

IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY
BETWEEN:

No M45 of 2011

The National Competition Council
Applicant
and
Hamersley Iron Pty Ltd
(ACN 004 448 276) & Others
Respondents

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IN THE HIGH COURT OF AUSTRALIA
MELBOURNE REGISTRY
BETWEEN:

No M46 of 2011

The National Competition Council
Applicant
and
Robe River Mining Co Pty Ltd
(ACN 008 694 246) & Others
Respondents

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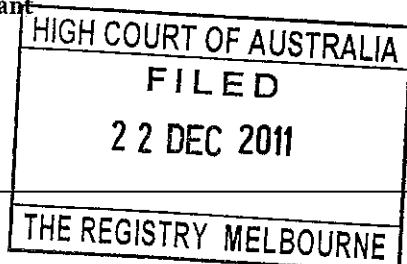
APPLICANT'S REPLY SUBMISSIONS

Filed on behalf of the Applicant

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PART I: CERTIFICATION

1. These submissions are in a form suitable for publication on the Internet.

PART II: ARGUMENT

Reply to Rio Tinto Submissions

The Hilmer Report and other extrinsic material

2. Rio Tinto submits that the Hilmer Report supports a private profitability interpretation of criterion (b). A proper reading of Chapter 11 of the Hilmer Report does not support Rio Tinto's contention: see the Council's Submissions dated 25 November 2011 at [26]-[31]. Indeed, it is plain that, when the Hilmer Report spoke of facilities that "*cannot be duplicated economically*", it was referring to facilities that exhibit natural monopoly characteristics.

Some economic activities exhibit natural monopoly characteristics, in the sense that they cannot be duplicated economically. While it is difficult to define precisely the term "natural monopoly", electricity transmission grids, telecommunications networks, rail tracks, major pipelines, ports and airports are often given as examples. Some facilities that exhibit these characteristics occupy strategic positions in an industry, and are thus "essential facilities" in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets. For example, competition in electricity generation and in the provision of rail services requires access to transmission grids and rail tracks respectively.¹ [emphasis added]

In some markets, the introduction of effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics, and hence cannot be duplicated economically. For example, effective competition in electricity generation and telecommunication services requires access to transmission grids and local telephone exchange networks respectively. Facilities of this kind are referred to as "essential facilities".² [emphasis added]

3. Further, when the Hilmer Report spoke of access to a facility being "*essential, rather than merely convenient*",³ it did so in reference to "*effective*" competition, not competition "*per se*".

3.1 The Tribunal found that to be significant: (2010) 271 ALR 256 at [827]-[828].

3.2 The reference to "*effective*" competition tends against a private profitability approach to criterion (b) – an approach that would prevent the possibility of access in circumstances where the facility could be duplicated profitably, irrespective of the impact duplication has on the ability of competitors to compete "*effectively*" in upstream or downstream markets.

¹ Hilmer Report at p 240.

² Hilmer Report at p 239.

³ Hilmer Report at p 251.

4. Rio Tinto also submits that a natural monopoly approach to criterion (b) is contrary to the competition policy contained in the Hilmer Report.⁴
- 4.1 That submission overstates the role that criterion (b) plays in the Part IIIA access regime: see the Council's Submissions dated 25 November 2011 at [41]-[47].
- 4.2 Criterion (b) is not the sole determinant of whether access is granted. It is merely part of the process by which the designated Minister determines whether the relevant service is an essential facility, access to which would promote a material increase in competition in a dependent market.
- 10 5. Nor is it necessary, as Rio Tinto submits,⁵ that the words "*from society's perspective*" be added to criterion (b) to reflect a natural monopoly approach. An uneconomical duplication of a facility of national significance will be wasteful "*for anyone*", including a competitor in the market.
6. As regards Rio Tinto's analogies with s 46 and s 50 of the Act,⁶ they are not of assistance. Part IIIA was introduced in order to overcome perceived difficulties and limitations in the application of s 46 to essential facilities.⁷ The mischief that Part IIIA sought to address was not individual instances of market failure but structural impediments to the promotion of "*effective*" competition in related markets: see the Council's Submissions dated 25 November 2011 at [26].
- 20 7. Contrary to Rio Tinto's submissions,⁸ the ordinary meaning of the word "*feasible*" does not "*connote ... a private endeavour by a commercial firm*". It is equally consistent with either a private profitability or natural monopoly approach to criterion (b).

