FURTHER SUBMISSIONS TO THE NATIONAL COMPETITION COUNCIL IN RESPONSE TO DRAFT RECOMMENDATION DATED 4 NOVEMBER 2005

BHP BILLITON IRON ORE PTY LTD

Application by Fortescue Metals Group Ltd for Declaration of Service Provided by the Mt Newman Railway Line

30 December 2005

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1. BACKGROUND

1.1 On 5 December 2005 BHPBIO submitted its Outline of Principal Submissions (**Outline**) to the Council in response to the Council's Draft Recommendation that the service provided by the Mt Newman Line be declared.

1.2 BHPBIO now makes the following Further Submissions in response to the Council's Draft Recommendation. These Further Submissions are drawn from material that has only become available since the publication of the Draft Recommendation, as well as matters that BHPBIO has only been able to develop since that date.

1.3 These Further Submissions are intended to provide more detail and support for some of the matters contained in BHPBIO's Outline, and should be read in conjunction with the Outline.

1.4 These Further Submissions and the annexures also include some information that is confidential to BHPBIO. The relevant information is marked as "confidential" in the Further Submissions and annexures, and is provided to the Council on the basis that it does not make that information available to any other person or organisation without the permission of BHPBIO.

2. ANALYSIS OF JUNIOR EXPLORERS

Background

2.1 In its Draft Recommendation, the Council indicated that there are a number of junior iron ore explorers in the Pilbara who "will not invest the resources necessary to "prove up" iron ore resources within their tenements unless and until they have some prospects of gaining access to rail transport …".[1]

2.2 Accordingly, the Council determined that it was satisfied that declaration of the Mt Newman Service would result in junior explorers "proving up" their iron ore deposits which in turn would promote competition in the market for iron ore tenements in the Pilbara.

Independent Report

2.3 BHPBIO has obtained an independent report concerning the likely impact of declaration of the Mt Newman Service on the trading of iron ore tenements in the Pilbara. The report, a copy of which is **Annexure 1**, was prepared by Statewide Tenement and Advisory Services Pty Ltd, who act as consultants to the mining industry in Western Australia in ground acquisition and tenure and exploration management. The company specialises in State Agreement Act tenure management for the iron ore sector. The conclusion in the report is that it is unlikely that declaration of the Mt Newman Service would increase or promote competition in the trading of iron ore tenements in the Pilbara.

Conclusion

2.4 For the reasons set out below, the Council cannot be satisfied that there is a market for iron ore tenements in the Pilbara, or that, if such a market exists, declaration of the Mt Newman Service would promote competition in that market.

Relevance of analysis of junior explorers

2.5 While the relevant market in which the Council has found that competition will be promoted by access is a Pilbara-wide iron ore tenements market, BHPBIO contends that the only iron ore tenements held by junior explorers that could be affected by declaration of the Mt Newman Service are those tenements which are sufficiently close to the Mt Newman Line "to be capable of efficient exploitation".[2].

2.6 This paper accordingly examines junior iron ore explorers with iron ore deposits that are within 80 km of the Mt Newman Line. This is consistent with the Council's finding in its

[1] NCC Draft Recommendation, para 7.177(b).

[2] NCC Draft Recommendation, para 7.58.

Draft Recommendation that it would not be economical to develop the Mindy Mindy spur line (approximately 80 km in length from Mindy Mindy to the FMG Line) due to the potential size of FMG's deposit at Mindy Mindy.

2.7 The information outlined in this analysis, such as the existence, size, deposits and activities of junior explorers, is relevant to several matters raised by BHPBIO in its Outline.

2.8 First, in identifying a market for iron ore tenements in the Pilbara the Council has given insufficient weight to the likelihood that:

(a) there may not be any economically viable deposits in the Pilbara other than those held by BHPBIO, RTIO/HDMS and Hancock; and

(b) even if the Mt Newman Service is declared it may nevertheless be uneconomic for junior explorers to exploit any deposits that may exist.[3]

2.9 Further on this point, it is also not known whether junior explorers hold iron ore deposits of a grade that meets customer requirements, or that could feasibly be blended to produce a product that meets those requirements.[4] There are also very few, if any, iron ore deposits sufficiently close to the Mt Newman Line that are of sufficient size and quality as to be saleable in a market for iron ore tenements in the Pilbara.[5]

2.10 Secondly, declaration of the Mt Newman Service is not likely to promote competition in the market for rail haulage services given the uncertainties outlined above about the existence, location, grade and size of junior explorers' deposits. In light of these uncertainties, it is submitted that there is no current or foreseeable demand for rail haulage services from junior explorers, as it is unlikely that junior explorers will be in a position to develop or ship stand alone products.[6]

2.11 Thirdly, the availability of alternative options for junior explorers, and the junior explorers' small scale and valuation, means that any promotion of competition in the relevant markets is likely to be trivial in relative terms.[7]

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[3] Outline, para 3.13.

[4] Outline, para 3.17.

