisfied merely by a finding that the market exhibits a natural monopoly structure; in addition the decision maker must be satisfied that no firm could find it rational to seek to enter the market, even though the market exhibits natural monopoly features.

8 Rio/BHP are quite unspecific as to how their "private profitability" test is actually to be applied. It seems that the decision maker has to contemplate the business plan which any new entrant might devise, and come to a conclusion that, over the life of the investment, revenue could not exceed the capital costs plus operating costs plus a reasonable rate of return.

9 But how is the revenue of the new entrant to be predicted? In the present case, whether it would be "privately profitable" for a new entrant to develop a second railway line would depend on a whole series of factors as to what price it would offer for use of its line; whether Rio as the incumbent would choose (contrary to its behaviour to date) to offer access to its line in competition; how that competition would play out over time; accordingly, how much of the total market demand the new entrant could earn on a sustained basis; the ability of purchasers of the service to pay; and so on.

10 Fortescue contends that criterion (b) is about market structure, not about the characteristics or business plans (rational or otherwise) of a particular firm. The decision maker just does not engage in the exercise Rio/BHP contend is a prerequisite for declaration. The decision whether to develop a new and rival facility is always left to the market participant. All that occurs is that where there is a benefit to competition in a downstream or upstream market (criterion (a)), and where the relevant market structure exhibits the features described by Posner (and captured by criterion (b)) – features which have a tendency to impede competition in the market for the service to be declared – then, subject to satisfaction of the remaining criteria, the potential new entrant can make the decision on entry or not with an additional bargaining chip. That chip is the right to negotiate with the incumbent on reasonable terms of access to the existing facility.

11 A further question, in Rio/BHP's world, is what sort of "anyone" is to be contemplated? They ran a lengthy case before the Tribunal that the "anyone" included a particular firm, like Fortescue, that conducted a vertically integrated operation into further downstream markets – markets for iron ore tenements and indeed for the global sale of iron ore.[2] At the heart of the Rio/BHP case was not that it was "privately profitable" for a new entrant to build a parallel railway just for the sake of offering access to the railway to persons who wanted to offer an above rail haulage service, but that a person like Fortescue could afford to pay whatever it took to build a second, duplicative and wasteful railway because it was a vertically integrated operation making a lot of money selling iron ore to China.

12 If one were to ignore these further downstream markets, it was difficult on the evidence, and unsurprisingly so, to form conclusions on what might be "privately profitable": see T 960. It was only by factoring in the assumption of a vertically integrated operation supplying iron ore to what is currently a highly profitable

[2] See T[955]

market in China that a view could affirmatively be formed that it was "privately profitable" to build certain wasteful second lines, lines which in part but not whole duplicated the Rio lines: see T961-965.

13 To understand the impact, and ultimate statutory irrelevance, of the incumbents' approach, it may assist to take a simple (and obviously abbreviated) example. Assume that Fortescue has a quantity of iron ore which, if shipped, will earn it $3.1 billion in profits. Assume that it will cost Fortescue $3 billion to build its own railway line. Assume that it would cost $500 million for Rio's existing line to be modified to accommodate Fortescue's demand, and meet all of Rio's demand.

14 To say it is "privately profitable" for Fortescue to build this (wasteful) line is to depart from what criterion (b) speaks of; even if Fortescue as an integrated operator could build the railway line and make a profit, a person contemplating merely developing a facility (a railway line) to provide the service (use of the line) would be unlikely to find it economical to do so. It could not be confident that Fortescue would pay $3 billion in haulage fees rather than negotiating with Rio for the carriage of some or all of Fortescue's iron ore. That is an issue that will face any possible alternative supplier of infrastructure faced with competing with a natural monopoly. (Rio's submissions at [24] fail to grapple with the distinction between an integrated miner and a rail haulage operator in this regard).

