



INTERNATIONAL

Outline of response to NCC draft recommendation

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Date: 12 December 2005

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1. CRITERION (A): THE IRON ORE TENEMENTS MARKET

1.1. THE RELEVANT MARKET HAS BEEN INCORRECTLY DEFINED

1. The market proposed by the NCC (a Pilbara-wide market for mineral tenements containing proven iron ore deposits) is unsound.
2. First, the NCC has defined the market by reference to a particular temporal stage in the production of iron ore i.e., it has proposed that the relevant market is one in which iron ore is supplied or capable of being supplied post-exploration but pre-exploitation. However, this is not likely to be an 'antitrust' market according to established economic principles. The correct market for the purpose of competition analysis is likely to form part of either an iron ore production market or a minerals exploration market.
3. Second, the geographical dimension of the market as defined by the NCC is unclear. It refers to a Pilbara-wide market, yet when considering the impact of declaration the 'market' being considered seems limited to the sites adjacent to the Mt Newman Line. Regardless which of these the NCC intended, the proper geographical market is likely to be far broader, making a promotion of competition implausible.
4. Third, the NCC appears to inappropriately exclude from its tenement market those tenements owned by BHPBIO, Rio Tinto and now also FMG.

1.2. IT IS UNLIKELY THAT DECLARATION WOULD PROMOTE COMPETITION IN ANY OF THE POSSIBLE MARKETS

5. If transactions for iron ore tenements take place in a wider mineral exploration market or an iron ore production market, the effectively competitive nature (and size alone) of these markets would preclude declaration promoting competition.
6. Even if the market posited by the NCC exists, the NCC cannot be satisfied that access to the Mt Newman Service would promote competition for the following reasons:
 - Declaration will not alter the competition to **acquire** iron ore tenements, which is and will remain vigorous and effective;
 - As regards competition in the **supply** of iron ore tenements, declaration will not materially alter the position of junior explorers, as whether an iron ore tenement is capable of being independently exploited does not depend solely on access to rail track services;
 - Moreover, even if declaration were to alter the position of junior explorers, this would not in and of itself promote competition – but would merely alter the division of rents between them and BHPBIO;

- Finally, BHPBIO, Rio Tinto and now FMG's supply side participation in the market makes it very unlikely that any additional activity by junior explorers would change the degree of competition in this market, except in a trivial sense.

2. CRITERION (A): RAIL HAULAGE MARKET

2.1. LACK OF CLARITY AND PROBLEMS WITH NCC MARKET DEFINITION

7. First, the NCC effectively treats the Mt Newman Line as a standalone market notwithstanding the NCC's adoption of a Pilbara-wide geographic market definition.
8. Second, the NCC's view that rail track and haulage services are in distinct markets hinges on the incorrect finding that the diseconomies of scope are slight. Further, the NCC has been inconsistent in assuming for the purpose of making a finding in respect of separability (and hence for market definition) that the third party use of the service will be slight, while assuming the opposite for the purpose of assessing impacts on competition that the scale of use will be significant.
9. Third, the NCC fails to consider whether the rail track services under Part IIIA and the haulage services under the RTA are in separate *product* markets.

2.2. DECLARATION OF THE MT NEWMAN SERVICE WOULD NOT PROMOTE COMPETITION

10. Even if the NCC market definition were accepted, there already is a constraint on BHPBIO's ability to exclude competitors in the form of the RTA, which requires BHPBIO to provide a haulage service at a cost-based price. Competition would only be promoted in the rail haulage market if the degree of competitive constraint on any rail haulage service that BHPBIO would offer to itself or others (through the RTA) would increase beyond that which currently applies.
11. However this would be unlikely to occur. First, it is unlikely that declaration would enable entry beyond that which the RTA already permits. This is because the supply of a haulage service is only possible if the purchaser of that service can acquire other services that are complementary to it, including port services and possibly blending facilities – such that the threat of entry is only credible if a new entrant is able to provide (or the acquirer can otherwise obtain) the full set of these complementary services that would be necessary to a user of those haulage services. There is no evidence that a new entrant would be able to put together (or that the acquirer could otherwise obtain) the full set of complementary assets necessary to do so. As a result, it has not been established that the threat of entry would be credible.
12. Second, even if entry were *possible*, for entry to be *effective*, the entrant's unit costs must be such that it imposes a degree of competitive constraint on BHPBIO relative to the likely prices that would apply under the RTA. This is unlikely to occur on two grounds:
 - First, if the relevant scale on which entry were contemplated was that associated with transporting iron ore from the Mindy Mindy mine, then an entrant into the rail haulage activity would suffer too great a cost penalty to be able to constrain BHPBIO; and

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- Second, the only way a third-party specialist rail haulage provider could attain the necessary custom to attain minimum efficient scale without creating sufficient diseconomies of scope (which would undermine the NCC's finding in relation to market definition) would be for the access seeker to transport (or somehow affect the competition to transport) BHPBIO's *own* iron ore from mine to port. However, this possibility seems implausible.