[5] Outline, para 3.18.

[6] Outline, paras 3.40 – 3.48.

[7] Outline, paras 3.55 – 3.59.

Analysis of Critical Facts

2.12 The number of mining tenements in a region has no direct relationship to the mineral potential of the area nor the number of likely iron ore or other mineral deposits that might exist or be found.

2.13 In any event, there are only a limited number of junior explorers that hold iron ore tenements that are sufficiently close to the Mt Newman Line and the interests of a number of those explorers are shared or intertwined (see **Annexure 2**).

2.14 Over 75% of the applications for these iron ore tenements have been made since 2003. This has coincided with, and is most likely the direct result of, the unexpected increase in global demand and prices for iron ore.[8]

2.15 Most junior explorers have previously undertaken or are currently exploring, prospecting or mining minerals other than iron ore. This activity has also not been confined to areas close to the Mt Newman Line (see **Annexure 3**).

2.16 Of those iron ore tenements held by junior explorers that are sufficiently close to the Mt Newman Line, it has not been established whether any of them hold iron ore deposits of a size and grade that are marketable, with or without blending with iron ore of a higher grade. In fact, to our knowledge, no junior iron ore explorer has an announced iron ore resource or reserve.

2.17 Even without declaration of the Mt Newman Service, junior explorers have exploited and are exploiting, in a variety of ways, the rights to explore and mine their iron ore tenements (see **Annexure 4**).

2.18 The market value of the majority of junior explorers is very low in relative terms. Those values have risen in recent times, presumably due to the increase in demand and prices for iron ore. These increases in market value have occurred without declaration of the Mt Newman Service, and without those junior explorers knowing whether their iron ore tenements contain any iron ore products, or whether any mineralisation could result in any products that are marketable, with or without blending with higher grade iron ore (see **Annexure 5**).

Results of analysis

2.19 If there is a market for iron ore tenements, it is unlikely that declaration of the Mt Newman Service would promote competition in this market, for the following reasons:

[8] Over 75% of the 102 applications for iron ore tenements were made since the beginning of 2003, 59% since the beginning of 2004 and 28% during 2005.

(a) it is unlikely, or at least not established, that any junior explorer holds iron ore deposits of a size and grade that are marketable, with or without blending with iron ore of a higher grade;

(b) the multitude of ways in which junior explorers have exploited and are exploiting their rights over iron ore tenements is evidence that access to the Mt Newman Service is not essential for the promotion of competition; and

(c) an increase in the market value of tenement holders does not of itself represent a promotion of competition but merely represents a once only windfall to these companies without any alteration of the competitive dynamic within the market.

2.20 If any market exists, it is only a market for highly speculative share trading that does not result in any change to the market for iron ore products, and merely promotes very short term share price spikes (which deliver limited if any financial returns to the economy).

2.21 In view of the small scale and valuation of the junior explorers, any promotion of competition would, in any event, be trivial relative to:

(a) the value of the current production and shipment of iron ore from the Pilbara; and

(b) the costs that are likely to be incurred by BHPBIO in connection with providing track access.

3. COSTS AND DISECONOMIES

3.1 Paragraphs 2.22 and 2.31 to 2.45 of BHPBIO's Outline describe the direct impacts and diseconomies of scope that are likely to be imposed upon BHPBIO in the event of third party access to the Mt Newman Line. To date, the Council has failed to recognise these significant costs.

3.2 In order to ensure that the Council has before it correct and sufficient information on the significant costs of third party access (relevant both to the consideration of criterion (b) and criterion (f) in the Council's Draft Recommendation) prior to making its Final Recommendation, BHPBIO now provides the Council with copies of the four recently sworn affidavits which have been filed in Federal Court Proceeding VID 1641 of 2004.

3.3 These affidavits (which are included with these Further Submissions as **Annexure 6**) contain material to a level of detail which was not previously available, but which bears significantly on the costs of third party access.

4. PROTECTED CONTRACTUAL RIGHTS

Background

4.1 The Council recognises that while the question of protected contractual rights does not ordinarily arise at the declaration stage, it may do so in some circumstances.[9]

4.2 The Council has set criteria for determining whether this issue should be considered at the declaration stage. The Council states that it should only take into account the future effect of s 44W(1)(c) where there is a "very high likelihood" that the right in question would constitute an *absolute barrier* to the promotion of competition and this would require at a minimum that:

(a) the protected contractual right is entirely incompatible with access on any terms (either because it is directly inconsistent with access or because upholding the right would make access not viable);

(b) the protected contractual right is highly unlikely to expire or be amended or terminated within the declaration period; and

(c) the holder of the protected contractual right is unlikely to waive that right.

4.3 This is an overly-restrictive approach. The Council must be "satisfied" that declaration would promote competition, as set out in s 44G(2)(a) of the TPA. In BHPBIO's submission, the Council cannot be so satisfied even if there were only a "likelihood" that the existence of a "protected contractual right" would prevent there being a promotion of competition in due course. Thus, the Council's proposed test in relation to assessment of protected contractual rights at the declaration stage is excessively onerous and will lead the Council into error.

