COMMONWEALTH OF AUSTRALIA

Trade Practices Act 1974

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No 5 of 2006

RE: **APPLICATION FOR REVIEW OF THE DEEMED DECISION BY THE COMMONWEALTH TREASURER OF 23 MAY 2006 UNDER SECTION 44H(9) OF THE TRADE PRACTICES ACT 1974 (CTH) IN RELATION TO THE APPLICATION FOR DECLARATION OF SERVICES PROVIDED BY THE MOUNT NEWMAN RAILWAY LINE**

BY: **FORTESCUE METALS GROUP LIMITED**

Applicant

AFFIDAVIT OF STEPHEN O'DONNELL

AFFIRMED ON 21 DECEMBER 2007

Filed on behalf of BHP Billiton Iron Ore Pty Ltd and BHP Billiton Minerals Pty Ltd by:
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CONTENTS

On 21 December 2007 I, **STEPHEN O'DONNELL**, of 1 Treatts Rd, Lindfield in the State of New South Wales solemnly and sincerely declare and affirm:

Employment history

1. I have a Bachelor of Chemical Engineering from the University of Manchester with first class honours.

2. I have worked in a number of senior positions in the mining and rail sector. My recent relevant employment experience includes:

   (a) From 1995 to 2000, I was employed by MIM Holdings. I initially managed the Townsville Copper Refinery business and was then appointed as Executive General Manager of the Mt Isa Business Unit. In that capacity, I had responsibility for all mining, downstream operations and marketing associated with the Mt Isa complex.

   (b) From 2000 until 2002, I was the Executive General Manager of the Smelting Business Unit for Pasminco.

   (c) From 2002 until 2006, I was the Chief Executive Officer (**CEO**) of Pacific National. Pacific National was created when the National Rail Corporation Ltd and Freight Rail Corporation were privatised. Pacific National was initially a joint venture between Toll Holdings and Patrick Corporation. Pacific National operates one of Australia's largest rail freight businesses, specialising in the transport of bulk commodities, including coal and grain, across all Australian states and the Northern Territory. It operates on the Queensland Rail (**QR**) network pursuant to an access undertaking. While I was CEO of Pacific National it was transporting around 85 million tonnes of coal by rail each year, making it the second largest coal haulage operator in Australia.

   (d) Most recently, I have worked as an consultant to the Queensland Government and the Queensland Resources Council in undertaking an independent review of problems with the performance of the Goonyella Coal Supply Chain (**Goonyella Supply Chain**).

3. As CEO of Pacific National I had involvement with the operation of a number of rail access regimes. These included the ARTC Access Regime for the Defined Interstate Rail Network, the QRNA Access Undertaking in Queensland, the WestNet rail track access regime and the Victorian rural rail access arrangements. Other than in relation to the Victorian network, Pacific National's role under these regimes was that of an "above rail" train operator using track which was controlled by a "below rail" operator such as the Network Access division of QR, and competing with other "above rail" operators such as QR's rail freight division. Pacific National held the lease from the Victorian Government of the Victorian rural rail network for about 12 months.

Outline

4. In this affidavit, I:

   (a) provide the background to the review of the Goonyella Supply Chain that I undertook in 2007; and

   (b) comment on some of the issues that arise in relation to common user systems when compared with single user systems.

Introduction to the Goonyella Supply Chain

5. The Goonyella Supply Chain is a name which is used for ease of reference to loosely describe a group of infrastructure facilities which are owned by different parties but are collectively engaged in the transportation of export coal from coal mines in the Bowen Basin in Central Queensland, using sections of the Queensland rail network, to two coal terminals located at the Port of Hay Point – the Dalrymple Bay Coal Terminal (**Dalrymple Bay Terminal**) and the Hay Point Services Coal Terminal (**Hay Point Terminal**).

