



**FURTHER SUBMISSION  
TO THE NATIONAL COMPETITION COUNCIL**

**BHP BILLITON IRON ORE PTY LTD**

**Application by Fortescue Metals Group Ltd for Declaration of Services**

**12 July 2005**

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**PREFACE**

1. BHP Billiton Iron Ore (**BHPBIO**) makes this further submission to the Council in light of two new matters:
  - (a) Having reviewed the submissions of other parties in relation to this matter, including submissions filed with the Council by FMG on 6 May 2005 (**FMG Submission**)<sup>1</sup>, there are real doubts as to whether the factual position on which FMG's Application in this matter is based, has changed. BHPBIO's submissions and supporting materials provided to the Council on 3 June 2005 (**BHPBIO Submission**) were prepared largely on the basis of the matters set out in the FMG Application. Particularly where those matters are no longer the basis on which FMG advances its application in this matter, or where it is impossible for BHPBIO to discern reasonably whether this is the case, BHPBIO has a right to be heard.
  - (b) Rio Tinto has announced that it has reached agreement with Hancock Prospecting to purchase a 50% interest in the Hope Downs iron ore project, with the development and ongoing management of the project to be managed by Rio Tinto.<sup>2</sup> The project will use the Pilbara Iron managed port, rail and power infrastructure going forward.<sup>3</sup>
2. Expressions used in this submission have the same meanings as those given to them in the BHPBIO Submission.

**FMG SUBMISSIONS**

**FMG's changes in position**

3. FMG has fundamentally changed its position in relation to significant factual and other matters. Most importantly, FMG previously stated in the FMG Application and in public statements to the ASX, that:

*"FMG ... is in the process of developing a processing plant to service its mining operations at Mt Nicholas, as well as a railway from Mount Nicholas to FMG's planned facilities at Port Hedland."*<sup>4</sup>

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<sup>1</sup> The FMG Submissions and those of other parties were first made available to BHPBIO on 14 June 2005.

<sup>2</sup> Rio Tinto *News Release* "Hope Downs joint venture strengthens Rio Tinto's position in global iron ore market" (1 July 2005)

<sup>3</sup> Rio Tinto *News Release* "Hope Downs joint venture strengthens Rio Tinto's position in global iron ore market" (1 July 2005)

<sup>4</sup> FMG Application, para 3.2

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and

*"Regardless of the NCC outcome, FMG is still going to build its own railway line which in no way is contingent on the NCC declaration outcome."<sup>5</sup>*

Contradicting these statements, FMG now states, in the FMG Submission, that:

*"If Fortescue is successful in its efforts to have the Facility declared, it is entirely possible it will not be necessary for Fortescue to build those sections of its proposed railway line that will run in close proximity to the Facility. Instead, Fortescue would seek to use the Facility."<sup>6</sup>*

4. It is clear that the Council, all interested parties in the matters before the Council, the ASX and the investing public have been misled by FMG or FMG has changed direction in relation to its plans to construct its own railway line from Mt Nicholas via Christmas Creek, to Port Hedland.
5. A detailed analysis of other statements now made by FMG which depart significantly from its previous statements and announcements is **attached** as **Attachment A**. These changes in position go to the very basis on which FMG's Application is made.

**Council cannot be "satisfied" of the declaration criteria on the basis of the FMG Submission**

*FMG Submission is unreliable – little or no weight can be given to it*

6. The matters set out in Attachment A make it clear that the FMG Submission (in very important respects) is patently inconsistent with prior statements made by FMG publicly and in the FMG Application, or is otherwise exaggerated or incorrect. In these circumstances, the Council cannot be "satisfied" to the relevant standard of proof, in relation to many of the declaration criteria under section 44G(2) of the TPA.
7. For example, the statement now made by FMG that:

*"...development of Fortescue's Mindy Mindy mine is currently wholly dependent on access to the Facility being granted",*

is inconsistent with FMG's PER Stage A document filed with the WA Government, and is clearly incorrect, for the reasons set out in **Attachment A**. And yet, this statement is directly relevant to the Council's assessment of criteria (a) and (b) in s44G(2). Where the "story" from FMG is so inconsistent, the Council cannot be "satisfied" of the basis on which either of these criteria can be made out.

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<sup>5</sup> FMG Quarterly report for the period ending 31 December 2004

<sup>6</sup> FMG Submission, para 3.9

<sup>7</sup> See paragraph 3.8 of the FMG Submission.

