

ANNEXURE 6, PART 4

IN THE FEDERAL COURT OF AUSTRALIA)
VICTORIA DISTRICT REGISTRY)
GENERAL DIVISION)

No. VID 1641 of 2004

BHP BILLITON IRON ORE PTY LTD
(ACN 008 700 981)

Applicant

and

THE NATIONAL COMPETITION
COUNCIL

First Respondent

and

FORTESCUE METALS GROUP
LIMITED (ABN 57 002 594 872)

Second Respondent

AFFIDAVIT

I, **PETER HERBERT LLOYD MONKHOUSE** of 25 Glenroy Road, Hawthorn, in the State of Victoria say on oath that:

1. I am the Vice President, Strategy for BHP Billiton's (BHPB) Carbon Steel Materials division (CSM). The CSM division encompasses those operations that are owned, in part or in whole, by BHP Billiton and which are dedicated to the production and marketing of raw materials to the international steel industry. These operations include BHPBIO's iron ore operations in the Pilbara region of Western Australia.
2. In my present role, I am responsible for a range of matters, including:
 - (a) formulation and presentation of CSM strategy;
 - (b) assessment and negotiation of opportunities for joint venture arrangements and transactions with new entrants in the Pilbara iron ore industry;

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- (c) regulatory processes such as Part IIIA of the *Trade Practices Act (TPA)* and the *Rail Transport Agreement 1987 (RTA)*, insofar as those processes relate to the CSM division's operations; and
 - (d) the CSM division's budget for research and development.
3. Since being employed by BHPB in 1999, and immediately prior to being appointed to the position of Vice President, Strategy (CSM) in 2001, I held the positions of:
- (a) Vice President, Business Development and Evaluation Group of BHP's Mineral's division (October 1999 to March 2000); and
 - (b) Business Leader, BHP Base Metals (April 2000 to June 2001).
4. I graduated with a Bachelor of Electrical Engineering degree (1st Class Honours) from the University of Western Australia in 1981, and obtained a Masters of Business Administration from Monash University in 1990.
5. Prior to being employed by BHPB, I held the following positions:
- (a) engineer with the Clough Engineering Group from 1980 to 1987;
 - (b) various positions, including Associate Director, in the Corporate Advisory Group of Potter Partners (subsequently UBS Warburg) from 1988 to 1995. During that period I spent a year working for SG Warburg in London, in their corporate advisory/mining group; and
 - (c) various roles at CRA from 1995 to 1996. Following Rio Tinto's merger with CRA, I subsequently transferred to London, working in Rio Tinto's Business Evaluation Department. At the time I left Rio Tinto in 1999, I held the position of Business Development Executive.
6. I have written and co-written a number of articles relating to the cost of capital, real options and mine planning and I act as a referee for a number of journals. The details of the articles are set out at Annexure "PM-1".



7. I have read the affidavits of Rodney Hoare and Robert (Bob) Ridley sworn on 22 December 2005 and that of Phillip Price sworn on 23 December 2005 and in particular, the sections relating to the operational impacts of third party access on BHPBIO's operations. In this affidavit, I describe and explain various non-operational categories of costs that are likely to be imposed on BHPBIO as a result of access to the Mt Newman rail line, and that part of the Goldsworthy rail line from where it crosses the Mt Newman rail line to Finucane Island (collectively referred to as "the rail lines") being granted to one or more third parties.

Strategic importance of integration of mine, rail and port operations

8. BHPBIO's mine, rail and port operations are managed by BHPBIO as an integrated system. The mine, rail and port operations are operated with the objective of optimising the integrated system as a whole, rather than seeking to optimise the individual aspects of the mine, rail and/or port operations. This is necessary because each of the mine, rail and port operations imposes operational constraints on the other; accordingly, the total system efficiency and productive capability is only as good as the least efficient and productive component.
9. Similarly, all expansion and investment planning in relation to BHPBIO's operations is undertaken in relation to the mine, rail and port system as a whole, and not in relation to individual components. The expansion planning seeks to achieve optimisation of the entire system and, where possible, avoid unnecessary latent capacity in any of the mine, rail and port operations. With all expansion planning, BHPBIO undertakes detailed modelling of the operation of the entire system as expanded, to determine whether the expanded system will be able to achieve the required level of iron ore production. As explained in the affidavit of Rod Hoare referred to above, that modelling is undertaken by TSG Consulting, and more specifically Rod Hoare, under direction from BHPBIO.
10. In order to manage BHPBIO's mine, rail and port operations as an integrated system, BHPBIO requires control over the operation of each of the system components. This is because there is considerable variation in operational requirements resulting from both supply side factors (particularly variations in ore grades and impurities, maintenance requirements and outages) and demand side factors (particularly variations in shipping arrival and demand for specific products). These variations require BHPBIO to operate



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with a high degree of flexibility, so that changes can be made to each of the mine, rail and port operations in order to respond to variations in supply and demand requirements and maximise production.