6. The entities and stakeholders associated with the Goonyella Supply Chain (referred to throughout this affidavit as "**participants**") include:

   (a) A number of coal producers operating across a number mines, including:

      (i) Blair Athol, operated by Rio Tinto Coal Australia (**Rio Tinto**);

      (ii) Hail Creek, operated by Rio Tinto;

      (iii) Riverside, operated by BM Alliance Coal Operations Pty Ltd;

      (iv) South Walker Creek, operated by BHP Mitsui Coal Pty Ltd;

      (v) German Creek, operated by Anglo Coal (Capcoal Management) Pty Ltd

      (vi) Moranbah North, operated by Anglo Coal Australia Pty Ltd;

      (vii) Oaky Creek, operated by Xstrata Coal Queensland Pty Ltd;

      (viii) North Goonyella, operated by Goonyella Coal Mines Pty Ltd;

      (ix) Burton, operated by Thiess Pty Ltd;

      (x) Foxleigh, operated by Foxleigh Mining Pty Ltd;

      (xi) Coppabella, operated by Australian Premium Coals Pty Ltd (**APC**); and

(xii) Moorvale, also operated by APC;

(b) Babcock and Brown Infrastructure, the long term leaseholder of the Dalrymple Bay Terminal;

(c) Dalrymple Bay Coal Terminal Pty Ltd (**DBCTPL**), the operator of the Dalrymple Bay Terminal;

(d) BHP Billiton Mitsubishi Alliance (**BMA**), the owner and operator of Hay Point Terminal;

(e) QR, a statutory corporation created and wholly owned by the Queensland Government which operates the Queensland rail network and freight and passenger trains on that network;

(f) QR Network Access (**QRNA**), the division of QR which operates the rail network;

(g) QR National (**QRN**), the division of QR which operates freight and passenger trains on the Queensland rail network;

(h) the Queensland Government; and

(i) the Ports Corporation of Queensland.

7. The Dalrymple Bay Terminal is a major port facility near Mackay in Queensland which is used for the loading of metallurgical and thermal coal from the Bowen Basin mines onto ships for export. The Dalrymple Bay Terminal has a number of berths, a number of ship loaders and on-shore stockpile yards. It has a current capacity of approximately 60 million tonnes per annum (**mtpa**), with expansion projects forecast to increase capacity in two stages between now and the end of 2008.

8. The Dalrymple Bay Terminal was originally developed by the Queensland Government with a view to encouraging development of the Bowen Basin coal fields. In about 2001, the Queensland Government awarded a long-term lease over the Dalrymple Bay Terminal to a consortium led by Babcock and Brown.

The Goonyella Supply Chain Review

9. In June 2007, I was commissioned by the Queensland Government and the Queensland Resources Council to undertake an independent review of the Goonyella Supply Chain (the **Review**).

10. In the period leading up to the Review, the Goonyella Supply Chain had been failing to match the desired mine production rate. As a consequence, mine operators were unable to deliver their contract tonnages, at a time of sustained increase in demand in the export coal market and a

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markedly increased coal price. This led to adverse media attention and significant complaints from overseas customers.

11. The objectives of the Review were to:

(a) identify system constraints;

(b) have stakeholders agree on realistic throughput targets against contracted throughput;

(c) recommend a reporting regime to restore customer confidence; and

(d) make recommendations focused on improving the capacity of the system to delivery contracted throughput, confidence in capacity forecasts and transparency.

12. As part of the Review, I considered the efficiency and effectiveness of the Goonyella Supply Chain system at an operational level (ie on a day to day basis), governance processes underpinning the management of the Goonyella Supply Chain, and issues associated with capacity expansion.

13. In the course of undertaking the Review, I had the opportunity to discuss the various issues associated with the Goonyella Supply Chain with the participants, including:

(a) CEO's and senior executives of the coal producers;

(b) the board and senior management of QR;

(c) senior executives associated with the Dalrymple Bay Terminal, Hay Point Terminal and the Ports Corporation of Queensland;

(d) senior ministers and officials of the Queensland Government; and

(e) the QCA.

14. I met with each participant in the Goonyella Supply Chain at least once and, where appropriate, had follow up meetings.

15. The Review report was presented to the Queensland Government and the Queensland Resources Council on 29 July 2007. A copy of my letter to the Queensland Resources Council and Queensland Government setting out the results of the Review of the Goonyella Supply Chain, and the supporting documentation which accompanied the letter is annexed and marked "**SO-1**". A copy of the press release issued by the Queensland Government relating to the Review is annexed and marked "**SO-2**". The findings set out in the Review represent my genuine views and conclusions based on the information presented to me in the relatively short timeframe allowed for the Review, and having regard to the objects of the Review.

