NATIONAL
COMPETITION
COUNCIL

Hamersley Railway
Robe Railway
Goldsworthy Railway

Applications for declaration under section 44F(1) of the *Trade Practices Act 1974*

Summary conclusions and recommendations

29 August 2008

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1 Introduction

1.1 The following summary has been prepared to accompany the National Competition Council's (**Council**) final recommendations relating to the applications by The Pilbara Infrastructure Limited (**Applicant** or **TPI**) (a wholly owned subsidiary of Fortescue Metals Group (**Fortescue**)) for declaration of the:

- Hamersley Service (application of 16 November 2007)
- Goldsworthy Service (application of 16 November 2007)
- Robe Service (application of 18 January 2008).

1.2 The three final recommendations were provided to the designated Minister (Hon Wayne Swan MP, Treasurer) on 29 August 2008.

1.3 This summary covers all three recommendations and is intended to outline some of the key elements of the Council's consideration and conclusions. The summary is not part of the Council's recommendations. It is not intended to be a summary of the submissions nor a complete statement of the reasons which are contained in those recommendations.

2 The applications

Hamersley, Robe and Goldsworthy applications

2.1 In these applications, the Applicant has sought access to the rail track service provided by each of the Hamersley, Robe and Goldsworthy railways (and associated infrastructure), in order to be able to offer a rail haulage service to mining companies seeking to move bulk materials between any points on a railway, including interconnection points with other rail networks and railway lines.

2.2 The Applicant has sought declaration of *all points* services, allowing access to run trains between any places on a railway. This will enable it (or another access seeker) to offer haulage services to a range of potential customers who may wish to have ore transported from different mine locations to one or more ports accessible through use of the particular railway, possibly in conjunction with other railways or means of transport.

2.3 The providers of the Hamersley and Robe services are joint ventures or companies associated with or owned by Rio Tinto Iron Ore. The providers of the Goldsworthy Service are BHP Billiton Iron Ore and various entities owned by or associated with that company.

Other Pilbara railway applications

2.4 In 1998, the Council received an application for declaration of a service provided by the Hamersley Railway from Robe River Mining Company (**The 1998 Robe River Application**). The Federal Court found that the service sought was the use of a production process and therefore not subject to declaration. A subsequent appeal against that ruling was abandoned when Rio Tinto acquired Robe River.

2.5 In 2004-6, the Council considered an application by Fortescue for declaration of a service provided through the use of the Mt Newman Railway. This was a *point to point* service allowing transport from a rail siding near Mindy Mindy to near Port Hedland (**Mt Newman Service**).

2.6 On 23 March 2006, the Council recommended that the Mt Newman Service be declared for a period of 20 years. The Mt Newman Service was deemed not to have been declared after the then Treasurer made no decision within 60 days of receiving the Council's recommendation. On 9 June 2006, Fortescue sought review of the deemed decision by the Australian Competition Tribunal. That review is underway and a hearing is expected in the first part of 2009.

Issues regarding the applications

2.7 Both Rio Tinto Iron Ore and BHP Billiton Iron Ore raised various jurisdictional or technical issues relating to one or more of these applications.

2.8 **Jurisdiction for Hamersley Application** - Rio Tinto Iron Ore argued that the Council was bound by orders made in relation to the 1998 Robe River Application and could not consider TPI's Hamersley Application. The Council did not accept that view and on 24 December 2007, Hamersley Iron Pty Ltd (a Rio Tinto subsidiary) applied to the Federal Court for orders prohibiting the Council from considering the application. The matter was heard on 26 March 2008. The Court delivered its judgment on 5 May 2008, dismissing Hamersley Iron's application.

2.9 **Production process exception** - Rio Tinto Iron Ore and BHP Billiton Iron Ore both contend that Council does not have jurisdiction in respect of any of these applications because each of the services for which declaration is sought is the use of a production process and therefore exempt from the operation of Part IIIA.

2.10 In *BHP Billiton Iron Ore Pty Ltd v National Competition Council* (2007) 162 FCR 234, the Full Court of the Federal Court, dismissing an appeal by BHP Billiton Iron Ore, found that the Mt Newman Service was not the use of a production process. (BHP Billiton Iron Ore had appealed from an earlier Federal Court decision that also found that its Mt Newman Service was not the use of a production process and that the decision in relation to the 1998 Robe River Application was 'plainly wrong'.)

