

**APPLICATION BY FORTESCUE  
METALS GROUP LIMITED FOR  
DECLARATION OF SERVICES  
PROVIDED BY BHP BILLITON  
ORE PTY LTD**

**ISSUES PAPER**

**National Competition Council**

**11 March 2005**

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# 1 The application and background

- 1.1 On 15 June 2004, the National Competition Council (Council) received an application under Part IIIA of the *Trade Practices Act 1974* (TPA) from Fortescue Metals Group Limited (FMG) to recommend the declaration of a service provided by part of the Mount Newman railway line and part of the Goldsworthy railway line in the Pilbara region of Western Australia.
- 1.2 FMG seeks access to the service the subject of the declaration application in order to operate trains and rolling stock to transport iron ore and iron ore products from Mindy Mindy and various other mine sites to export port facilities at Port Hedland.
- 1.3 FMG is involved in a 50/50 incorporated joint venture with Consolidated Minerals Limited trading under the name Pilbara Iron Ore Pty Ltd. This joint venture is nearing completion of resource identification at Mindy Mindy. FMG's application for declaration is made both on its own behalf and in its capacity as a joint venture shareholder and operations manager of Pilbara Iron Ore Pty Ltd.
- 1.4 The Mount Newman and Goldsworthy railway lines are owned by the joint ventures comprising BHP Billiton Minerals Pty Limited 85%, Mitsui-Itouchu Iron Pty Limited 10% and Itouchu Minerals and Energy of Australia Pty Limited 5% - referred to as the Mount Newman Joint Venture Participants and the Goldsworthy Joint Venture Participants respectively. Both railway lines are managed by BHP Billiton Iron Ore Pty Ltd (BHPBIO) on behalf of the joint ventures.
- 1.5 The Council considered that FMG's application raised two threshold questions. The first was the identification of the relevant 'provider' of the service the subject of the application for declaration as defined in section 44B of the TPA. The second was whether use of the railway lines the subject of the application for declaration, was part of a 'production process' as referred to in the definition of 'service' in section 44B of the TPA. If so, there would be no relevant service to which Part IIIA of the TPA could apply.
- 1.6 The Council released a preliminary issues paper and considered public submissions. It concluded that the use of the relevant part of the Goldsworthy railway line was part of a production process but that the use of the relevant part of the Mount Newman railway line

was not. Accordingly, only the later of these services is a 'service' for the purpose of Part IIIA of the TPA and is open to declaration.

- 1.7 This paper identifies and seeks comment on the principal issues in considering whether FMG's application for declaration of the service described as the use of that part of the Mount Newman railway line specified in FMG's application, satisfies the declaration criteria under section 44H of the TPA.

## **2 Declaration criteria**

- 2.1 Under the declaration provision of Part IIIA of the TPA, a business wanting access to a particular service must apply to the Council to have the service declared. The Council considers the application before forwarding a recommendation to the designated Minister, who decides whether or not to declare the service. The Minister's decision is reviewable by the Australian Competition Tribunal (the Tribunal). Declaration of a service would entitle the applicant to seek access, either through an agreement with the service provider or, in default of an agreement, through arbitration by the Australian Consumer and Competition Commission (ACCC).

- 2.2 The Council cannot recommend that a service be declared unless the Council is satisfied of all of the following matters, which are set out in s. 44G(2) of the TPA:

- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;*
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;*
- (c) that the facility is of national significance, having regard to:
  - (i) the size of the facility; or*
  - (ii) the importance of the facility to constitutional trade or commerce; or*
  - (iii) the importance of the facility to the national economy;**
- (d) that access to the service can be provided without undue risk to human health or safety;*
- (e) that access to the service is not already the subject of an effective access regime; and*

*(f) that access (or increased access) to the service would not be contrary to the public interest.*

2.3 The Council must also consider whether it would be economical for anyone to develop another facility that could provide *part* of the service: s. 44F(4).

### **3 Submissions**

3.1 The Council is calling for submissions from interested parties on issues relevant to FMG's application for declaration. Interested parties should feel free to comment on issues additional to those raised in this paper.

3.2 Unless confidentiality is requested, submissions will be treated as public documents and be published on the Council's web page. Parties wanting to submit information on a confidential basis must discuss the matter with the Council's Secretariat prior to submission.

3.3 **Written submissions should be sent to Mr John Feil, Executive Director, National Competition Council, GPO Box 250B, Melbourne VIC 3001, or e-mailed to [info@ncc.gov.au](mailto:info@ncc.gov.au) by Friday 8 April 2005.**

3.4 Where possible, respondents should provide a copy of their submission in both electronic and print form.

3.5 Parties interested in making submissions in the current matter may find the Council's previous work in declaration matters of assistance. Of particular assistance may be the Council's recent publication, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*.<sup>1</sup>

3.6 Any queries should be directed to Ms Michelle Groves on (03) 9285 7476.

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<sup>1</sup> Available at <http://www.ncc.gov.au/pdf/DEGeGu-002.pdf>

## Abbreviations and glossary of terms

ACCC	Australian Competition and Consumer Commission
BHPBIO	BHP Billiton Iron Ore Pty Ltd
Council	National Competition Council
CPA	Competition Principles Agreement
FMG	Fortescue Metals Group Limited
Goldsworthy Joint Venture Participants	Joint venture comprising BHP Billiton Minerals Pty Limited 85%, Mitsui-Itouchu Iron Pty Limited 10% and Itouchu Minerals and Energy of Australia Pty Limited 5% which owns the Goldsworthy railway line.
Goldsworthy Railway Service	The service described at paragraph 4.2(1)(b) and 4.2(2)
Mount Newman Joint Venture Participants	Joint venture comprising BHP Billiton Minerals Pty Limited 85%, Mitsui-Itouchu Iron Pty Limited 10% and Itouchu Minerals and Energy of Australia Pty Limited 5% which owns the Mount Newman railway line.
Mount Newman Railway Facility	That part of the Mount Newman railway line and associated infrastructure required to provide the Mount Newman Railway Service as described at paragraph 4.2(1)(a) and 4.2(2).
Mount Newman Railway Service	The service described at paragraph 4.2(1)(a) and 4.2(2)
NCP	National Competition Policy
Part IIIA	Part IIIA of the Trade Practices Act 1974
TPA	Trade Practices Act 1974
Tribunal	The Australian Competition Tribunal

