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Dear Mr Feil

Part IIIA Application by Fortescue Metals Group Limited (*FMG*) – Submissions in response to NCC Draft Recommendation

We refer to the submissions lodged with the Council on 5 December 2005 and published on the Council's website on 8 December. We do not intend to comment in detail on all of the submissions lodged but feel obliged to make some observations on certain statements made in the submission provided by FMG. Our comments are set out below. While we have focused on a number of key issues, there are many other aspects of the FMG submission with which we disagree, but which are not addressed in this letter.

Paragraphs 2.7 – 2.10 of FMG submission – FMG's railway line

The Council should note that the **only** two occasions when FMG has made any qualification to its commitment to build and use its independent rail line from its Chichester Deposits to Port Hedland has been in its submissions to the Council in May and December 2005. All releases, reports, presentations, announcements to the ASX and other comments from FMG have contained no such qualification. As RTIO pointed out in paragraph 3.8 of its 5 December Submission (***December Submission***) the announcements to this effect included an ASX announcement after the Council released its Draft Recommendation in which FMG advised that its intention to build the line was "firm" and that the positive recommendation "does not affect" these plans. There was no hint of any qualification along the lines of those now set out in paragraphs 2.8 and 2.10 of the FMG submission.

Further, in paragraph 2.9, FMG confirms that it is "highly likely" that it will build its Chichester line. More specifically, in its letter to FMG dated 26 July 2005, the Council sought clarification of FMG's intentions regarding its Chichester line. FMG responded by letter dated 28 July 2005 unequivocally stating its intention to construct the Chichester line and that there were no specific likely events that would "trigger a change of strategy".

As RTIO points out in paragraph 3.7 of its December Submission, the Council must conduct its analysis of the Application on the basis of the most likely scenario. The most likely scenario (in fact "highly likely" according to FMG) is that FMG will construct its Chichester line and rail its own ore from its Chichester project. The Council is certainly not justified in applying a **most unlikely** scenario (ie, non-construction of the Chichester line) for the purpose of deciding whether a large part of the Service will in fact be duplicated.

Paragraph 2.16 – Demand for Mt Newman railway line

It is noted that FMG believes that "BHPBIO's own level of demand is likely to exceed 200 million tonnes per annum" within the proposed declaration period. This is consistent with the submission of BHPBIO (see paragraphs 2.12 – 2.16). However the Council has only done its analysis in relation to criterion (b) on the basis that the relevant range of demand is 200mtpa from all sources (paragraph 6.78 of the Draft Recommendation).

As RTIO points out at paragraphs 3.1-3.3 of its December Submission, RTIO strongly contends that a natural monopoly test should not be applied when assessing criterion (b), especially in this case when more than two thirds of the Service will be duplicated and will not in fact be used. However, if the Council decides, nevertheless, to apply this test, it should do so on the basis that BHPBIO's requirements alone will exceed this demand. As a consequence, the Council must review its analysis to decide whether, for the new levels of demand, it would be "cheaper for a single facility rather than multiple facilities to provide the service" (paragraph 4.21 of Guidelines). Doubtless the modelling work being undertaken by BHPBIO to be submitted by 6 January 2006 (see paragraph 2.21 of BHPBIO's submission) will assist the Council in this regard.

Paragraphs 2.17 – 2.22 – BHPBIO expansion of the Mt Newman rail line

The assertions made in these paragraphs are based on the assumption that BHPBIO will build spare capacity into its line and that this will be unutilised. There is no basis for this assertion. First, BHPBIO has stated in its submission that it has no current plans to double track (paragraph 2.10) and that, if it does, it will be on an incremental basis to meet BHPBIO's own demand for its rail system (paragraph 2.11). Therefore, if and to the extent that BHPBIO does dual track the Mt Newman rail line, it will itself have the demand for the capacity provided by that dual tracked facility. One would not expect the situation to be any different. No company invests in capacity that is not required. The assertion that BHPBIO itself will bring spare capacity into existence is therefore misconceived. This in turn invalidates FMG's argument – in the context of its "social cost benefit" analysis – that interface and other costs arising from declaration will be negligible.

Paragraphs 3.36 – 3.58 – Promotion of competition in market for iron ore

The essence of FMG's position in relation to promotion of competition in the iron ore market appears to be based on an assertion that the recent rise in iron ore prices demonstrates that competition is not effective in the market (paragraph 3.41), and that this would be resolved by mandated access to the Mt Newman Service because small producers would be "nimbler" and able to respond more rapidly to demand surges (paragraph 3.46). Both of these assertions are incorrect.

