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17 January 2006

ATTENTION: Mr. John Feil

BY EMAIL:
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National Competition Council

Level 9 / 128 Exhibition Street
Melbourne VIC 3000

Dear Mr. Feil

FURTHER SUBMISSIONS MADE BY BHP BILLITON DATED 30 DECEMBER 2005 AND 6 JANUARY 2006.

Fortescue Metals Group ("Fortescue") was acting on the understanding given to us that BHP Billiton would be required to submit its submissions in response to the Council's Draft Recommendation by 5 December 2005, identical (fairly) to all other interested parties. Fortescue further understood that an extension, until 6 January 2006, was granted to BHP Billiton solely in respect to its desire to supply further information related to the modelling of capacity for the railway. It was further our understanding that you would not be posting submissions on the web until a later date and therefore we took your assurances that we would suffer no disadvantage from submitting all our information by the deadline of 5 December.

We are therefore surprised and disappointed that the NCC has accepted two further submissions from BHP Billiton which contains arguments quite unrelated to the issue of the capacity of the railway. Indeed the submissions made by BHP Billiton dated 30 December 2005 contains no information based on new modelling and seeks to counter claims made by Fortescue in its submissions. We therefore request that this brief response is considered in your deliberations and that its contents are published on the NCC website so that the record can publicly be set straight.

<u>Junior Explorers</u>

In its submission dated 30 December 2005, BHP Billiton submitted what it claimed to be an independent report showing that declaration was unlikely to promote competition in the trading of iron ore tenements in the Pilbara. The submission was made by Christopher Clegg – principal of Statewide Tenement & Advisory Services Pty Ltd. Since his company undertakes tenement management service for BHP Billiton, Fortescue respectfully suggests that the degree of independence is questionable. The basis of his assertion that competition is unlikely to be increased rests on "port infrastructure, shipping, marketability, product quality and mineral reserve" which he claims are more important than rail access. Again with respect Christopher Clegg is not an expert in the logistic considerations he alludes to and clearly isn't aware of Fortescue's obligations contained within the *Railway and port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004* to ensure that its port is an open access port available for the use of third parties. His concerns about product quality and mineral reserve seem to entirely miss the point, namely that deposits of suitable quality are not being looked for because of lack of access to suitable infrastructure. Therefore his comments hardly count as evidence that a market would not develop.

BHP Billiton also sought to argue both that it was unlikely that any "juniors" existed close enough to the Mt Newman railway line to be able to exploit the declaration (despite the fact that its own submission helpfully identified 24 such entities) and that there were juniors exploiting tenements without needing access to the Mt Newman railway line. This latter category consisted of:

- Flinders – a JV with Fortescue
- Poondano – which clearly requires access to the Mt Newman line if it is to be developed (albeit that this might not happen for 11 years)
- A variety of others – all of which are tenements where holdings have recently changed and in which interest has been sparked by, amongst other things, the prospect that the declaration will succeed and the value of the tenements will increase accordingly.

Nothing that BHP Billiton submitted in relation to "juniors" was based on new modelling work and if anything its submission identified how the prospect that the declaration would succeed has already energised the speculative end of the market.

<u>Costs and Diseconomies</u>

In its submission dated 30 December 2005, BHP Billiton submitted four affidavits that merely reasserted previous claims. The essence of the contained arguments was that additional trains would cause delays and therefore increase the cycle times experienced by BHPBIO's trains. Leaving aside the unsubstantiated claims that Fortescue's trains would be slower and more unreliable, we do not dispute that additional "meets" have the potential to increase BHPBIO's cycle times. However it would be possible to undertake the remedial investment required to offset the delay caused by additional trains and leave the existing operator no worse off. BHPBIO's subsequent modelling submissions clearly demonstrate this – the only problem being that the modelling was based on overlaying a requirement for 3 train pathways per day from Mindy Mindy on top of BHPBIO's system in 2009 after the RGP3 Project had been completed.

The deficiency with the modelling was that, as Fortescue has repeatedly made clear, its requirements to service Mindy Mindy can be met with one return train pathway per day. Since the remedial investment required to offset 3 extra train pathways per day was considerably less than the cost of duplicating the facility – it follows that accommodating merely one return pathway per day could not exceed the cost of duplicating the facility and therefore the declaration should be made.