## **4 The service, the facility and the service provider**

### **Preliminary matters – ‘service’ and ‘provider’**

4.1 Identification of both the ‘service’ the subject of the application for declaration and the ‘provider’ of that service are of threshold importance in considering an application for declaration. Determination of these issues affects the application of the declaration criteria including the issue of jurisdiction, namely, whether Part IIIA and declaration is available.

4.2 In its application, FMG defined the service the subject of its application for declaration as:

1. the use of the facility, being:
  - (a) that part of the Mt Newman Railway Line which runs from a rail siding that will be constructed near Mindy Mindy in the Pilbara to port facilities at Nelson Point in Port Hedland, and is approximately 295 kilometres long further details of which are set forth and coloured red in the diagram annexed to the application and marked ‘Annexure 1’ for the purposes of identification; and
  - (b) the part of the Goldsworthy Railway Line that runs from where it crosses the Mt Newman Railway Line to port facilities at Finucane Island in Port Hedland, and is approximately 17 kilometres long further details of which are set forth and coloured red in the diagram annexed to the application and marked ‘Annexure 2’ for the purposes of identification.
2. access to the facility’s associated infrastructure, including, but not limited to:
  - (a) railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway);
  - (b) bridges;
  - (c) passing loops;
  - (d) train control systems, signalling systems and communication systems;

- (e) sidings and refuges to park rolling stock;
  - (f) maintenance and protection systems; and
  - (g) roads and other facilities which provide access to the railway line route.
- 4.3 FMG does not seek access to any rail haulage service used in relation to the facility. Accordingly, the application for declaration does not include the use of locomotives and rolling stock.
- 4.4 As discussed at paragraphs 1.5 and 1.6, the Council considered in detail the threshold questions of the relevant ‘service’ and ‘provider’ of that service for the purposes of section 44B of the TPA. It concluded that the Goldsworthy Railway Service was not a service to which Part IIIA of the TPA applied whereas the Mount Newman Railway Service was such a service (NCC 2004b, para 2.2). Accordingly, the service the subject of FMG’s application for declaration and the one considered in this issues paper, is the Mount Newman Railway Service.
- 4.5 In its application, FMG identified the Mount Newman Joint Venture Participants and BHPBIO, the operator and manager of the railway lines respectively, as the relevant ‘provider’ of the service the subject of the application for declaration. The Council concluded that the relevant ‘provider’ of the Mount Newman Railway Service is the Mount Newman Joint Venture Participants (NCC 2004b, paras 3.8 and 3.9).

## **The facility**

- 4.6 Both the declaration criteria in section 44G(2) of the TPA and the definition of service in section 44B refer to the facility that provides a service. The TPA does not define the term ‘facility’ although the definition of ‘service’ in section 44B expressly includes the use of a railway line.
- 4.7 In the Sydney Airport decision, the Tribunal concluded that “a facility for the purposes of the Act is a physical asset (or set of assets) essential for service provision” (para 82). The relevant facility is therefore comprised of “a minimum bundle of assets required to provide the relevant services subject to declaration” (para 192).

- 4.8 In its application, FMG defined the relevant facility as that part of the Mount Newman and Goldsworthy railway lines and associated infrastructure described in paragraph 5 of its application and reproduced at paragraphs 4.2(1) and (2) of this issues paper. As the Council has concluded that the only service covered by the application is the Mount Newman Railway Service, the relevant facility is limited to the minimum bundle of assets required to provide that service. As such, the part of the Goldsworthy railway line specified in paragraph (1)(b) of FMG's description of the 'facility' is not relevant.
- 4.9 The minimum bundle of assets required to provide the Mount Newman Railway Service is that part of the entire Mount Newman railway line specified by FMG in its application (see paragraph 4.2(1)) and associated infrastructure (see paragraph 4.2(2)). That is the relevant facility for the purposes of FMG's application for declaration (Mount Newman Railway Facility). Identification of all the specific assets making up the Mount Newman Railway Facility is not required as part of the declaration process. This may, however, be necessary for the purpose of access negotiation and arbitration under Part IIIA if the service is declared.



## **5 s. 44G(2)(b) - that it would be uneconomical for anyone to develop another facility to provide the service**

### **Background**

- 5.1 The Council cannot recommend that a service be declared unless it is satisfied that it would be uneconomical for anyone to develop another facility to provide the service (s. 44G(2)(b)) (criterion (b)).
- 5.2 Criterion (b) tests whether a facility exhibits natural monopoly characteristics. Criterion (b) is concerned with the nature of the facility rather than with the effect on competition of provision of the service provided by means of the facility.
- 5.3 The facility is a natural monopoly if the facility can serve the range of reasonably foreseeable demand for the services provided by the facility at less cost than that of two or more facilities. This requires consideration of the costs to society as a whole rather than the commercial costs of developing another facility.
- 5.4 The development of another facility notwithstanding that the existing facility can satisfy foreseeable demand at less cost would be socially inefficient. In the Duke EGP decision, the Tribunal considered the potential for inefficient development of another facility stating as follows:

*Thus we accept that if a single pipeline can meet market demand at less cost (after taking into account productive allocative and dynamic effects) than two or more pipelines, it would be “uneconomic”, in terms of criterion (b), to develop another pipeline to provide the same services. ...it is a matter for a pipeline owner to decide whether or not to construct an “inefficient” pipeline. Generally speaking, owners act on private cost, rather than social cost considerations. If development of a competitive pipeline is economic in a private cost sense, and is driven by opportunities in the market, then this may have implications for the assessment of criterion (a) (paragraph 64).*

## Issues for consideration

- 5.5 As discussed at paragraph 4.9, the relevant facility (referred to as the Mount Newman Railway Facility) for the purposes of FMG's application for declaration is that part of the Mount Newman railway line and associated infrastructure required to provide the Mount Newman Railway Service. The Mount Newman Railway Facility will be a natural monopoly and satisfy criterion (b) if it can meet the reasonably foreseeable demand for the service more cheaply than two or more facilities.
- 5.6 The relevant range of demand is assessed taking into account current demand and demand in the reasonably foreseeable future. The time period relevant to this consideration varies depending on the timing and probability of foreseeable changes in demand and supply. Matters such as the dynamism of the particular market, investment lead-times and the prospect of increased competition are all matters to be taken into account.
- 5.7 In addition to determining the reasonably foreseeable demand for the service, it is necessary to consider whether the facility has sufficient capacity to meet that demand and whether it can do so more cheaply than if the demand was satisfied through multiple service providers. Relevant to this consideration are the costs of any modification or expansion of the facility required to satisfy the foreseeable demand.
- 5.8 In its application, FMG estimated that the facility, which is described as the use of part of both the Mount Newman and Goldsworthy railway lines and associated infrastructure, is capable of accommodating approximately 150 million tonnes per annum with only minimal expenditure on increasing the capacity of the existing track. The railway lines currently carry approximately 90 million tonnes per annum. As such, the lines have excess capacity of 60 million tonnes per annum (FMG 2004a, para 13.3). In its submission, the Western Australian Government noted that the BHPBIO railway lines are being progressively upgraded to enable capacity expansion to meet increased demand. The Government further stated that it had received independent advice that "the addition of new single track railways is not as cost effective as double tracking the existing rail systems ... Double tracking has ... the potential to provide a quantum leap in capacity which could meet all foreseeable market demand" (WA Government 2004, p.3).

- 5.9 FMG has entered into a State Agreement with the State of Western Australia for the development of a rail line from the Chichester Ranges to FMG's proposed port facility at Port Hedland.<sup>2</sup> It is not clear whether the proposed railway line contemplated under the State Agreement would provide services that are substitutable for the services the subject of its application for declaration. The Council notes, however, that the Western Australian Department of Industry and Resources expects that the proposed railway line would run closely parallel to the existing Mount Newman railway line for a substantial portion of the length of the existing line (DIR, at p.32).
- 5.10 As noted in paragraph 5.4, the willingness of a firm to construct an alternate facility does not demonstrate the absence of a natural monopoly. Rather, the duplication of the facility may be inefficient if the foreseeable demand for the service provided by the existing facility can be satisfied by that facility at lower cost, that is, it is a natural monopoly. The willingness of a firm to duplicate an existing natural monopoly facility would, however, have implications under criterion (a).
- 5.11 The Council seeks information on capacity, foreseeable demand, and options for and the costs of satisfying that demand in relation to the Mount Newman Railway Facility.

### **The Council seeks comments on:**

- *What is the current and the reasonably foreseeable level of demand for the service(s) provided by the Mount Newman Railway Facility?*
- *What is the current capacity of the Mount Newman Railway Facility? Does it currently satisfy demand and will it do so in the future given reasonably foreseeable demand? What is the level of spare capacity (if any)?*
- *Is it cheaper for the Mount Newman Railway Facility to meet this demand rather than two or more facilities?*
- *What degree (if any) of modification and/or expansion to the Mount Newman Railway Facility would be needed in order to satisfy current and reasonably foreseeable demand for the service(s) provided by it?*

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<sup>2</sup> The Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004.

## **6 s. 44G(2)(a) - that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service**

### **Background**

6.1 The purpose of criterion (a) is to limit access regulation to circumstances where access is likely to enhance the environment for competition in a dependent market(s). Whether competition will be enhanced depends critically on the extent to which the incumbent service provider can, in the absence of access regulation, use market power to adversely affect competition in a dependent market. If the service provider has the ability and incentive to use power to adversely affect competition in a dependent market, regulated access may improve the environment for competition, offering the prospect of tangible benefits to consumers, including reduced prices and better service provision.

6.2 In assessing whether criterion (a) is satisfied, the Council must:

- define the relevant market(s) in which competition may be promoted and verify that the market(s) are separate from the market for the service to which access is sought; and
- determine if access (or increased access) would promote a more competitive environment in the additional market(s). This requires an assessment of:
  - whether the incumbent has the ability and incentive to exercise market power to adversely affect competition in the dependent market(s); and
  - whether the structure of the dependent market(s) is such that declaration would, by constraining the exercise of market power by the service provider, promote competition. High barriers to entry that are unrelated to the existence of the bottleneck facility may preclude any promotion of competition as a result of declaration.

- 6.3 The issue under criterion (a) is whether access would improve the opportunities and environment for competition such that competitive outcomes are more likely to occur (Sydney Airport decision, para 106). Criterion (a) is concerned with the process of competition rather than the particular commercial interests or pursuits of individual competitors.

## Issues for consideration

### Relevant dependent market(s)

- 6.4 The first step in the application of criterion (a) is to define the market(s) in which competition may be promoted as a result of declaration. Such market(s) (referred to as the dependent market(s)) must be separate from the market for the services the subject of the declaration application. Typically the dependent market(s) will be either upstream or downstream from the market for the services the subject of the application which (if criterion (b) is satisfied) represents the bottleneck that declaration seeks to unlock.