2.11 The High Court, on 29 July, heard an appeal by BHP Billiton Iron Ore against the Full Court's ruling and reserved its decision. (The Court gave no indication as to when its decision will be made, although the Council is hopeful that a decision might be delivered by the end of the 2008.)

2.12 Pending the High Court's decision the Council is required to follow the Full Court's approach. In the Council's view the circumstances of these three applications are indistinguishable from those considered by the Full Court in relation to the Mt Newman Service and, therefore, the production process exception does not apply.

2.13 **Requirement for a 'particular service'** - Rio Tinto Iron Ore submitted that because the applications provide for rail access between all points on a railway, they fail to identify a 'particular service' for which declaration is sought as required by the Trade Practices Act (**TPA**) and make it impossible to meaningfully apply the declaration criteria.

2.14 While, the Council agrees with Rio Tinto Iron Ore that applications must be made with sufficient particularity, in these cases the services for which the Applicant is seeking declaration are sufficiently described and delineated and the Council has been able make the assessments and judgments required to properly consider the applications.

2.15 **Changes or additions to the applications** - Rio Tinto Iron Ore and BHP Billiton Iron Ore submitted that Part IIIA of the TPA does not permit declaration applications to be amended and that the various amendments made by the Applicant to correct the identification of parties to the various joint ventures that own or operate the railways invalidate the applications.

2.16 In the Council's view it is appropriate to allow an applicant to provide supplementary material, particularly in circumstances where the clarification occurs early and no possible prejudice is suffered by any party. To require that an application proceed on the exact terms on which it was first submitted would not accord with the purpose of Part IIIA and would create anomalous results. The Council considers that the provision of supplementary information in the circumstances of these applications does not make them invalid.

3 Access regulation under Part IIIA

Objectives of access regulation

3.1 Generally a competitive market is the best means of determining the prices and other terms of access to the services provided by infrastructure or other facilities. Where such services are provided in markets that are effectively competitive, access is most likely to be provided where it is efficient and at appropriate prices, and regulation is unnecessary.

3.2 There are, however, a limited number of situations where participation in what would otherwise be competitive markets depends on access to a facility that cannot be economically duplicated.

3.3 In these situations competition is likely to be significantly constrained (with consequent losses in efficiency and innovation) unless mechanisms are put in place to ensure that access is available on appropriate terms. Alternatively the economy would be burdened with inefficient and wasteful duplication of costly facilities. Part IIIA provides for such mechanisms.

Submissions on access regulation policy

3.4 As part of its public consultation process the Council received a number of submissions that addressed broader policy issues relating to whether access regulation is appropriate in relation to these railways or more generally.

3.5 The Council considers that Part IIIA already accords with many of the desired policy aims expressed in the policy oriented submissions it received. Declaration is only available in limited situations and even if a service is declared, commercial negotiations over access terms and prices are the preferred means of resolving such issues. Recourse to regulation through ACCC arbitration of access disputes is only available in the event that access issues cannot be resolved through commercial negotiation. Even if a service is declared an access seeker may not get access through arbitration.

3.6 The Council is also aware of calls for the introduction of an 'efficiency override' to ensure declaration is not available where a service provider's operations would be impaired by access. However, the Council notes that the criteria for declaration already require that the Council recommend against declaration unless it is satisfied that access is not contrary to the public interest. In effect, where the Council considers that access is contrary to Australia's public interest it must recommend against declaration.

The character of regulation under Part IIIA

3.7 In the Council's view, it is vitally important to recognise the character of regulation that results from declaration. Declaration addresses a small number of situations where access to a service provided by means of a facility which cannot be economically duplicated is necessary to enable third parties to compete effectively in a dependent market.

3.8 The negotiate/arbitrate process that results from the declaration is a light handed intervention designed to maximise opportunities for commercial resolution of access issues, minimise regulatory intervention and protect the legitimate interests of service providers so as to ensure that incentives for efficient investment are

maintained. This approach only involves a regulator to the extent that parties are unable to reach a commercial agreement and then only to the extent necessary to determine a matter at issue. Declaration does not necessarily lead to regulated access through application of an ACCC arbitration determination and in any event, declaration cannot give rise to blanket regulation of the relevant services or facilities operated by a service provider.

