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**RIO  
TINTO**

**IRON ORE**

**SUBMISSION TO THE  
NATIONAL COMPETITION COUNCIL  
BY RIO TINTO IRON ORE  
IN RESPONSE TO THE DECLARATION APPLICATION  
OF FORTESCUE METALS GROUP LIMITED  
DATED 11 JUNE 2004**

**VOLUME 1 OF 2  
(SUBMISSION)**

**6 MAY 2005**

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Map showing the Mount Newman Spur Portion

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Map prepared by FMG for its Stage B PER (figure 1) showing the proposed alignment for both the Chichester Line and its Mindy Mindy Line

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Statement of Professor Robert Willig

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Statement of Evans & Peck

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Statement of Mr Philip Williams

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## A. Executive Summary

### 1. Executive Summary

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#### (a) Introduction

- 1.1 Rio Tinto Iron Ore (**RTIO**) is the division of the Rio Tinto Group with responsibility for Rio Tinto's iron ore interests. Its Australian interests include the Pilbara iron ore mines operated by Hamersley Iron Pty Limited (**Hamersley**) (100% owned by Rio Tinto) and Robe River Iron Associates (**Robe**) (53% owned by Rio Tinto), and the infrastructure servicing these mines, including the associated rail networks and ports at Dampier and Cape Lambert.
- 1.2 The Hamersley operating mines are Mount Tom Price, Paraburdoo, Channar, Marandoo, Yandicoogina, Eastern Range and Brockman No 2. The Robe operating mines are Mesa J and West Angelas. Product exported from the Hamersley and Robe mines totalled approximately 130 million tonnes (**mt**) in 2004. Expansion programs are currently underway to increase export capacity to about 170 mt by 2006.
- 1.3 In RTIO's submission, the National Competition Council should recommend **against** declaring the service that Fortescue Metals Group Limited seeks to have declared. RTIO's reasons for this view are briefly outlined in this executive summary and then discussed in more detail in the body of the Submission.

#### (b) Preliminary Issues

- 1.4 RTIO contends that the Council erred in its preliminary decision to accept FMG's Application insofar as it applied to the Mount Newman railway line. It is clear from the material filed by BHP Billiton Iron Ore Pty Limited that its use of the Mount Newman railway line is an integral and essential operation in its production process. Accordingly, any service arising from the use of the Mt Newman railway line is not a service within the meaning of section 44B of the *Trade Practices Act 1974* (Cth). RTIO's reasons for believing the Council erred in its preliminary decision are set out in Section 4 of this Submission.
- 1.5 RTIO also questions whether the Application has been made in 'good faith' as required by section 44F(3) of the TPA. The Application did not mention the facts that:
- (a) FMG intends to construct its own railway line from Port Hedland to its Chichester Ranges deposits irrespective of the outcome of the Application; and
  - (b) the Mindy Mindy project has arrangements in place for the transport of its iron ore, if it is developed.
- For these reasons the Council should recommend that the Service not be declared, without proceeding to consider in detail the declaration criteria (see Section 3).
- 1.6 If the Council does proceed to consider the declaration criteria, a number of key facts need to be borne in mind when applying the criteria:

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- FMG has made it clear that the Chichester Line will be built irrespective of the outcome of the access application and that this railway line will service FMG's proposed iron ore mines in the Chichester Ranges. The Hope Downs Iron Ore Project also intends to build its own railway line.
  - Accordingly, the only iron ore deposit that could utilise the Service is Mindy Mindy. FMG itself has said that the declaration process relates specifically to the Mindy Mindy joint venture project.
  - Mindy Mindy:
    - is a relatively small deposit (68 mt resource, yet to be JORC Code classified), that may never be developed;
    - is subject to a tenure dispute; and
    - in any event, as mentioned above, appears to have plans in place to transport its ore if it is developed.

**(c) Access Criteria**

- 1.7 Having canvassed these preliminary matters in Section B, RTIO's Submission then deals, in Section C, with the key declaration criteria set out in section 44G of the TPA.

***Criterion (b) uneconomical to develop another facility***

- 1.8 In RTIO's view a private investment test should be applied in considering criterion (b). A private investment test is suggested by the natural meaning of the words in criterion (b). Such an approach is also consistent with the United States essential facilities doctrine and with the sound economic and public policy principles underpinning that doctrine. Statements from Professor Joseph Kalt and Professor William Baumol, supporting this view, are Annexures A and B respectively. In applying a private investment test, it is clear that (if Mindy Mindy is viable at all) it would be economical for it to construct a spur line linking Mindy Mindy to the Chichester Line.
- 1.9 The Council has, to date, interpreted criterion (b) as involving a natural monopoly test. The Council has even gone so far as to state that criterion (b) may be satisfied even though an existing facility already provides the same services as the facility subject to the declaration application, because the facility subject to the declaration application could still be a 'natural monopoly'. Attached is a statement from Professor Janusz Ordover (Annexure C) that concludes that although a natural monopoly test is useful where there is no parallel facility or where there is no independent commitment to construct such a facility, it makes no sense to apply a natural monopoly test where a facility has actually been duplicated or there is an independent commitment to duplicate. In such circumstances, criterion (b) is necessarily not satisfied. In this case the Chichester Line, which will be built irrespective of the outcome of the Application, will exactly duplicate the Mt Newman railway line for approximately 200 kilometres. Accordingly, Professor Ordover concludes that, in this case, the Council should focus solely on whether that part of the Mt Newman railway line that could be used as part of a spur line to connect to the Chichester Line is a natural monopoly. Also attached is a statement from Professor Robert Willig strongly agreeing

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with Professor Ordovery's conclusions about how criterion (b) should be applied where a facility has been or will be duplicated (Annexure D).

1.10 The analysis of whether the part of the Mt Newman railway line that could be used as a spur is a natural monopoly, reveals that it is not. It would cost less (both for Mindy Mindy and in terms of cost to society) for the Mindy Mindy project to build a spur line connecting Mindy Mindy to the Chichester Line than it would for Mindy Mindy to access the BHPBIO Mt Newman railway line. A statement from consulting engineers, Evans & Peck, confirming this conclusion is Annexure E.

1.11 As a result criterion (b) is not satisfied.

***Criterion (a) promotion of competition in another market***

1.12 Criterion (a) requires a comparison of the future with and without declaration. Section 44W(1)(c) of the TPA provides that the Australian Competition and Consumer Commission may not make an access determination that would have the effect of 'depriving any person of a protected contractual right'. A protected contractual right is a right under a contract that was in force at the beginning of 30 March 1995. BHPBIO leases the land upon which the Mt Newman railway line is situated pursuant to various agreements with the State of Western Australia entered into prior to 30 March 1995. These leases confer on BHPBIO the right of exclusive possession. As a consequence, the ACCC would be prevented by section 44W of the TPA from making an arbitration decision that required BHPBIO to provide a service comprising use of the Mt Newman railway line to a third party. This means that, with or without declaration, a third party could not obtain an arbitration decision from the ACCC that required BHPBIO to provide the service. In RTIO's view, this means that criterion (a) cannot be satisfied in relation to any market. Nonetheless, set out below are submissions about the relevant markets identified by the Applicant, as requested by the Council in its Issues Paper.

1.13 FMG, in its Application, identifies six possible dependent markets. Of these there are only three which could conceivably be separate dependent markets: the market for iron ore; the market for rail haulage; and the market for tenements (although RTIO strongly contends that in fact there are no separate dependent markets identified – they are all part of the iron ore market). Attached as Annexure F is a statement from Mr Philip Williams of Frontier Economics Pty Limited considering whether such markets are in fact separate, and the application of criterion (a).

1.14 In relation to the market for iron ore:

- the market for iron ore is not a separate market from the market in which the Service is provided. Efficiencies arising from vertical integration between mine operations, rail transport, port handling, shipping and selling of Pilbara iron ore are so overwhelming as to make those activities part of the same functional market. Accordingly, criterion (a) cannot be satisfied in relation to the market from iron ore;
- even if this is not accepted, iron ore is sold on a global basis and the market encompasses all of the different types of iron ore. The entry of the Mindy Mindy project into the iron ore market would not have any effect on the state of

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competition in that market because of the very small size of Mindy Mindy. This conclusion would hold even if a narrower market definition was used (for example, the seaborne markets for lump, fines and pellet treated as separate product markets); and

- in any event declaration will make no difference to the likelihood of Mindy Mindy entering the iron ore market for the following reasons:
  - apparently Mindy Mindy already has arrangements for the transport of its ore if it is developed;
  - it is very uncertain that the Mindy Mindy deposit will ever be developed given the tenure dispute, uncertainty about its reserves and the fact that even FMG has not planned for Mindy Mindy to be mined for at least another eight years;
  - if Mindy Mindy is viable, as noted above, it is likely to cost less for Mindy Mindy to build a low cost spur line linking Mindy Mindy to the proposed Chichester Line than to access the BHPBIO Mt Newman railway line; and
  - in any event FMG (and the Mindy Mindy project) have an enforceable right to negotiate and enter into a contract with BHPBIO for carriage of iron ore products with terms and conditions of such contract to be set by an independent expert in the event of disagreement (as a result of the Mt Newman State Agreement and related Rail Transport Agreement).

1.15 In relation to the postulated rail haulage market:

- rail haulage (like track access) is part of the iron ore market because of the significant efficiencies arising from vertical integration. Accordingly, criterion (a) cannot be satisfied in relation to the postulated rail haulage market;
- in any event there is no market for rail haulage services in the Pilbara. There are currently no transactions in the Pilbara rail haulage market. There are also no prospective transactions. Neither FMG nor any other person intends to use declaration to enable it to provide rail haulage services to third parties. Furthermore, there does not appear to be demand for rail haulage services in the Pilbara (with iron ore mines preferring to establish their own railway lines or, possibly, obtain track access services rather than rail haulage);
- declaration would not promote competition even in a theoretical rail haulage market, because there is nothing to suggest that either the Applicant or any other person intends to use the declaration in order to provide rail haulage services to third parties. The access request is focussed solely on the transport of iron ore from Mindy Mindy to Port Hedland; and
- there are, in any event, already a number of parties who are obliged under their State Agreements to provide rail haulage services to third parties, notably BHPBIO, RTIO and, potentially Hope Downs. In addition, FMG will be operating its Chichester Line as an open access line and any theoretical new provider of rail haulage services could also operate on that railway line (and potentially the

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proposed spur to Mindy Mindy). Accordingly, declaration of the BHPBIO railway line would not promote competition in the theoretical rail haulage services market.

1.16 In relation to the postulated iron ore tenements market:

- the iron ore tenements market is not a separate market from the iron ore market. Parties who acquire or trade tenements also produce iron ore or intend to produce iron ore. As noted above, the iron ore market is not a separate market from the market for the service. In any event declaration would not promote competition in the iron ore market;
- if the Council does treat tenements as a separate market from the global market for iron ore, then the tenements market would be global. Further, the tenements market would not be confined to iron ore tenements, but would include tenements for all minerals. Companies willing to trade tenements are likely to operate on a global basis without regard to whether the tenement they wish to purchase and trade involves iron ore or any other mineral; and
- in any event there are already numerous potential purchasers of iron ore tenements in the Pilbara, including BHPBIO, RTIO, Hancock Prospecting Pty Limited, FMG, Mount Gibson Iron Limited, Iron Ore Holdings Limited, other international iron ore players such as Anglo American plc, and Japanese, Chinese and Korean steel mills who wish to acquire iron ore tenements. Accordingly, BHPBIO does not have monopsony power in relation to Pilbara iron ore tenements. Declaration will not, in any way, promote competition for the acquisition of such tenements.

1.17 Accordingly, declaration would not promote competition in any market.

***Criterion (d) health and safety***

1.18 The Council cannot be satisfied, on the limited material available, that access to the Mt Newman railway line could be provided without undue risk to human health and safety.

***Criterion (e) effective access regime***

1.19 The access regime created by the Mt Newman State Agreement and related Rail Transport Agreement creates an effective access regime for the transport of iron ore to Port Hedland.

***Criterion (f) public interest***

1.20 The Council cannot be satisfied that access to the Service would not be contrary to the public interest because:

- the Pilbara iron ore industry is vital to the Australian economy and is performing well with existing producers responding to the increase in demand with massive capacity increases;
- declaration would create bottlenecks because of the inefficiencies associated with parties sharing infrastructure. Declaration runs the risk of creating in the Pilbara the same types of problems faced by the coal industry in Queensland and New South Wales;

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- enforced third party access would operate as a disincentive to future investments in similar private facilities; and
  - the market place is currently working, with the increase in demand, notably from China, leading to a rapid expansion of capacity by existing Australian producers.

1.21 Accordingly, the Council cannot be satisfied that the criteria for declaration are met and should recommend against declaration.

1.22 This Submission is made on the basis of events as they currently stand, and information that is currently publicly available. If there is a change in fundamental circumstances, before any determination is made, RTIO reserves the right to make further submissions to the Council. Further, RTIO is aware that FMG and BHPBIO have each issued Federal Court proceedings the determination of which will have a bearing upon the power and jurisdiction of the Council to consider the Application. In RTIO's submission, it is inappropriate that the Council proceed with consideration of the Application until matters in the Federal Court have been resolved. By proceeding now the Council runs the risk of, at worst, acting without power and, at best, acting on information that may be out of date by the time of the Federal Court proceeding is resolved and, hence the Application can be finally dealt with.



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## B. Preliminary Issues

### 2. The Access Application

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#### (a) The Service to which Access is Sought

- 2.1 It is important at the outset to identify the 'Service' to which access is sought.
- 2.2 In paragraph 5.1 of its application dated 11 June 2004 (the **Application**), Fortescue Metals Group Limited (the **Applicant** or **FMG**) describes the service that it seeks to have declared as the use of the 'facility', as well as access to the facility's associated infrastructure (the **Service**). The Applicant does not seek access to any form of rail haulage service (eg, the use of locomotives or rolling stock in relation to the facility for the purpose of iron ore transport).
- 2.3 The facility is described in paragraph 5.1 of the Application as being:
- (a) that part of the Mount Newman railway line that runs from a rail siding that will be constructed near Mindy Mindy in the Pilbara to port facilities at Nelson Point in Port Hedland (further identified in Annexure 1 to the Application (the **Mt Newman railway line**)); and
  - (b) that part of the Goldsworthy railway line that runs from where it crosses the Mt Newman railway line to port facilities at Finucane Island in Port Hedland (further identified in Annexure 2 to the Application (the **Goldsworthy railway line**)).
- 2.4 Before dealing with the substance of the Application, the National Competition Council (the **NCC** or **Council**) identified and sought submissions concerning the 'threshold' issue of whether the use of the facility was part of a production process. RTIO filed its submission concerning this threshold issue on 4 October 2004.
- 2.5 On 15 December 2004 the Council decided that:
- use of the relevant part of the Mt Newman railway line was not part of a production process and was therefore a 'Service' for the purposes of Part IIIA of the *Trade Practices Act 1974* (Cth) (the **TPA**); but
  - use of the relevant part of the Goldsworthy railway line was part of a production process and was therefore not a 'Service' for the purposes of Part IIIA of the TPA.
- 2.6 Accordingly, the Council decided that it had jurisdiction to consider whether the Mt Newman railway line met the declaration criteria, but that it did not have jurisdiction to consider whether the Goldsworthy railway line met the criteria for declaration. In order to reach that decision, the Council determined that it would treat the Application as two separate Applications, one for each of the Mt Newman railway line and Goldsworthy railway line.
- 2.7 BHP Billiton Iron Ore Pty Limited (**BHPBIO**) has brought proceedings against the NCC and the Applicant in the Federal Court of Australia (the **Federal Court**) challenging the

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Council's decision on the threshold issue and seeking a declaration that the 'Service' arising from the use of the Mt Newman railway line is not a 'Service' to which Part IIIA of the TPA applies. The Applicant has also issued proceedings in the Federal Court, against the Council, BHPBIO and the other participants in the Goldsworthy Joint Venture, seeking a declaration that the Service provided by the Goldsworthy railway line is a Service to which Part IIIA of the TPA applies.

- 2.8 RTIO makes further comment regarding the 'threshold' issue identified by the Council, and the Council's decision regarding this issue, in Section 4 of this Submission. It remains RTIO's view that the Council does not have jurisdiction to receive and consider the Application in respect of the Mt Newman railway line (for the reasons discussed in Section 4 below). Accordingly, this Submission is made without prejudice to that position.
- 2.9 Notwithstanding the uncertainty created by the Federal Court proceedings, the Council has decided to seek submissions now and apparently intends to make a recommendation as to whether use of the Mt Newman railway line satisfies the declaration criteria prior to jurisdiction being decided.
- 2.10 Accordingly, the relevant Service that the Council is considering is the Service provided by 295 kilometres (*km*) of the Mt Newman railway line from a point near Mindy Mindy to Port Hedland. This is a two way single track with appropriate passing loops operated by BHPBIO on behalf of the Mount Newman Joint Venture.

**(b) Limitations of Part IIIA of the TPA**

- 2.11 It is also instructive at the outset to identify the basis on which access to the Service is sought and the possible effects that declaration would have.
- 2.12 The Applicant asserts that it requires access to the Service for a number of reasons, set out in paragraph 7.3 of its Application. These asserted reasons can be distilled into the following justifications advanced, by the Applicant, for declaration:
- (a) to transport iron ore and iron ore products from the Mindy Mindy deposit and other mine sites to Port Hedland (see paragraphs 7.3(1) to (4) of the Application);
  - (b) to increase the options available to the Applicant when determining the optimum method of transporting iron ore from the Chichester Ranges to Port Hedland (see paragraph 7.3(5) of the Application); and
  - (c) to facilitate the combining of the facility with the Applicant's 'own rail infrastructure' (discussed further below) to create what the Applicant describes as a 'looped railway system'<sup>1</sup> intended to provide a double tracked facility for the entire length of the Applicant's north-south railway line as it runs parallel to the facility (also discussed further below) (see paragraph 7.3(6) of the Application).