- 6.5 The High Court has accepted the following definition of 'market':

*A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them (if there is no close competition there is of course a monopolistic market). Within the bounds of a market there is substitution - substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive. ... Whether such substitution is feasible or likely depends [on a number of factors] ... in determining the outer boundaries of the market we ask a quite simple but fundamental question: If the firm were to 'give less and charge more' would there be, to put the matter colloquially, much of a reaction? (Re Queensland Co-operative Milling Association Ltd (1976) 25 FLR 169 at 190).*

- 6.6 Markets are normally defined by reference to four dimensions; namely, the product, functional, geographic and temporal dimensions. This requires the identification of:
- *product dimension* - the goods and/or services supplied and the sources or potential sources of substitute products;

- *functional dimension* – the different vertical stages of production and/or distribution that comprise the field of competition;
- *geographic dimension* – the areas that are supplied, or could be supplied, with the relevant product and to which consumers can practically turn; and
- *temporal dimension* – the period over which substitution possibilities need to be considered.

6.7 In its application, FMG argued that declaration would promote competition in the following dependent markets (FMG 2004a, para 12.1):

- 1) iron ore production both within Australia and other countries;
- 2) production, development and exploitation of other minerals and products in the Pilbara region of Western Australia requiring transport services from the source of production to port facilities at Port Hedland;
- 3) ownership, development and exploitation of iron ore tenements;
- 4) the haulage of iron ore and other minerals from various mine sites in the Pilbara region of Western Australia;
- 5) retail of iron ore and other minerals, both as sold at the mine and also as sold at export terminals; and
- 6) export of products from Port Hedland (by rail, road and sea).

6.8 FMG provided subsequent argument that these dependent markets were functionally distinct from the market for the service the subject of the application for declaration (FMG 2004b). The Council seeks views on FMG's characterisation of the dependent markets.

## Would access promote competition?

6.9 The assessment of criterion (a) requires the Council to consider whether declaration will enhance the opportunities and environment for competition in a dependent market. This consideration involves a comparison of the future conditions and environment for competition *with* and *without* declaration.

- 6.10 The Council must determine whether access facilitated by declaration would promote a more competitive environment in a dependent market. This requires an assessment of:
- (i) whether the service provider has the ability and incentive to exercise market power to adversely affect competition in a dependent market; and
  - (ii) whether the structure of the dependent market is such that declaration would, by constraining the exercise of market power by the service provider to adversely affect competition in the dependent market, promote competition.

### Market Power

- 6.11 In Australian trade practices law, ‘market power’ is defined as the ability to profitably and sustainably raise prices above proper economic costs, or behave in a market in some other manner for a sustained period, without being constrained by current or potential competitors (See *Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd* (1989) 167 CLR 177; and *Eastern Express Pty Ltd v General Newspapers Pty Ltd* (1992) 35 FCR 43). A monopoly service provider necessarily has power in the market in which the monopoly service is provided. It may not, however, be able to exercise market power in a dependent market. This may be the case where, for example, there are substitutes for the monopoly service such that it does not occupy a bottleneck position. Other constraints such as regulatory obligations may also constrain the market power of the monopoly service provider. The service provider must have both the ability and incentive to exercise market power in a dependent market for criterion (a) to be satisfied.
- 6.12 In its application, FMG asserted that the facility is a bottleneck facility as access is necessary to compete in any of the dependent markets set out at paragraph 6.7 (FMG 2004a, para 12.2). FMG argued that given the nature and location of the rail track, road is not an economic substitute for the rail service. In particular, it stated by way of example that the operating cost of transporting iron ore from Mindy Mindy to Port Hedland by means of a railway is approximately \$1.50 per tonne. In contrast, the cost of using haulage trucks to transport the same volume of iron ore and iron ore product would be in excess of \$50 per tonne (FMG 2004a, para 13.1). The Council seeks views as to the extent to which road haulage or any other transport option may provide a substitute to rail in providing the Mount Newman Railway Service.

- 6.13 As noted in paragraph 5.9, FMG has entered into a State Agreement with the State of Western Australia for the development of a railway line from the Chichester Ranges in the Pilbara to FMG's proposed port facility at Port Hedland. Information from the Department of Industry and Resources suggests that the proposed railway line is expected to closely parallel the existing Mount Newman railway line for a substantial length of the line (DIR, p.32). In a report to the Australian Stock Exchange, FMG expressed its commitment to the development of this railway line regardless of the outcome of its application for declaration of the Mount Newman Railway Service. It further noted that the ability to secure access to the Mount Newman railway line was not critical to its mining projects in the Chichester Ranges, the development of the railway line and Port Hedland port facilities<sup>3</sup>.
- 6.14 The extent to which the proposed Chichester Ranges to Port Hedland railway line would provide an alternative to the Mount Newman railway line is not clear. If this is the case, it may demonstrate that the Mount Newman Railway Facility is not a bottleneck – that is, a bottleneck exists where access to the facility is essential to compete in any dependent market. If the facility is not a bottleneck, the service provider does not have market power to adversely affect competition in a dependent market. An exercise of market power may be constrained by the willingness of access seekers to bypass the facility by constructing an alternate facility. The extent to which the market power is constrained will depend upon the cost of bypass. Evidence of the commercial viability and preparedness of firms to bypass the services provided by the facility is of relevance to criterion (a).
- 6.15 Significant infrastructure, including rail lines, necessary for the development of the Pilbara iron ore industry were the subject of State Agreements between the Western Australian Government and the iron ore producers. Such agreements include the Iron Ore (Mount Newman) Agreement (scheduled to the *Iron Ore (Mount Newman) Agreement* 1964) and related Rail Transport Agreement 1987 which cover the Mount Newman railway line.
- 6.16 In its application, FMG referred to clause 9(2) of the Iron Ore (Mount Newman) Agreement and the Rail Transport Agreement which

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<sup>3</sup> [http://www.fmgl.com.au/info\\_company\\_1a1.html](http://www.fmgl.com.au/info_company_1a1.html) - ASX Release 2005, Quarterly Report Dec 04.