4.4 In any event, each of the conditions specified by the Council arises in the present case.

Incompatible with access

4.5 The Council states that the Western Australian Government's rights under the Special Lease are inconsistent with a right of exclusive possession (see paragraph 7.118). This ignores the most fundamental right of a leasehold interest - namely, that of exclusive possession.

> "A lease (or "demise") gives the tenant the right to exclusive possession – the right to exclude all others from the land".[10]

[9] NCC Draft Recommendation, para 7.113.

[10] Butt, *Land Law*, 1996 3rd Ed, para 1509.

4.6 A right of exclusive possession may be conditional, by contract or statute, but it is nevertheless a fundamental right of leasehold.

> "A right of exclusive possession is secured by the right of a lessee to maintain ejectment and, after his entry, trespass. A reservation to the landlord, either by contract or statute, of a limited right of entry, as for example to view or repair, is, of course, not inconsistent with a grant of exclusive possession. Subject to such reservations, a tenant for a term or from year to year or for a life or lives can exclude his landlord as well as strangers from the demised premises. All this is long-established law: see *Cole* on *Ejectment* (1857) pp. 72, 73, 287, 458".[11]

4.7 Further, the High Court's decision in *Goldsworthy Mining Ltd v The Commissioner of Taxation* (1973) 128 CLR 199 at 213 makes it clear that any conditions to a lease or restrictions on a tenant confirm, rather than deny, the existence of that right. In that case, Mason J stated (in relation to a special lease granted by the State of WA under the *Iron Ore (Mount Goldsworthy) Agreement Act* 1964 and the *Land Act* 1933):

> "Although these provisions restrict the use to which the joint venturers may put the premises and impose obligations of an important kind, in my view, they are not inconsistent with existence of a right of exclusive possession in the joint venturers. **Indeed the provisions assume the existence of that right**." (emphasis added)

4.8 BHPBIO submits that it has a clear right of exclusive use pursuant to the Special Lease, subject to its terms. The Special Lease clearly grants a lease over the "demised premises", as required by clause 8(1)(b)(i) of the Mt Newman State Agreement. Further, the express provisions for limited third party entry upon the land the subject of the Special Lease (see clause 1(7) of the Special Lease) and for the conditional provision of a rail carriage service on the railway constructed on that land (see clause 1(6) of the Special Lease, and clause 9(2)(a) of the State Agreement) clearly *assume* the existence of a right of exclusive use.

4.9 The exceptions to the right of exclusive possession granted to the Mt Newman Participants clearly do not extend to requiring them to permit a third party to operate trains on the Mt Newman Line. There is no such provision in the Special Lease, the Mt Newman State Agreement or in the RTA.

4.10 Thus, it is clear that to declare a rail track service over the Mt Newman Line, such that a third party may ultimately run a train on the Mt Newman Line (on whatever terms) will deprive BHPBIO of, and will entirely be inconsistent or incompatible with, the conditional leasehold rights to the exclusive use of the demised premises under the Special Lease, and the contractual right to continue to enjoy those rights for many years to come (as to which, see further below).

[11] Per Windeyer J in *Radaich v Smith* (1959) 101 CLR 209, 222.

4.11 The provisions of clause 3(1) of the Special Lease clearly do not extend so far as to permit the "Western Australian Government to allow for third party access to the Mt Newman Service".

(a) Any granting of an easement or right over the demised premises, or to permit the use of the demised premises in favour of a third party, does not extend to the use of, and interference with, the railway track and other improvements on the demised premises (being the "railway and ancillary installations and facilities including a service road between the mine and the port", as set out in clause 1(2) of the Special Lease).

(b) The right of the Western Australian Government to require the grant of an easement, right or permit to use the demised premises:

(i) is only to be invoked where it is "reasonably necessary (taking into consideration the present and future use or development of the demised premises by the lessees) in connection with the overall development or use of the demised premises or of lands adjacent to the demised premises" - no such circumstances are evident in this case; and

(i) is expressly conditional upon the requirement that:

"no such grant, use or permission to use (as the case may be) would:

(a) unduly prejudice the Lessees or prejudicially interfere with the operations of the Lessees under the Agreement; or

(b) increase the Lessees' commitments or prejudicially interfere with the Lessees' control over the demised premises".

These express provisos to clause 3(1) have been ignored by the Council in its Draft Recommendation.

4.12 The provisions of clause 3(1) of the Special Lease clearly do not permit the Western Australian Government to require the Mt Newman Participants to provide the Mt Newman Service, because such a service requires much more than a right to enter upon or use the land, and because it would clearly "prejudicially interfere" with the existing operations of the Mt Newman Participants.