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<sup>1</sup> 'Beneficial Effects of Declaration of the BHP Billiton Railway Line', FMG Briefing dated 15 June 2004.

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- 2.13 It is important to recognise that these justifications for access advanced by the Applicant are largely beyond the scope of Part IIIA of the TPA and, accordingly, are irrelevant to the Council's consideration of the Application. They are discussed below in reverse order.

***A 'looped railway system'***

- 2.14 Part IIIA of the TPA cannot require the combining of the facility with the Applicant's proposed new railway line and therefore this is not a legitimate or relevant basis to recommend declaration of the Service. The Mt Newman railway line is a two-way single track with appropriate passing loops. It is not a one-way track; the Service provided by the track is a two-way service. Part IIIA of the TPA cannot require BHPBIO to convert its track into a one-way track or require BHPBIO to use the Applicant's parallel track. The concept of requiring the service provider not only to change the way in which it operates and uses its own facility, but also to use another person's facility so that it can provide the Service sought, is far removed from both the spirit and letter of Part IIIA of the TPA. Therefore the Council must disregard this purported justification for access when considering the Application.

***The Chichester Ranges deposits***

- 2.15 The Applicant has announced that it will build a railway line from its Mount Nicholas/Christmas Creek iron ore deposits in the Chichester Ranges to Port Hedland.<sup>2</sup> Further the Western Australian government has enacted a State Agreement in respect of (inter alia) FMG's railway line from the Chichester Ranges to Port Hedland. FMG has not only announced that it will construct this railway line but it has also confirmed in press releases and announcements to the Australian Stock Exchange (the **ASX**) that the construction of the railway line is in no way dependent on the outcome of the Application and that the Application is unrelated to the development of its Chichester Ranges deposits. Specifically, in its 10 November 2004 announcement to the ASX entitled 'State Agreement for Rail & Port Infrastructure', the Applicant stated:

It should be noted that the State Agreement deals with FMG's intended open access rail line from the Chichester Ranges to Port Hedland. This is to be contrasted with, and is entirely different from FMG's application to the National Competition Council under the Trade Practices Act, for 'Declaration' of the access by FMG (and others) to the existing BHP Billiton rail line running from Port Hedland to Newman. The application relates to FMG's separate joint venture Mindy-Mindy deposit located some 80 kilometres to the south west of FMG's proposed mine sites in the eastern Chichester Ranges.<sup>3</sup>

FMG's press release and announcement to the ASX on 15 December 2004 was to similar effect.<sup>4</sup>

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<sup>2</sup> 'China Signs to Build Railway', announcement by the Applicant to the ASX dated 23 August 2004 ([www.fmgl.com.au](http://www.fmgl.com.au)); 'State Agreement for Rail and Port Infrastructure', announcement by the Applicant to the ASX dated 10 November 2004 ([www.fmgl.com.au](http://www.fmgl.com.au)).

<sup>3</sup> 'State Agreement for Rail and Port Infrastructure', announcement by the Applicant to the ASX dated 10 November 2004 ([www.fmgl.com.au](http://www.fmgl.com.au)).

<sup>4</sup> 'Positive NCC decision on Newman to Port Hedland Rail Declaration Process', announcement by the Applicant to the ASX dated 15 December 2004 ([www.fmgl.com.au](http://www.fmgl.com.au)).

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- 2.16 Recent speculation regarding the enforceability of the Applicant's railway construction agreement has not affected the Applicant's stated commitment to construct such a facility, irrespective of the access Application.<sup>5</sup> The Applicant has recently stated in an announcement to the ASX dated 29 March 2005:

The Company is confident that project certainty remains unaffected by China Metallurgical media speculation and will be implemented expediently in accordance with the construction agreement or via alternate arrangements.<sup>6</sup>

- 2.17 Therefore, since the Application was made, the Applicant has gone to extraordinary lengths to advise the public and regulatory authorities that the Application is in no way connected with the development of its Chichester Ranges deposits, which will be serviced by an independent railway line that will be built irrespective of the outcome of the Application. Accordingly this basis for the Application must now also be disregarded.

**Other deposits**

- 2.18 Other than the Mindy Mindy deposit, the Applicant does not identify any deposit or other mineral resource that is likely to utilise the Service to which access is sought.
- 2.19 The only other deposit in the vicinity of Mindy Mindy that could conceivably utilise the Service is the Hope Downs Iron Ore Project (**Hope Downs**). Hancock Prospecting Pty Limited (**Hancock Prospecting**) has, however, indicated that it will construct its own railway line linking Hope Downs to Port Hedland. In a press release issued on 5 April 2005, Hancock Prospecting stated that it and Kumba Resources Limited (**Kumba Resources**) 'have agreed to work together towards submitting a Development Proposal to the State Government by 30 June 2005 which proposal will be based on Hancock Prospecting's preference that the project develops its own independent rail and port infrastructure'.<sup>7</sup> This was confirmed in a speech by Ms Gina Rinehart, the Chairman of Hancock Prospecting, on 12 April 2005 reported in *The Australian* as follows:

Ms Rinehart said yesterday her \$3 billion Hope Downs iron ore project would have its own infrastructure and plans were too advanced to change now.

With a July 1 deadline for her Hancock Prospecting to submit a development plan to the State Government, 'it would not be humanly possible to change it, after all the work we have done', Ms Rinehart told the Metal Bulletin China Iron Ore Conference in Beijing.<sup>8</sup>

Hope Downs' proposal is to construct a 360 km railway from Hope Downs to Port Hedland to service the Hope Downs mine, which will have an initial production rate of about 25 million tonnes per annum (**mtpa**).<sup>9</sup> The rail proposal has been approved by both the

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<sup>5</sup> 'Response to Media Comment and Speculation', announcement by the Applicant to the ASX dated 29 March 2005 ([www.fmgil.com.au](http://www.fmgil.com.au)).

<sup>6</sup> 'Response to Media Comment and Speculation', announcement by the Applicant to the ASX dated 29 March 2005 ([www.fmgil.com.au](http://www.fmgil.com.au)). This position was further confirmed in a presentation by Mr Andrew Forrest of the Applicant to the Sydney Mining Club on 5 May 2005.

<sup>7</sup> 'Press release of Hancock Prospecting Pty Ltd', 5 April 2005 ([www.hancockprospecting.com.au](http://www.hancockprospecting.com.au)).

<sup>8</sup> 'Hopes down: Gina derails FMG', *The Australian*, 13 April 2005, page 31.

<sup>9</sup> Hope Downs Iron Ore Project Presentation, March 2005 ([www.hancockprospecting.com.au](http://www.hancockprospecting.com.au)).

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Western Australian and Federal Environment Departments. Hancock Prospecting has also brought successful proceedings in the Supreme Court of Western Australia establishing that it has a legally enforceable right, under the Mount Newman Agreement entered into between the State of Western Australia and the Mount Newman Iron Ore Company Limited on 26 August 1964 (the **Mt Newman State Agreement**) and the associated Rail Transport Agreement, to have its iron ore carried by BHPBIO pursuant to the freight carriage provisions of those Agreements.<sup>10</sup> There is nothing to suggest that Hancock Prospecting intends to operate its own trains on the Mt Newman railway line from Mindy Mindy to Port Hedland pursuant to any declaration of the railway line following the Application by the Applicant. In fact, all indications are to the contrary.

- 2.20 In the absence of any evidence that identifies that there are any such deposits or resources that are likely to utilise the Service, 'other deposits' cannot be relevant to determining whether the declaration criteria are satisfied.

**Mindy Mindy**

- 2.21 It follows from the above that the Application for declaration relates solely to the Mindy Mindy deposit. The Applicant itself stated in its 15 December 2004 announcement to the ASX that the '[d]eclaration process ... relates specifically to [the] Mindy Mindy joint venture project'.<sup>11</sup>
- 2.22 Therefore, in applying the declaration criteria and in considering the future with and without declaration, only the Mindy Mindy deposit is relevant.
- 2.23 It is important to note the following significant points about the Mindy Mindy deposit:
- Mindy Mindy is owned by Pilbara Iron Ore Pty Limited (**PIO**) in which FMG has a 50% shareholding. The other 50% is held by Consolidated Minerals Limited (**Consolidated Minerals**). Consolidated Minerals controls PIO (and Mindy Mindy) by virtue of its right to appoint the Chairman of PIO who has a casting vote on the PIO Board.<sup>12</sup> Thus, FMG apparently does not have a right to any part of the Mindy Mindy production (which will be owned by PIO) and does not have control over whether the deposit is developed at all, or if it is developed, how the ore is to be transported to the coast.
  - On 12 April 2005 Consolidated Minerals issued an announcement in the form of an 'open briefing' to the ASX in which Mr Michael Kiernan, the Managing Director of Consolidated Minerals, outlined Consolidated Minerals' intentions in relation to Mindy Mindy. At page 6 of that Briefing Mr Kiernan said,

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<sup>10</sup> *Hancock Prospecting Pty Ltd v BHP Minerals Pty Ltd* [2003] WASCA 259 (the **Hancock Prospecting decision**).

<sup>11</sup> 'Positive NCC Decision on Newman to Port Hedland Rail Declaration Process', announcement by the Applicant to the ASX dated 15 December 2004 ([www.fmg.com.au](http://www.fmg.com.au))

<sup>12</sup> Consolidated Minerals Limited 2004 Annual Report, page 40 ([www.consminerals.com.au](http://www.consminerals.com.au)).

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We have an arrangement with the owners of other iron ore projects being planned in the area that we will have access to their railway lines on a user pays basis with no capital cost to us.<sup>13</sup>

It appears from this statement that the Mindy Mindy project already has arrangements in place with the owners of planned iron ore projects to use their railway lines (the only apparent owners in this category being Hope Downs or FMG) and does not require access to the Mt Newman railway line.

- The Mindy Mindy joint venture is currently the subject of a tenure dispute. Geologist and engineer, Derek Ammon, is claiming an interest in tenements held by the Mindy Mindy iron ore joint venture.<sup>14</sup> Furthermore, there are as yet no Australasian Code of Reporting of Exploration Results, Mineral Resources and Ore Reserves (the **JORC Code**) compliant resources at Mindy Mindy or, to our knowledge, any published study about the feasibility or otherwise of Mindy Mindy. Even the Applicant has stated the Mindy Mindy deposit will not be mined for at least eight years.<sup>15</sup> Given the uncertainty of tenure, the uncertainty about resources and the uncertain position of the iron ore market in eight years time, there must be very significant doubt as to whether the Mindy Mindy deposit will be developed in the foreseeable future.
- The Applicant asserts that it will construct a railway line from its Chichester Ranges mine sites to Port Hedland (the **Chichester Line**) irrespective of the outcome of the access Application. The FMG railway line will run next to the Mt Newman railway line for approximately 200 km of the 295 km of Mt Newman railway line in respect of which declaration is sought. If the Mindy Mindy deposit is to be developed, a low cost spur line could readily be constructed from Mindy Mindy to the Chichester Line to carry iron ore mined at Mindy Mindy to port.
- There is currently an enforceable right to negotiate a rail haulage service on BHPBIO's railway line.<sup>16</sup> As such, there will be no impediment to the Applicant being able to utilise a haulage service for the purpose of transporting any iron ore or iron ore products from Mindy Mindy to Port Hedland, which (as is apparent from paragraphs 7.1 to 7.3 of the Application and subsequent announcements from FMG) is the fundamental reason for pursuing this Application.
- Finally, the Applicant has estimated that the resource at Mindy Mindy is only 68 mt.<sup>17</sup> Therefore, even if mining the resource would be ultimately economic, the

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<sup>13</sup> 'Open Briefing, Cons Minerals, Strategy & Outlook', announcement to the ASX dated 12 April 2005 ([www.consminerals.com.au](http://www.consminerals.com.au)).

<sup>14</sup> 'Geologist draws first blood over iron ore claim', *West Australian*, 20 September 2004, page 31.

<sup>15</sup> Public Environment Review lodged by the Applicant in respect of the Pilbara Iron Ore and Infrastructure Project: East-West Railway and Mine Sites (Stage B) dated 17 January 2005, pages 82-83.

<sup>16</sup> *Hancock Prospecting Pty Ltd v BHP Minerals Pty Ltd* [2003] WASCA 259.

<sup>17</sup> Public Environment Review lodged by the Applicant in respect of the Pilbara Iron Ore and Infrastructure Project: East-West Railway and Mine Sites (Stage B) dated 17 January 2005, pages xiii and 57.

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small size of the resource relative to the global iron ore market means Mindy Mindy could not have any effect on competition in the global iron ore market.

2.24 The implications of the above for the criteria for declaration are discussed in detail in Section C below.



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### 3. Good Faith

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3.1 Section 44F(3) of the TPA provides:

If the applicant is a person other than the designated Minister, the Council may recommend that the service not be declared if the Council thinks that the application was not made in good faith.

3.2 In *Carpentaria Transport Pty Ltd* (1997) ATPR (NCC) 70-003, at 70,268, the Council stated:

The Council considers that the criterion "not in good faith" is designed to eliminate trivial applications and those applicants who are obviously vexatious or are applying only to put the provider to the unnecessary expense of responding to an access declaration application.

(See also *Specialized Container Transport* (1997) ATPR (NCC) 70-004, at 70,340).

3.3 In its initial Submission to the Council, in relation to the threshold issue identified in paragraph 2.4, RTIO questioned whether the Application was made in good faith given that the Application did not mention the fact that FMG intended to construct its own railway line from Port Hedland to its Chichester Ranges deposits. As is obvious not only from this Submission but also from the Council's Issues Paper (paragraphs 5.9, 5.10 and 6.13), this is a highly relevant factor in assessing whether the criteria in section 44G(2) of the TPA are satisfied.

3.4 Recently, a further issue has come to light that is relevant to the good faith issue. As mentioned in paragraph 2.23 above, the Mindy Mindy deposit is owned by PIO, a company controlled by Consolidated Minerals. On 12 April 2005 Consolidated Minerals issued an announcement in the form of an 'Open Briefing' to the ASX in which Mr Michael Kiernan, the Managing Director of Consolidated Minerals, outlined Consolidated Minerals' intentions in relation to Mindy Mindy.<sup>18</sup> At page 6 of that Briefing Mr Kiernan said:

We have an arrangement with the owners of other iron ore projects planned in the area that we will have access to their railway lines on a user pays basis with no capital cost to us.

3.5 Not only should such an arrangement have been revealed by FMG, but it renders the entire Application nugatory. If the Mindy Mindy project has arrangements in place with the owners of planned iron ore projects to use their railway lines (the only apparent owners in this category being Hope Downs or FMG) then the project will not need access to the 295 km rail service that it seeks from Mindy Mindy to Port Hedland. As explained in Section 2 and as FMG confirmed in its announcement of 15 December 2004, this Application relates specifically to Mindy Mindy, but Consolidated Minerals, the party who controls Mindy Mindy, has now announced that the project has other rail transport arrangements in place. RTIO submits that there is thus no basis on which the Council can

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<sup>18</sup> 'Open Briefing, Cons Minerals, Strategy & Outlook', announcement to the ASX dated 12 April 2005 ([www.consminerals.com.au](http://www.consminerals.com.au)).



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continue to consider the Application, and that it should be rejected pursuant to section 44F(3) of the TPA.

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## 4. Production Process

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- 4.1 In its Statement of Reasons, published in November 2004, the Council stated that it had made the following decisions relevant to the Mt Newman railway line:
- (a) that notwithstanding that the Application by FMG had sought an access declaration in respect of both the Mt Newman and Goldsworthy railway lines (owned by different operators), the Council would treat the Application as two separate Applications for declaration; and
  - (b) that the Service in respect of the specified part of the Mt Newman railway line is a Service to which Part IIIA of the TPA applies, as the 'production process' exception contained within section 44B of the TPA does not apply.
- (a) Separate Applications**
- 4.2 The Council had no power or discretion to make its decision to treat the original FMG Application as two separate Applications. The proper course of action was for the Council to decline to accept the Application in that form and require FMG to submit separate Applications in respect of the separate facilities, thereby requiring FMG to separately address each of the relevant criteria specified in section 44G(2) of the TPA.
- 4.3 As the matter now stands, the Application purports to address the applicability and relevance of each of the section 44G criteria in circumstances where only part of the identified 'facility' (the Mt Newman railway line) remains the subject of the NCC processes. FMG has not even formally advised the Council or interested parties that access to only part of the Service sought will satisfy the objectives propounded by FMG as justifying the declaration.
- (b) The Process Issue**
- 4.4 RTIO maintains the position that (any) Service arising from the use of the Facility is not a 'service' within the meaning of section 44B of the TPA. As a consequence, the Council does not have jurisdiction to deal with the Application pursuant to Part IIIA of the TPA.
- 4.5 RTIO refers to and repeats the matters set out in its Submission to the Council dated 4 October 2004. In RTIO's submission, it is clear from the material filed by BHPBIO that its use of the Mt Newman railway line is an integral and essential operation in its production process.
- 4.6 RTIO submits that the Council is in error in respect of its analysis of section 44B of the TPA and the reasons of Justice Kenny in the *Hamersley decision*,<sup>19</sup> in at least two material respects:
- (a) the Council has incorrectly interpreted and applied the decision of Justice Kenny to mean that the 'production process' is complete at the first point where a commodity

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<sup>19</sup> *Hamersley Iron Pty Ltd v National Competition Council* (1999) 164 ALR 203 (the *Hamersley decision*).