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8. The inconsistent statements made by FMG in relation to fundamental matters necessarily raise the inference that the FMG Submission is generally unreliable. In BHPBIO's view, little or no weight can be given to any matter in the FMG Submission, unless it is reliably corroborated or substantiated by evidence.
9. These inconsistencies raise the plain inference that FMG's application has not been made, or at least is now not being prosecuted, in good faith (see s44F(3)). It may be inferred from FMG's conduct that FMG is now prosecuting this application only so as to cause maximum cost and distraction to BHPBIO.
10. Alternatively, if FMG has significantly changed the factual basis on which it makes its application, it should be required to state its position clearly in a new application with the Council pursuant to section 44F(1) of the TPA.

*Bare propositions – no reliable evidence advanced by FMG*

11. In many places, the FMG Submission simply sets out bare propositions without any supporting evidence.
12. An analysis of the bare propositions in the FMG Submission (together with a summary of the evidence provided by BHPBIO on the same issues) is **attached** as **Attachment B**.
13. The assertions made by FMG as set out in Attachment B are said to form part of the basis on which the Council is to be satisfied that the declaration criteria are made out. The Council, however, clearly cannot be satisfied on the basis of bare propositions. It must ensure that it has satisfactory evidence before it in order to be "satisfied" that the declaration criteria are made out as required by section 44G(2).

**The FMG Submission does not support declaration**

14. In any event, the FMG Submission still discloses no proper basis on which the Council can be satisfied that the declaration criteria under section 44G(2) can be made out.

*Criterion (b) is not made out*

15. Despite FMG's recent change in position, on the balance of the evidence put forward to the Council, FMG is still more likely than not to construct the FMG Line – the recent change in position only indicates that it is "possible" that the FMG Line will not be built. The FMG Submission provides:

*"3.10 FMG acknowledges that the construction of its railway, if built in its entirety from Christmas Creek to Port Hedland, will in effect duplicate that part of the Facility where the two facilities run closely parallel."*

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Further, FMG has recently confirmed that it still proposes to construct the FMG Line.<sup>8</sup>

16. Hence, it is still more likely than not that another facility will be developed by FMG/TPI which will provide the Service, or "provide part of the Service"<sup>9</sup> – see paragraph 44G(2)(b) and ss44F(4).
17. On the record now before the Council, the Council cannot be satisfied that another facility will not be developed to provide the Service, or part of it. If another facility is developed, criterion (b) cannot be made out because under a proper construction of criterion (b), this in itself would demonstrate that it would be uneconomical to develop another facility to provide the Service.<sup>10</sup> Thus, the Service should not be declared.
18. FMG has submitted that it would be "cheaper to increase capacity of the Facility than it is to construct a new standalone facility."<sup>11</sup> This contention is made solely by reference to the initial capital costs of constructing a new facility on the one hand, or expanding the existing facility on the other. This comparison is misplaced.
  - (a) The Council's "social" test under criterion (b) is not made out simply by comparative reference to initial capital costs.
  - (b) BHPBIO has made extensive submissions on this issue in the BHPBIO Submission. Those submissions make it clear that the "social" costs of developing another facility are clearly outweighed by the costs of providing access to the Service.
  - (c) For the convenience of the Council, a summary of the relevant "social" costs is set out in a table **attached as Attachment C**.
19. It should be noted in passing that the WA Government Submission to the Council dated May 2005 (**WA Government Submission**) also makes the error of comparing only the initial capital costs of constructing another facility with those of expanding the existing facility.
20. In other contexts, the WA Government has left open what might be the most efficient structure of the infrastructure arrangements in the Pilbara:

*"Further expansion potential and increased flexibility with Hamersley Iron and Robe's rail and port operations, reconfiguration and again further expansion potential by BHP Billiton and the possibility of new rail and port facilities by Hope Downs and / or FMG, together give the Pilbara the ability to respond to a burgeoning and longer-term sustained growth in demand for iron ore*

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<sup>8</sup> FMG ASX Announcement 14 June 2005

<sup>9</sup> In this case, some 70% of the Service sought to be declared – access to rail track for approximately 220 km from Port Hedland to the Shaw Siding on the Mt Newman Line.

<sup>10</sup> See BHPBIO Submission, paras 57-78; CRA Economic Report, section 4.1.4.

<sup>11</sup> FMG Submission, paras 3.2, 3.3.

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*from East Asia. The question on infrastructure to be resolved is the configuration of the systems, as double-tracked rail networks of existing producers carrying ore for third parties or as a third multi-user rail and port infrastructure system. It is difficult at this point to see the potential for four economically viable networks.*"<sup>12</sup>

In this statement, the WA Government recognises the broader costs and benefits to be considered beyond initial capital costs – here the WA Government has referred expressly to the much more significant issue of "the ability to respond to a burgeoning and longer-term sustained growth in demand for iron ore from East Asia".