4.13 Further, even if the Council were correct in its assessment, any access seeker would have to seek the favour of the Western Australian Government to invoke clause 3(1) of the Special Lease, before the protected contractual rights of the Mt Newman Participants could be interfered with. Even if BHPBIO were to grant its consent (discussed further below), the Council cannot assume that the Western Australian Government would exercise its discretion in this way, and in the absence of being so satisfied, the Council cannot be satisfied that declaration would promote competition as required in criterion (a).

4.14 Further, it is not relevant that it might be possible for a third party to operate a train on the Mt Newman Line without preventing either the State or BHPBIO from fulfilling its obligations under the State Agreement/RTA - s 44W(1)(c) protects **rights** not obligations (see paragraph 7.118(d) of the Draft Recommendation).

Likely to Expire

4.15 The Council has misunderstood the nature and origin of the protected contractual rights.

4.16 Clause 8(1)(b)(i) of the Mt Newman State Agreement requires the State to grant to the Company, "on such terms and conditions (including renewal rights) as subject to the proposals … shall be reasonable … special leases of Crown Lands within the harbour, the townsites and the railway".

4.17 Any such leases granted pursuant to that provision are then not to be resumed other than with the consent of the Company, as required by clause 8(4)(b) of the Mt Newman State Agreement:

> "the State … shall not … without the consent of the Company resume nor suffer nor permit to be resumed … any of the lands the subject of any lease or licence granted to the Company in terms of this Agreement …".

4.18 The terms of the Special Lease granted pursuant to these provisions include:

(a) the grant of a lease over the demised premises for a term of 21 years from 7 April 1967, "with the right to renew the same from time to time as hereinafter provided upon the same terms and conditions"; and

(b) the right to "renew this Lease for a further term of 21 years at the same rent and containing the same covenants agreements powers reservations conditions and provisions as are herein contained (including this covenant for renewal) which shall also be contained in all further renewals but excluding subclause (2) of clause 1 of this lease".

4.19 In short, it is clear that the Mt Newman Participants have a long-standing contractual right to lease the demised premises for continuing periods of 21 years until such time as they permit their leasehold interest to expire, or they consent to its resumption. That contractual right arose in 1967. Further, both the Western Australian Government and BHPBIO are continuing to rely on that right as they propose and make, and approve, respectively, further significant investments in the Mt Newman mine/rail/port operations.

4.20 It is irrelevant that the current term of the Special Lease (having been renewed in 1988) will expire in 2009. Pursuant to clause 8(1)(b)(i) of the Mt Newman State Agreement, the Mt Newman Participants have a protected contractual right to a lease of the demised premises, on the terms set out in the Special Lease (except clause 1(2)), going forward well beyond 2009.

4.21 It is incorrect, therefore, for the Council to find that "the exclusive possession right is based entirely upon the Special Lease". The protected contractual rights of the Mt Newman Participants to continue to lease the demised premises and to enjoy (conditional) exclusive possession of the relevant land continue to prevail indefinitely and well beyond the expiry of the current term of the Special Lease.

Waiver

4.22 The Council's finding that "there is no evidence to suggest whether the Mt Newman Participants might waive their protected contractual rights" (see paragraph 7.123 of the Draft Recommendation) is incorrect.

4.23 At paragraph 53 of Annexure 13 to the BHPBIO Submission, it was clearly stated that:

> "If the Service were declared, the Mt Newman Participants would not voluntarily supply the Service. This is because of the very substantial costs and inefficiencies that would be imposed on the Mt Newman Participants if they were to provide the Service (as has been explained elsewhere)."

4.24 Those costs and diseconomies are summarised at paragraph 189 of BHPBIO's submission dated 3 June 2005 and are reiterated in BHPBIO's Outline of Principal Submissions dated 5 December 2005. Those costs and diseconomies cannot be addressed in any terms pursuant to which the Service might be provided. No other operation has been permitted to run trains on the Mt Newman Line over the life of that asset thus far. It is therefore extremely unlikely that BHPBIO would waive any protected contractual right in these circumstances, and the Council cannot conceivably be satisfied that such a waiver would be forthcoming.

Conclusion

4.25 The Council's proposition that there must be a "very high likelihood" that the contractual right in question would constitute an *absolute barrier* to the promotion of competition has no foundation in law or practicality.

4.26 In any event, even on the Council's test, it is clear that there are protected contractual rights that would constitute an *absolute barrier* to the promotion of competition. In particular:

(a) the nature of the protected contractual right is entirely incompatible with access on any terms (because it is directly inconsistent with access and because upholding the right would make access not viable);

(b) the protected contractual right is highly unlikely to expire within the declaration period; and

(c) it is extremely unlikely that BHPBIO will waive that right.

5. RELEVANCE OF THE RTA

Introduction

5.1 Under s 44G(2) of the TPA, the Council must be satisfied that all of the criteria listed in that sub-section have been met before it can recommend that a service be declared. Criterion (a) provides that the Council must be satisfied that access to the service would promote competition in at least one market other than the market for the service.