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exists that is capable of being sold (NCC's 'Preliminary Matters: Statement of Reasons' (**Council's Reasons**), paragraphs 4.15-4.18); and

- (b) the Council has incorrectly ruled that 'if a service falls outside the production process exception in respect of one product, then the exception in sub-paragraph (f) does not apply...' (Council's Reasons, paragraph 4.44).

4.7 RTIO's position is further explained below. However, before explaining why these determinations are wrong in principle, RTIO reiterates that the second determination is based on a factual error. As RTIO explained in paragraph 7.4 of its September 2004 Submission, even the MAC Fines product is not a finished product until after:

- fines derived from rescreening MAC Lump at the port are blended with other MAC Fines at the port; and
- the inevitable final blending and assembly of MAC Fines product at port and during ship loading to achieve customer specification on a uniform basis.

(c) **Marketable Commodity**

4.8 BHPBIO submitted extensive material to the Council describing the nature of its operations in the Pilbara. As far as RTIO is aware, that evidence was unchallenged.

4.9 The effect of BHPBIO's evidence is that its operations (including rail) are dedicated to the production of iron ore which meets relevant export contractual specifications. It is not, as the Council suggests, a production process dedicated to the production of a 'marketable commodity' (Council's Reasons, paragraphs 4.18-4.19).

4.10 Every commodity, irrespective of its state, is marketable. Indeed, iron ore in its 'in situ' state is saleable. In this context, every component used to assemble a motor vehicle is 'marketable' in isolation – yet it would be illogical to argue that a production line dedicated to the production of motor vehicles is not a production process.

4.11 BHPBIO's production process is designed to create iron ore which meets its export sales specifications, not simply to produce iron ore which, in some form and at various stages, might be 'marketable'. As Justice Kenny points out, the production process exclusion should **not** be narrowly construed. In the context of Justice Kenny's decision, it is clear that she regarded the production process as being a process:

...to create the product or products **which the process of production is designed to create** (our emphasis, the *Hamersley decision*, paragraph 51).

4.12 Justice Kenny's decision therefore makes clear that a production process does not end when any product that might happen to be 'marketable' is created; it ends when the product that the process of production is **designed to create** is produced.

4.13 RTIO considers that the test adopted at paragraph 4.16 of the Council's Reasons is, for the reasons set out above, misconceived and unsupported by the findings of Justice Kenny in the *Hamersley decision*. Indeed, the Council has embarked upon the very process of 'fragmenting' BHPBIO's production activities which, as Justice Beaumont cautioned, ran

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the risk of producing 'an artificial and unrealistic result' (See *Commissioner of Taxation v Reynolds Australia Alumina Ltd* (1987) 18 FCR 29, 35 which was cited with approval at paragraph 53 of Justice Kenny's reasons).

**(d) Completion of One But Not All Products**

4.14 RTIO further submits that the Council has made a second, fundamental error in its construction of the 'production process' exception contained within the definition of 'Service' in section 44B of the TPA. Contrary to the warning of Justice Kenny that the 'production process' exception should not be given a narrow construction, the Council wrongly determined that:

...if a service falls outside the production process exception in respect of the product, then the exception in sub-paragraph (f) does not apply, and the service in question falls within the definition of service under section 44B of the TPA. This is so regardless of the fact that the **same service** may be part of a production process for other products produced by the same provider (our emphasis, Council's Reasons, paragraph 4.44).

4.15 The Council acknowledges that the 'same service' is used as part of the production process. Once the Council has acknowledged this, it is difficult to see how it could decide that the production process exception does not apply. As Justice Kenny stated:

On any view, the Council is obliged to satisfy itself that the 'service' to which access is sought **does not include any matter** in paragraphs (d), (e) and (f) of the definition (Our emphasis, the *Hamersley decision*, paragraph 58).

Clearly, having found that the Service was part of a production process for some products, the Council could not satisfy itself that the 'Service' did not include **any matter** that involved the use of a production process.

4.16 Alternatively, it may be that the basis for the Council's decision was a view by the Council that, when the first 'marketable' (should read 'finished') product is produced, the production process comes to an end (notwithstanding that other products that are at that point 'non-marketable' (should read 'unfinished') are still being produced by that process). If so, RTIO considers that this view is unsustainable. The error in such a determination is clearly demonstrated by returning to the motor vehicle production line analogy. Assume the production line produces utility vehicles, one tenth of which are to be sold as 'cab/chassis' vehicles without a tray and nine tenths of which are to be sold as 'traybacks'. If the last step in production is the fitting of the tray and the production line is so organised that a tray is not fitted to every tenth vehicle on the production line, the process that continues after the vehicles reach the cab/chassis stage could not be characterised other than as a production process.

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## 5. Conclusion on Preliminary Issues

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### 5.1 In RTIO's submission:

- the Council does not have jurisdiction to receive the Application. Use of the Mt Newman railway line is an integral and essential operation in BHPBIO's production process. Accordingly, any Service arising from the use of that facility is not a service within the meaning of section 44B of the TPA; and
- even if this is not accepted, there are serious questions as to whether the Application has been made in good faith as required by section 44F(3). The Council should recommend that the Service not be declared on this basis.

### 5.2 In its Issues Paper the Council seeks comments on the declaration criteria in section 44G of the TPA. Accordingly, and without prejudice to the points made above, the following sections of this Submission consider whether the criteria for declaration set out in section 44G of the TPA are satisfied. For reasons discussed in Section 2, the following key points need to be borne in mind in considering the declaration criteria:

- FMG has stated publicly that it will build the Chichester Line, irrespective of the outcome of the access Application. Hope Downs has also stated it will build its own railway line;
- accordingly, the access Application relates only to the Mindy Mindy deposit. The Mindy Mindy deposit is the only iron ore deposit likely to utilise the Service;
- the Mindy Mindy deposit:
  - is controlled by an entity other than FMG;
  - may never be developed;
  - has arrangements in place for the transport of its iron ore; and
  - will, even if developed, be a very small producer.

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## C. Criteria Issues – Section 44G

### 6. Overview

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- 6.1 Section 44G(2) of the TPA provides that the Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:
- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;
  - (b) that it would be uneconomical for anyone to develop another facility to provide the service;
  - (c) that the facility is of national significance, having regard to:
    - (i) the size of the facility; or
    - (ii) the importance of the facility to constitutional trade or commerce; or
    - (iii) the importance of the facility to the national economy;
  - (d) that access to the service can be provided without undue risk to human health or safety;
  - (e) that access to the service is not already the subject of an effective access regime; and
  - (f) that access (or increased access) to the service would not be contrary to the public interest.
- 6.2 In addition, section 44F(4) of the TPA provides that the Council must also consider whether it would be economical for anyone to develop another facility that could provide part of the Service. As noted above, the Service to which access is sought is to be duplicated for 200 km of the 295 km in respect of which access is sought. Therefore, there is a substitute for exactly the same Service for a very substantial part of the distance covered by the Service. The requirement in section 44F(4) of the TPA, that the Council consider whether it would be economical for anyone to develop another facility to provide part of the Service, is therefore very apt in this instance - the facts demonstrate for themselves that it is economical for someone to develop another facility that provides most of the Service sought. This is discussed further in conjunction with the discussion on section 44G(2)(b) of the TPA in Section 7 below.
- 6.3 As the Council recognised in its 'Guide to Part IIIA of the *Trade Practices Act 1974*, Part B Declarations December 2002' (the **Guidelines**), at paragraph 1.12, the Council must be affirmatively satisfied that all of the declaration criteria in section 44G of the TPA are met before it can recommend declaration. If the Council is not satisfied that one or more of the criteria are met, then it must recommend that the Service not be declared.
- 6.4 In accordance with the approach adopted by the Council in its Guidelines and Issues Paper, this Submission will begin by examining criterion (b), followed by criteria (a), (d), (e) and (f). The Submission does not discuss criterion (c).

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## 7. Uneconomical to Develop another Facility

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- 7.1 Section 44G(2)(b) of the TPA provides that the Council cannot recommend that a service be declared unless it is satisfied:

that it would be uneconomical for anyone to develop another facility to provide the service.

- 7.2 In this section we first outline the factual background relevant to the application of criterion (b), in particular, the fact that a railway line between Port Hedland and the Applicant's Chichester Ranges deposits will be built in the near term in any event and the fact that the Applicant regards the construction of a spur line to Mindy Mindy as feasible. Secondly, the Submission considers how criterion (b) should be interpreted. The Submission argues a private investment test should be applied. The Submission also argues that irrespective of whether a private investment or natural monopoly test is applied, regard should be had to any alternative facilities that have been built or will be built irrespective of the outcome of the access application. This means that, in this case, even if a natural monopoly test is applied, the relevant question is whether it is more economical for the Applicant to access the BHPBIO Mt Newman railway line rather than it or someone else constructing a spur connecting Mindy Mindy to the Chichester Line. Thirdly, the Submission considers the relative costs of access and the costs of constructing a new spur line, and concludes that the costs of access would outweigh the costs of constructing a new spur line. Finally, the Submission concludes that, whether a private investment test or natural monopoly test is applied, the Council cannot be satisfied that criterion (b) is met.

### (a) Factual Background

#### *Introduction*

- 7.3 In considering whether criterion (b) is satisfied it is relevant to have regard not only to the Mt Newman railway line but also to other existing facilities that could provide the same Service.
- 7.4 As the Council recognises at paragraphs 4.84-4.85 of the Guidelines:
- 4.84 In assessing whether it is uneconomic to 'develop' another facility, it is appropriate to consider facilities that have already been developed. In the Duke EGP decision, the Tribunal stated:
- There is no logic in excluding existing pipelines from consideration in the determination of whether criterion (b) is satisfied. The policy underlying the Code would not be advanced if the Tribunal were to proceed in that blinkered way. We therefore think it appropriate to enquire whether the MSP or the Interconnect provide or could be developed to provide the services provided by means of the EGP. (para 57)
- 4.85 The term 'develop' is sufficiently broad to encompass modifications or enhancements to existing facilities. If an existing facility does not provide the *services provided by the facility subject to declaration*, but could economically be modified or expanded to do so, then criterion (b) is not met.

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- 7.5 RTIO agrees with these comments. Having regard to existing facilities must necessarily entail also having regard to facilities that will be built in the near term irrespective of whether or not access is granted (to do otherwise would divorce the determination of the Application from the most likely state of events at the time access is actually required).
- 7.6 Therefore the fact that the Applicant has made it clear that the Chichester Line will be built in the near term, irrespective of whether or not access is granted, puts this Application in the same position as if the Chichester Line had been constructed and, consistent with the decision of the Australian Competition Tribunal (the **Tribunal**) in the *Duke EGP decision*,<sup>20</sup> the Council must take this into account in determining whether criterion (b) is satisfied.
- Chichester Line will be built in any event**
- 7.7 The evidence that the Chichester Line will be built irrespective of the outcome of this Application is set out below. Doubtless FMG will confirm that this is the case in its submission in relation to the Application or in response to any inquiry from the Council.
- 7.8 The Applicant has announced that it has 'entered into a binding contract with China Railway Engineering Corporation (**CREC**) to build and finance the railway component of the Pilbara Iron Ore and Infrastructure Project' from its various Chichester Ranges mine sites to Port Hedland.<sup>21</sup> As noted above (see paragraph 2.16), despite recent speculation about the enforceability of this contract, the Applicant has announced to the ASX that the construction project will proceed regardless.
- 7.9 On 10 November 2004, an agreement entitled the 'Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement' (the **Railway and Port State Agreement**) was entered into by the State of Western Australia (the **State**) and The Pilbara Infrastructure Pty Limited (**TPI**) (a wholly owned subsidiary of FMG). This relates to FMG's proposal for its subsidiary, TPI, 'to construct and operate a multi-user railway from in the vicinity of the Chichester Ranges to multi-user port facilities within the Port of Port Hedland, or to a location near the boundary of that port for delivery to such port facilities by multi-user conveyor ...'.<sup>22</sup> The Railway and Port State Agreement will, subject to satisfaction of certain conditions precedent and obtaining approval for its detailed proposal from the State, oblige TPI to construct and operate a railway on the terms set out in the Railway and Port State Agreement.
- 7.10 The Railway and Port State Agreement has been ratified, and its implementation authorised, by the *Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004 (WA)* (the **Railway and Port State Agreement Act**).
- 7.11 As noted above (see paragraph 2.15), the Applicant has made it clear in announcements to the ASX that FMG's intended open access railway line from the Chichester Ranges to Port Hedland is entirely independent of its Application for declaration of BHPBIO's Mt Newman

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<sup>20</sup> *Re Duke Eastern Gas Pipeline Pty Ltd* [2003] ACompT 2 (the *Duke EGP decision*).

<sup>21</sup> 'China Signs to Build Railway', announcement by the Applicant to the ASX dated 23 August 2004 ([www.fmgil.com.au](http://www.fmgil.com.au)).

<sup>22</sup> *Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004 (WA)*.



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railway line and that the Chichester Line will be built irrespective of the outcome of the access Application.

***The Mindy Mindy line is feasible***

- 7.12 The other factor that is relevant in determining whether criterion (b) is satisfied is whether the construction of a spur line linking Mindy Mindy to the Chichester Line (independent of the Mt Newman railway line) is considered feasible.
- 7.13 None of the announcements referred to in paragraphs 7.7 to 7.11 above relate to a railway line linking Mindy Mindy to the Chichester Line. They relate only to the Chichester Line. The Applicant does appear, however, to regard a line to Mindy Mindy as feasible. In particular the Applicant has sought environmental approval for the construction of a north-south railway line extending from Port Hedland all the way to Mindy Mindy. The 'Public Environmental Review' lodged by the Applicant in respect of the 'Pilbara Iron Ore and Infrastructure Project: Stage A Port and North-South Railway' dated September 2004 (the **Stage A PER**) confirms (at page vii) that the 'Pilbara Iron Ore and Infrastructure Project: Stage A' incorporates a 'railway stretching south-southeast some 345 km to resources in the East Pilbara at Mindy Mindy'. The Stage A PER also makes clear that the Applicant is pursuing this development as an alternative to gaining access to the existing BHPBIO infrastructure:

There is also no guarantee that FMG will be able to gain access either to the existing BHPBIO rail infrastructure or to the proposed Hope Downs railway should it be built. Due to this uncertainty FMG must control its own future by pursuing the development of its own independent port and railway infrastructure (at page 7).

- 7.14 On 17 January 2005 the Applicant lodged a second Public Environmental Review in respect of the 'Pilbara Iron Ore and Infrastructure Project: Stage B East-West Railway and Mine Sites' (the **Stage B PER**). The Stage B PER explains (at page xi):

For the purposes of environmental assessment and development, the Pilbara Iron Ore and Infrastructure Project has been separated into two stages:

- Stage A: Development of a port facility at Port Hedland and a railway stretching 345 km from Port Hedland, south to Mindy Mindy; and
- Stage B: Development of four iron ore mines in the Pilbara and a 160 km railway from the eastern-most mine site to connect to the Stage A north-south railway.

- 7.15 The Chichester Line, described above, comprises:
- (a) part, but not all, of the 'Stage A' railway between Port Hedland and Mindy Mindy; and
  - (b) the 'Stage B' railway connecting the north-south railway line with the Applicant's Chichester Ranges mine sites.

Neither the Stage A PER nor the Stage B PER state that the Chichester Line will be built first, but this is the position according to the announcements quoted above. Nonetheless, the fact that the Applicant has sought environmental approval and lodged the Stage A PER for a railway line all the way to Mindy Mindy, and has stated it is doing so as an alternative

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to obtaining access, strongly suggests the Applicant regards a railway line connecting the Chichester Line with Mindy Mindy as feasible.

- 7.16 The announcement by Consolidated Minerals on 12 April 2005, referred to in paragraphs 2.23 and 3.4 above, seemingly also confirms the feasibility of Mindy Mindy using an alternative service to the Mt Newman railway line to transport its ore to Port Hedland. If Mr Kiernan is referring to arrangements with FMG to use its Chichester Line, then the Mindy Mindy proponents must have in mind a link to that railway line that does not include access to the Mt Newman railway line. Presumably this is a minimum cost spur line that would be built as part of the Mindy Mindy project.

**(b) Interpretation of Criterion (b)**

***The Council's view***

- 7.17 In its Issues Paper, the Council states:

- 5.2 Criterion (b) tests whether a facility exhibits natural monopoly characteristics...
- 5.3 The facility is a natural monopoly if the facility can serve the range of reasonably foreseeable demand for the services provided by the facility at less cost than that of two or more facilities. This requires consideration of the costs to society as a whole rather than the commercial costs of developing another facility...
- 5.5 ... The Mount Newman Railway Facility will be a natural monopoly and satisfy criterion (b) if it can meet the reasonably foreseeable demand for the service more cheaply than two or more facilities.

- 7.18 The Council notes, at paragraph 5.9 of its Issues Paper, that FMG has entered into a State Agreement for the development of the Chichester Line. The Council goes on to note at paragraph 5.10 that:

the willingness of a firm to construct an alternate facility does not demonstrate the absence of a natural monopoly. Rather, the duplication of the facility may be inefficient if the foreseeable demand for the service provided by the existing facility can be satisfied by that facility at lower cost, that is, it is a natural monopoly.