The CPA

United States essential facilities doctrine

8. The United States "*essential facilities doctrine*" does not assist in the interpretation of criterion (b).
- 8.1 The Hilmer Report specifically reviewed the "*essential facilities doctrine*" and decided to recommend the adoption in Australia of a different and distinct legislative access regime.⁹ Indeed, the Hilmer Report noted that "*the limits of the US doctrine are not*

⁴ Rio Tinto Submissions dated 15 December 2011 at [13].

⁵ Rio Tinto Submissions dated 15 December 2011 at [13].

⁶ Rio Tinto Submissions dated 15 December 2011 at [14].

⁷ Hilmer Report at p 243. See also *NT Power Generation Pty Ltd v Power & Water Authority* (2004) 219 CLR 90 at [85] (McHugh A-CJ, Gummow, Callinan and Heydon JJ).

⁸ Rio Tinto Submissions dated 15 December 2011 at [18].

⁹ Hilmer Report at p 243-244. See also *BHP Billiton Iron Ore v The National Competition Council* (2007) 162 FCR 234 at [154]-[155].

*clear, and it has been observed that 'the doctrine has not developed with clarity, coherence or consistency, let alone with strong economic foundations'.*¹⁰

8.2 Nor is it correct to submit¹¹ that one of the principles of the essential facilities doctrine is a direct analogue of criterion (b): see *NT Power Generation Pty Ltd v Power & Water Authority* (2004) 219 CLR 90 at [121].

A private feasibility construction and economic principles

9. Rio Tinto submits that the private profitability approach to criterion (b) results in an economically efficient use of resources because, where privately profitable entry is possible, the “interplay of market forces performs a social cost/benefit analysis on the construction of the alternative facilities.”¹² There are a number of problems with that approach, many of which were identified by the Tribunal: (2010) 271 ALR 256 at [823]-[824].¹³

9.1 A facility owner may not want to share access to its facility even if it is financially rational to do so.

9.2 The service provider may be motivated to refuse access in order to maintain a competitive advantage in the dependent market.

9.3 Alternatively it may simply not be interested in pursuing the profits offered by access.

10. Rio Tinto contends that all that is needed for criterion (b) not to be satisfied is to demonstrate that “if an alternative facility were to be developed by anyone, it [would] be able to earn revenue that exceeds the capital and operating costs of the development, including an economic rate of return on the capital deployed”.¹⁴ Rio Tinto submits that the idiosyncrasies of any particular firm are irrelevant.¹⁵

10.1 That is not the test propounded by the Full Court. The Full Court’s approach required the identification of a person, “whoever they might be, and whatever that person’s circumstances”, “for whom the development of an alternative facility is economically feasible”: (2011) 193 FCR 57 at [86].

10.2 However, what if the only person for whom it is profitable to develop a duplicate facility has no interest in doing so? What if the only persons who have an interest in using the

¹⁰ Hilmer Report at p 244.

¹¹ Rio Tinto Submissions dated 15 December 2011 at [21].

¹² Rio Tinto Submissions dated 15 December 2011 at [26].

¹³ See [22] and [34] of the Affidavit of Aleksandr Sundakov affirmed 7 August 2009 (**Sundakov Affidavit**).

¹⁴ Rio Tinto Submissions dated 15 December 2011 at [23] and [25]. See also the BHPB Submissions dated 15 December 2011 at [23].

¹⁵ Rio Tinto Submissions dated 15 December 2011 at [23].

relevant services do not have the capital available to them to do so profitably? The result will be no access and no duplicate facility.

