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What can we expect from the ALP Government?

After more than 10 years in the political wilderness, the ALP has regained the reins of power in Canberra. What can we expect from the ALP Government in the field of competition policy and regulation during its first term in office?

During the election campaign¹, Mr Kevin Rudd, the then Opposition Leader, promised to amend the *Trade Practices Act* to introduce the following reforms:

- to empower the Australian Competition and Consumer Commission (ACCC) to prevent creeping acquisitions
- to introduce criminal penalties for serious cases of cartel conduct
- to strengthen section 46 of the *Trade Practices Act* to combat predatory pricing and to widen the meaning of “take advantage” of market power
- to require that the Deputy Chair of the ACCC has a small business background
- to activate the jurisdiction of the Federal Magistrates Court to hear and determine restrictive trade practices cases.

Since the election, Mr Chris Bowen, the newly appointed Minister for Competition Policy and Consumer Affairs, has confirmed that the introduction of criminal cartel laws would be a priority, foreshadowing that the Rudd Government would be likely to drop dishonesty as an element of the criminal cartel offence.

Mr Bowen has also indicated that the newly elected Government will move to amend section 46 of the *Trade Practices Act* to override the impact of two recent High Court decisions: the Boral case and the Rural Press case:

- to clarify that a company may misuse its market power even if it does not recoup losses from below-cost pricing after driving out its competitors
- to broaden the meaning of “take advantage” of market power, thereby facilitating future prosecutions.

The precise impact of these foreshadowed amendments will not be known until the text of the legislation incorporating the proposed amendments is tabled in Parliament.

1] Radio interview of Mr Kevin Rudd on Radio 5AA (Adelaide) on 9 November 2007



The High Court rules on gas pipelines regulation

The High Court has rejected the ACCC's approach to asset valuation under the Gas Code as "idiosyncratic", preferring to adopt a straight forward interpretation of the Gas Code according to its terms, in order to promote greater certainty and predictability for investment in essential infrastructure.

East Australian Pipeline Pty Ltd (EAPL) has succeeded in its appeal to the High Court of Australia. On 27 September 2007, the High Court unanimously ordered that the orders of the Full Court be set aside, effectively reinstating the determination of the Australian Competition Tribunal.

Background

The case involved a dispute between EAPL and the ACCC over the regulatory value or "initial capital base" (ICB) of one of EAPL's gas transmission pipelines, the Moomba to Sydney Pipeline (MSP), a major pipeline linking the Cooper and Eromanga gas fields in north eastern South Australia with the Sydney metropolitan area. The MSP was commissioned in 1976 and was acquired by EAPL in 1994.

Under the provisions of the National Third Party Access Code for Natural Gas Pipeline Systems (Code) the calculation of regulated tariffs payable by third parties for transport on a regulated pipeline is based on the ICB of the pipeline. The Code confers on the relevant regulator, in this case the ACCC, the role of approving access arrangements, including the ICB, and specifies an elaborate procedure and detailed principles for this purpose.

The ACCC had set an ICB of \$545.4 million. When EAPL applied to the Tribunal for review of the ACCC's decision, the Tribunal set aside that decision and substituted an ICB of \$834.66 million.

The ACCC took the unprecedented step of applying to the Federal Court for judicial review of the Tribunal's decision. The ACCC argued that the Tribunal had exceeded its jurisdiction and had misconstrued the Code. The Full Court of the Federal Court upheld the appeal and restored the ACCC's decision. EAPL applied for, and was granted, special leave to appeal to the High Court.

Issues

There were two main issues before the High Court: the correct interpretation of the Code, particularly section 8.10, and the scope of the Tribunal's jurisdiction to review decisions of the ACCC under section 39 of the Gas Pipeline Access Law.

Section 8.10 of the Code

The key provision of the Code, section 8.10, lists a series of factors the relevant regulator must consider in establishing the ICB for an existing pipeline. Paragraphs (a), (b) and (c) of section 8.10 require consideration of the values that would result from applying well recognised asset valuation methodologies including, among others, the "depreciated optimised replacement costs" methodology (DORC). Paragraph (d) requires consideration of the advantages and disadvantages of each of the valuation methodologies applied under paragraphs (a), (b) and (c). Paragraphs (e) to (k) require consideration of further factors including, in paragraph (f), "the basis on which tariffs have been (or appear to have been) set in the past, the economic depreciation of the Covered Pipeline and the historical returns to the Service Provider". Paragraph (k) requires consideration of "any other factors the relevant regulator considers relevant".