(among other things) requires the Mount Newman Participants (as defined in the State Agreement) to carry the freight of the State of Western Australia and of third parties in accordance with by-laws or in the absence of such by-laws, on reasonable terms and charges.

6.17 FMG stated that this obligation was reaffirmed by the appeal decision of the Supreme Court of Western Australia in the Hancock Prospecting decision (FMG 2004c, para 11.2). On this point, the Western Australian Government stated that while the clear intent of the State Agreements was that Pilbara iron ore producers would carry freight for third parties, the fact that no access seeker to date has successfully negotiated access indicates that the access provisions have not been successful (WA Government 2004, p.3). The Council seeks further details on the operation of the State Agreement and related access provisions and the extent (if any) to which they may apply to and constrain the market power of the Mount Newman Joint Venture Participants.

6.18 Evidence of an actual exercise of market power by a service provider by, for example, unjustifiably refusing access, would demonstrate an exercise of market power for the purposes of criterion (a). In its application, FMG detailed prior negotiations for access with the service provider. It stated that negotiations commenced in July 2003 and continued until early 2004 and that the service provider “did not wish to cooperate with FMG while the Provider’s own focus was on the export of as much of its own iron ore product as possible” (FMG 2004a, annexure 3). As noted at paragraph 6.17, the Western Australian Government further noted that notwithstanding the access provisions in the relevant State Agreement, no access seeker has successfully negotiated access to the facility.

#### Would access promote competition?

6.19 Where a service provider has the market power to adversely affect competition in a dependent market, access will generally promote competition in that market by constraining the exercise of market power. Access can address the barrier to entry in the dependent market posed by the monopoly service provider’s market power, and as such, promote competition in that market. However, this may not be the case where a dependent market is characterised by high barriers to entry that are unrelated to the existence of the bottleneck facility.

- 6.20 In its application, FMG stated that it seeks access to the service in order to transport its iron ore and iron ore products from Mindy Mindy and various other mine sites to the export facilities at Port Hedland to enable the transport of iron ore from those mine sites for sale and export. It further stated that access would “facilitate FMG’s efforts to exploit other iron ore reserves that might not in their own right, justify the construction of rail infrastructure” (FMG 2004a, para 7.3). The Council seeks views as to whether access to the service through declaration would result in increased mining operations in the Pilbara region.
- 6.21 As set out in paragraph 6.7, FMG identified six dependent markets in which it is asserted that competition would be promoted as a result of declaration. Details were not provided as to how competition would be promoted specifically for each of the six markets. The characteristics and structure of each of the markets identified are quite different and the effect on competition of declaration would differ in each case. For example, declaration may have little effect on the international iron ore commodity market if the significance of any increased production flowing from declaration is minor relative to the market as a whole. In contrast, the impact of declaration on competition in more narrowly defined markets may be of greater significance.
- 6.22 BHP Billiton highlighted that it has invested in significant intellectual property to improve the operation and efficiency of the Mount Newman and Goldsworthy railway lines (BHP Billiton 2004b, para 2). This investment includes research, the development of know-how as well as the development of specific operational system tools and analysis.
- 6.23 BHP Billiton noted that an access seeker could run its rolling stock on the Mount Newman railway line without using the intellectual property but that it would not “achieve the efficiencies or gain the benefits which BHPBIO has achieved through use of this technology” (Ridley 2004, para 6.1). BHP Billiton further argued that “it should not be expected to disclose that intellectual property to any other person, including a party seeking access to its railway lines, where that person is likely to be a competitor of [BHP Billiton]” (BHP Billiton 2004b, para 2.3).
- 6.24 The definition of ‘service’ in section 44B of the TPA makes clear that the use of intellectual property is not a service to which Part IIIA of the TPA applies. It is possible that the inability to access intellectual property may be such a significant barrier to entry in the market for

the service that competition would not be promoted in a dependent market notwithstanding declaration of the service. Evidence of existing third party use of the service is relevant to this issue. The Western Australian Government noted that “BHPBIO is already in effect transporting the freight of third parties on the Mount Newman railway” (WA Government 2004, p.5). Further information of such arrangements is sought.

## **The Council seeks comments on:**

- *Are the ‘dependent markets’ identified by FMG in its application appropriately defined for the purposes of criterion (a)?*
- *Are there any other potential dependent markets in which access to the service may promote competition? If so, explain the nature of these markets and the prospects of increased competition as a result of declaration.*
- *Does the service provider have the ability and incentive to exercise market power to adversely affect competition in any dependent market? Are there any constraints on the exercise of such market power?*
- *To what extent (if any) is road haulage or any other transport option a substitute to rail in the provision of the Mount Newman Railway Service?*
- *To what extent would it be feasible for FMG to proceed with the Mindy Mindy project by bypassing the Mount Newman Railway Facility and using the services of the proposed Chichester Ranges to Port Hedland railway line? In what circumstances would such bypass be commercially viable?*
- *To what extent (if any) do regulatory arrangements including access obligations under the Iron Ore (Mount Newman) Agreement and the Rail Transport Agreement apply to and constrain the ability of the Mount Newman Joint Venture Participants to exercise market power?*
- *Is there any evidence that the Mount Newman Joint Venture Participants have exercised market power?*
- *Would access through declaration result in a promotion of competition in a dependent market? What (if any) are the impediments to this occurring?*
- *How necessary is the BHP Billiton intellectual property discussed in its supplementary submission to any access seeker to the Mount Newman Railway Service? Would the prospect of new entry be curtailed without access to the intellectual property?*
- *To what extent (if any) does BHPBIO currently transport the freight of third parties on the Mount Newman railway line? Do such arrangements confer to third parties rights of access to the rail line?*

**7 s. 44G(2)(c) - that the facility is of national significance, having regard to:**

- (i) the size of the facility; or**
- (ii) the importance of the facility to constitutional trade or commerce; or**
- (iii) the importance of the facility to the national economy**

## **Background**

7.1 Criterion (c) is a test of materiality, placing less important facilities outside the scope of Part IIIA. The Council notes that while declaration is concerned with access to services rather than facilities, criterion (c) relates national significance to the facility providing the service.