16. As indicated at page 6 of the supporting documentation at SO-1, in dollar terms the underperformance of the Goonyella Supply Chain resulted in lost revenue in excess of $1.2 billion from July 2006 until May 2007. Of the total lost revenue, $900 million was in the form of lost revenue from the sale of coal. This was calculated by comparing the tonnes of coal that were contracted for sale in the period, with the tonnes of coal actually shipped. In addition, approximately $300 million in additional demurrage was incurred by the participants in the Goonyella Supply Chain over and above the anticipated level of demurrage. These figures did not include any costs associated with delays in implementing capacity expansion as the Review did not consider that issue.

Principal issues that arise in relation to a common user system when compared with a single user system

17. As highlighted by the problems experienced with the Goonyella Supply Chain, there are a number of fundamental problems which are associated with the day to day operations of any common user rail and port system. These include:

    (a) lack of flexibility in daily operations, making it difficult to implement changes at short notice to maximise system throughput;

    (b) difficulties in aligning contractual frameworks to deal with commercial relationships between system participants;

    (c) delays associated with implementing changes;

    (d) constraints on operational and technological improvements; and

    (e) lack of appropriate governance and accountability mechanisms.

18. The Goonyella Supply Chain is a complex production and transportation system, with a large number of participants. However the issues identified above can occur in any multi-user rail and port system. For example, during my time with Pacific National, I observed some of these issues occurring in the rail access context where there are both track access providers and above rail carriage service providers. In fact, the rail component of the Goonyella Supply Chain is less complicated than these rail access situations as the rail system in the Goonyella Supply Chain is controlled and used by a single corporation (QR), which both operates and maintains the track and operates rolling stock to haul coal for all of the producers. In a rail access context, where there are two or more rail operators on the same line, the issues identified above can be amplified.

19. Further, the impact of these issues obviously increases as the number of participants in the multi-user system increases. However, these issues commence as soon as access is granted to another user of the system who will have different commercial objectives, and unified control of the system will be lost.

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20. Finally, over and above the day to day operational issues, there are issues associated with planning and implementing capacity expansion and investment in infrastructure, which typically are significantly more complex in common user systems.

21. Each of the issues identified in paragraph 17 above is discussed in more detail below.

Lack of flexibility in operations

22. Multi-user systems are usually run as scheduled operations. This is because it can be very difficult to implement a flexible operating strategy in a multi-user system because more than one participant is involved. However, the lack of flexibility in most common user systems reduces the capacity of the system.

23. An example is the scenario where a train is scheduled to arrive at a particular mine at a particular time but, due to a delay at the coal plant, there is insufficient coal to load the train. In a flexible system, the train could be redirected to a mine which had product ready for loading. In a multi-user system operating to a timetable, this level of flexibility is much more difficult to achieve and it is likely that the train would either:

    (a) be delayed at the mine waiting for the coal to be loaded, and therefore run late (which has flow on impacts on the system); or

    (b) would run with no load, or a reduced load (which would mean that the system is not reaching capacity).

24. A further example is the scenario where a ship arrives at the port and requires a particular coal product. In a flexible system, trains could be redirected to the mines which produce the particular product so that the ship would be serviced as quickly as possible. In a multi-user system, it would take considerably longer for the demands of the particular ship to be met.

25. Based on my experience working with multi-user systems, it is my view that as a result of the rigid timetable operation which usually exists in a multi user system it is generally necessary to build an additional 10 to 20% capacity into the system to achieve the same throughput as could be achieved with flexible operation of that system, under the control of a single user and operator.

26. It may be possible to run a multi user rail system in a flexible manner, but it would require a sophisticated operational framework, and it would be difficult to implement in a system that was capacity constrained. In addition, the commercial and contractual arrangements governing a flexible operational framework in a multi-user system would be extremely complex.

