

RIO TINTO

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**SUBMISSION TO THE
HON CHRIS PEARCE MP, PARLIAMENTARY
SECRETARY TO THE TREASURER, PARLIAMENT
HOUSE, CANBERRA**

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1. BACKGROUND AND CONTEXT

1.1 Introduction

1. This submission is made in connection with the final recommendation (**Final Recommendation**) by the National Competition Council (the **Council**) to the Designated Minister (the **Minister**) under Part IIIA of the *Trade Practices Act 1974* (Cth) (**TPA**) in relation to the application dated 11 June 2004 (**FMG's Application**) by Fortescue Metals Group Limited (**FMG**) for declaration of a service including that provided by the Mt Newman railway line (the **Service**) operated by BHP Billiton Iron Ore Pty Ltd (**BHPBIO**).
2. According to the announcement posted on the Council's website on 27 March 2006, the Minister is to make a decision on the matter by 22 May 2006. Rio Tinto Iron Ore (**RTIO**) urges the Minister, in making the decision, to take into account the matters raised in this Submission.

1.2 RTIO

3. RTIO is the division of the Rio Tinto Group with responsibility for Rio Tinto's iron ore interests. Its Australian interests include the Pilbara iron ore mines operated by Hamersley Iron Pty Limited (**Hamersley**) (100% owned by Rio Tinto) and Robe River Iron Associates (**Robe**) (53% owned by Rio Tinto), and the infrastructure servicing these mines, including the associated rail networks and ports at Dampier and Cape Lambert.
4. The Hamersley operating mines are: Mount Tom Price, Paraburdoo, Channar, Marandoo, Yandicoogina, Eastern Range and Brockman No. 2. Hamersley has also recently agreed to a joint development of the Hope Downs deposit with Hancock Prospecting Pty Ltd. The Robe operating mines are Mesa J and West Angelas. Product exported from the Hamersley and Robe mines totalled 143 million tonnes (**mt**) in 2005. Capacity has recently been expanded from 130mt to in excess of 170mt and an expansion programme is now underway to increase capacity to almost 200mt by the end of 2008.

1.3 Lack of transparency

5. According to the Council's announcement on its website, it is not intended to publish the Final Recommendation until after the Minister has made the decision. It is unsatisfactory that at this vital stage interested parties have not been given access to the Final Recommendation. The issues involved, and the consequences that will flow if the Service is declared, are so significant that the decision should not be made without the benefit of submissions that are directly responsive to the Council's position as set out in the Final Recommendation. This is particularly the case in this matter, where to date the Council has taken positions that appear to RTIO to be difficult to sustain. The public process at least allowed those parties, which vehemently disagreed with these positions, to respond. That opportunity is now not available at the final and most important phase of the process.

1.4 Nature of submission and assumptions

6. Given the importance of the matter, RTIO has no option but to make a submission based on its understanding of the Council's views, as reflected in the draft recommendation of the

Council published in November 2005 (the **Draft Recommendation**) and in subsequent publications, such as the report of G13 & Associates Pty Ltd (the **G13 Report**) released by the Council late in February 2006.

7. First it is assumed that the Council has not changed its position substantially from that adopted in the Draft Recommendation and that the Council still recommends that the Service provided by the Mt Newman railway line, from a point near the Mindy Mindy prospect to Port Hedland, be declared under Part IIIA of the TPA.
8. Secondly it is assumed from instructions apparently given by the Council to the authors of the G13 Report (see paragraph 4.3.6 of the G13 Report) that the Council has now formed the view that the level of demand for the Service from Mindy Mindy and other non-BHPBIO parties is no more than 10 million tonnes per annum (**mtpa**) (5mtpa from Mindy Mindy and 5mtpa from others). This would be a reduction in the demand assumed by the Council, in paragraphs 6.76 – 6.78 of the Draft Recommendation, where the Council anticipated 10mtpa from Mindy Mindy and unspecified demand from other 'junior explorers'.
9. This demand assumption must also entail an assumption that FMG will rail its ore from its Chichester deposits (Cloud Break, Christmas Creek, Mt Lewin and Mt Nicholas) on its own railway line (which is to run parallel to the Mt Newman railway line for about 200 kilometres (**km**)) (the **Chichester Line**), as consistently announced to the market by FMG.
10. Although it is unsatisfactory that RTIO has to speculate, this Submission is prepared on the basis of assumptions that the Final Recommendation is to the following effect:
 - that the Service be declared from a point near Mindy Mindy to Port Hedland;
 - that the demand for the Service will be limited to 10mtpa; and
 - that the ore from FMG's Chichester deposits will not utilise the Service.
11. The ineffectiveness of any limitation of the demand for the Service is discussed further in section 2.2 below. However, the fact that the Council appears now to have constrained demand for the Service demonstrates the sensitivity of the Council to the fact that the Service is unlikely to satisfy the declaration criteria unless the demand is limited. If a declaration depends for its efficacy on a limitation on the demand for the Service, it demonstrates how inappropriate and risky it is to declare the Service under Part IIIA.
12. In making this Submission, RTIO will refer to its previous submissions to the Council. The previous RTIO submissions (all of which are published on the Council's website) are as follows:
 - October 2004 (in which RTIO submits that the Council does not have jurisdiction because the 'production process' exception applies) (the **Production Process Submission**);
 - 6 May 2005 (in which RTIO submits that the Mt Newman railway line should not be declared because it does not satisfy the criteria for declaration set out in section 44G(2) of the TPA) (the **Criteria Submission**);
 - 5 December 2005 (in which RTIO submits that the Draft Recommendation, in which the Council concluded that the declaration criteria were satisfied, is flawed and in error) (the **Draft Recommendation Submission**); and