7.2 In identifying infrastructure of national significance, the Council has regard to the following matters listed in section 44G(2)(c):

- (i) the size of the facility; or*
- (ii) the importance of the facility to constitutional trade or commerce; or*
- (iii) the importance of the facility to the national economy.*

7.3 A facility need only satisfy one of these benchmarks to satisfy criterion (c).

## **Issues for Consideration**

7.4 FMG stated that the parts of the Mount Newman and Goldsworthy railway lines specified in its application (see paragraph 4.2(1)) cover a distance of approximately 300 kilometres. On the basis of size,

FMG contended that the facility was of national significance and satisfied criterion (c) (FMG 2004a, para 14).

- 7.5 FMG further argued that the facility was important to both constitutional trade and commerce and the Western Australian and national economies. In this regard, FMG stated that export revenue generated by the iron ore product currently transported by the railway lines is approximately \$3 billion. In addition, if used to full capacity, the railway lines could transport additional iron ore with an export revenue potential of over \$5 billion. Other economic benefits include State mining royalties and enhanced employment opportunities (FMG 2004a, para 14).
- 7.6 FMG's submission relates to the specified parts of both the Mount Newman and Goldsworthy railway lines. As discussed at paragraph 4.9, the Council concluded that the relevant facility for the purpose of FMG's application is limited to that part of the Mount Newman railway line and associated infrastructure required to provide the Mount Newman Railway Service. The Council seeks submissions as to whether criterion (c) is satisfied in respect of this facility.

### **The Council seeks comments on:**

- *Is the Mount Newman Railway Facility of national significance for the purpose of criterion (c)?*

## **8 s. 44G(2)(d) - that access to the service can be provided without undue risk to human health or safety**

### **Background**

- 8.1 The rationale for criterion (d) is that declaration should not occur where access or increased access to a service provided by a facility may pose a legitimate risk to human health or safety.
- 8.2 Some facilities require a degree of spare capacity to provide appropriate safety margins. In addition, access to facilities may need to be governed by conduct codes and operational guidelines. For a service to be declared, access must be possible without compromising system and operational integrity and safe operability.
- 8.3 The existence of relevant safety regulations may suffice to satisfy criterion (d) where these regulations deal appropriately with any safety issues arising from access to the facility under consideration. Alternatively, criterion (d) may be satisfied where it is possible to address any safety concerns raised by access to the service through the terms and conditions on which access is provided.

### **Issues for consideration**

- 8.4 FMG undertook in its application that if the service was declared and access granted, it would conduct its operations using the facility “in accordance with best practice and comply with all relevant safety and other legislation” (FMG 2004a, para 15.1).
- 8.5 Criterion (d) does not require such an undertaking. Rather, it requires consideration of whether access can be provided in a manner that does not give rise to undue risk to health and safety. This involves consideration of whether health and safety issues can be appropriately addressed through the terms and conditions of access. This may be facilitated through the modification of an existing or the development of an appropriate regulatory framework.

- 8.6 FMG refers to clause 9(2)(a) of the Iron Ore (Mt Newman) Agreement which requires the safe and proper operation of the Mount Newman railway line, without undue risk to human health or safety. The clause also requires the carriage of third party freight, including that of the State of Western Australia (see paragraphs 6.16 and 6.17).
- 8.7 As discussed at paragraph 6.22, BHP Billiton described its significant investment in intellectual property to improve the operational efficiency of its rail system in the Pilbara. Unless BHP Billiton provided a third party railway line user with its intellectual property, BHP Billiton argued that there would be an increased risk of rail track damage and rail accidents, and train breakages, derailments and collisions (Ridley 2004). It further stated that it “should not be expected to disclose that intellectual property” and cannot be compelled to do so under Part IIIA (BHP Billiton, paras 2.3 and 2.4).
- 8.8 The management of operational issues to ensure safe service delivery is generally addressed through the terms and conditions of access. The extent to which, and the terms and conditions on which, relevant intellectual property may be provided would ordinarily form part of the access agreement.
- 8.9 Evidence of existing third party access arrangements that have addressed health and safety concerns is relevant to the Council’s enquiries.

### **The Council seeks comments on:**

- *Are there any reasons why health and safety matters cannot be dealt with through appropriate terms and conditions of access so as to satisfy criterion (d)?*
- *What (if any) modifications to existing, or requirement for new, regulatory arrangements would be needed to ensure health and safety matters can be dealt with through the terms and conditions of access?*
- *Are there any examples where third party access to comparable rail infrastructure services is currently provided where human health and safety concerns have not been able to be addressed?*

## **9 s. 44G(2)(e) - that access to the service is not already the subject of an effective access regime**

### **Background**

- 9.1 Infrastructure services already covered by an ‘effective access regime’ cannot be declared for access under Part IIIA. The main purpose of criterion (e) is to allow State or Territory governments to develop industry-specific access regimes compliant with the Competition Principles Agreement that apply to the exclusion of Part IIIA.
- 9.2 The term ‘effective access regime’ is not defined in the TPA. Some guidance as to its meaning can be found in section 44G(3) which provides that when considering whether an access regime established by a State or Territory amounts to an effective access regime, the Council must apply the relevant principles in the Competition Principles Agreement; notably those contained in clause 6 of the agreement.

