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John Feil
Executive Director
National Competition Council
Level 9, 128 Exhibition Street
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By email: john.feil@ncc.gov.au

Dear Mr Feil

Draft recommendations on TPI's applications

The Pilbara Infrastructure Pty Ltd (**TPI**) provides the following short submission in response to the National Competition Council's (**Council's**) draft recommendations of 20 June 2008 in respect of TPI's applications for declaration of:

- the service provided by the use of the Hamersley Rail Network;
- the service provided by the use of the Robe Railway; and
- the service provided by the use of the Goldsworthy Railway.

TPI agrees with the Council's conclusions on the declaration criteria in each of the draft recommendations and with the Council's ultimate conclusion to recommend declaration of each of the services for a period of 20 years.

TPI does however make the following comments in respect of the Council's view in each of the draft recommendations that the global iron ore market is effectively competitive.[1]

Iron ore market is not effectively competitive

TPI submits that the global supply of iron ore is properly considered as sea-borne iron ore supply as distinct from captive iron ore supply. This is on the basis that captive iron ore supply could not respond to a price increase by a single sea-borne supplier. On a geographical basis sea-borne supply forms

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[1] Hamersley Railway Draft Recommendation at [4.30]; Robe Railway Draft Recommendation at [4.30]; Goldsworthy Railway Draft Recommendation at [4.33].

two international markets - an Asia Pacific basin market and an Atlantic basin market. TPI also submits that there is a domestic Australian market.

However, even if the market is defined on a broader basis as a global market for iron ore, that market is not effectively competitive. This is because, however the geographic market is defined, distance affects competition and prices for iron ore. TPI submits that this is true of any market where the cost of freight is a significant component of the delivered cost as is the case for iron ore.

The effect of distance on competition in the market for iron ore (however defined) is illustrated by the recent 85 percent price increase negotiated by Rio Tinto Limited (**Rio**) with Chinese buyers. Rio achieved prices for fines of US cents 144.66 per dry metric tonne unit and lump of US cents 201.69 per dry metric tonne unit, thus achieving a price increase of 96.5 percent for its lump ore and 79.88 percent for its fines,[2] being a weighted average increase of 85 percent. BHP Billiton Limited (**BHP Billiton**) reached an agreement with Boasteel for the same price increase[3] although made public statements to the effect that the increase should have been even greater.[4]

The increase achieved by Rio and BHP Billiton in the price negotiations is significantly greater than the 67 percent increase (being a tonne weighted average of 65 per cent for southern system fines and 71 per cent for northern system fines) achieved by Brazilian supplier Vale in its price negotiations with Asian suppliers in February this year. This means that Rio was able to negotiate a further 29.5 percent increase in the price of lump above the average price increase achieved by Vale and a 14.88 percent increase in the price of fines above what Vale was able to achieve with its more comparable southern system fines. It could be said that this is clear evidence of separate Asia Pacific and Atlantic basin markets.[5]

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[2] Rio Press Release of 1 July 2008, 'Rio Tinto announces further iron ore price settlements'.

[3] BHP Billiton News Release of 4 July 2008, 'BHP Billiton agrees iron ore prices with Baosteel, China'.

[4] Jo Clarke 'BHP hits out at Rio over price', Australian Financial Review, 25 June 2008. Fortescue Metals Group Limited's contract prices are set annually with reference to the agreed benchmark price for Rio and BHP Billiton. Accordingly, Fortescue's benchmark price will at the same benchmark price as that recently negotiated by Rio and BHP Billiton.

[5] That Rio has achieved price differences of this magnitude has effectively performed the standard market definition test. Rio and BHP have achieved a price increase that exceeds a small but significant non-transitory increase in price. The price increase normally used for a SSNIP is 5 to 10 per cent.

However, whatever market definition is adopted the price differences demonstrate that the cost of shipping iron ore from Brazil enables Australian suppliers to price up to a limit set by the delivered cost of supply by Vale. It is clear that Vale is not an effective competitor in the Asia Pacific region. If it was, Rio and BHP Billiton could not have achieved such a difference in prices.

TPI also submits that it is instructive that BHP Billiton plans to supply European iron ore customers at a lower price than its Asian customers.[6] The ability of Australian producers to engage in price discrimination in this way is another indicator that Australian suppliers have market power.

Another demonstration of ineffective competition and the exercise of market power is where customers are relatively unresponsive to changes in price. This is clearly the case in the markets for iron ore. Asian customers have had little ability to respond in any meaningful way to the recent price rises, particularly given their high demand for iron ore.

If a global sea-borne iron ore market definition is adopted then that market is highly concentrated with three major iron ore producers and exporters; BHP Billiton, Rio, and CVRD produce approximately three quarters of the sea-borne supply of iron ore. But this does not fully capture the effects of distance and the cost of iron ore freight in such a market. Certain parts of such a market will have less effective competition than others. If BHP Billiton's proposed takeover of Rio goes ahead, the global sea-borne market will be even less competitive than at present. The Asian Pacific region (whether seen as a separate market or not) will be affected to an even greater degree.

Access will promote competition in the market for iron ore

Given the market for iron ore, however defined, is not effectively competitive TPI submits that access to each of the services will promote competition in the market for iron ore by increasing the potential for supply. Because competition from other Pilbara based miners will have the same geographical advantage from which BHP Billiton and Rio clearly benefit they will have a greater affect on competition than suppliers such as Vale for which freight costs to Asia are substantial.

[6] Jo Clarke, "BHP, Rio take different roads to Europe" Australian Financial Review, 9 July 2008.

Please contact me if you have any questions or wish to discuss this submission.

Yours sincerely
The Pilbara Infrastructure Pty Ltd

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