FORTESCUE METALS GROUP LIMITED
SUBMISSIONS DATED 4 OCTOBER 2004

IN RESPONSE TO THE PRELIMINARY ISSUES PAPER
ISSUED BY THE NATIONAL COMPETITION COUNCIL
DATED SEPTEMBER 2004

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1. INTRODUCTION

1.1 Fortescue Metals Group Limited ("**FMG"**) lodged an Application (the "**Application**") with the National Competition Council (the "**Council**") on 15 June 2004 under Part IIIA of the Trade Practices Act (the "**Act**") seeking Declaration of a Service provided by the Facility comprising part of the Mount Newman Railway Line and part of the Goldsworthy Railway Line as managed by BHP Billiton Iron Ore Pty Ltd (the "**Provider**").

1.2 Part IIIA of the Act was introduced in 1995 as part of a wider package of reforms known as National Competition Policy. It followed the findings of the 1993 Hilmer Review (the "**Hilmer Report**") which recommended that a national access regime be implemented to deal with bottleneck infrastructure. The regime introduced by Part IIIA does not provide access to the infrastructure itself but to the services provided by the infrastructure. Accordingly it must be noted that the Service to which FMG sought access in its Application is not the right to operate the railway the subject of the Facility but rather the right to run its own trains on the railway.

1.3 The Provider responded to the FMG Application by two Responses (the "**BHP Responses**"). In the first Response dated 26 August 2004 (the "**Preliminary Response**") the Provider (via its parent "**BHP Billiton**") responded generally to the FMG Application. In the second Response dated 6 September 2004 (the "**Subsequent Submission**") Mr Phillip Anthony Price the Vice President – Integrated Planning for the Provider responded further by setting out some general commentary on the BHP Iron Ore business and in particular its rail scheduling system.

1.4 In response to the Application lodged by FMG and the two BHP Responses issued by the Provider the Council issued its Preliminary Issues Paper in September 2004 in which the Council sought submissions on the following fundamental question:

"*Is the service the subject of FMG's application a service within the meaning of Section 44B of the Act or does the production process exception at paragraph (f) apply?*"

1.5 The Submissions of FMG in response to that question are set forth in detail in this Document. In essence in these Submissions FMG deals with the Councils question in the following three ways:

(1) First it seeks to show the clear purpose and intent of Part IIIA of the Act and therefore how the exception at Section 44B(f) should be interpreted including by reference to the Councils own criteria;

(2) Second it demonstrates that the arguments put forward by the Provider do not support its assertion that the Service that FMG is seeking to have Declared is an integral part of its production process; and

(3) Third it refers to the Full Supreme Court decision in *Hancock Prospecting Pty Ltd and Ors -v- BHP Minerals Pty Ltd* and Ors [2003] WASCA259 which unanimously held that BHP Minerals is contractually bound to provide third

parties with use of or, access to, the railway Facility the subject of FMG Application (the "**Hancock Prospecting Case**").

1.6 Unless the context otherwise requires words or phrases used or defined in the FMG Application and/or in the Preliminary Issues Paper are similarly used in these submissions.

2. WHAT CONSTITUTES AN INTEGRAL (BUT NOT SUBSIDIARY) PART OF A PRODUCTION PROCESS?

2.1 The Service which FMG is seeking to have Declared is described in paragraph 3 of the FMG Application as follows:

(1) The use of the Facility, being:

(a) that part of the Mount 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 this 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 Mount 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 this 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.

2.2 In December 2002 the Council published "*The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974*" (the "**Guide**"). Part B of the Guide deals with the Declaration process and Section 3 covers the definitions in Section 44B of the Act.

2.3 In Section 3.31 of the Guide, the Council lists the factors that it will consider in determining whether the use of a facility was an integral part of the facility owner's production process. They are:

(1) *Whether the facility appears to constitute part of the production process of the facility owner.* A rail track of significant length, for example, may not have the appearance of being part of the production process.

(2) *Whether the facility is commercially separable from the production process.* If, for example, a rail track is capable of being used for a distinct commercial purpose, then this supports the conclusion that the rail track is not part of the facility owner's production process.

(3) *Whether the facility owner produces a merchantable product at an earlier stage than the use of the facility.* If, for example, the facility owner produces a merchantable commodity before using the rail track to transport that commodity, then this supports a conclusion that the rail track is not part of the facility owner's production process.