### **Issues for Consideration**

- 9.3 FMG noted in its application that the Western Australian Government sought certification of its rail access regime pursuant to section 44M of the TPA. In February 1999, that application was withdrawn. The Council had assessed the application and considered that it complied with the certification principles set out in clause 6 of the Competition Principles Agreement except in respect of one matter. That matter related to the lack of appropriate interface with the proposed national access regime.
- 9.4 Notwithstanding the lack of certification, the *Railways (Access) Code* came into effect in 2000 pursuant to the *Railways (Access) Act 1998*. The code only applies to railway networks and associated infrastructure for routes specified in Schedule 1 of the Code (s.5, Code). The Mount Newman railway line is not listed in Schedule 1 and as such, is not subject to the Code.



9.5 As noted at paragraphs 6.16 and 6.17, the Iron Ore (Mt Newman) Agreement requires (subject to certain conditions) the carriage of third party freight, including that of the State of Western Australia. FMG asserted that this obligation was reaffirmed by the Western Australian Supreme Court on appeal in the Hancock Prospecting decision. The Council seeks further information on the nature of this obligation including its applicability to the Mount Newman Joint Venture Participants.

### **The Council seeks comments on:**

- *To what extent (if any) does the Iron Ore (Mt Newman) Agreement and any other regulatory and contractual instruments applying to the Mount Newman Joint Venture Participants, provide an enforceable right of access? What is the nature of the right and to what extent does it comply with the principles set out in clause 6 of the Competition Principles Agreement?*

## **10 s. 44G(2)(f)- that access (or increased access) to the service would not be contrary to the public interest**

### **Background**

- 10.1 Criterion (f) requires the Council to be satisfied that access (or increased access) to the service would not be contrary to the public interest. The term 'public interest' is not defined in the TPA, and is difficult to define with any great specificity. This is partly because conceptions of the public interest can change over time as community attitudes change.
- 10.2 The public interest criterion does not constitute an additional positive requirement which can be used to call into question the result obtained by the application of criteria (a) to (e). Criterion (f) accepts the results derived from the application of (a) to (e), but enquires whether there are any other matters which lead to the conclusion that declaration would be contrary to the public interest (Eastern Gas Pipeline decision, para 145).
- 10.3 While no attempt to list public interest considerations can be exhaustive, matters which might be considered include the following open-ended list of items in clause 1(3) of the Competition Principles Agreement:
- ecologically sustainable development;
  - social welfare and equity considerations, including community service obligations;
  - government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
  - economic and regional development, including employment and investment growth;
  - the interests of consumers generally or of a class of consumers;
  - the competitiveness of Australian businesses; and
  - the efficient allocation of resources.

## Issues for consideration

- 10.4 FMG stated in its application that access to the service would be in the public interest because (FMG 2004a, para 17):
- 1) access to the Service would promote competition in the iron ore market as well as a number of markets both upstream and downstream of the iron ore market;
  - 2) access to the Service would encourage the entry of new participants into the markets and also promote competitors to intensify their existing activities;
  - 3) the entry of new participants and probable increased intensity from existing participants would mean improved economic activity and employment for the industry in Western Australia which would in turn feed back into the Western Australian and National economy;
  - 4) use of an existing railway line with spare capacity, as opposed to the development and subsequent usage of alternate or additional transport structures, will pose less stress on the environment and less demand on resources; and
  - 5) further promote the marketing and sale of iron ore at the point of extraction and/or at the point at which it is loaded onto the Facility.
- 10.5 FMG has highlighted the expected benefits from declaration that it asserts would flow from increased competition. It also noted possible environmental benefits arising from the avoidance of duplicating the facility. The Council seeks comment on both the benefits and the costs of declaration. Such costs include the direct costs of access negotiation and possible arbitration under Part IIIA, and may include other costs such as the need for government to modify existing or develop regulatory arrangements required to facilitate access.
- 10.6 BHP Billiton provided evidence that unless the operational intellectual property associated with the railway line was provided to a third party user, access to the line would increase its costs and result in operational inefficiencies (Ridley 2004, paras 6.2 and 6.3). In particular, it argued that such third party access would increase the risk of rail track damage and rail accidents, lead to a significant reduction in the life of the rail tracks and lead to a significant

increase in the operating and maintenance costs for BHPBIO (Ridley 2004). While the access seeker can be expected to pay for costs attributable to its use of the infrastructure as well as contribute to overhead and capital charges, the Council seeks comment as to whether there are any costs that could not be effectively addressed through the terms and conditions of access.

- 10.7 An issue that may be relevant is whether an increase in the supply sources or volumes of Pilbara iron ore would have any detrimental effect on the prices for Pilbara iron ore and overall export revenues earned. Related to this would be any benefit to the state economy from royalty payments received through increased production and new mine developments.

### **The Council seeks comments on:**

- *What are the likely costs and benefits that would result from declaration of the Mount Newman Railway Service?*
- *Are there any costs of access that could not be effectively addressed through the terms and conditions of access?*
- *Would access to the Mount Newman Railway Service otherwise be contrary to the public interest? If so, why?*

## **11 Exercise of residual discretion**

- 11.1 The Council has a residual discretion not to recommend declaration even though all of the criteria set out in section 44G(2) are satisfied. This residual discretion includes consideration of the matters set out in sections 44F(3) and 44F(4).

### **Section 44F(3): Application not in good faith**

- 11.2 Section 44F(3) states that the Council may recommend that the service not be declared if the Council thinks the application was not made in good faith. The subsection does not limit the grounds on which the Council may decide to recommend that the service not be declared.
- 11.3 In its submission, Rio Tinto Iron Ore raised the issue of whether FMG's application was made in good faith. In particular, it referred to actions taken by FMG for the construction of an alternate railway line to the Mount Newman railway line and raised the concern that such actions may be inconsistent with the application for declaration (RTIO, para 2.2). The Council seeks views on this point.