15 Rio makes assertions that, where it would be feasible (profitable) to construct an alternative facility, a rational incumbent will provide access to the existing facility and generate revenues, such access resulting from the "interplay of market forces".[3] As the Tribunal observed in the present case, there has never been access granted by Rio: T 1139. There are likely to be good commercial reasons for this. Rio's analysis again ignores the significance of the crucial downstream markets. On the example given above, it may be entirely rational for Rio Tinto to decide that it was better to saddle a major competitor in iron ore markets (Fortescue) with a $3 billion cost, than to extract a lesser sum from Fortescue in the form of haulage fees. As was observed by the Tribunal at T[823]:

> *[T]here are often reasons for an incumbent owner who is behaving rationally to deny access to a potential competitor even when sharing would be socially optimal. Forcing the competitor to use a less profitable alternative facility may harm that competitor. The incumbent may seek to exploit the fact that it will take some time to build the alternative facility. It may be that it is only profitable to build an alternative facility with limited capacity (which is lower than the spare capacity on the existing facility which would otherwise be available). The incumbent may be mindful of not giving a fledgling competitor a "leg-up" to facilitate its growth into a larger player.*

16 Apart from the above, issue is clearly joined between the parties on the construction of the text, the assistance to be derived from Hilmer and other extrinsic materials, and the assistance if any to be gained from the United States authorities on a very different text and case law framework

[3] RS[26]

Criterion (f) and the residual discretion

17 The substance of the case put by Fortescue on criterion (f) has been largely ignored by Rio/BHP.

18 According to Fortescue, the role of criterion (f) is to consider whether there is an aspect of the public interest, not addressed under the previous criteria, which might be harmed by access, that is, any access.

19 One understands how in an appropriate case national security, or national sovereignty, might be harmed by any access. That is not the present case.

20 What the Tribunal did instead was to embark on a whole series of assumptions about how the world might look in two scenarios, declaration or non declaration.

21 Declaration was assumed to carry with it that the whole of the potential third party demand (Fortescue's demand to transport ore plus all junior miners) would seek access to Rio's line; that Rio's line would be expanded just enough to carry this third party demand plus its own (but not so as to avoid Rio ultimately getting less ore to market than would otherwise be the case); that all of this at stage two of the process would lead to demands for access, arbitrations etc that would be all very troublesome and time consuming; that on average this would mean Rio would be delayed in transporting its own ore; that this would cost Rio a lot in the downstream market of sale of iron ore to China; and that this downstream market is (currently) so profitable for Rio that a big loss to it as a corporate citizen is a big loss to the public interest of Australia.

22 Interestingly, the Tribunal accepted that these types of delays, if they occurred, would equally occur if the rival (wasteful) line were built: T1304.

23 Rio/BHP never really grapple with whether it was an error to assume that stage one of the process invited, let alone mandated, the Tribunal engaging in these type of assessments. Their recitation that Fortescue is attempting to prevent a consideration of "costs and benefits" does not respond to the argument.

24 If Rio/BHP's contention on criterion (f) is accepted, effectively a monopolist can avoid declaration of a service provided it is engaging in a downstream market where its revenues and profits are so large that any possibility of delaying them produces a very large dollar loss, even if that possibility might never eventuate.

25 The better view is that criterion (f) is not the occasion for this type of exercise at all. It is not about what might (or might not) come to pass if the whole of the market demand comes the way of the incumbent, and how stage two might play out. It is simply about whether there is some fact of access, any access, that might harm an aspect of the public interest not addressed under the earlier criteria.

26 It is wrong to imply, as Rio Tinto does at RS[64], that the complex and speculative analysis of costs and benefits of access undertaken by the Tribunal under criterion (f) and the discretion in the present case has previously been undertaken under the rubric of criterion (b). Rio Tinto has not cited any previous decision in which such an analysis has been undertaken. Whilst there are some references in

the early Tribunal decisions to "*social cost benefit sense*",[4] never before has there been a cost/benefit calculus of predicted outcomes of declaration under criterion (b) (or (f), or the discretion).

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[4] See, for example, *Re Sydney Airports Corporation Ltd* (2000) 156 FLR 10 at [204]-[206]; *Re Duke Eastern Gas Pipeline Pty Ltd* (2001) 162 FLR 1 at [58]-[64], [135]-[144].