BHP Billiton also claimed that it would lose the required flexibility to deal with demand spikes. Again Fortescue does not dispute that when BHP Billiton has an urgent need to "sprint" a commodity from a particular mine site to the port the presence of a third party seeking access and demanding a fixed schedule would adversely impact its flexibility. However, we have made clear that we are not demanding a fixed schedule; we are prepared to work with BHP Billiton to develop access arrangements that have the minimum disruptive effect and that are sufficiently flexible to allow BHP Billiton to undertake sprint activity when required.

Protected Contractual Rights

In its submission dated 30 December 2005, BHP Billiton argued extensively that it had protected contractual rights and that declaration should not be recommended because those rights would enable it to deny access to third parties and therefore there could not be any increase in competition following a recommendation to declare the service. Fortescue has already dealt with this argument in its prior submissions and does not intend to merely repeat those arguments again. However we would like to strongly protest at the abuse of process in the submission of arguments that have absolutely no relationship with capacity issues whatsoever.

Relevance of the Rail Transport Agreement

In its submission dated 30 December 2005, BHPBIO sought to argue that the Rail Transport Agreement ("RTA") that it signed in 1978 acted to constrain its market power and therefore it was not in a position to exercise its market power to the detriment of competition. Once again Fortescue does not wish to burden the NCC by repeating refutations of this particular argument other than to point out that once again this is an argument unrelated to capacity issues on the railway or any modelling associated with the issue. However the fundamental inconsistency of BHPBIO arguing on the one hand that the RTA constrained its market power despite knowing on the other hand that it effectively used that RTA to deny access to Hope Downs should not pass unremarked.

Rail Capacity

In its submission dated 6 January 2006, BHPBIO submitted a report prepared by Evans & Peck ("E&P") which sought to explain why E&P has submitted a report to the Western Australian Government in which it had estimated that the capacity of a fully dual tracked system was around 400Mtpa and it now estimated that the capacity of BHPBIO's system was limited to between 234Mtpa and 247Mtpa if one assumed that there were no capacity constraints imposed by the capacity of the channel at Port Hedland.

However, whilst this report may have made for sanguine reading about the constraints that BHPBIO's "end effects" imposed on the capacity of their overall system this was hardly of relevance to analysing the capacity impact of a third party seeking access only to the "trunk" line and not seeking access either to port facilities or to any bulk material handling equipment. Ignoring the "end effects", which is the correct way to determine the capacity of the Service which Fortescue is seeking access to, would increase E&P's estimate of capacity back to 323Mtpa.

E&P's estimate of the capacity of a dual tracked railway was initially based on an assumption that each train would carry on average 30,464 tonnes per trip. E&P's latest estimate is based on an assumption that each train would on average carry only 23,781 tonnes per trip. The rationale for the change was that 23,781 tonnes was E&P's estimate of the average amount carried per train over the period 2004/5 and that this was not significantly different from BHPBIO's estimate of the same. However, the average amount moved per train on the BHPBIO system has been limited by, amongst other things, its inability to run trains comprising of three rakes simultaneously in opposite directions. However, this constraint would not exist in a fully dual tracked system in which there were no "meets" and therefore no need of passing sidings. A system using trains entirely comprising of three rakes would be capable of transporting around 37,000 tonnes per trip. However rather than using this theoretical figure Fortescue believes it would be appropriate to use the average figure per train that BHP Billiton expects to be able to achieve after its RGP3 Project has been implemented. That figure is 33,000 tonnes per trip as evidenced by TSG's submission to the NCC on behalf of BHPBIO [see Document 3 of Modelling Submissions – para 4.6(a)]. Using a figure of 33,000 tonnes per trip as opposed to 23,781 tonnes would increase E&P's estimate of the capacity of the trunk line from 323Mtpa up to well over 400Mtpa. Using the theoretical figure of 37,000 tonnes per trip would increase the capacity yet further.

If the railway was dual tracked and BHPBIO's capacity was adversely impacted by other users utilising train pathways, it is clear that running trains comprising three rakes (something that BHP Billiton is an acknowledged world leader at) can largely ameliorate the impact – a situation no different to using large aircraft to service an airport with limited landing slots. The capacity can be increased by ensuring that each train pathway (or slot for airports) carries a greater amount of freight (or passengers).

In summary, the capacity of the Service which Fortescue sought to declare will easily exceed 400Mtpa once the rail track from Port Hedland to the Yandi junction has been dual tracked and the new modelling undertaken by E&P is not relevant to the issue as it contains wholly inappropriate restrictions or assumptions.