10.3 Accordingly, it is not safe to assume that, if it is privately profitable to duplicate a facility, then duplication will occur unless it is economically inefficient to do so, in which case access will occur. The result may well be that neither occurs.

10 11. Where duplication is privately profitable yet economically wasteful, the private profitability test relies on the market to get it right and prevents the designated Minister considering declaration. That is so even though the facility is of national significance and exhibits natural monopoly characteristics and that access to the facility would promote a material increase in competition in a related market.

11.1 Those are the very circumstances in which the Hilmer Report envisaged the Minister should consider declaration so as to “guard against potential abuses” where owners of monopoly facilities “also compete in markets that are dependent on access to the facility”.¹⁶

11.2 It must be remembered that declaration does not result in access, but rather an enforceable right to negotiate. In markets where owners of monopoly facilities also compete in markets that are dependent on access to the facility, such a right may be necessary to ensure the efficient operation of the primary market so as to ensure effective competition in the dependent market.

20 12. Further, Rio Tinto’s submission, that a natural monopoly approach to criterion (b) would result in important aspects of economic efficiency being ignored, is not correct.¹⁷

12.1 Any allocative and dynamic efficiency costs relating to the provision of the relevant service (as opposed to those arising due to the incumbent’s operations in other markets) can be incorporated within a natural monopoly analysis provided the evidence is properly prepared.

30 12.2 Any other such costs can be taken into account under criterion (f) or the residual discretion (as was done by the Tribunal). As the Full Court stated in *Sydney Airport Corporation Ltd v Australian Competition Tribunal* (2006) 232 ALR 454 at [39], “[t]he construction and interpretation of ... s 44H(4) should not be approached on the basis that it is necessary to find a place for all possible competing arguments ... within the list of necessary pre-conditions of satisfaction in s 44H(4).”

¹⁶ Hilmer Report at p 239.

¹⁷ Rio Tinto Submissions dated 15 December 2011 at [28].

12.3 The private profitability test takes no specific account of economic efficiency at all. It will be satisfied whenever profits are sufficiently large not to be eroded by inefficient investments.

Other considerations

13. Rio Tinto submits that, unlike criteria (a) and (f), criterion (b) does not invite a comparison between access and no access.¹⁸ It does, however, invite a comparison between duplication and no duplication. That is the issue to which the natural monopoly enquiry is directed.
14. Rio Tinto submits that the private profitability approach to criterion (b) "*permits a clean analytical division between the key criteria for declaration*".¹⁹ However, the private profitability test advocated by Rio Tinto, which focuses on "*bottlenecks*",²⁰ is really only a test of whether or not access is necessary in order for third parties to enter the dependent markets. Expressed in that way, it reveals substantial overlap with the requirements of criterion (a).
- 14.1 However, the overlap is not absolute, as the private profitability test does not pay any regard to the efficiency of the duplication, and therefore the effectiveness of the competition that may result in a dependent market. That is a matter clearly relevant to criterion (a).
- 14.2 Accordingly, the private profitability test not only tends to compress the entire essential facility analysis into criterion (b), it does so in a manner that does not give full effect to the evident purpose of criterion (a).
- 20 15. Rio Tinto submits that the theory of natural monopoly applies only to firms and not facilities.²¹ That is not so. The theory of natural monopoly can be applied equally to production facilities.²²

Reply to BHPB Submissions

16. The submissions of BHPB largely echo those of Rio Tinto and the Council does not reply separately to them.



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¹⁸ Rio Tinto Submissions dated 15 December 2011 at [35(a)]. See also the BHPB Submissions dated 15 December 2011 at [28] and [35].

¹⁹ Rio Tinto Submissions dated 15 December 2011 at [35(c)].

²⁰ Rio Tinto Submissions dated 15 December 2011 at [35(d)].

²¹ Rio Tinto Submissions dated 15 December 2011 at [10(f)].

²² Sundakov Affidavit at [92]-[94]