***Why the Council's view is inappropriate***

- 7.19 In RTIO's view the natural monopoly test applied by the Council is incorrect. RTIO submits that criterion (b) requires the Council to be satisfied that it would be uneconomical in a private investment sense for anyone to develop another facility to provide the Service and that, if an alternative facility in fact exists or will be built irrespective of the outcome of the declaration Application, then criterion (b) cannot be satisfied.

- 7.20 RTIO holds this view for three reasons:

- the natural meaning of the words in criterion (b) strongly suggest a private investment test;
- the United States (**US**) essential facilities doctrine, on which Part IIIA of the TPA is in large part based, applies a private 'practicable and feasible' test not a natural monopoly test and there are sound economic and public policy reasons for doing so; and

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- when an alternative facility has been built or committed, the marketplace has spoken and demonstrated conclusively that it is economical to develop another facility.

***Natural meaning of criterion (b)***

7.21 Clearly in applying and interpreting criterion (b) the Council must accord primacy to the language of criterion (b). Criterion (b) does not simply ask whether the facility exhibits natural monopoly characteristics or whether it would be **more** economical to use the existing facility rather than develop another facility (as the Council's natural monopoly test implies). Rather, it asks whether it would be uneconomical, in an absolute sense, for anyone to develop another facility. Had Parliament intended criterion (b) to apply a comparative test, then the section would have said so. The use of the phrase 'uneconomical for **anyone**' further reinforces that the private investment test is preferred. Accordingly, the natural meaning of the words in criterion (b) indicate the test is 'would it be economical for a private investor to duplicate the facility?'

***US Essential Facilities doctrine***

7.22 The conclusion suggested by the natural meaning of the words used in criterion (b) is reinforced by the fact that the US essential facilities doctrine also applies a private 'practical and feasible' test. Set out in Annexure A is a statement from Professor Joseph P Kalt, that outlines the approach taken by the US essential facilities doctrine to the equivalent of criterion (b), and the economic and policy reasons underpinning the US approach. Also attached as Annexure B is a statement from Professor William Baumol in which he endorses the opinion of Professor Kalt and offers further insight into why a private feasibility test, rather than a social economic efficiency test, should be applied.

7.23 Professor Kalt explains that the essential facilities doctrine represents a set of economic principles and associated policy guidelines governing conditions under which sound public policy intervenes in the economic relations between parties in the market place by mandating access to activities or facilities when those activities and facilities are asserted to be unique or otherwise necessary ingredients for the provision of Services to the market place. In the US, four criteria are applied by the courts in determining whether a facility is considered 'essential' for antitrust purposes. These criteria have been set out with clarity in *MCI Communications Corporation v American Telephone and Telegraph*.<sup>23</sup> These criteria are:

- (1) control of the essential facility by a monopolist;
- (2) a competitor's inability practicably or reasonably to duplicate the essential facility;
- (3) the denial of the use of the facility to a competitor; and
- (4) the feasibility of providing [access to] the facility.

7.24 It can be seen immediately that criterion 2 of the essential facilities doctrine does not ask whether it would be uneconomical in a social sense to duplicate a facility; what is required

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<sup>23</sup> 708F.2d 1081, 1132 (7<sup>th</sup> Circuit 1983).

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is that a competitor could not reasonably or practicably duplicate the facility. As Professor Kalt explains at paragraph III(B)(4)(c) of his statement, US courts have held that:

[A] plaintiff must show more than inconvenience, or even some economic loss; he must show that an alternative to the facility is not feasible.<sup>24</sup>

- 7.25 The access regime established by Part IIIA of the TPA is, of course, not exactly the same as the US essential facilities doctrine. It is clear, however, that the Hilmer Committee had regard to the US essential facilities doctrine in recommending the introduction of Part IIIA of the TPA. The fact that the US essential facilities doctrine applies a private practical and reasonable test is relevant to understanding the natural meaning of the words in criterion (b) of section 44G(2) of the TPA.
- 7.26 This is further reinforced by the sound economic and public policy reasons underpinning why the US courts apply a 'practical and reasonable test' rather than natural monopoly test, as outlined in Part III of Professor Kalt's statement. In summary, if it is practically and reasonably feasible, in a private sense, for an alternative facility to be constructed and the incumbent refuses access to the existing facility, then by definition the alternative facility will be built. If the incumbent had been making monopoly profits in a related market, those monopoly profits will be lost whether or not the incumbent grants access. Because in these circumstances the incumbent knows that its rival will enter the related market come what may, it will (in order to maximise its own profits) be prepared to grant access, provided the price it can charge for access exceeds the costs it would incur in providing that access. The price the incumbent could charge for access will be capped by the amount it would cost the rival to build its own facility. In other words the forces of the market place will lead the incumbent to grant access in circumstances where its costs of providing access are less than the cost of building an alternative facility. In this way the US 'practical and reasonable test' results in market forces performing the social cost/benefit test and determining whether or not it is wasteful to build the new entrant's rival facility. From a policy perspective using market forces and the competing parties' respective self interest to compel them to assess accurately the costs and benefits of the alternatives is clearly preferable to the Council, the Minister and the Tribunal making such determinations. A regulatory 'mandated' view that the costs of sharing are lower and that access should therefore be imposed, runs a significant risk of being in error. The consequences of an incorrect determination are likely to be substantial (addressed in greater detail in Section 11 of this Submission). It is inappropriate to take this risk when market forces will determine the correct position.
- 7.27 Professor Baumol points out that the damage that flows from a regulatory body making determinations that would otherwise have been made by the marketplace is even more costly than the consequences outlined in Section 11 of this Submission. As Professor Baumol concludes:

To mandate access in such a situation runs the risk, not only of second guessing the market as to the true cost of access (and hence whether it would be 'more efficient' to use another

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<sup>24</sup> *Twin Laboratories, Inc. v Weider Health & Fitness* 900 F.2d 566, 570.

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facility than to share), but also of encouraging into the market an inefficient operator who needs subsidization to survive.

7.28 Accordingly, RTIO submits that the clear language of criterion (b), the guidance provided by US courts in applying the essential facilities doctrine, and the sound economic and public policy principles underpinning that approach, all indicate that a private investment test is to be preferred to the Council's natural monopoly test.

**(c) Position When The Facility Has Been or Will Be Duplicated**

7.29 As discussed at paragraphs 7.3 to 7.6 above, and consistent with the position of the Tribunal in the *Duke EGP decision*, referred to at paragraphs 7.4 and 7.6 above, even if a natural monopoly test is applied regard must be had to existing facilities and facilities that will be built irrespective of the outcome of the access Application. For the reasons outlined below, RTIO does not agree with the statements at paragraphs 4.35 and 4.87 of the Council's Guidelines, which state:

4.35 In these circumstances, it is possible to envisage a case where criterion (b) is satisfied even though competing services exist. criterion (b) is a test of whether a facility can serve the range of foreseeable demand for the services provided by the facility at less cost than that of two or more facilities. The status of a facility against this test does not change merely because another facility is inefficiently developed.

...

4.87 Where, however, an existing facility already provides (or could provide with only minor modifications or enhancements) the services provided by the facility subject to declaration, it does not necessarily follow that criterion (b) will not be satisfied. As discussed in paragraphs 4.30-4.39, a facility can exhibit natural monopoly characteristics whether or not it is the only one. Private considerations can make it commercially viable for an infrastructure owner to build another facility even though this would be inefficient if all social costs were considered. criterion (b) may be satisfied even when competing services exist.

7.30 Attached as Annexure C is a statement from Professor Janusz Ordover, upon whose analysis (in relation to the Moomba to Sydney pipeline coverage 'revocation application') the Council has placed considerable reliance in interpreting criterion (b). Professor Ordover disagrees with the Council's position as expressed in paragraphs 4.35 and 4.87 of the Guidelines. Also attached as Annexure D is a statement from Professor Robert Willig in which he endorses the opinions of Professor Ordover that the position of the Council, as expressed in paragraphs 4.35 and 4.87, is misconceived.

7.31 Professor Ordover remains of the view that, as was the case in relation to the Moomba to Sydney Pipeline:

When presence or entry of another facility is not at issue because there is no parallel (or otherwise equivalent) facility in place or when there is no independent commitment to construct such a facility, the regulatory assessment whether it would be 'uneconomical' for anyone to develop such facility must *per force* be based on purely technical criteria [ie, a natural monopoly test].

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In such circumstances Professor Ordovery endorses the application of a natural monopoly test. For the reasons given above, RTIO does not agree with this view and believes that a private test should be applied. Interestingly Professor Willig is much less enthusiastic about the appropriateness of applying a natural monopoly test as the sole determinant of whether criterion (b) is satisfied, even in situations where there is no other existing or likely alternative.

- 7.32 Professor Ordovery goes on to explain, however, that it is not appropriate to apply a technical natural monopoly test where a facility has actually been duplicated or will be duplicated:

On the other hand, when entry has already occurred or when there is an independent commitment to entry, even if such entry seemingly makes no sense when assessed from the vantage point of minimization of social costs, then the technical assessment whether it is or is not economic (or 'uneconomical') to build a parallel facility is 'trumped' by the revealed behavior of market participants. From the public policy perspective, revealed market conduct is more pertinent to the decision whether or not to subject the incumbent to an access regime than an *ex ante* technical test. Simply put, if another facility has been constructed (or will be constructed), it makes no sense for the regulator to conclude that it would be 'uneconomical' to develop that other facility using the 'technical test' that I proposed. Indeed, while such a finding might be of purely academic interest it is not, in my view, of consequence for the regulatory decision whether to declare the service or not. ... it makes no sense to apply the *ex ante* economic efficiency test (natural monopoly test) or any other test as to what 'uneconomical' means if the market has already revealed that private incentives are sufficiently strong to promote entry.

- 7.33 Professor Ordovery then goes on to explain that if, notwithstanding the above, the natural monopoly test were to be applied in a situation where a facility has been or will be duplicated, the sunk costs of the existing facility (the Mt Newman railway line here) and the sunk costs (or costs that would inevitably be sunk) of the rival facility (the Chichester Line here) should be disregarded.<sup>25</sup> As Professor Ordovery concludes, it would not be possible to be satisfied based on incremental operating costs alone that one or other facility was a natural monopoly in a technical sense:

If notwithstanding the above, it is decided that there should be a technical application of the *ex ante* economic efficiency test when the facility has in fact been duplicated or there is an independent commitment to duplicate, the way in which the NCC proposes to apply the test (as described in paragraphs 4.35 and 4.87 of the [Guidelines] and paragraph 5.10 of the Issues Paper) is flawed. As I explain below, once the facility has been constructed (or committed to be constructed) the only meaningful economic efficiency test that could be applied would examine whether for the incremental units of service it is more efficient to use the facility of the incumbent or that of the entrant. From that perspective, all the sunk and fixed costs associated with entry (such as the construction of the track) should be disregarded.

- 7.34 Professor Willig agrees with Professor Ordovery's conclusion:

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<sup>25</sup> This, of course, is not to suggest that any access charge would not include a capital component, just that in determining what is economically efficient in a social sense, sunk costs must be disregarded.



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[The NCC's position as stated in paragraphs 4.35 and 4.87 of the Guidelines] insists that a sometimes useful indicator trumps direct and uncontroverted evidence of what the indicator can sometimes (but not always) illuminate. Instead, a finding that there has been construction of duplicate facilities (or credible commitment to timely construction of duplicate facilities) by an independent firm that could provide the same service should end the inquiry into declaration, regardless of whether an *ex ante* analysis would show natural monopoly.

- 7.35 As a result of the above, if the natural monopoly test is correctly applied in the context of FMG's declaration Application the only question becomes whether it is more economical for FMG to access the BHPBIO Mt Newman railway line rather than it or someone else constructing a spur line connecting Mindy Mindy and the Chichester Line. As Professor Ordover states:

Indeed, the decision whether it is uneconomical to develop a facility that runs from the Junction to the Mindy Mindy Connection Point should not be based on the assumption that the pertinent costs include the costs of building the 200 km railroad facility from the Junction to Port Hedland. The proper assessment should focus on whether that part of the Mount Newman line that could be used as part of a spur line to connect to the FMG line at or in the vicinity of the Junction is a natural monopoly or not.

- 7.36 The relevant part of the Mt Newman railway line that would be used as part of a spur line to connect to the FMG Chichester Line is shown on the map exhibited as Chart 1 (the **Mt Newman Spur Portion**). The Mindy Mindy connection point is designated by an 'X' and the point at which Mindy Mindy would leave the Mt Newman railway line (if that line were used as part of a rail spur from Mindy Mindy to the FMG Chichester Line) is designated by a 'Y'. These points have been derived from the map exhibited as Chart 2, which is the map prepared by FMG for its Stage B PER showing the proposed alignment for both the Chichester Line and its Mindy Mindy line. The point of departure from the Mount Newman alignment (designated as 'Y' on Chart 1) is the point at which FMG chose to leave that alignment in its construction plans. The length of the Mt Newman Spur Portion is approximately 78 km and the length of the spur from the Mt Newman railway line (point Y) to the Chichester Line (the **Chichester Link**) is approximately 17 km.<sup>26</sup>

- 7.37 Not only do the principles espoused by Professor Ordover require that the analysis of criterion (b) be confined to the Mt Newman Spur Portion, but such an approach would be consistent with section 44F(4) of the TPA which requires the Council to:

...consider whether it would be economical for anyone to develop another facility that could provide part of the service.

- 7.38 As Professor Ordover points out, the answer to this question in respect of the 200 km where FMG's Chichester Line tracks the Mt Newman railway line is unequivocally 'Yes'. Once this position is reached, if the Council proposes still to consider the Application, the only issue to consider is whether it would be uneconomical for anyone to develop another facility to provide the same 'Service' as would be provided by the Mt Newman Spur Portion. If the natural monopoly test, as espoused by the Council, is to be used then the analysis

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<sup>26</sup> Evans & Peck report, annexure E, page 22.

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would entail an assessment of whether the Mt Newman Spur Portion is a natural monopoly.

**(d) Costs of Mindy Mindy Spur Relative to Costs of Access**

7.39 Even if the Council applies its natural monopoly test to the Mt Newman Spur Portion it will be impossible for the Council to conclude that the Mt Newman Spur Portion 'can meet the reasonably foreseeable demand for the service more cheaply than two ... facilities' (Issues Paper, paragraph 5.5). RTIO submits that the two facilities that could meet the foreseeable range of demand more cheaply would be:

- (a) a spur line constructed by the Mindy Mindy project from the mine to the most practical junction point with the FMG Chichester Line (which we assume is the point chosen by FMG for such intersection as depicted in Chart 2); and
- (b) the Mt Newman Spur Portion,  
run as two independent facilities.

7.40 As the Council points out in paragraph 5.6 of the Issues Paper, the first step is to determine 'current demand and demand in the reasonably foreseeable future'. According to its Press Release on 25 October 2004, BHPBIO is currently undertaking an expansion that will increase production to 118 mtpa by 2006 and is conducting a feasibility study to further increase production.<sup>27</sup> It is understood that the second expansion proposal referred to in that Release is now well progressed and that the likely production to be achieved by that expansion will be in excess of 150 mtpa.<sup>28</sup> It is understood that the 150 mtpa will therefore be railed entirely on the Mt Newman Spur Portion (with some of that production joining the Mt Newman railway line at the Yandi junction). If Mindy Mindy is developed, according to the Stage A PER the production rate is to be 10 mtpa (68 mt total resource mined over six years).<sup>29</sup> Thus the range of demand in the reasonably foreseeable future will be at least 160 mtpa. It is interesting that FMG, in paragraph 13.3 of its Application, concedes that the capacity of the Mt Newman railway line, without significant expenditure on expansion, is 150 mtpa.

7.41 RTIO commissioned a consulting firm, Evans & Peck, to build a model and undertake analysis so as to estimate the costs that would be involved in having Mindy Mindy product transported on the Mt Newman Spur Portion, assuming BHPBIO railings were 150 mtpa. Their report is attached as Annexure E. In sum Evans & Peck estimate that, without taking into account the unforeseen costs that are impossible to estimate but inevitably occur when two or more companies share a facility (discussed further in paragraph 7.43 below):

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<sup>27</sup> 'BHP Billiton Approves expansion of Western Australian Iron Ore capacity to 118 Million Tonnes per Annum', 25 October 2004 ([www.bhpbilliton.com](http://www.bhpbilliton.com)).

<sup>28</sup> *Iron Chronicle*, Volume 407 March 2005, page 2 (<http://ironore.bhpbilliton.com/docs/2005BhpChronicleMarch.pdf>).

<sup>29</sup> The Stage B PER at page 83, refers to the Mindy Mindy deposit having a life of six years. The same document, at pages xiii and 57, refers to a resource of 68 mt. Moreover, FMG's conceptual mine schedule illustrates a six year life. These items in combination infer a 10 mtpa rate. Also a presentation by FMG at the 'Explorers Conference', which was released to the ASX on 4 March 2004, refers to Mindy Mindy targeting 10 mtpa.



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- (a) the additional capital costs that would be involved in Mindy Mindy using the Mt Newman Spur Portion, taking account of such expenditure as would be required to make such usage feasible and, to the extent possible, allowing BHPBIO and the Mindy Mindy project to rail at full production rates; and
  - (b) the present value of the additional operating costs, and the interruption costs that are able to be estimated but cannot practicably be avoided, due to the usage of the Mt Newman Spur Portion by the Mindy Mindy project,

total between A\$114 million and A\$129 million. This is without any payment by the Mindy Mindy joint venture to BHPBIO for the usage of BHPBIO's capital assets and without the inestimable additional costs that inevitably occur when a single user facility is used by more than one user (addressed in paragraph 7.43 below).