3. CRITERION (B): UNECONOMIC TO DEVELOP ANOTHER FACILITY

13. The NCC has erred in its assessment of criterion (b) in two important ways. First, it has ignored the existence of the RTA as a means of economically developing an alternative facility to provide the service. Second, even putting the RTA issue to one side, the NCC has incorrectly carried out the assessment of social costs and benefits pertaining to declaration.

3.1. RTA REPRESENTS ECONOMIC DEVELOPMENT OF ALTERNATIVE

14. The NCC has ignored the RTA in its assessment of criterion (b). The significance of this is twofold:

- First, the RTA is likely to constitute another facility that provides a sufficiently close substitute to the service that would be provided were the Mt Newman Service to be declared under Part IIIA so that criterion (b) cannot be established. In other words, the RTA is 'another facility' for the purposes of criterion (b); and
- Second, ignoring the RTA (and specifically failing to consider it as a relevant counterfactual for the purposes of criterion (b)) distorts the cost/benefit analysis that is required under the NCC's own social benefit test.

3.2. INCORRECT ASSESSMENT OF SOCIAL COSTS AND BENEFITS

15. The NCC has incorrectly carried out its assessment of social cost and benefits pertaining to declaration in the following respects:

- The presumed capacity of a double-tracked Mt Newman Line has been substantially overstated by the NCC;
- The current and future utilisation of the Mt Newman Line has been underestimated by the NCC. In fact, the Mt Newman Line is and is likely to remain near capacity, taking account only of BHPBIO's own needs;
- The NCC's assessment of criterion (b) has failed to recognise that, once the Mt Newman Service is declared, it may have to accommodate significant third party tonnage (possibly including the entirety of FMG's predicted output);

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- The social costs and benefits depend substantially on the level of third party use, as the interference and investment-deterrence effects of open access would be markedly stronger at the higher 45 mtpa level than at the 10 mtpa level;
- The scope diseconomies associated with declaration form an important part of the social cost/benefit calculus, yet the NCC has not attempted to quantify them; and
- The NCC concludes that such quantification can be carried out post-declaration by the ACCC at the point of arbitration of any disputes. One of the many difficulties with this approach is that once the Mt Newman Service is declared, there may be no arbitrated solution available which both satisfies the arbitration principles under Part IIIA and is compensatory to BHPBIO.

4. CRITERION (F): PUBLIC INTEREST

16. The NCC's assessment of criterion (f) does not reflect as serious an assessment as that criterion demands – especially in view of the ease with which the NCC is willing to find that criteria (a) and (b) are satisfied in the case of vertically integrated or single-user railway lines and other facilities exhibiting natural monopoly characteristics and vertical integration.
17. One particular matter that is relevant to the public interest test is the fact that – even on the NCC's assessment – any benefits resulting from declaration are likely to be slight i.e., a promotion of competition in one market (tenements) which is likely to already be competitive and another (rail haulage) where the prospects of transactions seem at best slight. As a result even a low probability of associated efficiency costs would be likely to outweigh these claimed social benefits.
18. As a separate matter, in assessing whether declaration would have the likely effect of reducing the efficiency and competitiveness of the Australian economy the NCC must take account of the fact that the consequences of declaration are not certain. Rather, declaration involves risks that include those arising from the difficulties involved in predicting the extent of the diseconomies of scope that third party use of the service would impose on BHPBIO. The costs associated with those risks materialising are also themselves uncertain, as they depend on the evolution of world markets for iron ore and the resulting opportunity cost of disruptions to supply.
19. Were a scenario to eventuate in which use of the declared service imposed significant diseconomies of scope on BHPBIO; world demand for iron ore remained strong; and in the counterfactual world, any incremental tons mined by FMG (or other potential users of the declared service) could have been shipped by alternative means (including the RTA); then the losses caused by declaration would be high.
20. This need not be the most likely scenario for the efficiency costs of declaration to outweigh its potential benefits. In effect, if the losses associated with that scenario are sufficiently high, then even a moderate likelihood of that scenario eventuating would make declaration contrary to the public interest. It is submitted that (1) the likelihood of such a scenario eventuating is high rather than low; and (2) even if the likelihood were not high, it would still be sufficient to outweigh the potential gains from declaration in expected value terms.