First, as the Council recognises in paragraphs 7.147 and 7.148 of its Draft Recommendation, the price increases that have recently been experienced result from an unexpected surge in demand, led by China, not from a lack of competition. China's imports have increased from 70mt in 2000 to an expected 270mt in 2005. This has led to an unprecedented expansion program by the world's iron ore producers, such that – whilst the market remains tight today – supply and demand are forecast to come closer to equilibrium over the medium term. Most analysts expect prices to have returned to levels closer to their long term trend by 2009. This demonstrates that market forces and competition are working very effectively in the iron ore market.

As to the assertion that small producers could and would respond more rapidly than the existing producers, this is totally unsubstantiated and defies the universal acclaim given to the existing Pilbara producers for their rapid response to China's surge in demand[1] (especially compared with the slow response from the coal industry where there is an abundance of small producers using shared infrastructure). The extent and rapidity of the Pilbara producers' response to China's increased demand is articulated in paragraphs 3.30, 3.31, 3.38 and 5.6-5.8 of RTIO's December Submission.

As is demonstrated in these paragraphs, Australia's ability to respond to such surges would be significantly impeded, not enhanced, if there were third party access to the Mt Newman Service. In fact, if any improved response were possible beyond what is currently being experienced, it could only come as a consequence of the existing producers pursuing their expansion programs without the imposition of the barriers of multi-usage and putting in place additional means whereby other potential producers could rail their ore to port. One means to achieve this is addressed in paragraph 5.20 of RTIO's December Submission; namely the construction of a spur line to link up to the relatively less utilised (and open-access) FMG Chichester line.

Finally, in this context, RTIO also notes the comments by the Australian Competition & Consumer Commission (***ACCC***) in its recently released "Public Competition Assessment" in relation to Rio Tinto's proposed acquisition of a 50% interest in the Hope Downs Iron Ore Project.[2] One of the clear conclusions of the ACCC was that, given the small annual tonnages that would be produced from the Hope Downs Project (estimated at about 30mtpa), development of the Project by a party independent of Rio Tinto would not affect competition in the global iron ore market. By parallel, this assessment by the ACCC must mean that the development of the Mindy Mindy Project (which is considerably smaller than Hope Downs) would also not affect competition in the global iron ore market. This directly contradicts FMG's assertion, in paragraph 3.55 of its latest submission, that Mindy Mindy is not "too small to have a competitive impact on the global market for iron ore".

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[1] The Reserve Bank of Australia's Statement on Monetary Policy dated 7 February 2005 and 'Australia's Export Infrastructure' Report to the Prime Minister by the Exports and Infrastructure Taskforce dated May 2005.

[2] 'Public Competition Assessment' by ACCC dated 19 December 2005, entitled 'Rio Tinto – Proposed Acquisition of a 50% interest in the Hope Downs Iron Ore Project'.

Paragraphs 3.70 and 3.71 – Market for iron ore tenements

In these paragraphs of its latest submission, FMG acknowledges the substance of the point made by RTIO in paragraph 4.72 of RTIO's December Submission; namely that the activity and interest in iron ore tenements is very intense and that, therefore, if there is a separate market for iron ore tenements in the Pilbara (which RTIO strongly disputes), it is a very competitive market.

It is noted that FMG attributes the increased interest, not only to the iron ore price levels, but also to the potential for access to the Mt Newman Service as a result of its Application (paragraph 3.71). There is no evidence of this whatsoever. In fact, as the Council discovered when it spoke to "junior explorers", small producers are not interested in track access – they are interested in haulage by BHPBIO or RTIO (paragraph 7.208 of Draft Recommendation). They do not anticipate haulage by an independent third party (because they know that this is unlikely for the reasons set out in paragraph 4.60 of RTIO's December Submission) and in fact are worried that the securing of access by FMG might diminish their prospects of obtaining haulage (paragraph 5.14 of Draft Recommendation). Therefore, the only evidence available is that the prospect of "declaration" of the Mt Newman facility may have a **dampening** effect on activity in the asserted iron ore tenements market, rather than being a driver of increased activity.

In this regard, it is noted that – at paragraph 3.26 of BHPBIO's latest "Outline of Principal Submissions" to the Council (dated 5 December 2005) – BHPBIO refers to recent vigorous competition for iron ore deposits in the Pilbara, and notes that in each case this occurred without declaration of the Mt Newman Service. RTIO endorses this observation.

