RIO TINTO

IRON ORE

SUBMISSION TO THE NATIONAL COMPETITION COUNCIL BY RIO TINTO IRON ORE IN RESPONSE TO THE REPORT BY G13 & ASSOCIATES PTY LTD DATED 26 FEBRUARY 2006

10 March 2006

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1. Introduction

1.1 Rio Tinto Iron Ore (***RTIO***) has previously filed submissions on 6 May and 5 December 2005 concerning the substance of an application (the ***Application***) by Fortescue Metals Group Limited (***FMG***) for declaration of certain services provided by BHP Billiton Iron Ore Pty Ltd (***BHPBIO***) . The latter submission was filed in response to the draft recommendation published by the National Competition Council (the ***Council***) on 4 November 2005 (the ***Draft Recommendation***).

1.2 In addition to the submissions referred to above, by letter to the Council dated 21 December 2005, RTIO made further comment in response to certain aspects of FMG's submission dated 5 December 2005. In that letter, RTIO submitted to the Council (amongst other things) that:

(a) FMG had reiterated its intention to construct an independent rail line from its Chichester deposit to Port Hedland, and that as a consequence the Council must conduct its analysis of the Application on the basis that this is the most likely scenario; and

(b) if (contrary to RTIO's submissions) the Council maintains its position that a natural monopoly test should be applied when assessing criterion (b), the Council must conduct its analysis on the basis that FMG's Chichester line will be constructed and that BHPBIO's own demand will absorb available capacity on the Mt Newman line.

1.3 By letter to the Council dated 17 January 2006, FMG made a number of comments regarding submissions filed by BHPBIO on 30 December 2005 and 6 January 2006, which included modelling conducted by Evans & Peck. In that letter, FMG criticised BHPIO for conducting operational modelling on the basis of 10 mtpa of Mindy Mindy ore, and stated that, in the context of the Mt Newman line:

> ...Mindy Mindy will produce 5 mtpa and will require at most one train pathway per day to move product to Fortescue's port facilities at Port Hedland.

1.4 The Council has instructed G13 & Associates Pty Ltd (***G13***) to respond to certain questions posed by the Council. The instructions given to G13 by the Council have not been published. Nevertheless, the G13 report dated 26 February 2006 (the ***G13 report***) identifies (at p.3) specific questions apparently posed by the Council and which form the substance of the G13 report.

1.5 RTIO makes the submissions set out below regarding certain aspects of the G13 report. In doing so, RTIO wishes to register its strong protest about the very limited time afforded to interested parties to respond to the report.

2. Analysis Should Relate Only to Mindy Mindy Spur Line

2.1 There is a substantial limitation to the G13 report and its value in assisting the Council with the matters that it needs to address.

2.2 Although the instructions provided to G13 by the Council are not published, it is implicit from the report that G13's analysis has been restricted to a comparison of the costs of access to the Mt Newman line as against the "cost" of constructing a 439 kilometre facility from Mindy Mindy to Anderson Point.

2.3 For that purpose, G13 has conducted its analysis on the basis that a total of 10mtpa of iron ore (comprising 5mtpa for Mindy Mindy and 5mtpa for other "junior explorers") is to be carried on the Mt Newman Line if access is granted. G13 has therefore assumed that the 60mtpa of iron ore notionally to be produced by FMG from its Cloud Break and Christmas Creek deposits will not be railed on the Mt Newman line. As a consequence, the fundamental assumption adopted (but not expressed) by G13 is that the FMG Chichester line will be constructed, independently of the outcome of the Application. Further, the assumption is made that the total demand for the Mt Newman Service from Mindy Mindy **and** "junior explorers" will not exceed 10mtpa.

2.4 These underlying assumptions represent a departure by the Council from the position it took in its Draft Recommendation, and these departures are very significant in terms of the overall assessment of the FMG Application against criteria (a) and (b) in Section 44G(2) of the Trade Practices Act:

- The reduction in demand by Mindy Mindy from 10mtpa to 5mtpa, and by hypothetical "junior explorers" to no more than 5mtpa from 30mtpa (as assumed by the Council in paragraph 6.78 of its Draft Recommendation), is inconsistent with any finding that there would be any more than a trivial impact on competition in any market that the Council may postulate. Therefore criterion (a) cannot be satisfied on these assumptions.
- Furthermore, acceptance of these assumptions necessarily support the conclusion set out in paragraphs 3.7 and 3.8 of RTIO's December submission: this is that, in all respects (including for the purpose of deciding whether the Mt Newman Facility will be duplicated for a distance of approximately 200km), the Council must assess the FMG Application on the assumption that FMG's Chichester line will in fact be built and operated by FMG (as consistently advised by FMG to the market). For the reasons expressed in paragraphs 3.9 – 3.12 of RTIO's December submission (and as adamantly contended by Professors Ordover and Willig), these assumptions reinforce that criterion (b) cannot be satisfied to the extent that the Mt Newman railway line is duplicated.

2.5 In addition to the economic analysis dictating that criterion (b) cannot be satisfied to the extent of duplication, the factual analysis outlined in paragraphs 3.13 – 3.15 of RTIO's December Submission demonstrates that there will be no demand for the Mt Newman Service to the extent of duplication. No user (least of all FMG) will pay access fees to

BHPBIO to share a heavily utilised rail track when the alternative is to use an under-utilised "open access" rail track that operates alongside the BHPBIO track.

