RIO TINTO

IRON ORE

CHIEF EXECUTIVE

5 December 2005

Mr John Feil
Executive Director
National Competition Council
Level 9, 128 Exhibition Street
Melbourne VIC 3000

Dear Mr Feil

Part IIIA Application by Fortescue Metals Group Limited (*FMG*)

I refer to the Draft Recommendation released by the Council on 4 November 2005. The detailed response of RTIO is attached.

The Draft Recommendation raises issues of particular concern to Rio Tinto. While these are dealt with in a more structured manner in the attached response, I thought it appropriate that I highlight them in this covering letter.

First, the Draft Recommendation concludes that the costs of turning the Mt Newman rail facility into a multi-user facility "would not outweigh the capital and operating cost savings" from third parties having access to the facility under Part IIIA. This conclusion has been reached notwithstanding:

- Detailed submissions, from RTIO and also BHPBIO, about the very substantial interface costs and diseconomies that will inevitably flow from the change in the nature of the facility. Based on experience at multi-user coal facilities on the east coast of Australia, these costs alone can be very significant indeed. For example, as detailed later, if the opportunity for the latest round of iron ore expansions were missed the cost could be some $12 billion. The Draft Recommendation acknowledges that these costs exist, but decides that they are not sufficient to outweigh the savings from sharing the facility.

- Highly authoritative support for these concerns about the costs and inefficiencies that flow from multi-user facilities, from the Prime Minister's Exports and Infrastructure Taskforce Report in May 2005 and the Reserve Bank of Australia in its February 2005 Statement on Monetary Policy.

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- Technical and engineering studies, including quantitative analysis, prepared by independent firms commissioned by RTIO and also BHPBIO, which demonstrate that the Council's views on cost savings from declaring the Mt Newman facility, as set out in the Draft Recommendation, are misconceived.

The Council appears to have reached its conclusions without the benefit of expert technical assistance or quantitative analysis.

I need hardly repeat what is at stake here. At risk is Australia's most efficient export industry that has been lauded by the Exports and Infrastructure Taskforce and the Reserve Bank for its quick response to the opportunities presented by China's surge in demand. These bodies have concluded that the reason the Pilbara producers have performed so well is the dedicated and integrated infrastructure operated by them. By contrast, the prime reason the east coast coal industry has not performed well is the multi-user infrastructure that it relies upon. Thus, unlike situations where the adverse consequences of a regulatory decision may be unforeseen, in this case the significant exposure has been highlighted by independent analysis as well as by the incumbents. We are therefore at a loss to understand why the Council has reached the position set out in the Draft Recommendation. As you are aware, once the nature of the facility is changed the decision will, in practical terms, be permanent and the damage irreversible.

I note the Council's belief, as set out in the Draft Recommendation, is that the experience at Dalrymple Bay and the Hunter Valley need not translate to a 'declared' Pilbara facility. The Council bases this distinction on the third party usage of the BHPBIO railway line being "no more than 10mtpa" and the only user being Mindy Mindy. However in other parts of the Draft Recommendation the Council contemplates FMG using the facility for its Cloud Break and Christmas Creek ore (up to 60mtpa) and for other potential users to include up to 16 "junior explorers." Apart from this inconsistency, there is no basis for the distinction regardless of the number of users. Once there is more than one user, each user will have rights and interests that must be taken into account before any major change to the facility is undertaken. This is a symptom of multiple usage and will apply irrespective of the initial access terms. Reaching a consensus or determining differences will inevitably delay the implementation of an upgrade or other improvement. Worse still, if there were a market downturn before the parties' differences were resolved, the opportunity could be lost for a decade or more (perhaps to a foreign competitor such as CVRD).

There are various scenarios set out in the enclosed response which demonstrate the magnitude of the cost of delay in implementing an expansion. Since 2002 the Pilbara producers have put in place an extra 75mtpa of capacity (worth an extra $3.75 billion annually) to meet the China-inspired surge in demand. There have been recent announcements of further expansions, which will take the extra capacity to almost to 110 mtpa, worth $5.5 billion each year in extra revenue. A delay of only six months to each of the expansions making up the extra 110mtpa would cost $2.75 billion.

If the last tranche of expansions recently announced (about 35mtpa) were indefinitely delayed because, by the time the decision had been taken the opportunity had been lost, the cost to Australia would be about $1.75 billion for every year until it could be resurrected. Over 10 years this gives a present value of around $12 billion.

I appreciate that the Council may believe that these costs are "overstated". Rio Tinto does not believe they are and we base this belief on our experience of delays that arise in decision making when multi-user facilities are involved. On several occasions Rio Tinto companies engaged in coal production have examined the RTIO facilities to see if they can adopt some of the practices that account for our success in the Pilbara. The barrier they always face is that they are not the only user and operator of the ex-mine facilities. This is not surprising. It is axiomatic that, with a multi-user facility, the diversity of interests that must be taken into account when making major decisions increases significantly compared with a single user facility. The recipe is there for delay and if a delay occurs, then the costs I have outlined will automatically flow. It does not matter if the delay will not always occur – it need only happen once or twice for a relatively short period and the cost is so large that any perceived savings from multiple usage will be wiped out.

We have many other comments on the Draft Recommendation, such as our concern that the Council has relied so heavily on unidentified "junior explorers" to make very controversial and novel findings in relation to markets. For example the notion that an explorer will not spend time and money to identify and prove up a deposit if there is no immediately available infrastructure defies the history of mining development, almost all of which has started with a discovery in a remote area. Similarly, I am surprised that the Council relies on statements from "junior explorers" to find that the value of identified iron ore deposits in the Pilbara is depressed, when there is currently such intense interest in taking a stake in the Pilbara, whether that be in deposits or companies which hold interests in the Pilbara.

We agree with the Council's view that the iron ore market is global and competitive. We experience the competitive nature of the market every day. We do however, question why the Council in the Draft Recommendation seeks to distinguish between rail track and rail haulage and focuses on rail track access in the context of potential small developers. As the Council acknowledges, such developers, if they progress a deposit to the development stage, are much more likely to be interested in rail haulage than track access. This service is provided for under various Pilbara State Agreements.

Therefore, in summary, we do not believe that the Council is justified in the findings it makes and we are concerned that the damage that will flow from a declaration is immense. Even if the Council believes that our concerns may be overstated, the risk is far too great for Australia to take. Like most of Australia's mineral commodity businesses, iron ore is wholly dependent on international demand over which we have no control.

The key to our success is being able to capture opportunities as they present themselves. If we don't, our foreign competitors will. We must not risk taking a step that we and many others believe will impede this success.

I urge the Council to consider carefully the matters raised in this letter and in the attached response to the Draft Recommendation. I sincerely hope that the Council will reconsider its proposed position. If it would assist, we would be happy to discuss these issues further with the Council.

Yours sincerely

Sam Walsh
Chief Executive