### **Section 44F(4): Consideration of alternative facilities**

- 11.4 Section 44F(4) requires the Council to consider whether it would be economical for anyone to develop another facility that could provide part of the service. This issue is related to but distinct from the consideration of natural monopoly under criterion (b). Views are sought on this issue.

## **12 Duration of declaration**

### **Background**

- 12.1 Section 44H(8) requires that every declaration include an expiry date. This can be a specified future date and/or can involve an event which may occur in the future. The period of declaration will vary according to the circumstances of each application.
- 12.2 In considering the appropriate duration of a declaration, the Council has regard to the importance of long term certainty for businesses. Given the nature of facilities under consideration, some access seekers may require declaration as a pre-condition to embark on significant investment, substantial developments or long term contractual commitments. The Council also considers that declaration should apply for a sufficient period to be able to influence the pattern of competition in relevant upstream or downstream markets.
- 12.3 Against these considerations must be balanced the potential for technological development, reform initiatives (such as changes in legislation governing access to the relevant service) and future market evolution. All these factors may have implications for the monopoly characteristics presently associated with a service or other industry. A change in relevant factors may mean that a service that meets the criteria for declaration today may not do so in the future.
- 12.4 Further, the Council considers that access regulation governing services, including the question of access itself, should be reviewed periodically. At the end of a period of access, the need for regulation can be reviewed.

### **The application**

- 12.5 FMG has sought a declaration period of 20 years. It argued that this period is required in order to enable the resources at Mindy Mindy and its other mines to be mined (FMG 2004a, para 9).

## **The Council seeks comments on:**

- *What is an appropriate duration for declaration of the Mount Newman Railway Service and why?*
- *Are there any reasonably foreseeable factors which may materially affect the Council's assessment of FMG's application for declaration? What is the time frame for the realisation of such factors?*

## Appendix A – Sections 44F & 44G of Part IIIA

### Section 44F: Person may request recommendation

- 44F(1) [Written application to Council] The designated Minister, or any other person, may make a written application to the Council asking the Council to recommend under section 44G that a particular service be declared.
- 44F(2) [Council must act] After receiving the application, the Council:
- (a) must tell the provider of the service that the Council has received the application, unless the provider is the applicant; and
  - (b) must recommend to the designated Minister:
    - (i) that the service be declared; or
    - (ii) that the service not be declared.
- 44F(3) [Application not in good faith] If the applicant is a person other than the designated Minister, the Council may recommend that the service not be declared if the council thinks that the application was not made in good faith. This subsection does not limit the grounds on which the Council may decide to recommend that the service not be declared.
- 44F(4) [Consideration of alternative facilities] In deciding what recommendation to make, the Council must consider whether it would be economical for anyone to develop another facility that could provide part of the service. This subsection does not limit the grounds on which the Council may decide to recommend that the service be declared or not be declared.
- 44F(5) [Withdrawal of applications] The applicant may withdraw the application at any time before the Council makes a recommendation relating to it.

### Section 44G: Limits on the Council recommending declaration of a service

- 44G(1) [Access undertakings] The Council cannot recommend declaration of a service that is the subject of an access undertaking in operation under section 44ZZA.
- 44G(2) [Council to be satisfied of matters] The Council cannot recommend that a service be declared unless it is satisfied of all of the following matters:
- (a) that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service;



- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
  - (i) the size of the facility; or
  - (ii) the importance of the facility to constitutional trade or commerce; or
  - (iii) the importance of the facility to the national economy;
- (d) that access to the service can be provided without undue risk to human health or safety;
- (e) that access to the service is not already the subject of an effective access regime;
- (f) that access (or increased access) to the service would not be contrary to the public interest.

44G(3) [Effective access regimes] In deciding whether an access regime established by a State or Territory that is a party to the Competition Principles Agreement is an effective access regime, the Council:

- (a) must apply the relevant principles set out in that agreement; and
- (b) must not consider any other matters.

44G(4) [Council to follow Minister's decision] If there is in force a decision of the Commonwealth Minister under section 44N that a regime established by a State or Territory for access to the service is an effective access regime, the Council must follow that decision, unless the Council believes that, since the Commonwealth Minister's decision was published, there have been substantial modifications of the access regime or the relevant principles set out in the Competition Principles Agreement.

## **Appendix B – Competition Principles Agreement (extract)**

- 6(2)** 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 unless:
- (a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or
  - (b) substantial difficulties arise from the facility being situated in more than one jurisdiction.
- 6(3)** For a State or Territory access regime to conform to the principles set out in this clause, it should:
- (a) apply to services provided by means of significant infrastructure facilities where:
    - (i) it would not be economically feasible to duplicate the facility;
    - (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and
    - (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and
  - (b) incorporate the principles referred to in subclause (4).
- 6(4)** A State or Territory access regime should incorporate the following principles:
- (a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.
  - (b) Where such agreement cannot be reached, governments should establish a right for persons to negotiate access to a service provided by means of a facility.
  - (c) Any right to negotiate access should provide for an enforcement process.
  - (d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.
  - (e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.
  - (f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.
  - (g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

- (h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.
- (i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:
  - (i) the owner's legitimate business interests and investment in the facility;
  - (ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;
  - (iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;
  - (iv) the interests of all persons holding contracts for use of the facility;
  - (v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;
  - (vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;
  - (vii) the economically efficient operation of the facility; and
  - (viii) the benefit to the public from having competitive markets.
- (j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:
  - (i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;
  - (ii) the owner's legitimate business interests in the facility being protected; and
  - (iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.
- (k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.
- (l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.
- (m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.
- (n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.
- (o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.
- (p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any

aspect of access and a single forum for enforcement of access arrangements.

## **Application, preliminary issues paper and determination**

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