- 7.42 By contrast FMG has announced that it can construct the Chichester Line, which is a full service line involving signalling and facilities capable of servicing 45 mtpa of production, at a cost of A\$1.27 million per kilometre.<sup>30</sup> Such a full service line would need more equipment (for example, signalling) than a spur line that only serviced 10 mtpa from Mindy Mindy. Nevertheless, allowing even the same per km rate would require expenditure of only A\$99 million to replicate the 78 km of the Mt Newman Spur Portion.<sup>31</sup> Thus without allowing for the unforeseen and inestimable costs that inevitably arise from sharing a facility and without allowing for a capital usage charge properly payable from FMG to BHPBIO, the cost of FMG constructing and operating its own facility would be less than the true cost of FMG sharing the Mt Newman Spur Portion with BHPBIO.<sup>32</sup>

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<sup>30</sup> FMG has released a number of presentations to the ASX which state that the estimated cost of the 'below track' for the Chichester Line is A\$515 million (eg, presentation given by FMG at the 'Explorers Conference' which was released to the ASX on 4 March 2004; presentation entitled 'Financing Strategy' which was released to the ASX on 8 March 2004; and presentation given by FMG entitled 'Investor Presentation' which was released to the ASX on 24 November 2004). We estimate that the length of the Chichester Line is 405 km (345 km (length of north-south railway as estimated in the Stage A PER) minus 100 km (estimated length of Mindy Mindy spur) plus 160 km (estimated length of east-west railway as estimated in the Stage B PER)). As such, the estimated cost per kilometre equals about A\$1.27 million (A\$515 million divided by 405 km).

<sup>31</sup> The cost of constructing the Chichester Link has not been included. This is because, for economic reasons, the Chichester Link will be built even if access to the Mt Newman line is granted. It would be cheaper for FMG to build the Chichester Link than pay the additional cost that would be required to allow for congestion through the Chichester Ranges (difficult terrain and steep grades) if Mindy Mindy stayed on the Mt Newman railway line until the point where the Mt Newman railway line and the Chichester Line almost intersect. This is scenario 2 in the Evans & Peck report (Annexure E) and adopting this route would entail additional costs of A\$69 million, an amount that is considerably above the construction costs of the Chichester Link, based on FMG's costings.

<sup>32</sup> In its most recent presentation to the Sydney Mining Club on 5 May 2005, FMG has acknowledged the likelihood of an increase from its original total estimated project cost of A\$1.85 billion. However, no new cost estimate has been provided other than an indication that the total cost will now likely exceed A\$2 billion. However, a commensurate increase in the assigned cost per kilometre for a rail spur line will not alter the analysis set out in this Submission.

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7.43 However, the inestimable and unforeseen costs referred to in paragraph 7.41 cannot be ignored. Section 11 of this Submission discusses the inevitability of lost capacity when more than one user operates on the same facility. This is the experience of Pacific National Pty Limited (***Pacific National***) that operates on both dedicated and multi-user facilities and has been the experience with the Hunter Valley rail system. These costs result from clashes that cannot be resolved by engineering or any other solutions. They occur because two or more operators have communication breakdowns, apply different maintenance, training or safety standards or are driven by self interest rather than the interest of maximising capacity of the facility as a whole. In doing its analysis as to the true costs of Mindy Mindy production being carried on the Mt Newman Spur Portion, the Council needs to make an allowance for the costs of this lost capacity. As the rail system will be running at full capacity, such lost capacity will result in lost sales. The BHPBIO trains on the Mt Newman railway line carry about 30,000 tonnes of iron ore each. At an average 2005 price of \$US40 per tonne, this equates to sales revenue lost to BHPBIO (and Australia) of about US\$1.2 million per lost train. Whilst it may be difficult to estimate in advance the number of lost trains that will inevitably result from multiple usage, at such a significant per train value, it is not difficult to postulate a very significant present value for such lost capacity. Examples of unexpected but inevitable events that would result in loss of capacity that would not have occurred if the railway facility were not shared include:

- for whatever reason (eg, a mishap at a loadout facility) a train does not take its allocated slot and this is not communicated to the other users in time for that user to reschedule;
- a derailment of a train that would not have been on the relevant track if there had been independent facilities; and
- any interruption to a train (affecting that train and potentially others) if that train would not have been on that facility had there been independent facilities.

**(e) Conclusion**

7.44 RTIO considers that a private investment test should be applied in considering whether criterion (b) is satisfied. The Chichester Line linking FMG's Chichester Ranges deposits to Port Hedland will be built irrespective of the outcome of the access Application. The Stage A PER and the 12 April 2005 announcement by Consolidated Minerals strongly suggest that the construction of a line linking Mindy Mindy to the Chichester Line is economically feasible in a private sense. Furthermore, the analysis in paragraphs 7.39 to 7.43 above suggests that, if the Mindy Mindy development is viable at all, the construction of a low cost spur is likely to be a cheaper option than accessing BHPBIO's Mt Newman railway line. Accordingly, if a private test is applied, then a spur line to the Chichester Line will pass the necessary private investment hurdles (demonstrating that it is economical) well before access to the Mt Newman railway line will pass those hurdles.

7.45 Even if a natural monopoly test is applied, regard must be had to alternative facilities that already exist, or that will be built irrespective of the outcome of the relevant access Application. This is confirmed by Professor Ordovery's statement and Professor Willig's statement. For the reasons espoused by Professors Ordovery and Willig, even if a natural

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monopoly test, as applied by the Council, is to be used, then in this case the analysis must be confined to an assessment of whether the Mt Newman Spur Portion is a natural monopoly.

7.46 When:

- (a) the additional A\$114 million to A\$129 million capital and operating costs estimated by Evans & Peck; and
- (b) an allowance for inevitable lost capacity that cannot be engineered out of the system when two or more users share a facility,

are each taken into account, it is not possible for the Council to be positively satisfied that the costs of constructing a spur line linking Mindy Mindy to the Chichester Line would exceed the costs of the Mindy Mindy Project and BHPBIO sharing the Mt Newman Spur Portion. In fact, the Council should conclude that the cost to society as a whole (and to the Mindy Mindy development itself) would be lower if Mindy Mindy built and operated its own spur line, and BHPBIO continued to operate its Mt Newman railway line as an integrated and dedicated facility.

7.47 Accordingly, whether a private test is applied or a natural monopoly test is applied, criterion (b) is not met.

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## 8. Promotion of Competition in Another Market

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- 8.1 Section 44G(2)(a) of the TPA provides that the Council cannot recommend that a service be declared unless it is satisfied:
- that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.
- (a) **The Future With and Without Coverage – The Implications of Protected Contractual Rights**
- 8.2 The Council states at paragraph 5.60 of its Guidelines:
- [Criterion (a)] is assessed by a comparison of the future conditions and environment for competition with and without **declaration**. The Tribunal determined in the Sydney Airports decision – and affirmed in the Duke EGP decision – that the criterion (a) assessment requires a consideration of the future with and without **declaration** because access refers to the right to negotiate access to a declared service (emphasis added).
- 8.3 RTIO agrees that criterion (a) requires a comparison of the future with and without declaration.
- 8.4 In applying the 'future with and without declaration' test, it is important to accurately identify what may occur as a result of declaration. The only direct consequence of declaration is that if a third party is unable to agree with a provider on one or more aspects of access to a declared service, then the provider or the third party may notify the Australian Competition and Consumer Commission (the **ACCC**) that an access dispute exists. The ACCC may then arbitrate that dispute and make a determination that is binding on the access provider.
- 8.5 Section 44W(1)(c) of the TPA provides, however, that the ACCC must not make a determination in respect of an access dispute that would have the effect of 'depriving any person of a protected contractual right'. 'Protected contractual right' is defined in section 44W(5) of the TPA as 'a right under a contract that was in force at the beginning of 30 March 1995'.
- 8.6 RTIO understands that BHPBIO conducts the operations relevant to the Services provided by the facility pursuant to the terms of the Mt Newman State Agreement. BHPBIO has been granted a special lease (Port Hedland to Mount Newman (Lease No. 3116/3687)) (the **Special Lease**) pursuant to clause 8(1)(b) of the Mt Newman State Agreement.
- 8.7 This Special Lease was granted pursuant to section 116 of the *Land Act 1933 (WA)* (now the *Land Administration Act 1997 (WA)*), as amended by the applicable State Agreements. A lease such as the Special Lease confers on the lessee the right to 'exclusive possession' of the leased land. While the Special Lease contains a number of reservations to allow representatives of the State or local government to have limited access to the lease area, it confers on BHPBIO the right to:

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...peaceably hold and enjoy the demised premises during the ... term without any interruption by the [Crown or the Minister for Lands] or any person rightfully claiming through under or in trust for [Crown or the Minister for Lands].

This is consistent with, and reinforces, BHPBIO's right of 'exclusive possession'.

- 8.8 As a consequence of the rights conferred by the Mt Newman State Agreement and the Special Lease issued under it, BHPBIO is entitled to the exclusive right to occupy the relevant land comprising its rail corridor, and the exclusive possession of its rail facilities, for the purposes of conducting its railway operations. As the Mt Newman State Agreement and the Special Lease were in force at the beginning of 30 March 1995, each of these rights is a 'protected contractual right' within the meaning of sections 44W(1)(c) and 44W(5) of the TPA.
- 8.9 Accordingly, the ACCC would be prevented by section 44W(1)(c) of the TPA from making an arbitration decision that required BHPBIO to provide a service comprising use of the Mt Newman railway line to a third party. This means that with or without declaration, a third party could not obtain an arbitration decision from the ACCC that required BHPBIO to provide the Service. Third parties will continue to have an enforceable right to negotiate and enter into a contract for the carriage of iron ore products by BHPBIO pursuant to clause 9(2)(a) of the Mt Newman State Agreement and the Rail Transport Agreement. This right does not, however, extend to track access, as is sought by FMG's Application.
- 8.10 As a consequence of the above, the Council cannot be satisfied that declaration would promote competition in any relevant market, however defined.
- 8.11 In RTIO's view, the above analysis means that criterion (a) cannot be satisfied and there is no need for further enquiry in relation to the matters raised in the Council's Issues Paper. Nonetheless, if the Council does not accept the above, we set out below submissions about the relevant markets identified by the Applicant and a consideration of whether competition in any of those markets would be promoted by declaration (leaving aside the point about protected contractual rights noted above).

**(b) Markets Identified By The Applicant**

- 8.12 The Applicant has identified in its Application the following markets in which access (or increased access) to the Service would promote competition (at paragraph 12.1 of the Application):
1. iron ore production both within Australia and other countries;
  2. production, development and exploitation of other minerals and products in the Pilbara region of Western Australia requiring transport service from the source of production to port facilities at Port Hedland;
  3. ownership, development and exploitation of iron ore tenements;
  4. the haulage of iron ore and other minerals from various mine sites in the Pilbara region of Western Australia;
  5. retail of iron ore and other minerals, both as sold at the mine and also as sold at export terminals; and

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6. export of products from Port Hedland (by rail, road and sea).

8.13 RTIO has the following observations about these six dependent 'markets':

- iron ore production (item 1) and the retail of iron ore (item 5) clearly occur within the same market; and
- reference is made to the production, development and exploitation of other 'minerals and products' in the Pilbara and the export of 'products' from Port Hedland (items 2, 4 and 6). Other than iron ore, no minerals or products requiring rail transport services or export from Port Hedland are identified. The mere:
  - listing of a few examples of other minerals without identifying credible development opportunities (see paragraph 7.1 of FMG's Supplementary Submission dated 11 June 2004); and
  - assertion by FMG about the prospect of 'other minerals and products' using a heavy haul specific purpose iron ore railway line,

does not establish a market for such products. Apart from the fact that the Pilbara is known as an iron ore province and is not renowned for other minerals, even if other minerals were found it is more likely than not that they would be entirely unsuitable for transport on a purpose built heavy haul railway line between a point near Mindy Mindy and Port Hedland (eg, gold and diamonds).

8.14 Accordingly, FMG has not established that these suggested 'markets' exist and they are not considered further in this Submission. As a consequence, in this Submission, RTIO addresses three possible dependent markets:

- the iron ore market (items 1 and 5);
- the hypothetical market for the haulage of iron ore in the Pilbara (item 4); and
- the hypothetical market for the ownership, development and exploitation of iron ore tenements (item 3).

8.15 Each of these markets is considered in turn below. In relation to each market the Submission considers:

- is the relevant 'market' a market that exists and is separate from the market for the Service? and
- if the relevant market is considered by the Council to be a separate market, would the granting of access to the Service promote competition in that market?

8.16 Attached as Annexure F is a statement by Mr Philip Williams of Frontier Economics Pty Limited (**Frontier Economics**) considering whether criterion (a) is satisfied in relation to any of these three possible dependent markets asserted by the Applicant.

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**(c) Iron Ore Market**

***Not a different market from the market for the Service***

- 8.17 For the reasons set out in paragraphs 48 to 60 of Mr Philip Williams' statement, the Service is part of the iron ore production market.
- 8.18 The Council's Guidelines outline when the Council will treat different stages of production as functionally separate markets. The Council states at paragraph 5.23:
- 5.23 The Council requires the following conditions to be met for markets to be regarded as functionally separate:
- (a) the layers at issue must be separable from an economic point of view (economically separable). That is, the transaction costs in the separate provision of the good or service of the two layers cannot be so large as to prevent such separate provision from being feasible. In effect, to be in different markets, vertical integration must not be inevitable; and
  - (b) each layer must use assets sufficiently specific and distinct to that layer such that the assets cannot readily produce the output of the other layer (economically distinct). In effect, supply-side substitution must not be so readily achievable as to unify the field of rivalry between the two layers.
- 5.24 In the Sydney Airport decision, the Tribunal found that functional market definition depended on whether there were overwhelming economies of joint production or joint consumption that dictated that the vertically related activities must occur within the same entity. Similarly, Brunt (1990) refers to the equally broad 'efficiencies of vertical integration'. Both the Tribunal's approach in the Sydney Airport decision and the above test of economic separability are concerned with the viability of vertical separation.
- 8.19 In RTIO's submission, the efficiencies arising from vertical integration between mine operations, rail transport, port handling, shipping and selling of Pilbara iron ore are so overwhelming as to make those activities part of the same functional market.
- 8.20 The efficiencies created by a mine operator controlling its rail and port functions are the same as those that have been addressed in connection with the invoking of the 'production process' exception. Even if the Council is of the view that the Mt Newman railway line is not part of BHPBIO's production process, it is a separate question as to whether each Pilbara producer's rail activities are so integrally linked with its other iron ore activities that all such activities are in the same market.
- 8.21 Control of the railway line creates the system flexibility needed to operate a process to produce iron ore to customer specification using ore from different mines or parts of mines. For example, by controlling train scheduling a mine operator can ensure the optimum mining plans for each mine are used, with precisely the right quality and quantity of iron ore being delivered from each mine to port at precisely the right time so as to create the necessary blend of product for export purposes. Control of day-to-day operations of the railway line also allows the mine operator to respond to the small changes in operations that are a normal feature of any production environment. For example, the grade or tonnage of ore in fact available from a particular mine may be different from that expected,



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in which case the entire recipe for the specification being produced may need to be revised with consequent changes to train scheduling. It is also possible, for example, to utilise the rail system itself in blending through scheduling and operational flexibility (for example, by leaving a train loaded with a particular quantity and quality of ore in a siding until required).

- 8.22 Iron ore mines, particularly those located in remote areas, are critically dependent on their rail operations. The ability to run additional trains or alter train timetables at short notice to meet shipping and customer requirements is crucial. This flexibility can be obtained only if a mine operator controls its own rail system. In addition, any breakdown or accident affecting the rail system, particularly in a remote area, can cause very significant losses to a mine operator either as a result of demurrage or lost sales. If a mine operator controls its own rail and port system it can manage these risks in a way that is not possible if third parties outside its control also use the railway line (this issue is addressed further in Section 11 below).
- 8.23 It is feasible in a remote area such as the Pilbara for a mine operator to own and operate its own railway system. The position in the Pilbara can be contrasted with the position in, say, the Hunter Valley in relation to coal, where a combination of environmental concerns, high land values and the presence of a government-owned railway line, mean that it is unlikely to be feasible for a private operator to construct its own railway line, whatever the efficiencies of doing so may be.
- 8.24 Given the efficiencies of Pilbara iron ore mines owning their own railway systems, it is not surprising to observe that, in practice, mine operators in the Pilbara do own their own railway systems. In the Pilbara BHPBIO, Hamersley and Robe each constructed their own railway lines and ports. The fact that Pilbara operators choose to operate their own railway lines is reinforced by:
- (a) FMG having chosen to construct its own railway line linking its principal mine sites in the Chichester Ranges to Port Hedland; and
  - (b) Hope Downs, notwithstanding that it has an enforceable right to have BHPBIO carry its ore, having recently stated its intention to build and operate its own dedicated railway.<sup>33</sup>
- 8.25 The overwhelming efficiency advantages of an iron ore mine operator in the Pilbara controlling its own railway line, coupled with the fact that, in practice, iron ore mine operators in the Pilbara do own their own rail systems, mean that the Council cannot be satisfied that the Service operates in a market separate from the iron ore market.
- 8.26 This conclusion means that the Council cannot be satisfied that criterion (a) is satisfied in relation to the iron ore market.