Paragraph 3.75 – State Agreement and Rail Transport Agreement

Further to the comments set out in the section above, we also note that – at various points in its latest submission – FMG seeks to assert that BHPBIO's Mt Newman facility is not available for the transport of freight of any description (see, for example, paragraphs 3.9 and 3.75 of the FMG submission). This assertion is incorrect, for the reasons set out in paragraphs 4.51 to 4.54 of RTIO's December Submission. In short, the Mt Newman State Agreement and the Rail Transport Agreement provide a clear haulage service mechanism for potential producers of iron ore and/or other minerals like manganese and chromite.

Paragraphs 7.16 and 7.17 – Distinction between track access and haulage

FMG's comments also seek to confuse the fundamental distinction between haulage and track access. This is perhaps most clearly demonstrated by paragraph 7.31 of FMG's submission, which declares that "Granting access to the track is less of an obligation than carrying the freight of third parties". The interface costs and diseconomies of scope identified in RTIO's December Submission indicate that this assertion is fundamentally misconceived.

Paragraphs 7.16 and 7.17 of FMG's submission reflect this misconception, by claiming that mandated track access would be "less intrusive" for BHPBIO than the provision of haulage as required under the Mt Newman State Agreement. Paragraph 7.17 also implies that the provision of "track services" is, in fact, part of BHPBIO's obligation, under the Mt Newman State Agreement, to "carry the freight of third parties". This suggestion is rejected, not only by RTIO, but by the Western Australian Government (see paragraph 4.40 of RTIO's December Submission). The State Agreement obligation is clearly restricted to freight carriage, and does not extend to a requirement to provide track access. Not only is FMG's suggestion entirely at odds with the plain wording of the State Agreement obligation (and equivalent obligations imposed on RTIO under its State Agreements), it is also inconsistent with the exclusive rights ("protected contractual rights") held by BHPBIO and discussed in paragraphs 4.35-4.48 inclusive of RTIO's December Submission.

Paragraphs 7.3 – 7.32 – Public Interest

In these paragraphs, FMG asserts that the problems associated with multi-user facilities on the east coast of Australia will not apply in the Pilbara. In doing so it relies on the sharing of rail infrastructure by Hamersley Iron and Robe River following Rio Tinto's acquisition of North Limited, which gave it a majority 53% interest in Robe River (paragraphs 7.6, 7.7 and 7.29).

As the Council is aware from its discussions with RTIO following the lodgement of RTIO's May submission, this experience demonstrates the very point that RTIO has made about multiple usage in both its December Submission and its accompanying letter of 5 December. This is that, in order not to be impeded by the inefficiencies of two separate operators using the same infrastructure, the Robe and Hamersley operations were integrated first into Pilbara Rail Company Pty Ltd (***PRC***) and then into Pilbara Iron Pty Ltd (***PI***). PRC was jointly owned by Robe and RTIO, but controlled by RTIO, and PI is wholly owned and controlled by RTIO. The system has never operated with two users independently running their own trains. The trains have always been operated by a single entity controlled by RTIO.

The integration of the Robe and Hamersley operations, so that they could be operated by a single entity, was possible because of RTIO's common ownership of both operations. The same will not apply with Mindy Mindy (or any other third party user) and BHPBIO. Thus, the very model that RTIO was determined to avoid (ie, two independent parties running trains on the same infrastructure) will be the model imposed on BHPBIO.

It is interesting to note that FMG, in paragraph 7.20 of its submission, concedes the essence of the submissions made by RTIO in relation to the problems of multi-user infrastructure in paragraphs 3.35-3.37 and 5.8-5.13 of RTIO's December Submission. FMG acknowledges that "regulatory intervention would be....[required]...in those cases where a commercial settlement could not be achieved". This is the fundamental reason why expansion decisions cannot be made or implemented nearly as quickly with multi-user facilities as they can with single user facilities. It was recognised by the Infrastructure Taskforce and the Reserve Bank of Australia.[3] Disputes always arise when there are multiple users, as they have at Dalrymple Bay and Port Waratah. Different parties have different interests and objectives. If regulatory intervention is required then, as experienced at Dalrymple Bay, the delay can be substantial and extremely costly.

The costs that flow from the inevitable delay in major expansions, as outlined by RTIO in its December Submission and its covering letter, will be incurred. They cannot simply be ignored, as FMG seeks to do. Given the acknowledged importance of the iron ore industry to the national economy, the imposition of a structure that imposes these immense costs must be contrary to the public interest.

Yours sincerely

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[3] See footnote 1.