5.2 As part of its reasoning in each case, the Council determined that the obligation on BHPBIO to provide rail haulage services under the Mt Newman State Agreement or the RTA did not "significantly" constrain BHPBIO's ability to exercise market power to adversely affect competition in each of the markets for iron ore tenements[12] and rail haulage services.[13]

5.3 This section analyses the Council's reasoning in reaching these conclusions and demonstrates that the Council's reasoning is erroneous.

Council's reasoning

Misapplication of the test

5.4 The Council has erred in its approach to considering the extent to which the RTA constrains the ability of BHPBIO to exercise any market power it may have[14] to adversely affect competition in the dependent markets.

5.5 This is because the Council has required the constraint imposed by the RTA to be "significant" rather than simply greater than that potentially imposed by the application of Part IIIA to the facility and the service sought to be declared.

If declaration of the Service under Part IIIA will impose no greater constraint on BHPBIO than the RTA, then declaration cannot promote competition in any other market. In this case, the RTA imposes a significant and at least equivalent constraint on BHPBIO, for the following reasons, shortly stated.

(a) It is clear that the RTA applies and is enforceable by third party iron ore miners.[15]

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[12] Draft Recommendation, para 7.180.

[13] Draft Recommendation, para 7.199.

[14] BHPBIO has previously provided submissions to the Council submitting that it does not have any market power as found by the Council in its Draft Recommendation. BHPBIO reiterates those submissions.

[15] See *Hancock Prospecting v BHP Minerals* [2003] WASCA 259.

(b) The RTA provides for a negotiate/arbitrate model of settling terms on which the rail haulage service is to be provided, with a very low threshold for invoking a quick and effective dispute resolution mechanism.[16]

(c) The terms on which the rail haulage service is to be provided must not "unduly prejudice or interfere" with the operations of the Mt Newman Participants, but this requirement is clearly circumscribed,[17] there are provisions for constructing further infrastructure etc to expand capacity so as to avoid prejudice or interference, and the ambit of this requirement is clearly subject to the dispute resolution provisions.

(d) There has been, and will be, no demand for the provision of rail haulage or rail track services by persons other than potential providers of iron ore.

BHPBIO is not able to withhold supply of a rail haulage service to competing iron ore providers – the RTA effectively and significantly constrains BHPBIO in this regard. More importantly, declaration of a rail track service will impose no greater nor more effective constraint on BHPBIO.

5.6 In any event, the Council's reasoning that the RTA does not "significantly" constrain BHPBIO's ability to exercise any alleged market power is misguided.

Relevant factors

5.7 In reaching its conclusions, the Council relied upon the following matters:[18]

(a) no iron ore producer or potential producer has ever succeeded in negotiating a haulage service under the State Agreement or the RTA. The Council identified two unsuccessful attempts to negotiate access to third party haulage services, by HDMS and FMG respectively;

(b) the Western Australian Government's submission, without anything more, that "*it is debatable whether the State Agreement access provisions have been effective*";[19] and

[16] See clause 3 of the RTA, which requires no more than written notice for the appointment of an independent expert whose decision is final.

[17] The prejudice or interference must not relate to "downstream" effects (see clause 4(b) of the RTA). Further, once terms have been settled for a rail haulage service, no further claim of prejudice or interference may be made. If terms cannot be agreed, they are to be determined by the independent expert. Hence, BHPBIO cannot arbitrarily determine what might "unduly prejudice" its operations.

[18] Draft Recommendation, paras 7.180 and 7.199.

[19] Western Australian Government submission 2005, p 13.

(c) its finding that the access regime provided for by the State Agreement and the RTA is unlikely to constitute an "effective access regime" for the purposes of criterion (e) of s 44G(2) of the TPA.

5.8 BHPBIO considers that the Council's reasoning in respect of each of the above considerations is flawed. Each consideration is addressed below.

Previous negotiations

5.9 That no iron ore producer has successfully acquired a rail haulage service under the State Agreement or the RTA in the past is not a function of BHPBIO exercising any alleged market power.

BHPBIO's legal obligation

5.10 BHPBIO is legally obliged to negotiate and provide third party rail haulage services under the RTA. This was established, unanimously, by the Western Australian Court of Appeal in *Hancock Prospecting Pty Ltd and Ors v BHP Minerals Pty Ltd and Ors*.[20]

5.11 In that case, it was held that BHPBIO is obliged to negotiate terms of access for carriage of iron ore products under the RTA at the request of a "third party". The qualifying threshold for a third party is low.

The Court has set a "commercially sensible" threshold for a third party to meet:

> "In any event, I do not see how the "detailed contractual arrangements" contemplated by cl. 2 of the Schedule to the RTA could be established except by a person whose plans for mining were well advanced. That is the case here. … Clearly, the respondents cannot carry iron ore products of a third party until that third party has provided the iron ore which is to be carried. Thus, a third party is a person who will be producing iron ore at some stage. However, the definition does not assist in determining or limiting the period within which the third party may be involved in negotiations with the respondents. That must be determined by adapting a construction which leads to **a commercially sensible result**, having regard to the object of the agreement" (emphasis added).[21]

5.12 Accordingly, if any third party with sufficiently well advanced mining plans so as to make commercial negotiations sensible, wishes to acquire rail haulage services under the RTA, BHPBIO cannot refuse to negotiate with that party, nor ultimately refuse to provide the service sought.