21. In these circumstances and for the reasons expressed in the BHPBIO Submission, the Council cannot be satisfied that criterion (b) is made out.

*Criterion (a) is not made out*

22. Even taking into account the FMG Submission, the following propositions are clear:

- (a) the Service will only be used for the development of the Mindy Mindy deposit, at some point beyond 2015;
- (b) the promoters of the Mindy Mindy deposit will have several options available to them to transport iron ore from that deposit to a port facility, not least:
  - (i) transportation by the Mt Newman Participants pursuant to the RTA by way of rail carriage service.<sup>13</sup> This option is asserted by FMG itself in the FMG Application, where FMG states:
 

*"FMG has an enforceable right of carriage with respect to the Mt Newman Railway Line and the Provider is required to negotiate transport arrangements with FMG (before the FMG's mines are in active production)."*<sup>14</sup>
  - (ii) transportation by commercial arrangement with Rio Tinto or the Mt Newman Participants by way of rail carriage service<sup>15</sup>; and
  - (iii) the development of the FMG Line and the Mindy Mindy spur line, at some time in the future (around or beyond 2015)<sup>16</sup>; and

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<sup>12</sup> Department of Industry and Resources, *Western Australian Iron Ore Industry Report 2003*, p24

<sup>13</sup> Once the Mindy Mindy project is sufficiently progressed (note: No resource or reserve has been announced at Mindy Mindy to date), the promoters will be able to require the provision of a rail carriage service pursuant to the RTA – see *Hancock Prospecting v BHP Minerals*, WA Court of Appeal.

<sup>14</sup> FMG Application, para 5.10.

<sup>15</sup> The announcement of the joint venture arrangements as between Hancock Prospecting and Rio Tinto on 1 July 2005 is an example of such an arrangement being struck.

<sup>16</sup> It is noteworthy that the FMG Submission goes only so far as to contend that "currently" it does not propose to construct the Mindy Mindy spur line – see paragraph 3.8 of the FMG Submission.

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- (c) Mindy Mindy may never be developed, as it is unlikely to be economic, even if access to the Service is granted.<sup>17</sup>

In light of these facts and for the reasons expressed in the BHPBIO Submission, it cannot be established to the required standard that declaration of (and hence access to) the Service will promote competition in any market.

23. Further, even if the Council were to take into account FMG's latest possibility, that access to the Service will be used to transport iron ore from its Chichester Ranges deposits to the port, there would be no promotion of competition by declaration of the Service. Declaration will serve only to provide FMG with a wider range of commercial options for the transportation of its ore to port. While making access available might be convenient to FMG, it will not promote competition. FMG is already able to compete and the impact of making access available will simply be to alter the distribution of rewards as between the facility owner and the beneficiary of the access service.

As FMG itself admits:

*"[Declaration will] increase the options available to FMG when determining the optimum method of transporting FMG's iron ore and iron ore products from Chichesters to Port Hedland"<sup>18</sup>*

There will be no promotion of competition in any downstream market as a result of declaration, in these circumstances.<sup>19</sup>

24. The FMG Submission states that the Council's definition of market power is "unduly restrictive"<sup>20</sup>. However, the definition adopted by the Council is widely accepted among economists and regulators. In proposing a departure from that definition, FMG has presented none of the economic analysis that would be needed to justify such a departure from orthodoxy.
25. The FMG Submission states that BHPBIO and Rio Tinto are able to exert "market power over the Asian steel mills". This proposition is examined in the CRA Economic Report and the facts do not support FMG's contention. It is clear that BHPBIO does not have sufficient market power over buyers of iron ore to enable it to profitably restrict output below the competitive level<sup>21</sup>.

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<sup>17</sup> See paragraphs 16 to 20 of the BHPBIO Submission and CONFIDENTIAL Annexure 3.

<sup>18</sup> See paragraph 7.3(5) of the FMG Application.

<sup>19</sup> See also BHPBIO Submission, paras 34, 46, 119-123; CRA Economic Report, para 366.

<sup>20</sup> See paragraph 4.2 of the FMG Submission.

<sup>21</sup> See especially, sections 2.1.5, 2.1.6 and 2.1.7 and paragraphs 210-224 of the CRA Economic Report. See also the analysis of current pricing of iron ore in paragraphs 170 to 209 of the CRA Economic Report.