3. IS THE SERVICE THAT FMG IS SEEKING TO HAVE DECLARED AN INTEGRAL (BUT NOT SUBSIDARY) PART OF A PRODUCTION PROCESS?

3.1 The Service that FMG is seeking to have Declared is the use of a railway line which runs a distance of approximately 300 kilometres from a point near Mindy Mindy in the Pilbara district of Western Australia to Port Hedland on the coast. An additional spur line was included that ran from where the Goldsworthy Railway Line crossed the Mount Newman Railway Line through to the port facilities at Finucane Island. Taken together this Facility is a rail track of significant length and dimension, and accordingly *does not have any appearance of being part of the Provider's production process*.

3.2 The Facility comprises parts of two separate rail tracks both of which come under State Agreements with the Western Australian State Government. The Mount Newman Railway Line is covered by the Iron Ore (Mount Newman) Agreement Act 1964 as amended and the Goldsworthy Railway Line is covered under the Iron Ore (Mount Goldsworthy) Agreement Act 1964 as amended (the "**State Agreements**").

3.3 The State Agreements were varied in January 1987 by the Rail Transport Agreement. It is important to note that in all cases the State Agreements and the Rail Transport Agreement impose obligations on the operators to carry the freight of third parties on their railways.

3.4 BHP Minerals has repeatedly acknowledged that it has an obligation to carry the iron ore product of third parties on these railway lines. Carriage by BHP Minerals of freight of third parties, demonstrates the rail track is being used or is capable of being used for a separate distinct commercial purpose. This supports the conclusion that the Facility is not an integral part of the Provider's production process and *is commercially separable from it*.

3.5 As part of its development "*Mining Area C*", the Provider entered into a joint venture with POSCO (its largest customer) to create the POSMAC Joint Venture whereby POSCO acquired a 20% interest in the "*C Deposit*" section of Mining Area C. Under that agreement POSCO agreed to purchase three million tonnes per annum of product from Mining Area C. Further as part of the POSMAC Joint Venture a '*two stage sale structure*' was established, which BHP Billiton Minerals Pty Ltd ("**BHP**

Minerals") has acknowledged and claimed was "*fundamental to, and cannot be severed from"* its proposed arrangements (refer Section 7.15 of the ACCC's Final Determination of BHP Minerals Application for Authorisation in respect of the POSMAC Joint Venture for Deposit C of Mining Area C, Pilbara Region, Western Australia (the "**Determination**") – 5 March 2003).

3.6 This "*two stage sale structure*" comprises a process whereby iron ore is sold to the Mount Goldsworthy Joint Venture Participants prior to the ore being transported by rail to the Port Hedland port. Thus it is a fact that iron ore is currently being sold, prior to it being transported to port. As referred to in paragraph 3.5 of these Submissions BHP Minerals has acknowledged how fundamental and non severable this arrangement is. In other words this is clear evidence that *a merchantable product is produced at an earlier stage than* the use of the rail track (namely at the mine site prior to it being transported by rail to the port) which in turn evidences that the rail track is not an integral part of the Provider's production process.

3.7 Furthermore the fact that under the terms of the POSMAC Joint Venture the iron ore is sold to the Mount Goldsworthy Joint Venture Participants for transport along the Mount Newman railway line is a further example of the railway line being used for a *separable commercial purpose*. Moreover, paragraph 7.18 of the Determination also shows that BHP Billiton had offered to carry the iron ore of Hope Downs Iron Ore Pty Ltd from their area known as "*Hope One*", again evidencing the Facility being used or available for use, for a *separable commercial purpose*.

3.8 Accordingly by the criteria set down by the Council in its own Guide (see paragraph 2.3 of these Submissions), the Service that FMG is seeking to have Declared cannot be considered as an integral (and not a subsidiary) part of the Provider's production process. All three of the factors referred to by Council in its own Guide as being those that it would consider in determining whether a facility was not an integral part of a production process have been shown by FMG in these Submissions, to exist.