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<sup>33</sup> Hopes down: Gina derails FMG', *The Australian*, 13 April 2004, page 31; Hope Downs Iron Ore Project Presentation, March 2005 ([www.hancockprospecting.com.au](http://www.hancockprospecting.com.au)).



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***No promotion of competition in the iron ore market***

8.27 Even if the Council is of the view that the Service was provided in a separate market to the iron ore market, declaration would not promote competition in that latter market. Set out below is discussion first, of the appropriate market definition, and secondly, of the reasons why declaration would not promote competition in the iron ore market.

***Market definition***

***Product dimension***

8.28 As the Council notes in its Guidelines, defining the relevant product market(s) requires analysis of the availability of substitutes on the demand and supply side, such that separate product markets exist if their respective products are not substitutable in demand or supply.

8.29 Iron ore is exported from Australia to integrated iron and steel producers and to direct reduction plants throughout the world. Iron ore is the basic raw material for iron production, regardless of the process used (blast furnace or direct reduction). Iron is used in steel making, as is scrap steel. Steel making is a separate process from iron production and is produced in a basic oxygen furnace, an electric arc furnace or an open hearth furnace. The main importers of iron ore are the integrated iron and steel producers, who are generally referred to as steel mills.

8.30 Iron ore is sold in its natural state in two forms: lump, with a particle size above about 8-10 mm diameter (which can be fed directly into blast furnaces); and fines, with a particle size below 8-10 mm diameter (which require sintering (ie, aggregating into clusters) before being fed into blast furnaces). Fines may also be concentrated to produce pellets before being fed into the iron making process. Direct reduction plants can use lump, fines or pellets depending on the plant technology and design.

8.31 RTIO submits that there is a single iron ore product market that includes all supplies of iron ore, without distinction between fines, pellets and lump, for the reasons given at paragraphs 81 to 88 of Mr Philip Williams' [statement](#). In summary:

- lump and fines are jointly produced as outputs of the same production process. A firm cannot produce lump without also producing fines;
- the various types of iron ore have a high degree of demand substitutability since iron ore users can, to a significant extent, switch among the three types of ore. Sintering is carried out by the steel mills. Sintering allows fines to be used in all applications requiring lump, with the only real limit being steel mill sintering capacity shortage in times of high capacity utilisation. Fines are often preferred in times of excess capacity in the steel mills because of their lower cost compared with higher quality lump; and
- whilst the absolute levels of price of these different types of ore differ significantly [as a result of the differences in processing and in the case of pellets iron content](#), price changes are highly correlated. The correlation of price movement strongly supports the three forms of iron ore being in the same market.

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8.32 RTIO recognises that the Commission of the European Communities (the **CEC**) has previously considered that there are separate product markets for sinter fines, lump and pellets in assessing a number of merger notifications in the iron ore industry.<sup>34</sup> For the reasons given above, RTIO does not agree with the CEC's finding of three separate product markets.

*Geographic dimension*

8.33 The geographic dimension of a market is the geographic area or areas in which sellers of the particular product operate and to which purchasers can practicably turn for such goods or services. Whilst section 4E of the TPA refers to a market in Australia, section 44G(2)(a) of the TPA requires declaration analysis to be conducted in relation to markets whether or not in Australia.

8.34 Iron ore, like most metals and minerals, is actively traded as a commodity on a global basis. The CEC, in the decisions referred to above, found that the iron ore market was global. The CEC also distinguished between 'domestic' and 'seaborne' iron ore trade. Whilst RTIO also does not agree with this aspect of the CEC's decisions, since the decisions were handed down the propensity of Chinese buyers to purchase both domestic and imported ore and substitute one for the other depending on price, availability and quality has increased considerably. Therefore, RTIO is even more strongly of the view that seaborne and domestic iron ore are part of the same market.

8.35 Even if the Council is of the view that the relevant geographic market should be confined to seaborne iron ore, it is important to recognise that the CEC in the *Caemi decision # 2*,<sup>35</sup> found that the geographic scope of the seaborne iron ore market is worldwide. This is also the view of Mr Philip Williams for the reasons given in Section 6.1.1 of his statement. In summary, Mr Williams' reasons for reaching this view include:

- most seaborne suppliers sell in most seaborne areas, and most seaborne customers buy from iron ore producers worldwide; and
- price levels and contractual conditions are determined on the basis of overall market conditions in the seaborne market.

*Functional dimension*

8.36 For the reasons outlined above, RTIO submits that the relevant iron ore market encompasses all activities from development, mining, processing and transportation, to the sale of iron ore.

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<sup>34</sup> Case No COMP/M.2062 – decision in respect of the Rio Tinto/North Ltd takeover (1 August 2000) (*North decision*); Case No COMP/M.2420 – decision in respect of the joint acquisition of Caemi by CVRD and Mitsui (30 October 2001) (*Caemi decision # 1*); and Case No COMP/M.3161 – decision in respect of the purchase by CVRD of Mitsui's interest in Caemi (18 July 2003) (*Caemi decision # 2*).

<sup>35</sup> See *Caemi decision # 2*, [24]. See also detailed analysis of the Commission in *Caemi decision # 1*, [141-164].

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***No promotion of competition***

- 8.37 If the Council is of the opinion that the market for the Service is separate from the iron ore supply market (a position that RTIO strenuously rejects), RTIO considers that declaration could not promote competition in that market.
- 8.38 Criterion (a) is to be assessed by a comparison of the future state of competition in the relevant market(s) with and without declaration.
- 8.39 In this respect, as the Council has recognised in its Guidelines, the object of criterion (a) is to limit declaration to bottleneck or essential facilities in circumstances where access to the Services provided by the facilities is *essential* to permit 'effective competition' in a downstream or upstream activity (at paragraphs 5.61-5.62). As the Council also recognised in its Guidelines, a reference to 'effective competition' is not a reference to perfect competition, it is a reference to a degree of competition required for prices to be driven towards economic costs and for resources to be allocated efficiently at least in the long term.
- 8.40 RTIO submits that criterion (a) is not satisfied in this case because:
- declaration would not make it more likely that the Mindy Mindy project will enter the iron ore market because:
    - the Council cannot be satisfied that Mindy Mindy will enter the iron ore market, with or without declaration;
    - if the Mindy Mindy project is a viable new entrant, it will be able to construct a spur line connecting Mindy Mindy to the Chichester Line and enter the market with or without access;
    - there is currently an enforceable right to negotiate a rail haulage service on BHPBIO's railway line contained in the Mt Newman State Agreement (and the Rail Transport Agreement); and
    - it appears that Mindy Mindy already has its own arrangements to access the railway line of the owner of another iron ore project;
  - even if the entry of Mindy Mindy was facilitated by declaration, there is currently effective competition in the iron ore market and the entry of Mindy Mindy product would not alter the state of competition in the iron ore market; and
  - declaration does not make it more likely that any other iron ore producer will enter the iron ore market.
- 8.41 Each of these reasons is explored in more detail below.

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**Declaration does not make it more likely that Mindy Mindy will enter the iron ore market**

*No likelihood of entry by Mindy Mindy*

8.42 Mindy Mindy is the only deposit identified by the Applicant as having the potential to be assisted by declaration (other than the Applicant's Chichester Ranges deposits, which will be serviced by the Applicant's own Chichester Line). For the following reasons, the NCC cannot be satisfied that the Mindy Mindy project is likely to constitute a viable new entrant into the global seaborne iron ore supply market:

- the Mindy Mindy joint venture is currently the subject of the dispute in *Ammon v Consolidated Minerals Inc.* (CIV 1222 of 2004), an action by geologist and engineer Derek Ammon who, according to recent press reports,<sup>36</sup> is claiming an interest in the Mindy Mindy iron ore joint venture. In an application for security for costs in relation to these proceedings brought by Consolidated Minerals,<sup>37</sup> Commissioner Zilko SC found that 'if the factual situation underpinning those causes of action [pleaded in the amended statement of claim] is established at trial, the plaintiff has reasonable prospects of success'.<sup>38</sup> If the plaintiff is successful in these proceedings, this will inevitably change the development plans for Mindy Mindy;
- according to the recent Stage B PER, the Mindy Mindy deposit would not in any event be mined for at least eight years.<sup>39</sup> The uncertain nature of the iron ore market in eight years time must raise significant doubts as to whether the Mindy Mindy deposit will in fact be viable to mine;
- there is no JORC Code compliant resource at Mindy Mindy;
- the most recent quarterly report released by FMG (period ending 31 March 2005) makes no mention of Mindy Mindy at all; and
- FMG, the Applicant for the declaration, does not control Mindy Mindy. Rather its co-shareholder, Consolidated Minerals, controls PIO (the company that owns the deposit) and therefore controls whether and when Mindy Mindy will be developed and, if developed, whether Mindy Mindy would avail itself of a right of access to the Mt Newman railway line.

8.43 There is therefore great uncertainty about whether the Mindy Mindy project will ever enter the iron ore market, with or without declaration. Accordingly, the Council cannot be satisfied that the declaration would facilitate Mindy Mindy entering the iron ore market.

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<sup>36</sup> 'Geologist draws first blood over iron ore claim, *West Australian*, 20 September 2004, page 31.

<sup>37</sup> *Ammon v Consolidated Minerals Ltd and Anor* [2004] WASC 201.

<sup>38</sup> *Ibid*, [12].

<sup>39</sup> Stage B PER, [5.3.12].

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*Construction by the Applicant*

- 8.44 For the reasons discussed in paragraphs 7.7 to 7.11 above, it is clear that irrespective of the outcome of the Application, the Applicant will construct (through its subsidiary, TPI) an 'open access and multi-user' independent railway facility in the Pilbara from the Chichester Ranges to Port Hedland.
- 8.45 Furthermore, for the reasons discussed in paragraphs 7.39 to 7.43 above, if the Mindy Mindy development does ultimately prove viable, it is likely to cost less to construct a low cost spur line linking Mindy Mindy to the proposed Chichester Line than to access the Mt Newman railway line.

*Freight carriage obligations*

- 8.46 Under the Mt Newman State Agreement and the Rail Transport Agreement, as the Applicant acknowledges, the Applicant has an enforceable right to negotiate and enter into a contract with BHPBIO for the carriage of its iron ore products, with the terms and conditions of such contract to be set by an independent expert in the event of disagreement.<sup>40</sup> Under Part IIIA of the TPA the effect of declaration would be that a third party would be able to seek to negotiate the terms and conditions of access with BHPBIO and, failing agreement, to refer the dispute to the ACCC. The ACCC would then be able to arbitrate the terms and conditions of access. The principal difference between the rights established by the Mt Newman State Agreement and the associated Rail Transport Agreement on the one hand, and Part IIIA of the TPA on the other is that if declaration is granted under Part IIIA of the TPA a third party would be able to seek track access services whereas under the Mt Newman State Agreement and Rail Transport Agreement they may seek rail haulage services. The Council cannot be satisfied that obtaining track access, in preference to rail haulage services, would result in a promotion of competition in the iron ore market, given that each will result in iron ore being delivered into the iron ore market at a transportation price set by an independent arbitrator.
- 8.47 It is also likely that Hope Downs will build and operate its own railway line to Port Hedland according to recent announcements from Hancock Prospecting.<sup>41</sup> This will give the Mindy Mindy project a further option of seeking ore carriage on the Hope Downs line (or indeed seeking to run its trains on that line in the same way as it seeks to do on the Mt Newman railway line).

*Mindy Mindy has made its own arrangements*

- 8.48 It appears from the Consolidated Minerals open briefing referred to previously that Mindy Mindy already has in place arrangements with the owners of planned iron ore projects to use their railway lines (the only apparent owners in this category being Hope Downs or

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<sup>40</sup> *Hancock Prospecting P/L v BHP Minerals P/L* [2002] WASC 224, [25]; *Hancock Prospecting P/L v BHP Minerals P/L* [2003] WASCA 259, [57].

<sup>41</sup> 'Hopes down: Gina derails FMG', *The Australian*, 13 April 2004, page 31; Hope Downs Iron Ore Project Presentation, March 2005 ([www.hancockprospecting.com.au](http://www.hancockprospecting.com.au)).

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FMG). Whether the other iron ore project referred to is FMG or Hope Downs, it is therefore clear that if Mindy Mindy is viable it will be able to enter the iron ore market.

*Conclusion*

- 8.49 Declaration will not make it more likely that Mindy Mindy product will enter the iron ore market. First, the Council cannot be satisfied that Mindy Mindy is a viable new entrant, with or without declaration. If Mindy Mindy is a viable new entrant, however, it will be able to enter the market with or without declaration for the reasons explained above.

***Effect of Mindy Mindy on the iron ore market***

- 8.50 Even if the Council could be satisfied in some way that Mindy Mindy's entry would occur with declaration but would not occur without declaration, the entry of Mindy Mindy product would not promote competition in the iron ore market.
- 8.51 On the Applicant's own documents (such as the Stage B PER) the Mindy Mindy deposit has resources (as yet not JORC Code classified) of only 68 mt and a planned mine life of six years (hence the conclusion that production will be at the rate of 10 mtpa), an estimate that is optimistic given a resource of only 68 mt. The Stage B PER suggests such production will not commence for at least eight years. For the reasons outlined in section 6.2 of Mr Philip Williams' statement, the entry of a mine of this size into the international iron ore market(s) could not promote competition.
- 8.52 RTIO estimates that, in 2004, total global iron ore consumption was 1190 mt. Even if the market was limited to the seaborne sub-market, that sub-market in 2004 was 582 mt. RTIO also estimates that fines represent 66% of the seaborne sub-market, lump 20% and pellet 14%. Accordingly, Mindy Mindy would represent less than 2% of the seaborne sub-market even on 2004 figures (ie without allowing for the fact that the total market volumes will be significantly greater when Mindy Mindy commences production than in 2004). Even if fines, lump and pellet are treated as separate markets, and assuming that Mindy Mindy produced only fines, Mindy Mindy product would represent only approximately 2.6% of the seaborne fines market (again based on 2004 figures). The entry of a mine of this size with a mine life of only six years could have no effect on the state of competition or the mechanism for setting the iron ore price.

***No increase in the likelihood of entry by any other iron ore producer***

- 8.53 Beyond Mindy Mindy the only other known Pilbara iron ore deposit in the region that is approaching development is Hope Downs. Hope Downs' entry into the iron ore market is unrelated to the outcome of the Application. As discussed in paragraph 2.19 above, Hope Downs is currently proposing to construct its own railway line linking the Hope Downs mine to Port Hedland. There has been no suggestion that the Hope Downs development is in any way dependent on the declaration of the Mt Newman railway line under Part IIIA of the TPA. In fact the contrary is the case – Hope Downs has made it clear that it intends to develop and operate its own independent railway. The declaration will have no effect on the likelihood of Hope Downs entering the iron ore market.

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8.54 Accordingly, there is no iron ore mine that is likely to enter the iron ore market as a consequence of a declaration. Therefore a declaration could not promote competition in the iron ore market.

**Conclusion**

8.55 For the reasons given above, RTIO considers that the Council cannot be satisfied that either:

- the iron ore market is a distinct market from the market in which the Service is provided; or
- even if the iron ore market is a different market from the market for the Service, that declaration would result in the promotion of competition in the iron ore market.

**(d) Rail Haulage Market**

***Not a different market from the market for the Service***

8.56 For the reasons set out in sections 5.3 and 7.1 of Mr Philip Williams' statement, and discussed at paragraphs 8.17 to 8.26 above, rail transportation (including both rail haulage and track access) are part of the iron ore market. There is no separate market in which competition will be promoted other than the market in which the Service is provided.

8.57 The Tribunal in the *QCMA decision*<sup>42</sup> described a market as 'a field of actual and potential transactions between buyers and sellers'.

8.58 In the case of rail haulage in the Pilbara there are no actual purchases and sales of rail haulage services. There also appears to be limited potential for transactions for the reasons outlined below. This suggests that there is no market for rail haulage services in the Pilbara, reinforcing the conclusion that the raiing process is an activity undertaken in the broader iron ore market.

8.59 The nature of the Application confirms that rail haulage is not a separate market. The Applicant has sought declaration of the Mt Newman railway line **from a point near Mindy Mindy** to Port Hedland. It is clear from the Application and from the infrastructure the subject of the Application that the Applicant's purpose in seeking declaration is to use the Mt Newman railway line to transport iron ore from the Mindy Mindy deposit to Port Hedland. There is nothing to suggest that the Applicant is seriously considering establishing a rail haulage business providing services to third parties. For example, FMG has not identified in its Application a single potential customer for rail haulage services or suggested that it intends to operate a business providing haulage services.

8.60 This is not surprising because there is, in truth, no demand for rail haulage (as opposed to track access) services in the Pilbara. In this regard it is interesting to observe that:

- For the reasons outlined above, iron ore miners' overwhelming preference is to own and operate their own integrated rail system, including both above and below

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<sup>42</sup> Re Queensland Co-operative Milling Association (1976) 25 FLR 169 (the *QCMA decision*).



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rail. Hamersley, Robe and BHPBIO all built their own integrated rail systems. Hope Downs intends to do so. Even FMG intends to do so with respect to its proposed deposits in the Chichester Ranges.