Some of the factors in section 8.10 are, as the High Court noted, "forward looking". For example, the DORC valuation methodology involves considering the possibility of building a replacement pipeline according to the latest technology. The cost of building this hypothetical new pipeline is referred to as the "optimised replacement cost" (ORC). The DORC value is determined by depreciating the ORC to what might be called a second hand value to reflect the fact that the optimised replacement pipeline will last longer than the existing pipeline. Other factors in section 8.10 are "backward looking" such as the calculation of the depreciated actual cost (DAC), which involves applying the historical depreciation charged by the owner to the actual construction cost, or consideration of economic depreciation and historical returns.

The way the ACCC set the ICB

The ACCC had calculated the DORC value and the other values referred to in paragraphs (a), (b) and (c) of section 8.10 but, for various reasons, had rejected them as suitable values. Instead, the ACCC used what the ACCC conceded in the High Court to be an "idiosyncratic" approach by taking the ORC value and, as the Full Court said, "tweaking" or adjusting it by reference to the factors set out in (f).

Tribunal's decision

The Tribunal had held that, under a correct interpretation of section 8.10, it was impermissible to use ORC, a forward looking concept used only as part of the calculation of DORC under paragraph (b), and adjust it in a novel way by reference to backward looking factors such as those in (f). It concluded that such an idiosyncratic or novel valuation method does not comply with the section.

The Full Court disagreed, holding that the Tribunal had misconstrued the Code.

High Court's decision

The High Court agreed with the Tribunal. Although section 8.10 allows the regulator a wide discretion, the High Court made it clear that it is, nevertheless, limited.

The High Court construed the section according to the natural meaning of the words used and the section's logical structure, taking into account the context of the Code and its expressed objectives. The Court held that a proper construction of section 8.10 requires consideration of the factors set out in the section in a sequential process. Firstly the values derived from the methodologies referred to in paragraphs (a), (b) and (c) should be considered and then, by virtue of paragraph (d), the merits and disadvantages of each methodology should be considered. The balance of the factors could then assist in the choice between the methods or lead to some adjustment of the results of the chosen method.

The Court found that there was nothing in section 8.10 that would allow a person to "jettison or ignore" the valuation methodologies in subsections 8.10 (a) to (d) or "to give them cursory consideration only in order to put them to one side".

Conclusions

The High Court's decision is significant in that it decided authoritatively the correct way of interpreting and applying section 8.10 of the Code and any equivalent provision in the revised Code currently under consideration. Although section 8.10 will be applicable to only a limited number of existing pipelines, as most have already had an ICB set, it will, no doubt, influence the interpretation and application of other provisions in the energy sector where a regulator has a discretion in applying a series of considerations in an ordered fashion prescribed by legislation.



BHP derailed by third party access decision

The Full Federal Court's dismissal of BHP's appeal has set the scene for a final battle before the High Court to prevent Andrew Forrest's Fortescue Metals Group Limited (FMG) from gaining access to BHP's multi-billion dollar Pilbara iron ore rail network.

Introduction

On 5 October 2007, the appeal to the Full Federal Court by BHP Billiton Iron Ore (BHP) was dismissed with costs.

BHP has applied for special leave to appeal to the High Court. Pending the outcome of BHP's special leave application, we examine the Full Federal Court's decision and its implications.

BHP

BHP carries on the business of mining, blending and processing of various types of iron ore in the Pilbara region of WA on behalf of various unincorporated joint ventures for the purpose of producing bulk iron ore products for sale.

From a commercial perspective, BHP claims that its iron ore revenues will be endangered if it is forced to give third parties access to its rail network because it will increase costs, cause delays and discourage investment.

Fortescue

As the result of a joint venture between FMG and Consolidated Minerals, FMG seeks access to the rail link from Pilbara to Port Hedland and the "associated infrastructure" including track structures, bridges, track control systems, maintenance/protection systems, the roads and other facilities which provide access to the railway line route.

Access to this service is needed for FMG's small Mindy Mindy prospect which hopes to produce 5 million tonnes of iron ore annually. That compares with the 290 millions of iron ore that is expected to be exported nationally in 2007-08.

FMG's commercial position is that access to the railways will encourage new production by increasing the financial viability of the isolated iron ore deposits in the Pilbara which are otherwise too small to justify the construction of a railway.