4. THE PRELIMINARY BHP RESPONSE

4.1 In its Preliminary Response BHP Billiton makes the following assertions in apparent support of its argument that each of the Mount Newman and Goldsworthy rail services form an integral part of the Provider's production process:

(1) In *Hamersley Iron Pty Ltd -v- National Competition Council (1999) 164 ALR203* (the "**Hamersley Case**") Justice Kenny determined that that the term "*production process*" means a series of operations by which a marketable commodity is created or manufactured; and

(2) The processing and blending of ore in order to produce marketable products occurs at a number of stages between mining of the ore and loading it onto ships at port; and

(3) The rail service is integral to the blending of ores from different mines in order to create the Provider's finished products; and

(4) The use of each rail line is co-ordinated as part of the Provider's production process in order to achieve the necessary blending of products.

4.2 However the Provider fails to make a distinction between how the Provider, as a vertically integrated producer, produces the final product that it sells, and the series of production processes that are involved in arriving at that final product. The

POSMAC Joint Venture to which the Provider via BHP Minerals is a party demonstrates that a marketable commodity exists at the mine site, and in that respect the production process is therefore, on the Provider's own argument complete at that stage.

4.3 The fact that the Provider's chooses to undertake further processing when the ore reaches the port does not mean that the rail transportation system is thereby transformed into part of the production process. The Provider's own conduct and that of BHP Billton shows that the ore is already a marketable commodity prior to rail transportation.

4.4 Indeed if the argument of BHP Billiton was accepted then any vertically integrated producer could quite simply organise its production such that the final steps to creating the product that it sells do not take place until after the use had been made of any essential bottleneck infrastructure controlled by it and could thereby defeat the entire purpose of Part IIIA of the Act.

4.5 FMG further contends that although the Provider may use its so called Continuous Stockpile Management System ("**CSM System**") to organise the scheduling of trains from mining locations to the area where it chooses to undertake further blending there is nothing inherent about the CSM System that would make the rail track itself a primary integral part of the production process. The track remains merely a conduit that provides a service of allowing trains to run over it regardless of whether the CSM System or any other method of train scheduling is being utilised.

4.6 Furthermore as is shown in the two BHP Responses the BHP CSM System is inherently different to the *batch system* referred to and relied upon by Justice Kenny in the Hamersley Case. The FMG Application does not in any way seek a Declaration of the CSM System it is only the rail track which FMG is seeking to have Declared. The CSM System remains the exclusive property of the Provider.

5. THE SUBSEQUENT BHP RESPONSE

5.1 In its Subsequent Submission the Provider via its Vice President of Integrated Planning, again purports to argue that rail scheduling plays an integral role in the iron ore production process. However the arguments put forward repeat two false premises of earlier BHP Billiton arguments namely:

(1) The notion that a marketable product doesn't exist until the final blending and screening has taken place at the port.

(2) The notion that because the so called CSM System is used to co-ordinate the sequencing of trains transporting the ore that this scheduling system somehow renders the track itself part of the production process.

5.2 FMG emphasises that whilst rail scheduling using the CSM System may deliver benefits to the Provider listed by Mr Price in paragraph 6.21 of his submission, those benefits are irrelevant to the question at hand and remain the sole property of the Provider. They are irrelevant because a marketable product exists at the mine and that marketable product is subsequently transported by rail to the port where further processing can if so desired, take place.

5.3 The service provided by the track (i.e. allowing trains to run over it) is not altered by the manner in which the Provider undertakes its own train scheduling. FMG is seeking merely to use the track and does not seek access to the Provider's train

scheduling systems. The CSM System is not part of the FMG Application and can continue to be used solely by the Provider regardless of FMG's use of the railway Facility.

6. THE ORIGINAL PURPOSE OF THE INTEGRAL (BUT NOT SUBSIDIARY) PRODUCTION PROCESS EXEMPTION

6.1 The original purpose of the "*Integral but not Subsidiary Production Process*" exception was to protect the rights of investors where those investors had invested in assets designed to produce a return but found that their expectations of a reasonable return were undermined by regulatory intervention where those assets unintentionally came under the ambit of Part IIIA of the Act. The example given in the Hilmer Report (page 251) was a case where a small photographic company had sought access to the products of Kodak's research and development before Kodak could market its own innovations.

6.2 To put the issue clearly into context it is important to note that the Facility infrastructure the subject of the FMG Application was built 40 years ago. It was built to facilitate the development of iron ore in the Pilbara. What was made explicit at the time in the underlying supporting State Agreements was the obligation to carry the freight of third parties.