11. If BHPBIO did not have complete control over, and flexibility in the management of, its mine, rail and port systems, it would be difficult to achieve its current level of production with its current system configuration. As explained in the affidavits of Phillip Price, Bob Ridley and Rod Hoare, BHPBIO is currently operating at its maximum production capability, given the current system configuration and operational practices. It is BHPBIO's flexibility in managing the integration of its mine, rail and port operations that enables BHPBIO to implement operational changes to improve production output and respond to variability within the operating environment.
12. For the above reasons, ownership of, and complete control over, BHPBIO's rail operations is of a high strategic value to BHPBIO. This high strategic value has been recognised by BHPBIO for many years as illustrated in the following paragraphs.

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Costs of third party access

19. The presence of a third party on BHPBIO's rail lines will, in my view, have the following adverse effects on BHPBIO:
- (a) impose costs in connection with regulation;
 - (b) in the absence of capital expenditure, reduce BHPBIO's production capability;
 - (c) restrict and cause delays to BHPBIO's expansion and investment decision making and implementation; and
 - (d) distort the incentives to undertake investments in BHPBIO's operations.

The issues of reduction in BHPBIO's production capability are discussed in the affidavits of:

- Robert (Bob) Ridley (paragraphs 56 to 67);
- Phillip Price (paragraphs 88 to 105); and
- Rodney Hoare (paragraphs 59 to 83).

Direct costs of regulation

20. BHPBIO will face high unrecoverable costs in responding to the application by Fortescue Metals Group Limited (FMG) to declare services provided by its rail facilities in the Pilbara. These unrecoverable costs include both:
- (a) direct costs, such as the cost of procuring specialist consulting services and legal assistance; and
 - (b) indirect costs, principally through interference with management resources.
- BHPBIO's current estimation, with which I concur, is that the interference with management resources has delayed its planned expansion projects by a number of weeks. For example, at current prices, once completed, the planned expansion under BHPBIO's RGP3 project would produce additional revenue of around A\$20 million a week. Accordingly, each week that the commissioning of the project is

delayed will result in foregone revenue (at current prices) of around A\$20 million a week (some of which would have been paid to the State of Western Australia as royalties).

21. Further, these costs, and particularly the costs resulting from interference with management resources, will continue to increase as the regulatory process continues. For example, it is possible that the Minister's decision (to declare or not to declare) will be appealed to the Australian Competition Tribunal (ACT). Also, if the service is declared, the potential arbitration of terms and conditions of access by the Australian Competition and Consumer Commission (ACCC) will impose substantial regulatory costs.

Additional constraint on BHPBIO's expansion decisions

22. BHPBIO's operations are currently undergoing a rapid expansion through the implementation of various approved expansion projects and assessment of others. If a third party were to obtain access to BHPBIO's rail lines, BHPBIO would be required to factor the potential needs of such a third party into its expansion plans.
23. Expansion decisions are complex and have significant potential to give rise to disputes with a third party or parties. Some of the issues that would need to be resolved include:
- (a) the nature, and extent, of any capital contribution required from a third party or parties towards expansion costs; and
 - (b) the impact of any expansion on the availability of the rail line for given periods of time during the tie-in period of the construction phase.
24. Further, expansion plans have varying costs when assessed on a dollar per tonne of production capacity basis. Even if a third party does not participate in an expansion project, there may be disputes in relation to the utilisation of low cost expansion plans in which the new entrant does not participate.
25. All of these issues would require detailed negotiation (and potentially arbitration) to resolve. In my view, this requirement may slow down the process of evaluating BHPBIO's expansion plans (and possibly result in a decision not to undertake proposed expansions), and may also result in sub-optimal approaches to expansion.



Distortion of investment

26. I cannot predict with any certainty the precise impact that third party access will have on BHPBIO's investment decisions.
27. However, notwithstanding the above, it is clear that third party access, or the risk of third party access, will make it more difficult to gain approval for future investment in BHPBIO's operations. This is particularly the case in the environment where, as a general point, escalating capital costs in the Pilbara are tending to make investments in projects in that region more problematic.
28. For example, there was sufficient risk attached to BHPBIO's proposed Ongoing Works expansion project (as described in the affidavit of Phillip Price sworn on 23 December 2005) that BHPBIO determined that it should undertake that project as a series of staged expansions, rather than as a single project. This was in circumstances where the requisite market demand existed and BHPBIO had complete control of its mine, rail and port operations.
29. Therefore there is, in my view, a real risk that third party access may lead to, or be a factor in, the following outcomes:
- (a) the delay of an investment in an expansion project, with significant opportunity costs arising from deferred production (discussed in more detail below);
 - (b) expansion projects being undertaken on a more incremental basis, which may increase the "tie-in" costs of integrating each of the works undertaken in the various expansions; and
 - (c) a decision by BHPBIO not to undertake an investment in a proposed expansion project.
30. Some of the reasons that BHPBIO's investment decisions would be affected by third party access include that:
- (a) any investment decision relies critically on the incremental capacity being achieved. Third party access, and the threat of third-party access, makes estimating this