- Even when a prospective iron ore purchaser is prepared to contemplate using another iron ore producer's rail facilities, those prospective purchasers seem to prefer to obtain track access rather than rail haulage services. For example:
  - the Applicant has sought access to track access services not to rail haulage services. The Application has been brought under Part IIIA seeking track access notwithstanding the fact that the Applicant could, under the Mt Newman State Agreement and the Rail Transport Agreement, seek access to rail haulage services immediately and, if a dispute arose, have the matter referred to an arbitrator;
  - although Hope Downs brought proceedings in relation to the Mt Newman State Agreement and Rail Transport Agreement, Hope Downs has recently confirmed that it is pursuing the construction of its own railway line rather than seeking rail haulage services from BHPBIO; and
  - in 1999 Robe sought access to Hamersley's railway line, not to rail haulage services.

8.61 The reason there is no demand for rail haulage services is because of the efficiencies that an iron ore producer gains from operating its own trains rather than relying on a haulier carrying its ore for it. All of the factors outlined in paragraphs 8.17 to 8.26 above equally apply to this point – ie, if a producer cannot control its own dedicated line then, at the very least, it wants to control the railing process. Accordingly, there is no market for rail haulage services. Rather rail haulage services are non-existent as a market. The only demand is for absolute control over the movement of iron ore from mines to port via an integrated process that is part of the iron ore market.

***No promotion of competition in the Pilbara rail haulage market***

8.62 For the reasons set out in Mr Phillip Williams' statement and summarised above it is clear that there is no separate Pilbara rail haulage market. If, however, the Council were to take the view that there was a market for rail haulage in the Pilbara that was separate from the market for the Service (a position that RTIO strenuously rejects), declaration would not promote competition in any such Pilbara rail haulage market in any event for four key reasons.

8.63 First (as explained in section 7.2 of Mr Williams' statement), there is nothing to suggest that the Applicant or any other person intends to use any declaration to enable it to provide rail haulage services on the Mt Newman railway line to third parties. The Applicant's access request is focussed solely on the transport of PIO's iron ore from Mindy Mindy to Port Hedland. The Applicant does not assert that it intends to provide a rail haulage service. Nor has the Applicant identified any other person likely to provide rail haulage services on the Mt Newman railway line as a result of declaration. This is not surprising given that there also appears to be no demand for rail haulage services in the Pilbara (as noted in

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paragraph 8.60 above). In summary, there is no evidence at all to suggest that declaration would result in the emergence of an additional provider of rail haulage services in the Pilbara or that there would be any demand for such services if it did.

8.64 Secondly, if, notwithstanding the above, it is postulated that the Applicant will actually provide rail haulage services to third parties, declaration would not promote competition in any such rail haulage market. As noted in Section 7 above, the Chichester Line, which will run parallel to the Mt Newman railway line for 200 km, will be constructed in any event and it will be an 'open access' line. The Applicant (and any other theoretical potential provider of rail haulage services) could provide rail haulage services in the Mindy Mindy area using this line, without declaration of the Mt Newman railway line. Further, if the Mindy Mindy deposit is developed, for the reasons outlined in paragraphs 7.39 to 7.43 above, it is likely that a spur line will be built to join up with the Chichester Line. If there were to be demand for rail haulage services by another hypothetical (but in fact non-existent) party, then that party could negotiate rail haulage services with the train operator on that spur line as well as with BHPBIO. This is precisely the same situation in terms of number of potential carriers as would be the case if Mindy Mindy trains were on the Mt Newman railway line. In fact, as the Mindy Mindy spur will have a much lower utilisation than the Mt Newman railway line, it is likely that the operator on that line would be more eager for the business of the new third party seeking ore haulage than it would be if it operated on the highly congested Mt Newman railway line. Accordingly, RTIO submits that competition will actually be enhanced in the so-called rail haulage market if there is no declaration of the Mt Newman railway line.

8.65 Thirdly, there are already a number of companies that are required by their State Agreements to provide rail haulage services to third parties. As noted above, BHPBIO is obliged under the Mt Newman State Agreement and Rail Transport Agreement to provide rail haulage services to third parties, on terms and conditions that could ultimately be set by an arbitrator. Similarly, RTIO is obliged under its relevant State Agreements<sup>43</sup> to provide rail haulage services to third parties in the Pilbara, subject to certain conditions. Hope Downs is also obliged under clause 24(3) of its State Agreement to provide iron ore haulage services to third parties on its rail line if and when developed.<sup>44</sup> Furthermore, as noted above, the Chichester Line will operate as an open access line with the Applicant

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<sup>43</sup> RTIO's relevant State Agreements include:

- clause 10(2)(a) of the agreement between the State and Hamersley contained in the schedules to the *Iron Ore (Hamersley Range) Agreement Act 1963 (WA)*;
- clause 20(3) of the agreement between the State and Hamersley and Hamersley Iron-Yandi Pty Limited contained in Schedule 1 to the *Iron Ore (Yandicoogina) Agreement Act 1996 (WA)*;
- clause 12(1)(a) of the agreement between the State and Mount Bruce Mining Pty Limited contained in the schedules to the *Iron Ore (Mount Bruce) Agreement Act 1972 (WA)*; and
- clause 9(2)(a) of the agreement between the State and Robe contained in Schedule 1 to the *Iron Ore (Robe River) Agreement Act 1964 (WA)*.

<sup>44</sup> The agreement between the State and Hope Downs contained in the schedule to the *Iron Ore (Hope Downs) Agreement Act 1992 (WA)*.

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and potentially third parties free to provide rail haulage services if they wish. Accordingly, if there was actually demand for rail haulage services in the Pilbara there are already a significant number of options for a person seeking to acquire such services.

- 8.66 Fourthly, for the reasons given in paragraphs 8.2 to 8.11, BHPBIO has an exclusive right to occupy the relevant land comprising its rail corridor, and the exclusive possession of its rail facilities, for the purposes of conducting its railway operations. This exclusive right is a 'protected contractual right' for the purpose of Part IIIA of the TPA. As such, the ACCC is prevented from making an arbitration decision that requires BHPBIO to provide a service comprising use of the Mt Newman railway line to a third party. Consequently, for this reason as well, any declaration could not promote competition in the rail haulage market or any other market.
- 8.67 In summary, RTIO submits that the Council cannot be satisfied that either:
- rail haulage is a separate market from the market in which the Service is provided; or
  - if rail haulage is in fact a separate market, that declaration would result in a promotion of competition in the Pilbara rail haulage market.

**(e) Iron Ore Tenements Market**

***Not a different market from the market for the Service***

- 8.68 The reference to 'tenements' is, we assume, a reference to mining leases, exploration licences and other tenure granted under the *Mining Act 1978 (WA)* and/or relevant State Agreements.
- 8.69 No financial consideration is payable by the holder of a lease or licence to the Western Australian government for a grant of such a lease or licence. The lease or licence is granted on a 'first-come first-served' basis. The lease or licence will contain detailed terms and conditions, including obligations in relation to exploration.
- 8.70 As the Council notes in its Issues Paper, the Tribunal in the *QCMA decision* described a market as 'the field of actual or potential transactions between buyers and sellers'.<sup>45</sup> There is clearly not a 'market' in this sense for the grant of tenements.
- 8.71 In its Application, at paragraph 12.1, the Applicant describes the relevant market as the market for the 'ownership, development and exploitation of iron ore tenements' rather than the grant of tenements. Owning, developing and exploiting tenements is simply another way of describing the process of producing and selling iron ore. Accordingly, the 'ownership, development and exploitation of iron ore tenements' is clearly part of the market for the production and supply of iron ore. In his statement Mr Williams outlines the matters FMG would need to show in order to demonstrate that there is a distinct dependent market for iron ore tenements in the Pilbara including that:

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<sup>45</sup> The *QCMA decision*, 190; NCC's Issues Paper, [6.5].

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there are firms engaged in buying and selling iron ore tenements that are not also mining iron ore and have no intention to mine iron ore in the future. If firms that trade iron ore tenements also mine, or hope to mine if viable deposits are found, the activities associated with prospecting and initial exploration and development of iron ore resources should be defined to be part of the international iron ore market.

FMG has not produced any evidence that there are persons whose objectives are merely to acquire and trade iron ore tenements. If the discovery is sufficiently attractive, the tenement holder invariably wants to hold an interest in the tenement so that it can share in the rewards of development. Sometimes the realities are such that the tenement holder finds it more attractive to sell the tenement, but this is rarely the objective. Accordingly, there is no iron ore tenements market distinct from the iron ore market.

***No promotion of competition in any tenements market***

***Market definition***

8.72 In RTIO's submission the tenements market is not a separate market from the iron ore market. If, however, it could be established that there is a class of explorers who intend only to engage in tenement dealings and not in the iron ore market (something which RTIO seriously questions), it is inconceivable that any such participant would be interested only in tenements for iron ore, tenements in the Pilbara or even tenements in Australia. Such a hypothetical participant would have no real interest in any particular commodity or location – their only interest would be to gain something of value to trade. Therefore if there is any tenements market it is highly likely that it would be a market for tenements for any minerals and be a global market.

8.73 Even if regard is had only to holders of iron ore tenements, it could be seen that the principal holders of iron ore tenements are iron ore producers who operate on a global basis and hold tenements on a global basis. Foreign parties hold interests in iron ore tenements in Australia (eg, the Chinese and Japanese partners of Rio Tinto, the Japanese and Korean partners of BHPBIO, and Kumba Resources (South Africa) in respect of Hope Downs). Similarly Australian producers hold tenements in other countries (eg, RTIO in Canada, Guinea, Brazil and India). Small exploration companies and individuals are generally less active in international locations than domestic locations but if there is an increase in demand for any commodity these participants increase their international activity (eg, as occurred with gold exploration in South East Asia in the late 1970s and early 1980s when there was an increase in gold prices). The foregoing applies whether the tenements are for iron ore or other minerals.

8.74 In summary if there is a separate market for tenements, that market would be a market for all tenements (not limited to iron ore) and would be a global market.

***No promotion of competition in any tenements market***

8.75 As any hypothetical market for tenements is a global market for all tenements then it is highly unlikely that access to the Mt Newman railway line between Mindy Mindy and Port Hedland would promote competition in that global market.

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- 8.76 Even if regard is had only to iron ore tenements in the Pilbara, there is no evidence to suggest that the fact that the Mt Newman railway line is not declared under Part IIIA of the TPA in any way inhibits the trading of tenements. As Mr Phillip Williams points out in section 8.2 of his statement, BHPBIO does not have any monopsony power in relation to the acquisition of the tenements, even if considering only iron ore tenements in the Pilbara. In addition to BHPBIO other potential purchasers of iron ore tenements in the Pilbara include RTIO, Hope Downs, FMG, Consolidated Minerals, Mount Gibson Iron Limited (which has recently farmed into tenements held by Poondano Exploration Pty Limited), Iron Ore Holdings Limited (a company associated with Derek Ammon) and potentially Anglo American plc (now the owner of Kumba Resources), and the Japanese, Korean and Chinese steel mills, many of whom already have joint venture interests with other producers in the Pilbara and have expressed interest, especially in recent times, in acquiring further equity in iron ore deposits and mines. As a result BHPBIO would not currently have any monopsony power in connection with the purchase of iron ore tenements in the Pilbara.
- 8.77 The fact that the absence of declaration is not inhibiting potential purchasers of tenements is well illustrated by the Applicant's own history. The Applicant claims to have the largest holding of tenements in the Pilbara. The Applicant, like BHPBIO, Robe and Hamersley before it and now Hope Downs, intends to construct its own railway line linking its mine to port. The fact that the Mt Newman railway line is not declared under Part IIIA of the TPA in no way inhibited FMG from seeking to acquire tenements and similarly, would not discourage any other Australian purchaser, including those listed above, from seeking to acquire tenements. As Mr Williams points out in his statement, BHPBIO does not have any monopsony power in relation to the acquisition of tenements in the Pilbara.
- 8.78 Finally, even if obtaining third party rail transportation services in the Pilbara was in some way considered necessary for the development of competition in the iron ore tenements market, a new mine could obtain rail haulage services from BHPBIO pursuant to the provisions of the Mt Newman State Agreement and the Rail Transport Agreement or utilise the railway line (or haulage) services that could be obtained from other existing producers, Hope Downs or FMG (including any service that FMG or another entity might provide on a spur line from Mindy Mindy to the Chichester Line if the Mindy Mindy deposit is developed).
- 8.79 Accordingly, declaration could not promote competition in any tenements market, if such a market exists.

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## 9. Health and Safety

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- 9.1 Section 44G(2)(d) of the TPA requires the Council to be satisfied:  
that access to the service can be provided without undue risk to human health and safety.
- 9.2 As the Applicant notes, the Mt Newman State Agreement requires BHPBIO to 'operate its railway in a safe and proper manner'. In addition Hamersley, Robe and BHPBIO's railway lines in the Pilbara are regulated under various Western Australian Acts and Regulations.
- 9.3 The Applicant states (at paragraph 15.1 of the Application):  
FMG undertakes that if the Declaration is granted, it will conduct its operations on or utilising the Facility in accordance with best practice and comply with all relevant safety and other legislation. FMG will ensure its operations are safely and effectively integrated with the Provider's safety and operating procedures in a manner that ensures there will be no undue risk to human health or safety as a result of access being made available or the Declaration being granted.
- 9.4 The Applicant has made no attempt to describe the manner in which its operations are capable of being 'safely and effectively integrated with the Provider's safety and operating procedures' in light of the legislative and operational requirements outlined above. Until arrangements concerning safety issues in respect of the Applicant's operation on BHPBIO's rail track are put in place and capable of analysis, it is not possible for the Council to be satisfied that the access sought in the Application can be provided without 'undue risk to human health or safety'. In other words, RTIO submits that the Council cannot be satisfied that criterion (d) is satisfied.
- 9.5 The Council should not underestimate the health and safety issues that arise as a result of an access application of this type. Heavy haul railways are specialist infrastructure, with BHPBIO's trains carrying 30,000 tonnes of ore each. The length of each train is about three km and the skills required to operate a train of this type safely are significant. It takes 1.5 to 4 kilometres (depending on gradient) to bring to a halt a train travelling at a speed of 65 km per hour. Many of the tasks required of a train driver are counter-intuitive – for example notwithstanding that the locomotive accommodating the driver at the head of the train might be travelling uphill, the driver could be required to brake as most of the train behind the driver is still travelling downhill. The consequence of accelerating rather than braking could be a 'broken train', meaning decoupling of sections of the train and possible derailment.
- 9.6 Similarly maintenance and other regimes to protect track and consist integrity must be scrupulously planned and adhered to. Further they need to be consistent. For example problem detection devices on a railway line, such as hot bearing detectors or dragging equipment detectors, must be compatible with the type of equipment using the railway line.
- 9.7 A superficial answer to safety is to say that with appropriate regulation under legislation, such as the *Rail Safety Act 1998 (WA)*, safety can be ensured. However this overlooks the fact that because of miscommunications, different standards of skill levels or training

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regimes, or different approaches to maintenance, accidents are far more likely to occur if there is more than one operator on a railway line such as the Mt Newman railway line. The inevitability of a decline in safety being brought about by multi-usage of a facility is as apparent as the inevitability of a decline in capacity and ability to respond to surges in demand (addressed in Section 11). The Council should therefore exercise great caution in deciding whether criterion (d) is met.



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## 10. Effective Access Regime

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- 10.1 Section 44G(2)(e) of the TPA provides that the Council cannot recommend that a service be declared unless it is satisfied:

that access to the service is not already the subject of an effective access regime.

- 10.2 Section 44G(3) of the TPA provides that, in deciding whether an access regime established by a State or Territory that is a party to the Competition Principles Agreement is an 'effective access regime', the Council must:

- (a) apply the relevant principles set out in that agreement; and
- (b) subject to section 44DA, not consider any other matters.

- 10.3 The Applicant makes very clear in the Application, at paragraph 7.1, that '[I]f the service is Declared, FMG will utilise access to the Service to operate trains and rolling stock to transport iron ore and iron ore products from Mindy Mindy to port facilities at Port Hedland'. The sole purpose of the Application is to facilitate the transport of PIO's ore from Mindy Mindy to Port Hedland. As discussed above, the Mt Newman State Agreement and the Rail Transport Agreement give PIO, at an appropriate stage in its development, the right to negotiate with BHPBIO for BHPBIO to haul Mindy Mindy ore to Port Hedland. As established in the *Hancock Prospecting decision*, Mindy Mindy or any other potential iron ore mine has a legally enforceable right to negotiate access to such haulage services, with any dispute about the terms and conditions of access being referable to an independent expert. The access regime created by the Mt Newman State Agreement and the Rail Transport Agreement will give the Mindy Mindy project precisely what FMG is seeking; a legally enforceable right to have its ore hauled from Mindy Mindy to Port Hedland. All of the above seems to suggest the Mt Newman State Agreement and the Rail Transport Agreement create an effective access regime in a practical sense for PIO and FMG.

- 10.4 RTIO's knowledge of the Rail Transport Agreement is limited to the description contained in the *Hancock Prospecting decision*. Accordingly, RTIO is not currently in a position to comment further on this Agreement. However, in a practical sense, it is an enforceable means by which third parties can obtain the only Service relevant – the movement of iron ore to the Western Australian coast. Therefore, it should be considered to be an effective access regime.

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## 11. Public Interest

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11.1 Section 44G(f) of the TPA requires the Council to be satisfied :

that access (or increased access) to the service would not be contrary to the public interest.