6.3 This is further reinforced by the terms of the 1987 Rail Transport Agreement between the Western Australian State Government and BHP. The 1987 Rail Transport Agreement made clear that there was an obligation to carry the freight of third parties even where that meant carrying iron ore of third parties that competed with BHP Minerals or the Provider in the market for iron ore.

6.4 Therefore obliging the Provider to allow third parties access to its railway line can never be regarded as something that would act against the public interest by deterring investment. The obligation to carry third party ore was known and explicit at the time the investment was made and continues to be a binding contractual obligation of the Provider as determined by the unanimous judgement of Appeal Court of the Supreme Court of Western Australia in the Hancock Prospecting Case.

6.5 Accordingly the Provider is being inconsistent with its public statements of allowing third party access to the rail Facility and disingenuine in its attempts to use the "*Integral Production Process*" exception of Section 44B(f) to thereafter refuse access by seeking to exclude the rail Facility service from the FMG Application. To allow this to occur would be to completely subvert the fundamental legislative intent of Part IIIA.

7. THE HAMERSLEY CASE AND THE HANCOCK PROSPECTING CASE

7.1 In its Preliminary Response BHP not surprisingly placed great store on the decision of Justice Kenny in the Hamersley Case. However that decision is not applicable to the FMG Application for a number of reasons, the most pertinent of which are as follows:

(1) The Provider does not use the batching system which Justice Kenny found to be important to the Hamersley production process;

(2) The Provider does produce a marketable product at an earlier stage prior to loading on the rail Facility;

(3) The Provider's rail Facility is commercially separable from its production process which is evidenced by the Provider's acknowledgements that it does and is prepared to, carry the products of third parties on its rail Facility.

7.2 Most notably however the Hamersley Case was decided before the unanimous Appeal Court decision of the Supreme Court of Western Australia in the Hancock Prospecting Case. In the Hancock Prospecting Case (which the Provider notably does not refer to) the Supreme Court unanimously determined that BHP Minerals was contractually obliged to carry the iron ore products of third parties on its railway.

7.3 In the Hancock Prospecting Case Justice Templeman said at paragraphs 30, 31 and 32:

"*30 The respondents say that to enter into negotiations with a third party would be a costly and time consuming business.* ***They accept that they are obliged to carry a third party's ore on the Mount Newman Railway*** *but say they should not be required to negotiate with a prospective third party who has simply a gleam in his eye a line must be drawn somewhere. It is submitted that the agreement draws the line at the point where a third party becomes a producer.*

31 ***In my view, the respondents' construction of the Rail Transport Agreement is untenable****. It would defeat the purpose of the agreement, which amended the Mount Newman Agreement for the purpose of facilitating the establishment of industry such as that proposed by the appellants, not of frustrating it. Furthermore, I accept the appellants submissions that it makes no commercial sense to require a prospective mine operator to undertake the huge expense of establishing a mining operation without having the slightest idea how much he will have to pay to transport his iron ore to the port.*

32 ***I have only slight sympathy for the respondents' unwillingness to deal with a prospective third party. While I accept that there are costs involved, I regard the burden as an incident of the respondents' privileged position under the Mount Newman Agreement****."*

7.4 Furthermore Justice Hasluck said at paragraphs 77, 78, 80 and 81:

"*77 It is important to keep in mind, in seeking to construe the Rail Transport Agreement harmoniously, and as a whole,* ***that the railway line cannot be regarded simply as a private facility owned by the Mount Newman Participants, albeit established at their expense, for, from the outset, it was envisaged that the railway was not for the exclusive use of the Mount Newman Participants. A right of access would be available to third parties****. Clause 4 of the Schedule expressly allows for competition between the producers of iron ore products.*

78 It emerges, then, bearing in mind that the Rail Transport Agreement is essentially a variation of the Mount Newman Agreement that the subject matter being dealt with by the substantive provisions of the former Agreement is a right of carriage made available to third parties in respect of a railway line which forms part of the infrastructure which might otherwise have to be provided by the government. ***The expanded right of carriage or, to put it another way, the expanded right of access to the rail system, so as to allow for the carriage of the iron ore products of third parties****, is essentially defined by the corresponding* ***duty upon the Mount Newman***

Participants to carry the iron ore products of such parties pursuant to contractual arrangements to be negotiated *in accordance with principles prescribed by the Schedule.*