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26. FMG proposes for the first time a new "market" in which criterion (a) is to be considered, namely that for "new contracts".<sup>22</sup> This should be rejected as it is not a market properly defined. Particularly:
- (a) If FMG's contention, in paragraph 4.12 that "*it is the market for new contracts which is one of the principal factors in determining the overall price*", were true, it would serve only to demonstrate that the "*new contract market*" is in fact an integral part of the overall iron ore market. If the "new contract" suppliers are capable of defeating a SSNIP by incumbents, then they are properly part of the same market.
  - (b) Under long term contracts in the iron ore industry, prices are adjusted annually. Prices are not determined once and for all when these contracts are first established. The CRA Economic Report provides substantial evidence<sup>23</sup> of rivalrous behaviour among incumbents in the iron ore market, the ability of incumbents to increase output in order to put price pressure on competitors, and the countervailing power of large customers. Arguably it is the rivalry between existing players that is the principal factor determining world iron ore prices. The entry of very small new suppliers, whose operations are high on the industry cost curve, is unlikely to promote competition in anything but a trivial sense.
27. FMG's argument that there *must be* an ulterior anticompetitive motive for a refusal of access<sup>24</sup> rests partly on the unsubstantiated assertion that scale economies are large, and partly on the apparent absence of alternative legitimate motivations for a refusal of access.
- (a) As to the first point, FMG's assertion that railway scale economies are "huge" is unsupported by any specific evidence that is pertinent to the case at hand. Such a bald assertion cannot be accepted.
  - (b) As to the second point, the diseconomies of scope associated with shared use of the Mt Newman Line, as identified in the BHPBIO Submission<sup>25</sup> and the CRA Economic Report,<sup>26</sup> mean that BHPBIO would quite legitimately not wish to share the railway infrastructure with any third party (iron ore miner or not). Put simply, any scale economies are overwhelmed by the scope diseconomies. The most plausible benefit BHPBIO can derive by denying access to third parties is the preservation of scope economies of its dedicated, vertically integrated, single-user

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<sup>22</sup> See paragraph 4.10 to 4.12 of the FMG Submissions.

<sup>23</sup> See, for example, sections 2.1.5 – 2.1.8, 3.1, and 3.4 of the CRA Economic Report.

<sup>24</sup> See paragraphs 4.13 to 4.14 of the FMG Submission.

<sup>25</sup> See paras 85-108.

<sup>26</sup> See, particularly, paragraphs 417 – 428 of the CRA Economic Report.



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operation that are essential to BHPBIO's ability to compete in the world iron ore market against its larger vertically integrated rivals.<sup>27</sup>

28. In these circumstances and in light of the lack of credible evidence supporting FMG's bare propositions, the Council cannot be satisfied that criterion (a) is made out.

*Criterion (d) is not made out*

29. The Council cannot, on the evidence before it, be satisfied that criterion (d) has been made out.
30. Particularly, the reference to paragraph 9(2)(a) in the Mt Newman State Agreement in paragraph 15.2 of the FMG Application in relation to this criterion is irrelevant, and hence this criterion is not "demonstrated by the facts", as asserted in paragraph 6.2 of the FMG Submission. Clause 9(2)(a) is relevant only to the operation of the Mt Newman Line pursuant to the Mt Newman State Agreement and is irrelevant to third party operators on the Mt Newman Line.
31. Some of the key safety issues that are likely to arise as a result of the fully integrated mine, rail and port Mt Newman production system being utilised by more than one rail operator are as follows:

- (a) *Who controls the system:* Potentially there will be two rail operators on the Mt Newman Line but there can only be one controller. Having two controllers would invariably lead to conflicting schedules, increased train meets and cycle times which may ultimately result in train accidents. In addition, if the controller does not comprehensively understand the operation and logistics of a fully integrated mine, rail and port production system, the requirement to blend to produce the final product specification will be affected. The net result of the above is an increase in the likelihood of rail accidents.

There is no evidence as to whom the controller will be, how that will be determined, and how the controller will effectively, fairly and equally regulate all traffic on the Mt Newman Line.

- (b) *Rolling stock and wheel maintenance:* BHPBIO has invested considerably in complementary below-rail and above-rail technology and has implemented advanced systems to determine when track or above-rail equipment requires maintenance. BHPBIO also undertakes scheduled grinding of its ore-car wheels, on a continual basis, in a specialised maintenance facility to ensure all wheel profiles are to design. These processes minimise the risk of derailments and subsequent injury to personnel and reductions in rail capacity.