3.9 It is important to distinguish the character of this regulation from general 'price control', 'rate of return regulation' and other broader, more intrusive, industry regulation—where access issues are likely to be only one of a range of issues and a primary focus is likely to be on restraining monopoly prices or promoting 'fair and reasonable' prices.

3.10 This distinction is illustrated in the recently enacted regime for regulation of natural gas pipelines where two forms of regulation are available—*light regulation* (involving a negotiate/arbitrate regime for settling access disputes) and *full regulation* (under which pipeline owners are obliged to submit comprehensive access arrangements for approval). The consequences of declaration are to impose a light regulatory regime similar to that under the light regulation alternative for gas pipelines.

3.11 Declaration cannot result in any change in ownership or control of a facility and the ACCC's arbitration role is governed by a range of specific statutory requirements that explicitly recognise the relevant interests of the various parties affected, including the legitimate interest of service providers in preserving their use of a service and making a commercial return on investment in infrastructure and other facilities. Part IIIA also requires a broad consideration of the public interest that includes consideration of the effects of a declaration on investment activity. In addition, the ACCC is specifically prohibited from making an access determination that would prevent an existing user (including the service provider) having sufficient capacity to meet its reasonably anticipated requirements.

4 Declaration

4.1 The Council cannot recommend that a service be declared unless it is satisfied that all of the following criteria are met:

(a) that access (or increased access) to the service would promote a material increase in 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.

4.2 The Council must also consider whether it would be economical for anyone to develop another facility that could provide part of the service and the duration of a declaration.

Criterion (a) – Promotion of competition

4.3 The Council's view is that the availability of third party access to the Hamersley, Robe and Goldsworthy services would promote a material increase in competition in the markets for iron ore haulage services on each railway and for iron ore tenements in the Pilbara, so criterion (a) is met in each case.

4.4 At present there is no haulage service available for use by parties that are independent of Rio Tinto Iron Ore or BHP Billiton Iron Ore. At best without access there would be only a single provider of iron ore haulage services on each railway. With access there is the likelihood of new entry and development of competitive haulage options enabling independent mine operators to transport ore for export.

4.5 More broadly, access would allow significantly greater opportunity for tenement owners to develop their tenements and market iron ore in their own right. It would enable participation by a greater array of potential purchasers of tenements and joint venture partners, reducing the scope for the exercise of market power in relation to the acquisition of tenements.

Criterion (b) – Uneconomical to develop another facility

4.6 The Council and the Australian Competition Tribunal have consistently found that the appropriate test for assessing whether criterion (b) is met is a social (national benefit) test that centres on identifying whether a facility exhibits natural monopoly characteristics such that a single facility is capable of meeting likely demand at lower cost than two or more facilities and therefore it is 'uneconomical' to duplicate the facility and society's resources are most efficiently used if additional facilities are not developed.

4.7 The Council is satisfied that it would be uneconomical for anyone to develop another facility to provide the Hamersley, Robe or Goldsworthy services and so criterion (b) is met in each case. The relevant railways exhibit strong natural monopoly

characteristics—such that a single rail track system is able to deliver services at lower cost than two or more track systems over a wide range of demand levels.

4.8 Even where a particular railway cannot accommodate likely demand in its current configuration, the Council is satisfied that expansion of the existing facility will involve less cost than the construction of a new facility and it is still uneconomical to duplicate the railway.

Criteria (c) and (d) – National significance, Health and safety

4.9 No party made substantive submissions in respect of whether these railways are of national significance given their size and their critical role in a major export industry. While there were some submissions raising possible safety issues, the Council is unaware of any evidence to suggest that regulation of rail safety would be made less effective as the result of access.

4.10 The Council is satisfied that both criterion (c) and (d) are met in respect of each application.

Criterion (e) – Effective access regime

4.11 The Council has considered whether any service for which declaration is sought is already subject to an effective access regime.

4.12 The **Western Australian Rail Access Regime** does not apply to any of the railways covered in these applications and while various **State Agreement Acts** provide for haulage of ore on the Pilbara railways, none of these has been certified as an effective access regime under Part IIIA. Furthermore, as noted by the Western Australian Government, 'no independent access seeker has been able to negotiate satisfactory access arrangements with the [State] Agreement companies'. In any case, any access rights provided under the State Agreement Acts are haulage rights, not rail track access rights as sought in these applications.

