CONNEX
Contract Negotiation Support

CLAUSE INSIGHTS

Third party access in infrastructure:

rethinking excess capacity clauses in concession agreements

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THE CONTEXT

Infrastructure is very capital-intensive and typically requires a certain minimum scale to effectively function. For example, it is not possible to build a functional railway with less than a full track. This minimum scale inevitably creates a baseline capacity that may exceed the immediate or long-term needs of the primary user. Typical examples of such infrastructure include railways, ports, desalination facilities, power and electricity transmission systems. This issue is becoming increasingly important with the myriad of corridor projects currently under development around the world.

In concession agreements – particularly those related to mining, energy generation, or green hydrogen production – infrastructure may not be the primary subject of the concession but can be absolutely critical to the operation's viability. In such cases, the operation of infrastructure is frequently outsourced to specialist service providers, while the infrastructure itself may remain publicly owned. A potential scenario includes the following:

Investor A developing Mine A builds railway A to export its minerals. The investor will be essentially building the railway and gaining complete access to it, with the government likely retaining ownership. What happens when Investor B comes along, discovers minerals in the region and would like access to railway A? Unless the reserves are enormous, it would hardly justify a second railway line. So, the key question is: what are the conditions in which Investor A (and the government) allow Investor B (or any other investor) access to the railway?

Well, it depends on how the agreement between Investor A and government was negotiated. Indeed, was access by another investor to the railway even discussed, really discussed, when Investor A negotiated with the government? Another investor aside, what has the government negotiated with regards to the transport of goods and people? Or has it? As this railway likely involves more than EUR 1 billion in capital investment, a great deal is at stake.

These agreements should include provisions that allow third parties to access spare or excess capacity in such infrastructure. These clauses are particularly relevant where the private operator (the "incumbent") is granted use rights, rather than ownership, over public infrastructure. Typically, such provisions aim to ensure that third-party access is permitted (Investor B), provided it does not adversely impact the operations of the current user (Investor A) and does not require the current user to incur additional costs.

THE CHALLENGE

While the rationale behind excess capacity clauses is sound, their practical implementation presents several difficulties:

1. Ambiguity in Measuring Excess Capacity

Determining excess capacity objectively is complex. It involves calculating total capacity minus current and anticipated usage, both of which can fluctuate substantially due to fluctuating market conditions. Additionally, capacity itself is not fixed – it is influenced by how the infrastructure is operated. For instance, railway capacity depends on train speed, frequency, and configuration. Incumbents may therefore be reluctant to agree to assessments that are based on assumptions outside their control or that would impose additional costs on its operations or require changes to its historical operating systems. An example of this would be running longer trains, requiring investments in rolling stock and changes to loading and unloading facilities and operational procedures.

2. Operational Impact of Shared Use

Introducing third-party users often reduces operational flexibility. This flexibility is typically factored into the incumbent's planning and day-to-day operations. This hidden 'use' of the infrastructure may seriously reduce the excess capacity available. This loss of flexibility can be considered a legitimate and acceptable adverse impact where the incumbent is expected to operate in a manner that reasonably maximizes the efficient use of the government's infrastructure.

3. Interruption Due to Expansion

When infrastructure capacity needs to be expanded to accommodate third parties, current operations may be disrupted by the expansion works. Even when initiated by third parties, such expansion works can interfere with the incumbent's efficiency and reliability of infrastructure use. This is likely a short-term issue, which can be compensated, and should be negotiated at the outset.

4. Cost Allocation Challenges

New users may gain access to infrastructure without bearing the initial capital (sunk) costs. While marginal costs of use may be low, this creates equity concerns if newcomers benefit disproportionately without contributing to past investments.

RECOMMENDATIONS: STRUCTURING EFFECTIVE CLAUSES

To address these challenges and ensure that excess capacity provisions are both enforceable and equitable, the following measures are recommended:

1. Shared Policy Objectives

The contract should clearly state that optimizing and sharing infrastructure use is a joint objective of the government and the incumbent user to avoid discussion about legitimate adverse impact (point two above).

2. Retention of Expansion Rights

Governments should reserve the right to expand infrastructure capacity as needed, affirming the limits of private use rights where infrastructure remains publicly owned.

3. Unilateral Access Rights

Governments should retain the authority to grant third-party access without requiring incumbent consent, subject to independent assessments ensuring no long-term unreasonable adverse impact, that is not properly compensated. There should be express latitude to determine what is "reasonable interference" or existing infrastructure use in the context of a multi-user system, particularly, as an expansion or rehabilitation project will often temporarily impact the existing available capacity of infrastructure.

4. Multi-User Models

Where substantial excess capacity exists, which is almost always the case when infrastructure has been built for a single user, a multi-user model with independent infrastructure management should be considered. This enables fair and efficient use among various stakeholders. Multi-use in this context does not only capture use by different, often competing companies, for transport infrastructure like rail and port, it also includes the use across different categories of goods and even passenger traffic on infrastructure. This allows the development of multi-use corridors that can have a major regional development impact.

5. Transparent Capacity Assessment

A clear methodology for calculating infrastructure capacity and usage should be defined in the agreement and applied by an independent party, ideally incorporating dynamic operational models, that do not give undue weight to existing operational inefficiencies of an incumbent user.

6. Equitable Cost Sharing

Expanding existing infrastructure may be relatively cheap compared to the capital outlays on initially building the infrastructure. Cost-sharing mechanisms should be put in place to compensate incumbents for sunk cost (like historic capex – Investor A above) and lost flexibility, ensuring a fair balance of benefits and burdens.

7. Refined Definition of Adverse Impact

The concept of "no adverse impact" should be limited to unreasonable interference, as assessed by a neutral third-party and aligned with the broader objective of optimizing infrastructure use. Again, if infrastructure use if optimized and leads to larger capacity for all, then all investors should welcome this, despite short-term downtime.

8. Separate Dispute Resolution

A dispute about the (third-party) use of infrastructure should ideally be resolved outside of the dispute resolution mechanisms of the broader concession agreement. Agreeing this upfront clarifies the position of the government vis-à-vis the multi-use of infrastructure, uncoupling the infrastructure rights and obligations from other economic rights given to an investor. Given what is at stake for company returns and government revenues, a culture and practice of dialogue is a key factor for resolution.

9. Define the Process of Third-Party Access

Parties should beyond writing down the principles of multi-use and put effort in detailing the process of third-party access or expansion of infrastructure. This provides upfront clarity on who or which agency(ies) is/are to decide, how safeguards for existing users are applied and whether or not compensation is to be paid.

TURNING CLAUSES INTO CATALYSTS

Access to infrastructure embedded within broader concessions can play a vital role in unlocking economic value beyond a single project or operator. However, to be effective, third-party access clauses must be extremely carefully crafted. They require clear definitions, independent assessments, and balanced cost-sharing arrangements to ensure that public infrastructure serves wider development goals without compromising the rights and operational integrity of the incumbent. With well-designed provisions, governments can leverage infrastructure more strategically, thus promoting inclusive growth, efficiency and fair competition.

The above article represents the views of the author himself and does not in any way reflect views of the CONNEX Support Unit, its Governing Board, its Advisory Committee or its Secretariat.

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