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<sup>27</sup> Indeed, it is well recognised that the fully integrated single user Pilbara railway systems are the most efficient heavy rail haulage systems in the world : see WA Government Submission, p9.

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If rolling stock and below rail infrastructure is not maintained to these specifications<sup>28</sup> and standards, the likelihood of on-track failures leading to delays and thus reduced capacity or possibly derailments and injury, is increased. There is no evidence as to how FMG or other operators will ensure consistency in equipment and its maintenance.

32. In these circumstances and in light of the lack of evidence supporting FMG's bare propositions, the Council cannot be satisfied that criterion (d) is made out.

*Criterion (e) is not made out*

33. FMG's submissions on this criterion are either irrelevant or simply bare proposition.
34. It is not relevant to the question of whether the RTA is properly an "effective access regime" that the WA Government's Rail Access regime has not been so certified.<sup>29</sup> That access regime has no application to the Mt Newman Line.
35. BHPBIO has set out a thorough analysis of the RTA and whether it is properly an "effective access regime" – see Annexure 14 to the BHPBIO Submission. This has not been addressed by FMG's bare proposition that, "Fortescue maintains that there is no effective access regime in place"<sup>30</sup>.
36. It should also be noted that in querying whether paragraphs 6(4)(c) and 6(4)(i) of the CPA (which are to be applied as guidelines, per s44DA) are "adequately addressed", the WA Government does not appear to have considered the application of the *Commercial Arbitration Act 1985* (WA). In this regard, see Annexure 14 to the BHPBIO Submission.

*Criterion (f) is not made out*

37. The FMG Submission does not detract from the evidence and submissions put forward in the BHPBIO Submission in respect of criterion (f). The Council cannot, on the evidence before it, be satisfied that declaration is not contrary to the public interest.
38. In addition, BHPBIO makes the following submissions to ensure that the Council has available to it all relevant material in determining whether access to the Service would be contrary to the public interest.
- (a) Paragraph 31 above provides examples of the serious safety issues that are likely to arise as a result of access. No evidence has been provided by FMG as to how matters such as these can be addressed.

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<sup>28</sup> It should be noted that FMG has contended that "BHPBIO's intellectual property which applies to its mixed fleet of ore cars has no application to Fortescue's newer ore cars".

<sup>29</sup> FMG Application, paras 10.6-10.7.

<sup>30</sup> See paragraph 7.2 of the FMG Submission.

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- (b) **Attachment C** provides a summary of the costs and benefits of declaration as outlined in detail in the BHPBIO Submission.<sup>31</sup>
- (c) A case study of the effects on investment in infrastructure as a result of multi-user systems and access regulation is **attached** as **Attachment D**.

**RIO TINTO ACQUISITION OF 50% OF HOPE DOWNS**

- 39. A copy of the Rio Tinto news release of 1 July 2005 in relation to this matter is **attached** as **Attachment E**.
- 40. This development does not alter the substance of the submissions set out in the BHPBIO Submission.<sup>32</sup>
- 41. Wherever BHPBIO has pointed to the development of the HD Line as a possible means of transporting iron ore from the Mindy Mindy deposit to the port, there remains open several alternative options to the promoters of the Mindy Mindy deposit, such as those set out in paragraph 22(b) above.

Hence, there is no effect on the submissions made by BHPBIO as to criterion (a).

- 42. Notwithstanding the arrangements now in place as between Rio Tinto and Hancock Prospecting, there is clear evidence on the record by virtue of the previous announcements by HDMS and Hancock Prospecting that the development of its own integrated, single-user rail and port infrastructure is a rational and "economical" way forward for the promoter of a viable and proven iron ore resource. That a more attractive commercial option has presented itself to the promoters, and that they have taken that option up, is beside the point. It remains the case that prospect of the HD Line being constructed on the basis proposed is clear evidence that it would not be uneconomical for "anyone to develop another facility to provide the service".

Hence, in substance, the recent announcement by Rio Tinto and HDMS has no effect on the submissions made by BHPBIO as to criterion (b).

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<sup>31</sup> In this regard, the WA Government Submission states (at p9) that the iron ore railways in the Pilbara are "regarded as some of the most efficient . . . in the world" with "world class port and rail facilities." This position will be compromised as a result of declaration.

<sup>32</sup> Although, it is noted that some of the BHPBIO submissions are based upon the prospect of the HD Line being constructed.

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43. BHPBIO reserves its right to make further submissions to the Council on this matter (including in response to other parties' submissions or in response to the Council's draft recommendation).

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