Contractual framework to deal with commercial relationships between system users

27. The participants in multi-user systems will usually have distinct commercial interests. In some areas, their objectives may be aligned (for example, participants in the Goonyella Supply Chain

may share the objective of increasing the capacity of the Goonyella Supply Chain). However, in other areas, their objectives will diverge and may even be competing. For example, in determining how an expansion should be funded, or the appropriate allocation of capacity resulting from an expansion, participants could be expected to have divergent interests.

28. The contractual framework which underpins the operation of a multi-user system should take into account and deal with the various commercial drivers of system users, but this generally is very difficult to achieve.

29. In my experience, most rail access regimes in Australia set out the high level operating principles for the access regime, but do not provide a detailed and practical framework for day to day operations. Rail access regimes also do not generally take into account or compensate for the full costs to all participants that result from the underperformance of one party negatively impacting on other parties, such as production or sales lost as a result of disruptions.

30. This is the case with the Goonyella Supply Chain, where the contractual framework has contributed to the difficulties experienced by the system. While there are user contracts between the rail operators and coal producers, and between the coal producers and the port operators, there is no contract between the rail operators and the port operators. In other words, there is no contractual accountability as between the rail operators and the port operators. In addition, the contractual framework is not sufficiently detailed to take account of the various problems and difficulties that can arise in a complex multi-user system such as the Goonyella Supply Chain. This has affected daily operations in the Goonyella Supply Chain, as well as longer term planning, as illustrated by the following examples:

(a) Operational issues – on occasions, a miner might have problems with the quality of its coal which could create delays in the system. For example, if the coal is too "sticky", it is difficult to unload from the train. Or if the coal requires additional treatment and processing at the port, it would take up limited stockpiling capacity for an extended period of time. The impact of these types of product quality contract issues on the other participants in the system is not accounted for in the contractual framework of the Goonyella Supply Chain.

(b) Longer term planning and forecasting issues – the contractual frameworks do not and can not impose on participants obligations to invest to meet particular expansion targets. This has resulted in components of the system failing to expand quickly enough to accommodate system demand. In particular, at the time of the Review, the rail network had a shortfall in rolling stock.

31. The importance of a clear contractual framework between system users is clearest when the system is underperforming. When the system is operating efficiently and production targets are being met, the relationship between system users is also likely to be without problems. However, when the system is not performing to the required standard, participants in the system may become

defensive or attribute blame to other participants, and the commercial relationships between participants can become dysfunctional. These problems can occur even when there are only two users operating on the same system, such as in most rail access situations.

Delays associated with implementing changes

32. Common user systems often operate under some type of access undertaking or access agreement. These undertakings and agreements, and any changes to the undertakings and agreement, usually require the approval of a regulatory authority.

33. The need to seek approval from regulators for changes to access arrangements can result in significant delays. It is not unusual for the regulatory process to add 6 to 12 months to the time taken to make a decision on expansions and changes to operations.

34. The delay results from the time that it takes:

    (a) to coordinate the participants in the multi-user system to come to a unified position in relation to a proposed change;

    (b) to collect, collate and provide the relevant information to the regulator; and

    (c) for the regulator to make necessary further enquiries and perhaps invite and review public submissions before making a decision.

35. In addition, the possibility that one or more participants might "game" the system is a factor which must be considered by the regulator, and may increase the time required by the regulator to consider a proposed change to an access undertaking or agreement.

36. The absence of a clear coordinating body in a multi-user system makes the regulatory process even more difficult and time-consuming.

Constraints on technological and operational improvements

37. In common user systems, the technical standards of the participants tend to move toward a "lowest common denominator" approach. One reason for this may be that there are contractual standards that participants are required to meet, and there is minimal incentive on the participants to improve their performance beyond those minimum contractual requirements.

38. Another reason for the "lowest common denominator" approach is that experimenting with or implementing technological or operational improvements is made more difficult where there is more than one commercial enterprise participating in a system due to the following factors:

    (a) the various requirements of each participant need to be considered before implementing any change. Support from all or many of the participants may be required before the change can be implemented;

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(b) even small changes in one part of the system often require system-wide change, which can be both expensive and complex;

(c) it may be difficult to predict the effect of any change on the wider system, particularly where participants have different equipment; and

(d) changes may require regulatory approval.