Part IIIA of the *Trade Practices Act* (TPA)

Part IIIA of the TPA establishes a regime to facilitate third party access to the services of certain essential facilities.

FMG applied to the National Competition Council under section 44F(1)

of the TPA for a declaration enabling the use of the facility (the railway line) and access to the facility's associated infrastructure (including railway track, bridges, train control systems, roads, maintenance and protection systems etc.)

Issues under the TPA

Section 44B recognises that the term "service" means a service provided by means of a facility and includes the use of an infrastructure facility such as a road or railway line.

Notwithstanding the inclusion of the use of a railway line as a service, section 44B(f) provides that "use" will be excluded if the use is "the use of a production process" (section 44B(f)) (the production process exception).

The term "production process" is not defined in Part IIIA or otherwise defined in the TPA.

The issue before the Full Federal Court therefore, was the proper construction of the terms "service" and "production process" as found in section 44B of the TPA.

The Decision of the Trial Judge

On 18 December 2006, Mr Justice Middleton at first instance, delivered the landmark decision, *BHP Billiton Iron Ore Pty Ltd v The National Competition Council* [2006] FCA 1764.

Justice Middleton found that BHP's railway line was not part of its production process and so not exempt from third-party access laws. In so finding, Justice Middleton overturned the 1999 decision of Justice Kenny in *Hamersley Iron Pty Ltd v NCC* [1999] 164 ALR 203. The result of the decision in Hamersley was to protect Rio Tinto's railways by determining that they were part of its production process. Justice Middleton held that Justice Kenny had incorrectly applied the production process exception in Hamersley.

The Decision of the Full Federal Court

On appeal, the Full Federal Court has upheld Justice Middleton's decision.

The majority Justices, comprising Justices Sundberg and Greenwood, held that FMG should be allowed to pursue access to BHP's Pilbara railway because the line is not part of BHP's production process.

Justice Greenwood stated that the production process exception requires the trial judge to analyse the sequence of operations (integrated or otherwise) to determine the content of the production process in a particular case. In this case, Justice Middleton concluded on the facts that the use of rail track infrastructure and the provision of haulage services to each unincorporated mining joint venture is an essential step. Having identified the production process and determined its scope and content, the question is then whether the service sought to be used by the third party is the use of that production process.

The following passage of Justice Greenwood's decision is instructive because it explains that:

"Prima facie, if a production process is found on the facts to comprise integers A, B, C, D, E, and F and the service sought by the third party is the use of integers B and C, the service sought by the third party is not the use of a production process as found."

Justice Greenwood reasoned that it is unlikely as a matter of construction that the Parliament intended that the notion "part of a production process" was to be brought within the concept of the "use of a production process". Parliament's election not to introduce the express words "part of a production process" indicates that the production process exclusion is to operate only in circumstances where the service sought by the third party is the use of the integrated sequence of operations comprising the production process as found on the facts and not any one of those steps.

Ultimately, Justice Greenwood found the relevant test to be,

"does the service sought by FMG use the production process" (at para 179)?

In this case, Justice Greenwood found that the production process involved:

- a set of operations spread over a very significant distance; and
- FMG seeking to use a 295km section of a 426km Mt Newman Railway Line and a 17km section of a 210km Goldsworthy Railway Line and related track services.

Ultimately Justice Greenwood held that FMG's proposed use is not of the kind or character (having regard to the production process in question) that use of that part on the facts, is use of the production process.

The majority decision therefore leans toward adopting a case by case assessment.

Dissenting judgment

The sole dissenting judgment delivered by Justice Ray Finkelstein calls for the matter to be reheard.

Justice Finkelstein said that the definition of what constitutes a "production process" is "imprecise" and "slippery" and that given BHP's assertion that the railway is part of an integrated production process, more analysis is needed.

Justice Finkelstein's decision is of some import, as it may provide the impetus and basis for BHP to construct an appeal to the High Court. Indeed, BHP has indicated that it will use all available legal avenues to protect its \$US2 billion railway investment.

Conclusion

Ultimately, if the majority decision of the Full Federal Court is upheld, and third party access granted to FMG, this will most likely result in a series of complex and hard fought negotiations between BHP and FMG, followed by possible arbitration of key terms and conditions of access.

As we wait to see whether special leave to appeal to the High Court will be granted, it is fair to say that regardless of whether the majority judgment of the Full Federal Court is disturbed or derailed, Part IIIA jurisprudence would benefit from the High Court's deliberations on the matter.