incremental capacity difficult and uncertain. This issue has the potential to affect our next investment decision;

- (b) there is a risk that any latent capacity in the rail line (which may exist to ensure that variability in demand, and ore grades and impurities, can be managed through flexibility in BHPBIO's rail operations) may be appropriated by the third party or regulator on the basis that there appears to be "spare capacity" in the line; and
- (c) there is a risk that regulators will underestimate the appropriate discount rate to be applied to the rail assets as a consequence of third party access, which will lead to an under-estimation of the rate of return calculated by the regulator in determining the conditions of third party access. In my view, this tends to occur as a consequence of regulators failing to take account of "option value". For example, there is a value to BHPBIO in having the option of amending or delaying a project once initiated.

31. The cost impact on BHPBIO of even minor delays is illustrated by the likely costs that would be associated with a 1 year delay to the RGP3 project, which is expected to increase total system throughput capability by 20 mtpa. I have broadly estimated that if the project were delayed by one year, the opportunity cost of the delay would be approximately A\$300 million.

32. This figure is estimated on the following basis:

- (a) at current iron ore prices of approximately A\$50 per tonne for fines products and A\$65 per tonne for lump products, the revenue forgone by delaying the RGP3 expansion project for one year is in excess of A\$1 billion;
- (b) in the financial year end June 2005, BHPBIO had an EBIT margin of 44%, indicating an EBIT forgone of in excess of A\$440 million; and
- (c) allowing for tax, and discounting the opportunity cost by one year, the opportunity cost of delaying the project by one year is in the order of A\$300 million.



33. The costs of these delays will also impact on the community more generally. For example, these costs will result in a reduction in mining royalties paid to the State of Western Australia.

SWORN by the said deponent at)
Melbourne, in the State of Victoria, this)
23rd day of December 2005)



Before me:



CHRISTOPHER MICHAEL EVANS
BLAKE DAWSON WALDRON
101 Collins Street, Melbourne, VIC 3000
An Australian practitioner within the meaning
of the Legal Profession Act 2004

Form 20A

(Order 14, rule 5A)

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VICTORIA DISTRICT REGISTRY)
GENERAL DIVISION)

No VID 1641 of 2004

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(ACN 008 700 981)**

Applicant

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**THE NATIONAL
COMPETITION COUNCIL**

First Respondent

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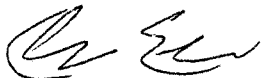
**FORTESCUE METALS
GROUP LIMITED (ABN 57
002 594 872)**

Second Respondent

AFFIDAVIT – CERTIFICATE OF COMPLIANCE

I, **CHRISTOPHER EVANS**, certify to the Court that the affidavit of **PETER HERBERT LLOYD MONKHOUSE**, sworn on 23rd December 2005 filed on behalf of the Applicant, complies with Order 14, rule 2 of the Federal Court Rules.

Date: 23rd December 2005


CHRISTOPHER MICHAEL EVANS
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of the Legal Profession Act 2004

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This and the following 1 page~~s~~ is the annexure marked "PM-1" referred to in the affidavit of **PETER HERBERT LLOYD MONKHOUSE** sworn at Melbourne in the State of Victoria this 23rd day of December 2005.

Before me:



CHRISTOPHER MICHAEL EVANS

BLAKE DAWSON WALDRON

101 Collins Street, Melbourne Vic, 3000

An Australian Practitioner within the
meaning of the Legal Profession Act 2004

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"PM-1"

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4. McCarthy J. and Peter H.L. Monkhouse, *To Open Or Not To Open – Or What To Do With A Closed Copper Mine*, Journal Of Applied Corporate Finance, Winter 2003, pp. 56-66.
5. Monkhouse, Peter H.L. and G. Yeates, 2005, Beyond Naïve Optimisation, *Orebody Modelling and Strategic Mine Planning*, pp. 3-8, Australasian Institute of Mining & Metallurgy: Melbourne.
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[CONFIDENTIAL INFORMATION REMOVED]