80 The definition of a third party in the Schedule to the Rail Transport Agreement speaks of a third party as a person operating a mine producing iron ore products. However, this definition does not provide any express or specific guidance concerning the question I have just posed. Thus, to my mind, the definition of third party cannot be accorded the decisive influence that was attributed to it by the learned Judge at first instance. The logic of the situation, which appears to be reflected in the structure and language of the substantive provisions of the Rail Transport Agreement, suggests that the right of carriage is intended to be utilised at the time when the carriage is required. This pre-supposes, as appears from the words "to be negotiated", that the detailed contractual arrangements may be negotiated prior to the time when the iron ore products are to be carried. ***This means that the Mount Newman Participants may be required to negotiate transport agreements with the third party before the third party's mine is in active production****. Having regard to the definition of third party, the contractual arrangements to be negotiated will inevitably be conditional upon third party (in this case the appellants) being the operator of the mine at the time the carriage is required. In that way proper weight is given to the definition of third party.*

81 I am of the view that an interpretation of this kind reflects the structure of the Rail Transport Agreement, gives proper weight to the various provisions of the Agreement and appears to be consistent with the commercial realities of the matter..."

7.5 Thus the Provider is seeking to argue the inarguable and to defend the indefensible namely that it should have exclusive use of the rail Facility the subject of the FMG Application because the Provider argues that this Facility is an integral part of its production process (and thus it is vital that it have exclusive use) when at the same time:

(1) The Provider has acknowledged an obligation to carry third parties iron ore products on that rail system;

(2) The Provider is already carrying some third party iron ore products on that system;

(3) The Provider has acknowledged the application of Part IIIA to the Mount Newman Railway Line; and

(4) The Supreme Court has unanimously held that the Provider is contractually obliged to carry the iron ore products of third parties on that rail system.

8. CONCLUSION

8.1 Any evaluation of whether the service provided by an infrastructure facility, of the type that FMG is seeking to have Declared, should be exempted on the grounds that it is part of a production process ought to consider the relevant factors listed in Section 3.31 of the Councils own Guide. As shown in paragraph 3 of these Submissions all the factors, suggested by the Council as relevant to considering this

issue, point to the same conclusion, namely that the infrastructure in question should not be exempted on the grounds that it part of a production process.

8.2 The information provided by BHP Billiton in support of its assertion that the Facility is an integral (non subsidiary) part of its production process are based on false premises. The manner that the Provider chooses to arrange its production is simply not relevant to the question being considered. BHP Billiton is a vertically integrated producer and thus can arrange its production so that the final product in the form that it chooses to sell, is not complete until after it has used the infrastructure.

8.3 If this argument of BHP Billiton is allowed to prevail, it would be a mandate for all vertically integrated producers to avoid Part IIIA of the Act by adjusting their production processes in a manner designed to replicate that of BHP Billiton. This would in effect render Part IIIA otiose.

8.4 The decision of Justice Kenny in the Hamersley Iron Case is not applicable to the FMG Application. The decision in the Hamersley Case was fundamentally premised on the fact that "*There was no evidence to show that Hamersley produces a marketable commodity*" (refer paragraph 34) prior to being transported by rail from the mine site. Irrespective of whether that premise was in fact true in the Hamersley Case, there is now clear evidence that BHP Billiton could and indeed does now produce a marketable commodity at an earlier stage.

8.5 The Hancock Prospecting Case clearly determines the obligation of the Provider to carry the iron ore product of the third parties on the Providers railway line. It would be a ludicrous and farcical situation indeed, that the Supreme Court has determined the Provider is contractual bound to make its rail system available to carry the iron ore product of third parties, that the Provider has acknowledged its preparedness to do so, but that Part III of the Act which is designed to implement these arrangements does not apply because the Provider says it has exclusive use of the rail system.

8.6 Finally and perhaps the most telling issue in relation to this question is the evidence provided by BHP Minerals itself to the ACCC as explained in Section 7.19 of the Determination. In response to submissions from Hope Downs Iron Ore Pty Ltd asserting that the POSMAC Joint Venture increased the barrier to entry to the Mount Newman railway line **BHP Billiton respond by stating that this was not the case because access could be obtained pursuant to Part IIIA of the Trade Practices Act.** In other words BHP Billiton acknowledged the application of Part IIIA to its railway track.

8.7 Accordingly FMG submits that the production process exception listed in Section 44B(f) of the Act cannot apply to the FMG Application.

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