2.6 In light of the above, it is wholly inappropriate for G13 to have been instructed to compare the costs of construction of a 439 kilometre independent rail line with the costs of sharing the Mt Newman line for this distance. Even assuming that a natural monopoly test is to be applied (a proposition with which RTIO strenuously disagrees) the only valid comparison is to assess whether the costs of constructing a spur line (with a total capacity of 5mtpa, with the potential to increase to 10mtpa) from Mindy Mindy to FMG's Chichester line would exceed the costs of sharing the Mt Newman line over the 78 kilometre section of that line that could be used instead of this spur line (ie the same exercise that Evans & Peck conducted for RTIO in relation to RTIO's May 2005 Submission). This comparison has not been undertaken by G13.

2.7 If the Council is not of the view expressed above (ie that the FMG Chichester line will be built and the assessment of the FMG Application against criteria (a) and (b) must in all respects be undertaken on this basis), then the G13 report is fundamentally flawed in its failure to account for the potential demand for track access in respect of the 60mtpa of iron ore forecast to be produced from FMG's Cloud Break and Christmas Creek deposits.

3. Comments on the G13 Analysis

3.1 RTIO does not intend to comment in detail on the G13 report, as it principally involves a critique of detailed costings and analysis provided by BHPBIO and its retained experts. We do however have some observations that we believe the Council must take into account in deciding the extent to which it relies upon the G13 report.

3.2 First, there are numerous errors and omissions in the analysis. For example:

- When assessing the capacity of the Mt Newman line, the G13 report only focuses on the physical capacity of the rail line. The G13 report fails to take into account the economic capacity of the system, such that it becomes more cost effective to build a duplicate track than to bear the costs of further congestion on a single track (eg increased cycle times, increased rolling stock, additional fuel and brake consumption to cater for increased stop/start operations). These factors often lead to a very different conclusion as to the optimal time to dual track from the conclusion reached when the modelling is based only on physical factors (as is the case with the G13 report). Put simply, in RTIO's experience, the economic capacity of a rail system is reached well before nominal physical capacity limits are breached.
- There is a gross underestimation of the maintenance requirements for a heavy haul railway of the nature operated by BHPBIO. The G13 report allows 7 hours per week for track maintenance (see Attachment C to the report). In RTIO's experience, even if operating at only a 100mtpa rate, the maintenance requirements are likely to be about five times this allowance.

- There is a statement at paragraph 4.3.4 of the G13 report to the effect that use of existing loops is preferable to by-passing them in a dual track construction programme, and this would "avoid the costs of about 100km of track construction". As RTIO pointed out at paragraphs 3.17 and 3.18 of its December submission, this is incorrect. It is RTIO's experience that it is generally less costly to by-pass loops than to incorporate them because of the disruption and other cost involved in incorporating loops. It is also RTIO's experience that the difficulties of building another track alongside an existing heavily utilised track can often mean that it is actually **cheaper** to build an independent track well away from the existing track. In the development of its own rail system, RTIO has, in fact, opted to by-pass loops and follow an alignment well removed from its existing track when it has duplicated some sections of the track.
- G13's estimate of the cost of passing loops is well below actual costs (see paragraph 4.3.6 – 3 loops for $25m). The actual costs being incurred by RTIO for sidings/passing loops currently being constructed are in the order of $20-25m **each**. These costs do not include attendant disruption costs which are incurred when tying the sidings into the main line.

3.3 The G13 report also includes a substantive disclaimer, which is relevant to the weight to be afforded to the report by the Council.

3.4 In the disclaimer, G13 makes it clear that the report has been prepared "with limited availability of contemporary data specific to BHPIO railway operations in the Pilbara". Further, it is noted that "in contrast to G13 normal practice", data, analyses and conclusions have not been "formulated or tested" with the benefit of on-site observation or dialogue with railway personnel. As a consequence, G13 emphasises that the views expressed in the report "must be considered as provisional".

3.5 Having regard to the matters quite properly drawn to the attention of the Council by G13 and APR Pty Ltd in the disclaimer, the Council should be reluctant to place reliance upon the G13 report in circumstances where it conflicts with operational data and analyses provided by BHPBIO concerning the operation of the Mt Newman line. The Council should treat the G13 report, in effect, as being no more than a desk top study.

3.6 The sources of data for "evaluation and judgments" of G13 are described on page 4 of the G13 report. They are:

- material provided by the Council, more fully described in Attachment D to the report;
- G13 and APR "assumptions" and industry knowledge, some of which are set out in Attachments B and C to the report; and
- unidentified public information.

3.7 The documents provided to G13 by the Council are identified in Attachment D. It is noted that there is no reference to G13 having been provided with the further letter from Evans & Peck to the Council dated 6 February 2006, which would have been relevant to at least

some of the assumptions adopted by G13, and the conclusion expressed by G13 at paragraph 4.1.3 of the report.

3.8 Further, and significantly, the modelling adopted by G13 is limited to an analysis conducted within the parameters of the G13 Railway Operations Model (***ROM***) described in Attachment J to the report. The ROM does not take into account the interface costs and diseconomies of scope which have been identified by BHPBIO in its submissions to the Council, for example BHPBIO's estimate of lost opportunity costs at A$1,620 million (see BHPBIO's Submission to the Council dated 5 December 2005, para 2.40). As a consequence, the modelling conducted by G13 (at best) cannot be more than an input into the Council's overall appraisal of criterion (b). It cannot – of itself – be determinative of the question of whether it would be uneconomical for anyone to develop another facility to provide the service. Accordingly, the Council must disregard the conclusion expressed by G13 at part 6(2) of the report.

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