5.13 While the initial obligation on BHPBIO is to negotiate terms of a rail haulage service, the RTA provides a readily-invoked mechanism for an independent expert to be appointed to

[20] [2003] WASCA 259.

[21] [2003] WASCA 259 at paras 33, 34; per Templeman J, with whom Murray J agreed.

resolve any disputes should negotiations be unsuccessful. In these circumstances, BHPBIO cannot exercise any alleged market power.

HDMS negotiations

5.14 BHPBIO and HDMS failed to reach agreement on the terms and conditions of a rail haulage service under the RTA not because of any ability to exercise alleged market power on behalf of BHPBIO, but because HDMS unilaterally decided upon another course of action which it found more commercially attractive. Negotiations were unsuccessful for this reason alone.

5.15 The history of negotiations between the parties demonstrates that BHPBIO negotiated with HDMS on reasonable commercial terms. Confidential Annexure 6 to BHPBIO's Submission dated 3 June 2005 sets out the history of negotiations from 1997 to late 2004 between HDMS and BHPBIO (and its predecessor, BHPIO):

(a) BHPBIO and HDMS negotiated in good faith over an extended period, considering a number of proposals, including HDMS's acquisition of rail haulage services under the RTA;

(b) in May 2001 and again in March 2004[22] BHPBIO offered HDMS detailed terms on reasonable commercial grounds on which BHPBIO was prepared to carry HDMS's iron ore on the Mt Newman Line pursuant to the RTA;

(c) each of those offers by BHPBIO led to detailed negotiations between HDMS and BHPBIO; and

(d) between October and December 2004, BHPBIO provided information requested by HDMS as part of the on-going negotiations but BHPBIO did not receive a response to its letter of 21 December 2004 regarding outstanding action items and agreement of a memorandum of understanding.

5.16 It is clearly evident that HDMS did not continue negotiations for the provision of a rail haulage service, because it considered that there was a more commercially attractive alternative available to it.[23]

5.17 There is no information before the Council to suggest that HDMS discontinued negotiations with BHPBIO because:

[22] HDMS suggested to BHPBIO that the indicative terms sheet provided by BHPBIO in May 2001 was an acceptable starting point for discussions.

[23] HDMS first proposed to construct its own railway line (following the model of other iron ore producers in the Pilbara) and then HDMS ultimately found an even more commercially attractive alternative when Rio Tinto offered to acquire 50% of the Hope Downs project and to rail HDMS iron ore on its own railway line.

(a) BHPBIO exercised any market power;

(b) BHPBIO refused to provide a rail haulage service under the State Agreement or RTA or a rail haulage service on reasonable terms and conditions; or

(c) BHPBIO did not negotiate in good faith or that negotiations were futile.

5.18 Indeed, it is quite clear that HDMS did not ever seek to appoint an independent expert under clause 3 of the Schedule to the RTA in relation to the negotiations over terms on which a rail haulage service would be provided under the RTA (as it may have, for example, if BHPBIO had offered patently unreasonable terms of access). HDMS could have readily availed itself of those rights at any relevant point in the negotiations in 2001 to 2004 but did not.

FMG negotiations

5.19 BHPBIO and FMG have not reached agreement on the terms and conditions of a rail haulage service under the State Agreement or under the RTA simply because, at the relevant time, FMG's mining plans were not sufficiently advanced such that any discussions or negotiations would be commercially sensible.

5.20 Paragraph 160 and paragraphs 12 – 14 of Annexure 14 to BHPBIO's Submission dated 3 June 2005 set out the scope and nature of the correspondence between BHPBIO and FMG:

(a) BHPBIO and FMG began negotiating the provision of a rail haulage service under the RTA in about July 2003;

(b) at that time, FMG's mining plans were not sufficiently advanced that any practical detailed commercial arrangements could be settled and BHPBIO advised FMG of this; and

(c) FMG discontinued correspondence with BHPBIO.[24]

5.21 Since then, Mr Graeme Hunt of BHPBIO has written again to FMG on 12 October 2005 making it clear that BHPBIO is "aware of [its] obligations to negotiate terms for rail carriage services with third parties" under the RTA. Mr Hunt stated:

> "I note that you had also previously approached us in relation to supply by BHPB Iron Ore of a rail carriage service under the RTA, but that those discussions had not proceeded because your project was not sufficiently developed to enable terms and conditions to be formulated. As you are now building your own rail system, I take it that you will not be pursuing the RTA avenue in relation to your main project.

[24] According to the chronology of negotiations between FMG and BHPBIO prepared by FMG and annexed to the FMG Application, the last written correspondence on this topic between FMG and BHPBIO was a letter from Graeme Hunt (BHPBIO) to FMG in early February 2004.