The above factors are likely to act as, at best, a disincentive and, at worst, a constraint on a participant undertaking an experiment or implementing a technological or operational change that would improve the efficiency of either its own operations or the systems operations.

39. By contrast, the operator of a single user system has the ability and incentive to undertake experimentation with technology and operating strategies to improve the efficiency of its system. I have read and considered the affidavit of Graham Peter Tew dated 31 October 2007, which describes the way in which BHP Billiton has focused on improvement of the technology and operating strategies of its iron ore operations in the Pilbara to achieve very high tonnages on its single track Mt Newman railway line. In my view, the level of continuous improvement described by Mr Tew is unlikely to be able to be achieved on a common user system, such as the Goonyella supply chain or a rail network which is shared by two different train operators.

Lack of appropriate governance and accountability mechanisms

40. To assist with addressing the challenges identified above, there is a need for clear governance and accountability structures in a multi-user system. This is particularly the case where the commercial interests of the entities using the system are not aligned. It is also important that there is one entity which coordinates participants to ensure that both short and long term planning and other decisions which impact on the entire system are made having regard to the interests of that system. If it is not practical or feasible for there to be a governing or coordinating body, then it is likely that problems will arise.

41. Even where a multi-user system is established with a clear governing or coordinating body, it is unlikely that the system will operate as efficiently as possible given the inherence conflicts that will arise. Rather, each "component" of the system will seek to operate in an efficient manner having regard to the requirements of the particular component, but without regard to the requirements of the total system.

42. The experience of the Goonyella Supply Chain provides an example of the impact of the lack of appropriate governance and accountability mechanisms on the efficiency of a multi-user system. In the Goonyella Supply Chain, there is no single entity with responsibility for the performance of the system, or with the authority to coordinate the many users of the system.

43. The capacity modelling that was undertaken to assist with forecasting the capacity of components of the Goonyella Supply Chain prior to the Review provides a useful example of the inefficiencies that can result from lack of appropriate governance and accountability mechanisms. Capacity modelling of the port facility was undertaken separately to capacity modelling of the rail facilities. However modelling of the total system capacity, taking into account each of the system components, was not undertaken.

44. The results of the modelling undertaken for each component of the system is a poor indicator of the capacity of the entire system, which will be the impacted by the interaction between each of the system components. This means that even if, for example, each component operates efficiently and meets its production or throughput targets 95% of the time, the total system may only meet its overall throughput targets 60 to 70% of the time.

45. The absence of total system modelling of the Goonyella Supply Chain meant that none of the participants had an accurate understanding of the capability of the Goonyella Supply Chain System, making accurate planning and forecasting impossible. Further, no single entity was responsible or accountable for the inadequacies of the system forecasts and planning. On a short term basis, system planning and forecasting was undertaken by the DBCTPL, using its best efforts based on projected ship arrivals. However, where plans and forecasts were not met, DBCTPL was not accountable and no entity had responsibility for long term total system expansion planning.

46. The lack of governance and accountability structures in the Goonyella Supply Chain meant that each user operated separately and independently of the system. However, optimising a system component does not result in optimisation of the total system. As a result, the Goonyella Supply Chain did not operate in an efficient manner.

47. A similar result could be expected in any multi-user system including, for example, a rail line which was the subject of an access regime and had a number of third party users.

Conclusion

48. In my experience, the issues discussed above are inherent in multi-user systems such as rail networks. While in some instances these issues may be mitigated by the terms and conditions of access and the operating practices of the rail network prior to third party access, I do not believe that that they can be removed. In practice, access terms and conditions are not able to deal effectively with the number of significant and complex issues that arise from multi-user systems.

49. In addition, access terms and conditions struggle to deal efficiently or effectively with capacity expansions and investment in the infrastructure and lead to expansion and investment being inhibited or delayed.

AFFIRMED by the said deponent at)
Melbourne in the State of Victoria on this)
21st day of December 2007)
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Before me:

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An Australian legal practitioner within the
meaning of the Legal Profession Act 2004