Port Capacity

In its submission dated 6 January2006, BHPBIO submitted a letter from Rodney Hoare, General Manager of TSG Consulting, in which it was asserted that the capacity of the port of Port Hedland was between 200 and 220Mtpa. This analysis was based on two key assumptions that are simply invalid. Firstly, it assumed that there were only six iron ore berths at the port – but there is no reason to assume such a restriction. Had the

Hope Downs development as well as Fortescue's proceeded at Port Hedland there would have been eight berths and the capacity of the port would have been around 260Mtpa.

Secondly, the analysis assumes that no further action is taken to expand capacity at the port. There are a number of ways to expand capacity at the port – ultimately with export tonnages approaching 260Mtpa the Port Hedland Port Authority could be expected to be able to justify the expenditure to dredge a new channel to increase the capacity of the port considerably.

However, the question under consideration should be the capacity of the Service that Fortescue is seeking to declare unconstrained by unjustifiable restrictions on either the number of berths or any other measures by which capacity at the port (which is not the subject of the declaration application) could be expanded.

<u>Operational Modelling</u>
In its submission dated 6 January2006, BHPBIO submitted a document [Document 3] detailing further modelling work undertaken by TSG. The analysis was confined to a consideration of the Mt Newman railway after the completion of the RGP3 Project in 2009 when BHPBIO is expected to have optimised its system at 129Mtpa. Four cases were then compared to this base case – which appears to have been chosen as the configuration where further expansion costs were going to be at their highest.

Two of the cases considered made the assumption that the performance of Fortescue's trains would be 20% poorer. Fortescue utterly rejects this invalid assumption. One case considered access to the Mt Newman service for the transport of 45Mtpa from Fortescue's deposits in the Chichester Ranges. Since Fortescue will have commissioned its own railway to service these deposits by 2009 this case should not be considered. That simply leaves Case D1 which was based on the export of 10Mtpa from Mindy Mindy. However as Fortescue has repeatedly made clear to BHPBIO, Mindy Mindy will produce around 5Mtpa and will require at most one train pathway per day to move the product to Fortescue's port facilities at Port Hedland. Modelling based on the requirement of 3 train pathways per day to move 10Mtpa therefore grossly overstates the likely impact. Fortescue respectfully submits that it seems that this scenario was not modelled by BHPBIO because it wouldn't give the desired result.

<u>Capital Cost Analysis</u>
In its submission dated 6 January2006, BHPBIO submitted its estimate of the capital cost of the corrective measures identified as being required by the TSG modelling [Document 4]. For reasons outlined above, this represents an overestimate of the likely impact and hence the remedial investment required. However even accepting the overestimate of the likely impact by TSG, BHPBIO's own estimate of the capital costs of dealing with Case D1 show it can be achieved for A$187m, which is considerably less than the capital cost associated with duplicating the facility.

If access were granted to allow Fortescue to move ore from Mindy Mindy to Port Hedland and that access were to cause delays within the BHPBIO system as a result of additional "meets", the impact can be offset by investment that is far smaller than the cost of duplicating the entire facility and therefore the Council is correct in recommending that the Service be declared.

Cost of Investment Delays

In its submission dated 6 January2006, BHPBIO submitted a document arguing that regulatory intervention has the potential to delay its investments and that the knock on effects could amount to in excess of A$1,600m in costs to BHPBIO. This cost was based on a series of assumptions that should be regarded as highly unlikely. There is no inevitability about the involvement of the Regulator and if BHPBIO chooses to delay its investments, that is no reason to allow self-inflicted costs to count as part of the costs of a declaration.

Summary

The art of sophistry is alive and well and clearly being practiced. Most of the BHPBIO submissions submitted after 5 December 2005 should not even be considered. The extension was allowed for modelling work to be undertaken. However the modelling of capacity by BHPBIO was unrelated to the Service being declared by Fortescue and was also biased towards the highest cost implications by choosing a point in time where the costs of increasing capacity were maximised. The cost implications were further inflated by assuming Mindy Mindy would require three times the level of access that Fortescue has advised BHPBIO that it would require. Nevertheless, even this skewed analysis clearly showed that the capital investment required to offset the impact of product from Mindy Mindy being transported down the railway by Fortescue was only a fraction of the cost of duplicating the facility and therefore in no way undermined the Council's Draft recommendation, which was to declare the Service.

We trust that the Council will ignore the incorrect and predominantly irrelevant recent submissions made by BHPBIO and will adopt its Draft Recommendation as the Final Recommendation.

Yours sincerely

JULIAN TAPP
FORTESCUE METALS GROUP LIMITED