> Presumably, you have not raised the RTA in relation to your Mindy Mindy project because you do not have sufficiently advanced plans in relation to the Mindy Mindy project. We are aware of our obligations to negotiate terms for rail carriage services with third parties whose plans for mining are "well advanced" and would be happy to discuss terms when your plans for Mindy Mindy are sufficiently well advanced to make this practicable".

5.22 A copy of this letter is **annexed** to these Further Submissions as **Annexure 7**.

5.23 BHPBIO's offer to revisit negotiations on providing a rail haulage service under the RTA has been widely reported in recent press.[25] FMG, however, has not responded to this offer.

No other third parties

5.24 That no other third party has sought to acquire a rail haulage service under the State Agreement or the RTA is not a function of BHPBIO exercising any alleged market power. BHPBIO has simply not been approached by others. There is no other demand for iron ore transportation.

5.25 Prior to the recent unforeseen surge in the demand and price for iron ore there were no other third parties seeking to produce iron ore in the Pilbara region, and thus to acquire a rail haulage service under the State Agreement or the RTA. Since the iron ore price surge in around 2004, there have been new junior explorers emerge, looking for iron ore deposits in the Pilbara, but none has sought an iron ore haulage nor any other transportation service from BHPBIO.

5.26 There are several reasons why such iron ore explorers have not sought negotiations for the acquisition of a rail carriage service from BHPBIO, including:

(a) it is highly uncertain whether third party iron ore explorers will have a marketable product (with or without blending). Until that position is clearer, seeking the acquisition of a rail haulage service is very premature; and

(b) even if a third party iron ore explorer had a marketable product, there is a constraint at Port Hedland with a lack of spare port capacity. Unless this is also addressed by a third party, it would be futile to acquire a rail haulage service.

Western Australian Government submission

5.27 In reaching its decision as to whether the RTA constrains BHPBIO's ability to exercise any alleged market power, the Council relied upon the Western Australian Government's view that it is *debatable* whether the RTA provisions have been effective or not.

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[25] See, for example: "Fortescue fights BHP line over right to use Pilbara rail", *The Australian*, Tuesday 6 December 2005, p 25; "Fortescue wins support for rail access", *Australian Financial Review*, Saturday 5 November 2005, p 8; "Share rail in Pilbara, BHP told", *The Australian*, Saturday 5 November 2005, p 33; "NCC on wrong track with Pilbara ruling", *The Australian*, Saturday 5 November 2005, p 36.

5.28 The Western Australian Government's opinion about the "effectiveness" of the RTA appears to be based solely upon the apparent lack of "successful negotiations" between third parties and BHPBIO for a rail haulage service. The Western Australian Government, however, has not sought to explore the reasons for those failed negotiations. BHPBIO has provided extensive submissions to the Council on this issue (as summarised above).

5.29 In these circumstances, the Council's reliance upon the Western Australian Government's statement is flawed. The Western Australian Government's statements on these issues are equivocal and do not provide a factual basis for the conclusions drawn by the Council. The Western Australian Government's statement that it is "debatable" whether the access regime under the RTA is "effective" does not put forward a persuasive view one way or the other.

Effective access regime

5.30 Whether or not the RTA provides an effective access regime for the purposes of criterion (e) is a different issue to determining whether BHPBIO's ability to exercise any alleged market power is practically constrained.

5.31 An access regime is regarded as "effective" under criterion (e) if it meets the principles set out in the CPA. Those principles or guidelines are relatively comprehensive and require the access regime to have specific characteristics. Even assuming that the access regime under the RTA does not meet one of those principles, this does not equate to that regime not acting as a constraint on BHPBIO's ability to exercise any alleged market power. The Council has erred in finding otherwise.

5.32 In any event, the Council has erred in reaching the conclusions at paragraph 10.27 of the Draft Recommendation, in the following terms:

> "(a) There is no access regime in place that covers track services in the Pilbara.
>
> (b) The existence of an effective access regime for a service that is a substitute for the Service is not relevant to criterion (e).
>
> (c) In any case, the third party haulage service provided for by the State Agreement and the RTA is not a substitute for the Service to which access is sought.
>
> (d) It is unlikely that the access regime set out in the State Agreement and the RTA would satisfy the clause 6 principles. It is therefore unlikely that the State Agreement and the RTA provide an effect access regime in relation to any service."

The conclusions reached in sub-paragraphs (a) to (c) above are incorrect in light of the requirements and proper construction of clause 6 of the CPA and sub-section 44DA(1) of the TPA.

5.33 Clause 6(2) of the CPA provides that:

> "The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause … ."

This intention is to be applied by the Council in deciding whether an access regime is "an effective access regime" (see sub-section 44(G)(3)). Where there is a State "access regime which covers the facility" (as against applying specifically to any particular "service" to which an application under Part IIIA has been made), it is the clearly stated intention of the parties to the CPA that that State regime will prevail, provided that it conforms to the principles set out generally in clause 6(4) of that agreement, construing those principles as guidelines only (see s 44(DA)(1)).