4.13 The Western Australian Government is considering a **proposed Pilbara Rail Haulage Regime**, which might provide for access to haulage services provided on some or all of these railways. However, at this stage the Council cannot be confident as to the content and timing of the proposed regime and considerable barriers exist to its ultimate implementation. In any event, the proposed Pilbara Rail Haulage Regime would apply to haulage services, not rail track access services.

4.14 The Council considers that it would be premature to take the possibilities arising from the proposed Pilbara Rail Haulage Regime into account, but that should such a regime eventuate and be effective it may give rise to grounds for an application for revocation of declaration of these services. Arguably, to the extent that haulage is an acceptable substitute for running trains and meets the requirements of tenement

owners to transport ore, it may be that the extra competition that would arise from access to rail track services may not be sufficient to justify declaration. Alternatively, it may be the access to rail track services would enhance the operation of the proposed regime relating to haulage services by maintaining competitive options for parties to run their own trains if haulage prices are unreasonable. At this stage, however, these issues are speculative as any regime has not been implemented.

4.15 The Council is satisfied that the applications satisfy criterion (e).

Criterion (f) – Public interest

4.16 The Council has considered the benefits and costs that are likely to result from access to the Hamersley, Robe and Goldsworthy services. In the Council's view benefits arise from:

- a material promotion of competition in the market for haulage services for iron ore on each railway and in the market for iron ore tenements in the Pilbara
- accelerated development of iron ore mines in the Pilbara by smaller mining companies and resulting additional iron ore exports
- avoiding unnecessary and inefficient duplication of railway facilities
- avoiding use of inefficient road haulage or other transport options
- avoiding additional impacts on native title rights associated with development of new railway facilities
- reduced adverse impacts on the environment.

4.17 While most of these forms of benefit will only arise in relation to a relatively small but significant component of the Pilbara iron ore industry (given that the two largest participants already have access to their own railways) the Council considers the benefits from access are significant.

4.18 In particular, where access will allow additional iron ore exports to occur, and to occur more quickly than would otherwise be the case, without reducing exports from existing sources, the benefits of access to Australia are likely to be significantly in excess of any costs. Similarly, where access allows additional mine operators to transport ore using existing railway capacity (or capacity that can be added through incrementing an existing railway rather than constructing an entire new railway) and the railway owners rights are properly addressed, there are significant benefits for Australia.

4.19 The Council has also considered the costs of access suggested by Rio Tinto Iron Ore, BHP Billiton Iron Ore and other parties making submissions including:

- costs and feasibility of expanding the various railways

- regulatory costs
- loss of production
- deterring or delaying optimisation of rail operations
- deterring or delaying efficient investment
- environmental costs
- loss of 'facilities-based competition'
- diseconomies and inefficiencies of multi user systems compared to single user systems
- impacts of regulation.

4.20 More generally the Rio Tinto Iron Ore, BHP Billiton Iron Ore and other submissions which drew on the companies' claims that declaration would be contrary to the public interest, suggested that access will convert single vertically integrated infrastructure operations into regulated multi user facilities with 'inevitable losses in efficiency'. Rio Tinto Iron Ore and BHP Billiton Iron Ore illustrated this loss in efficiency with repeated references to comparisons between what they see as the effective response of their iron ore export facilities to the sudden upturn in demand from China and the uncoordinated and ineffective response of eastern Australian coal exporters.

4.21 The Council fundamentally disagrees with the view of the service providers and their consultants that access to Pilbara railways under Part IIIA would transfer the apparent problems of the east coast coal industry to the Pilbara iron ore industry. The reasons for the problems in Australia's east coast coal industry are varied and complex and there is no single explanation for the apparently poor performance of the east coast coal industry in responding to a sudden unexpected increase in demand. Notably no service or facility in the east coast coal supply chain is declared under Part IIIA. There are some common features of this industry and the Pilbara iron ore industry—for example they both involve relatively complex logistics—but there are a range of differences—for example:

- in relation to the east coast coal facilities there is extensive government ownership involvement and complex leasing arrangements, whereas the Pilbara railways are privately owned and operated and will remain so even if some services provided by such facilities are declared
- east coast facilities are operated under a range of cooperative mechanisms or under operational separation rules, whereas the Pilbara railways are operated by their major users—a situation that will remain unchanged in the event of declaration
- east coast facilities generally serve a significant number of users, whereas even with declaration the Pilbara railways will have a single dominant user and only a small number of other likely users

- Pilbara railways are (and will continue to be) operated as part of vertically integrated arrangements (spanning mines, rail track services, above rail operations, ports and in some cases shipping) but vertical integration is rare in the east coast coal supply chain
- east coast facilities are regulated under comprehensive access arrangements (requiring approval of reference tariffs or revenue caps, valuation of a regulatory asset base and approval of investments that will add to that base and in some cases mechanisms to ration limited capacity), even with declaration the Pilbara railways would only become subject to a light handed negotiate/arbitrate regime.

4.22 No party arguing against declaration acknowledged or considered the specific characteristics of regulation of services declared under Part IIIA, the ongoing vertical integration and dominant role of the existing service providers and the safeguards for service providers,[1] or explained how the very significant costs alleged to arise from Part IIIA access could occur despite those safeguards.

4.23 When proper consideration is given to the safeguards in Part IIIA against adverse outcomes from access in specific situations, the Council considers the costs of access that are not adequately dealt with through the arbitration process are likely to be low.

4.24 In its consideration of criterion (f), the Council gave careful consideration to the legal opinion submitted by BHP Billiton Iron Ore regarding the powers of the ACCC to determine access disputes. BHP Billiton Iron Ore submitted that as a consequence of the conclusions in this opinion, the ACCC is unable to order an expansion of a facility to accommodate access seekers and therefore criteria (a), (b) and (f) cannot be satisfied.

4.25 The Council sought an opinion on the relevant ACCC powers from the Australian Government Solicitor. The Council acknowledges that there are differences of legal opinion on the extent of the ACCC's powers. However, it considers that the narrow interpretation of the ACCC's powers submitted by BHP Billiton Iron Ore is far from being clearly correct, such that the Council might be unable to be satisfied that particular declaration criteria are not met. The Council considers that interpretations of the ACCC's powers that are consistent with the objects of Part IIIA, and that are open, are to be preferred.

[1] Part IIIA contains a range of provisions governing the arbitration of access disputes and specific limitations on arbitration determinations by the ACCC which are designed to ensure the availability, prices and other conditions of access balance the interests of service providers and access seekers and achieve a positive national benefit. Service providers and other existing users of the services of declared facilities are given priority in a range of situations.

4.26 The Council considers that the likely benefits of access to the services provided by each railway will outweigh the likely costs, and access is not contrary to the public interest. The Council is satisfied that these applications satisfy criterion (f).

Section 44F(4) – Developing another facility for part of the service

4.27 In relation to the Finucane Island section of the Goldsworthy Railway and the eastern section of the Robe Railway, the Council considered whether congestion on these sections of railway, and the costs and limits on further expansion might require the development of a new facility to provide these parts of the Goldsworthy and Robe services respectively. It is not clear to the Council that the likely costs of any necessary expansion of these particular sections of railway are such that it is economical to develop an alternative facility to provide those parts of the relevant services. Even if this were the situation, this would not necessarily give rise to situations where the Council should not recommend declaration when the declaration criteria are otherwise met.

Duration of declaration

4.28 Section 44H(8) of the TPA requires that if the designated Minister declares the service, the declaration must specify the expiry date of the declaration. The Council considers that 20 years would provide sufficient certainty for all parties to undertake investment and implement other decisions in response to declaration.

4.29 The Council considers that a shorter declaration period is unlikely to provide sufficient certainty for potential users or their mine operator customers. The Council notes, however, that any declaration can be revoked on the recommendation of the Council. The Council may make such a recommendation if it considers that the declaration criteria are no longer met. This would allow the Council to reconsider declaration in the event of a significant development that impacted on the basis for its recommendation. For example, if the proposed Pilbara Rail Haulage Regime was implemented and effective, the Council could revisit whether criteria (a) and (f) continue to be satisfied.

5 Recommendations

5.1 The Council recommends that the Hamersley, Robe and Goldsworthy services be declared for a period of 20 years.

National Competition Council
29 August 2008