11.2 The Pilbara iron ore industry is vital to the Australian economy. In 2004 the value of the 228 mt in iron ore exports from the Pilbara was A\$6 billion. By 2010 export capacity of the existing Pilbara producers is likely to reach over 320 mtpa. Valued at current benchmark prices and exchange rates these sales would be worth an estimated A\$15 billion. All but four mt of Pilbara iron ore production is exported and Australia's share of the world seaborne iron ore trade has increased from 34% in 1992 to 39% in 2004 (228 mt out of total seaborne trade of 580 mt).

11.3 Further, existing Pilbara producers have responded to the recent rapid increases in demand for iron ore triggered by China's industrial boom. Total exports have already increased from 180 mt in 2002 to 228 mt last year. If announced expansions by existing producers currently being considered go ahead, exports are likely to rise to over 320 mt by 2010.

11.4 If a vital industry is performing well under existing conditions then extreme care needs to be taken by governments and regulators not to take any step that might jeopardise that performance. In RTIO's submission one of the reasons for the industry's ability to perform so well is the extraordinary efficiency of its very substantial privately owned and dedicated infrastructure. As explained in the following paragraphs, mandating access by third parties to that infrastructure will almost certainly adversely affect the performance of the industry. This is manifestly contrary to the public interest.

### (a) Creation of Bottlenecks

11.5 It is ironic that at the time when there is significant government and community concern about Australia's ability to respond to the current surge in commodity demand because of bottlenecks in export infrastructure, the Council (and the Minister) has to consider an Application that would have the effect of creating the same impediment for one of the items of export infrastructure that is held out as the 'ideal' because it does not suffer from any such impediment.

11.6 The initiative announced by the Australian Prime Minister on 18 March 2005, whereby an Exports and Infrastructure Task Force was established to review bottlenecks in export infrastructure, is a manifestation of this concern. The problem was addressed in the Reserve Bank of Australia's (*RBA*) Statement on Monetary Policy dated 7 February 2005 (the *RBA Statement*), where the problems caused by bottlenecks in coal export infrastructure were contrasted with the position in the iron ore industry. The reason for the difference was attributed to the fact the iron ore industry was 'more concentrated, with two companies controlling three vertically integrated supply chains accounting for over 90 per cent of exports', whereas the coal industry is 'fragmented' with 'a large number of mines shar[ing]...infrastructure'.

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- 11.7 Not only does this cast doubt on the wisdom of the Western Australian government's apparent desire to encourage more suppliers into the iron ore industry (see Western Australian government's submission to the Council dated October 2004), but it also highlights the problems in the Hunter Valley and North Queensland coal export chains involving multi-user rail and port facilities, with all the consequential issues that affect capacity and operating efficiency. Rio Tinto is heavily involved in the coal export business from eastern Australia and is the major shipper of coal from the two facilities focused on by the RBA – Dalrymple Bay in Queensland and Port Waratah in New South Wales. Rio Tinto's experience, especially in the Hunter Valley, consistently demonstrates the problems of having multi-user facilities in the supply chain. Not only does this create a layer of management that would otherwise be unnecessary (ie, those involved in endless communications with fellow users to try to coordinate requirements and design systems to facilitate multiple usage of the relevant facility), but it has affected capacity, thus resulting in lost sales.
- 11.8 No matter how earnest the attempts to marry requirements of multiple users, the 'lowest common denominator' always ends up prevailing. Thus if a user will not agree to upgrade an investment to improve capacity, the investment either does not occur or is interminably delayed. If a user misses its slot in the rail network because of a problem at, say, its loading facility, this has a snowballing affect across the entire rail network and capacity is lost that cannot be recovered. No amount of engineering can solve this. It is an inevitable clash that occurs because multiple users are on the same facility. By contrast if the facility is dedicated to one user, the ability of that user to respond to unexpected delays is unimpeded and, even more importantly, the ability to upgrade capacity to respond to unexpected surges in demand is maximised. The expansions in capacity already undertaken and planned by both RTIO and BHPBIO to respond to the relatively recent upswing in Chinese demand demonstrate this. As stated in the RBA Statement, the nature of the iron ore industry with vertical integration extending throughout the entire process has 'facilitated a rapid pick-up in transport capacity in response to strong global demand and prices'.
- 11.9 In the Hunter Valley there are, of course, multiple users of both rail and port facilities. However, to date, there have been only two instances of having more than one coal carrier on the same railway line and this experience added to the significant problems that existed. Until Pacific National was formed, there was a period of about two years when two coal hauliers operated on the Hunter Valley line; FreightCorp for the carriage of export coal to Newcastle and National Rail Corporation Limited for the carriage of domestic coal to Macquarie Generation's power stations. They operated on different scheduling cycles (36 hours for export and seven days for domestic) and this led to inevitable clashes at the loops that were loading both export and domestic coal. This was particularly evident at the Mount Thorley loop, the largest in the Hunter Valley, where the two carriers most frequently interfaced. It is the estimate of operators who used the Mount Thorley loop that capacity of one to two trains per day was lost from this cause alone and no amount of communication between the two train operators could resolve the problem.

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- 11.10 A similar conflict has arisen in the past month on the limited export capacity Stratford to Muswellbrook line sector due to the introduction of a new rail operator. Interail Australia Pty Limited has commenced a small shuttle service from Stratford to Duralie for haulage of coal. In addition, export trains from Stratford operated by Pacific National run on the same line. Due to clashes on this single line sector there have been four late cancellations of export trains in less than a month.
- 11.11 RTIO has spoken to Mr David Irwin, Business Manager-Coal of Pacific National, about the experiences of Pacific National on dedicated single user railway lines compared with multi-user railway lines. Pacific National operates two single user dedicated train services, one at Leigh Creek in South Australia and one on the New South Wales south coast for the haulage of BHPB coal. For all of its other operations it shares the rail networks with other carriers. Pacific National's experience on the two types of railway lines consistently reinforces the benefits of a single user dedicated railway track. It has been Pacific National's experience that clashes inevitably occur as each carrier pursues its own objectives for its own benefit. As a result capacity cannot be fully utilised.
- 11.12 These experiences confirm the findings of the RBA, which no doubt will be further reinforced by the findings of the Exports and Infrastructure Task Force. They are also consistent with the study by Evans & Peck set out in Annexure E. In short, two or more operators cannot extract from the same facility as great a capacity as a single dedicated operator. The costs are inevitably higher and the ability to respond to an upswing in demand is severely hampered by a multi-user facility. The infrastructure in the Pilbara has been singled out by the RBA as the ideal from the perspective of Australia's export performance. Access by way of declaration would mean that this advantage will be lost. The problems of the east coast coal industry would beset the iron ore industry, something that clearly is against the national interest.

**(b) A Chilling Effect on Investment**

- 11.13 If an investor in new or expanded facilities is likely to have to share that investment with a third party, thereby inhibiting flexibility, optimisation opportunities and capacity utilisation, it is axiomatic that the investor will be less likely to make the investment than if this impediment did not exist. If the facility is one to which a third party already has access, then any investment in new capacity will inevitably involve negotiations with that third party as to contributions, impact on existing services during construction, entitlement to utilise new capacity after construction etc. The 'lowest common denominator' outcome referred to above at paragraph 11.8 above will undoubtedly ensue.
- 11.14 The damage to the national interest flowing from the chilling effect on investment will be particularly acute if the facility involved is a key facility in the export chain, such as the Mt Newman railway line.
- 11.15 There have been numerous statements by key persons and instrumentalities that recognise the disincentive to investment that flows from forcing access to a facility. On each occasion the conclusion is that mandating access should be a 'last resort' or

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exercised sparingly so as to minimise the chilling effect on investment. Some of these observations are set out in the following paragraphs.

- 11.16 The concern that mandated access would act as a disincentive to future investment was expressed in 1993 in the *Competition Policy Report by the Independent Committee of Inquiry* (the **Hilmer Report**), the report which ultimately led to the introduction of Part IIIA of the TPA. At page 248 of the *Hilmer Report* the following is noted:

The Committee is conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another. Failure to provide appropriate protection to the owners of such facilities has the potential to undermine incentives for investment.

And at page 251 it is noted that:

...when considering the declaration of an access right to facilities, any assessments of the public interest would need to place special emphasis on the need to ensure access rights did not undermine the viability of long-term investment decisions, and hence risk deterring future investment in important infrastructure projects.

- 11.17 A similar concern was recognised in *Tracking Australia*, a report by the House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform, published in 1998, where the following comment is made at page 73:

In almost all cases the owner of infrastructure is likely to have made substantial investment, and through that assumed most of the financial risk associated with the facility.

And at page 74 it is noted that:

One obvious concern is that the private sector may simply stop investing in the development of infrastructure facilities where uncertainty over potential third party access exists.

- 11.18 This issue was also addressed by the Productivity Commission (the **Commission**) in the *Progress in Rail Reform Inquiry Report* in 1999 where it comments at page 163:

Mandated access to the privately owned integrated railways supporting large export operations (like the Pilbara iron ore operations) may benefit new mining operations but this may be at the expense of incumbents and the national interest as a whole. When incumbent track owners lose their ability to act in their own commercial interest they may withdraw from future investment.

Further, at page 175 the Commission notes that:

Regulation may diminish incentives for business to invest in infrastructure facilities. The negative impacts on investment are particularly important in the rail industry since the lack of suitable investment in rail infrastructure is a major factor limiting the industry's growth and future prospects.

- 11.19 The *Review of the National Access Regime Inquiry Report* in 2001 addresses, in great detail, the disincentives to investment posed by the Part IIIA access regime. Importantly, at page 67, the Commission states:

...in our] view, the concerns about the *potential* for access regulation to deter investment appear to be well-founded.

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In the Overview to this Report, at page XVIII, the Commission states that access regulation can intrude significantly on property rights and give rise to a range of costs that must be set against its benefits. It asserts that the relevant costs include reduced incentives to invest in facilities to provide new essential services or to maintain existing facilities; and inefficient investment in downstream markets. The Commission further states, at page XIX, that:

The potential 'chilling' effect of access regulation on investment in essential infrastructure services is the main concern. Investment may be deterred for two reasons:

- Potential exposure to access regulation is likely to increase the general level of risk attaching to investment in essential facilities. The inevitable regulatory discretion involved in the implementation of such regulation, and perceptions that regulatory discretions are likely to be biased in favour of service users, are among the factors that contribute to regulatory risk. These sorts of risks attach to investment in any regulated activity. However, the scale of investment in essential infrastructure, and the fact that, once in place, the assets are 'sunk' with few alternative uses, means that regulatory risk can be a more critical factor in the investment decision and may sometimes deter projects; [and]
- Investments in essential infrastructure will also be deterred if regulated terms and conditions are not expected to provide a sufficient return. A particular problem here is that the possibility of earning higher than normal profits if a project proves to be very successful may be required to balance the possibility that the project will fail. However, once a facility is operating, it will generally be impossible for regulators to delineate any upside returns from genuine monopoly rent – that is, returns in excess of those necessary to justify the investment. Regulatory pricing arrangements that (inadvertently) appropriate upside returns (so call 'regulatory truncation') can be a significant source of inefficiency arising from access regulation.

11.20 The significance of regulatory risk is discussed at pages 68 to 70 of this Report, and the impacts of regulated terms and conditions are discussed at pages 70 to 75. The Commission further notes, at page XIX, that:

Third party access and the resulting benefits to service users are only possible over the longer term if there is continuing investment in the essential infrastructure services themselves. On the other hand, while denial or monopoly pricing of access imposes costs on the community, such behaviour cannot threaten the continued availability of the services concerned. This asymmetry in potential outcomes highlights the priority that access regulation must give to ensuring that there are appropriate incentives for efficient investment.

11.21 See to similar effect the *Review of the Gas Access Regime Inquiry Report* undertaken by the Commission in 2004 which addresses the disincentives to investment posed by the Gas Access Regime.

11.22 The Commission's Discussion Draft from its *Review of National Competition Policy Reforms*, dated October 2004, contains a number of references to the disincentive that access regimes pose to investment. At page 236, the Commission notes that:

...if the application of access regulation leads to undue suppression of returns to facility owners, investment in essential infrastructure could be deterred. Given the importance of



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such infrastructure to Australia's economic performance and community well-being more generally, reduced investment in new facilities or the refurbishment of existing assets could also be costly ... [I]t is suggested that changes are required to give greater emphasis to facilitating investment so as to ensure the sustainability of service provision over the longer term.

- 11.23 One common theme in each of these references is similar to that of the RBA Statement, namely that investment in key infrastructure is crucial to the national economy. Each of the references cautions about the impact that mandating access to key facilities has on such investment. BHPBIO exported 81 mt of iron ore in 2003. Current capacity has been expanded to 118 mtpa and further expansions being considered by the company are likely to increase production to over 150 mt by 2010. At a current average Free on Board export price of about US\$40 per tonne, this increased level of production (all but 4 mtpa of which is exported) would be worth about A\$8 billion per year to the Australian economy. If third parties had been on BHPBIO's rail system through mandated access in 2003, whilst there might still have been some expansion undertaken, as the RBA Statement found for the east coast coal industry, the speed with which BHPBIO could respond and the extent of that response would have been adversely affected. Such an outcome is clearly against the national and public interest.

**(c) The Marketplace Works**

- 11.24 As the RBA observed, the existing iron ore producers have quickly expanded capacity to meet the recent surge in demand. Governments should let the marketplace work and not try to use the access regime under Part IIIA of the TPA or any other regulatory regime to distort market forces by subsidising new entrants. The result of government interference is likely to be the reverse of the objective being sought – ie, there will be a decline in the capacity of Australian iron ore suppliers to meet export demand rather than an increase.

- 11.25 The following statement was made by the Western Australian government in its Submission to the Council dated October 2004:

The Government's over-riding objective for the Pilbara iron ore industry is to provide the economic, social and environmental conditions for the Pilbara iron ore industry to capitalise on the rapid market growth in global iron ore demand and increase its market share (at page 3).

RTIO agrees with this objective. RTIO similarly has an objective to capitalise on growth in global iron ore markets; hence the current expansion programs at Hamersley and Robe so as to increase export capacity from 130 mtpa to 170 mtpa. No doubt BHPBIO is driven by the same objective in making its decision to increase its export capacity to 118 mtpa and in planning to further increase capacity to about 150 mtpa.

- 11.26 The area where we disagree with the Western Australian government is that access by third parties to dedicated and integrated infrastructure will assist in achieving this objective. The results of the RBA study referred to above support the contention that the ability of the industry to respond to the recent upswing in demand, led by China, is enhanced, not hindered by, the fact that the key items of infrastructure are single user dedicated and integrated facilities.



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11.27 In its submission to the Council, dated 8 July 2004, the Applicant criticises the existing Australian iron ore producers for losing market share in China and suggests this would not have occurred if there had been more producers and if those producers had access to the BHPBIO rail service (see paragraphs 10.5 and 10.7). There are numerous reasons for the decline in Australia's market share of China's imports. These include:

- the fact that the extent of the surge in demand by China was unexpected by all producers and forecasting agencies, following so soon after the 1998 Asian crisis;
- until the late 1990s China's imports were around 50 mtpa. In four years these have increased to 200 mt. Naturally such a rapid increase in demand is likely to result in at least a short term decrease in Australia's share of China's imports if Australia is to maintain its market share in other countries and preserve its share of the global seaborne ore trade (which has, in fact, increased between 2000 and 2004); and
- in the 1990s the increase in production in Australia was predominantly of pisolite ore from Yandicoogina. This ore is very attractive to producers in Japan and South Korea who have the capacity to handle the higher bound moisture content of Yandi ore, but in the immediate term has not been as popular in China as higher quality Brazilian ore (because of inland transport costs and compatibility of Brazilian ore with local ore).

11.28 Nevertheless the rapid expansion of capacity by existing Australian producers in response to China's increased demand and the development of coastal Chinese steel mills (thus making pisolite ore more attractive) have placed Australia in a position to win back lost market share. The most recent forecast from ABARE is that over the next five years Australia could return to supplying about 50% of the Chinese market, notwithstanding the huge increase in the market's size since Australia last held close to a 50% share.<sup>46</sup>

11.29 The important thing to observe from the above figures is that the existing Australian iron ore producers have responded to the rapid increase in demand from China. Between 2002 and 2010 existing Pilbara producers are likely to have increased export capacity from 180 mtpa to about 320 mtpa. They have been able to do so because each producer is unimpeded by co-users in doing whatever is required to increase capacity, whether that be a change to the way in which its infrastructure facilities operate, a capital expansion, or both. If the facilities were multi-user facilities the response to the increased demand would have been much slower, as it has been in the east coast coal industry.

11.30 The above figures highlight the need for regulatory agencies and government policy to encourage the existing producers, who have the facilities to enable a quick response to changed market conditions, to make use of and expand those facilities to meet the increased demand. They should not try to inject new players in a way that impedes those who have a proven track record in responding to market surges.

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<sup>46</sup> 'Australian Commodities', ABARE, March Quarter 2005.

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**(d) Conclusion**

11.31 The message to be obtained from the above analysis could not be starker. Do not interfere with a structure that confers on Australia a competitive advantage that is unmatched by most (if not all) other Australian export industries. Having identified the reason for the industry enjoying this competitive advantage (ie, dedicated and integrated infrastructure), do not take any step that will inhibit the producers' ability and incentive to use and expand that infrastructure so as to take maximum advantage of opportunities as and when they arise.

11.32 The above comments apply particularly in the case of this Application. The only potential identifiable user of the Service to which access is sought is the Mindy Mindy project, a resource that at best might produce 10 mtpa for six years. The benefit to Australia (if any) is miniscule compared with the damage that would be inflicted by access being granted. The NCC should not recommend declaration.

**6 May 2005**