5.34 Thus, it is BHPBIO's submission that even if the Council is correct in relation to the conclusions in sub-paragraphs (a) and (c) of paragraph 10.27 of its Draft Recommendation (which is denied), those conclusions are irrelevant to the proper construction of clause 6(4) of the CPA. Instead, all that is required is that there be an access regime in place which "covers the facility", as well as conforming to the principles set out more generally in that clause. The RTA is clearly an access regime which "covers the facility", in this case, namely, the Mt Newman Line.

5.35 Further, in BHPBIO's submission, the RTA already complies with the principles set out in clause 6(4) of the CPA, when those principles are properly applied as guidelines, rather than a binding rule (see sub-section 44(DA)(1)). Particularly:

(a) Threshold for entitlement to negotiate

The concerns set out in paragraphs 10.27(a)(i) and (ii) of the Draft Recommendation are misconceived in light of the findings of the Western Australian Court of Appeal in *Hancock Prospecting v BHP Minerals* [2003] WASCA 259, where a third party was found to be entitled to negotiate pursuant to the terms of the Schedule to the RTA upon that third party being able to embark upon "commercially sensible" negotiations with the Mt Newman Participants.

(b) Enforcement of right to negotiate

The concerns set out in paragraph 10.26(b) of the Draft Recommendation are groundless on the basis that any refusal on the part of the Mt Newman Participants to negotiate under the terms of the Schedule to the RTA will inevitably invoke a dispute to which clause 3 of the Schedule applies. The third party at that point may simply seek to appoint an independent expert so as to resolve the dispute and is free to do so in any case "where the (parties) are unable to reach agreement on any aspect of the detailed contractual arrangements" (see clause 3).

(c) Involvement of the Courts

The issue referred to in paragraph 10.26(b)(iii) does not arise under the principles set out in clause 6(4) of the CPA. Clause 6(4)(g) only requires that access disputes be resolved by an "independent body" appointed and funded by the parties, a requirement with which the RTA clearly complies.

(d) No regulatory guidance

The concern set out in paragraph 10.26(c) of the Draft Recommendation is misconceived. Clause 6 of the CPA does not require such "transparent regulation". Clause 6(4)(g) only requires that an independent body be appointed to resolve any dispute. Further, any provision of "guidance" by a dispute resolution body or other regulator would be of little use in these particular circumstances as there are, and only ever will be, very few applicants for a rail carriage service, and each is likely to seek a very different service from any other, given the very likely geographic separation of the assets of any such third party.

(e) Powers of dispute resolution body

The concern set out in paragraph 10.26(d) of the Draft Recommendation is simply a technical one and is of no practical significance in the application of the requirements of the RTA. Further, paragraphs 6(4)(g) and (o) of the CPA only require that the parties appoint and fund an independent body which has access to financial statements or accounting information pertaining to the service. It is implicit in the terms of the RTA that financial statements and accounting information will be available to the independent expert appointed by the parties to resolve disputes, in that the provisions of clauses 12, 13, 14, 30, 31 and 32 of the RTA, for example, require financial and accounting information to be put into effect. Thus, it is highly likely that an independent expert will seek and be provided with such information (and failing its provision, the independent expert may draw inferences contrary to the party failing to provide that information). In these circumstances, the requirements of clause 6(4) of the CPA, interpreted as guidelines, are complied with.

(f) Matters to be taken into account by the independent expert

The concerns set out in paragraph 10.26(e) of the Draft Recommendation are incorrect. The RTA clearly requires the independent expert to have regard to the economic value to the owner of investment in the facility, the economically efficient operation of the facility and the benefit to the public of having competitive markets, in that:

(i) investment in, and tax benefits of additional facilities and equipment in the system are dealt with under clauses 12, 13 and 14 of the RTA;

(ii) the allocation of costs under clauses 30, 31 and 32 of the RTA, and the payment of a "return on investment" for that part of the "common railway system" used by the third party pursuant to clause 33 must be taken into account; and

(iii) clause 4(b) of the RTA provides that the Mt Newman Participants cannot claim prejudice on the grounds of downstream competition with the third party and this must be taken into account by the independent expert.

5.36 For the reasons set out above, the Council has erred in finding that the facility is not already "covered" by an effective State access regime, as is required by clause 6(2) of the CPA.

Public interest

5.37 Finally, as has been submitted elsewhere, the application of the RTA to the provision of a rail haulage service will be far less intrusive than if BHPBIO is required to provide a track access service pursuant to declaration. That is, there are far fewer and much less severe diseconomies imposed upon the Mt Newman Participants under the RTA. In summary, this is a result of there being only one rail operator under the RTA.

5.38 Thus, the Council must take into account these very significant diseconomies from declaration, under criterion (f), especially where there are powerful considerations pointing away from there being any promotion of competition in other markets.

BHP BILLITON IRON ORE
30 December 2005