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- 10 March 2006 (in which RTIO responds to the G13 Report) (the **G13 Submission**).
13. In considering this Submission the Minister should bear in mind that the Service to which access is sought is use of the railway track (ie, a service where the access seeker would provide its own trains, drivers etc and use the owner's railway track (**track access**)) and not a freight carriage service (ie, a service where the owner of the railway carries a third party's freight on the owner's trains (**freight carriage**)). BHPBIO is already obliged to provide freight carriage services under its State Agreements¹, discussed further below.
 14. Another key point to note at the outset is that the issue of whether the Council and the Minister have the jurisdiction to declare the Service is currently before the Federal Court of Australia (the **Federal Court**). In these proceedings, the Federal Court is to consider whether the Service is exempt on the basis that it is part of a production process. The matter has not yet gone to trial. In 1999 the Federal Court found that the Hamersley facility was exempt on the basis that it was part of a production process.²

¹ Namely, the Mt Newman (Iron Ore) State Agreement between the State of Western Australia and the Mount Newman Participants (enacted as the *Mount Newman (Iron Ore) State Agreement Act 1964* (WA)) (the **BHPBIO State Agreement**) and the Rail Transport Agreement between the State of Western Australia and the Mt Newman Participants signed on 27 January 1987 (the **RTA**).

² *Hamersley Iron Pty Ltd v National Competition Council* (1999) 164 ALR 203 (the **Hamersley Decision**).

2. PRELIMINARY ISSUES

2.1 Production process

15. RTIO is firmly of the opinion that neither the Minister nor the Council has the jurisdiction to determine FMG's Application. This is because the Mt Newman railway line is part of BHPBIO's integrated production process and, according to the law as established in the Hamersley Decision, any service involving the use of the Mt Newman railway line is not a 'service' as defined in section 44B of the TPA.
16. This matter was the subject of extensive submissions in October 2004, when RTIO lodged its Production Process Submission. In this submission, RTIO pointed out that, in all relevant respects, the process described by BHPBIO was a 'production process'. RTIO was particularly interested in this aspect of FMG's Application, as it was Hamersley's rail facility that had been declared by Justice Kenny, in the Hamersley Decision, to be exempt from declaration, in 1999, on the basis that it was part of Hamersley's production process.
17. In its Draft Recommendation, the bases on which the Council found that the Mt Newman railway line could be distinguished from the Hamersley railway line, and thereby decided that the Mt Newman railway line was not a part of BHPBIO's production process, were flawed. There were two bases:
 - because there was a technical sale of product from one of BHPBIO's joint ventures to another prior to railing, this demonstrated that the product was 'marketable' and therefore that the 'production process' had finished before railing, notwithstanding that crushing and blending to create the product intended for ultimate sale to the customer occurred after railing; and
 - because one out of ten BHPBIO products was claimed by the Council to technically be in its finished state before railing, the Council found that the production process had finished prior to railing.
18. It is submitted that both of these bases, for deciding that the Mt Newman railway line is not part of BHPBIO's production process, are seriously flawed. A production process cannot cease to be a production process simply because one of the constituent parts can be sold separately prior to being assembled as a component of the final product being manufactured (eg, in a motor vehicle production line, each of the parts assembled to produce the vehicle can be and is sold separately, but no-one could claim that the motor vehicle assembly line is not a production process). Similarly, a process does not cease to be a production process simply because one out of ten products reaches its finished state prior to the end of the process. The error in the Council's approach can be seen again from the motor vehicle production line analogy. Assume the production line produces utility vehicles, one tenth of which are to be sold as 'cab/chassis' vehicles without a tray and nine tenths of which are to be sold as 'traybacks'. If the last step in production is the fitting of the tray and the production line is so organised that a tray is not fitted to every tenth vehicle on the production line, the process that continues after the vehicles reach the cab/chassis stage could not be characterised other than as a production process.

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19. The Minister is required to satisfy himself that he has jurisdiction before making a determination.³ It is unfortunate that the situation has arisen where that has become necessary. Given the precedent set by the Hamersley Decision, it is RTIO's view that the Council should have deferred consideration of FMG's Application pending an outcome from the Federal Court 'production process' proceedings. However, the Council has pressed ahead and dealt with the substance of FMG's Application, notwithstanding that this threshold issue remains undetermined and the subject of court proceedings. As a result, the Minister is now in the position of having to decide whether he has jurisdiction, in the knowledge that the Federal Court will make a future determination on the issue.

2.2 The Service to which access is sought

20. As noted at paragraph 11 above, it is assumed that the Council has recommended declaration of the Service on the basis that:
- (a) the total demand for the Service is up to 10mtpa and total use of the Service is therefore limited to that quantity; and
 - (b) in particular, the ore from FMG's Chichester deposits will not utilise the Service.

It is not known how or if the Council recommends that these two limitations be implemented, but it is RTIO's submission that they **cannot** be achieved.

21. If the 'Service' has been redefined in some way, such that the Council believes that either in practice or by law this limitation will apply, it is submitted that such a limitation cannot be effective. Section 44F(1) of the TPA makes it clear that the 'particular service' to be declared is the service described in the relevant application. The Service over which a declaration was sought in FMG's Application was the Service provided by two facilities, namely a 295km section of the Mt Newman railway line and a 17km section of the Goldsworthy railway line (paragraph 5.1 of FMG's Application). The Council has decided that it will only deal with the Service provided by the Mt Newman railway line because it decided that, consistent with the Hamersley Decision, it had no jurisdiction in respect of the Goldsworthy railway line. Apart from the fact that RTIO believes the same position applies with respect to the Mt Newman railway line (discussed at paragraphs 15 to 19 above), the Council has no basis to redefine the Service by reference only to a part of the facility described in FMG's Application.
22. However, if the Council has gone even further by recommending that the Service to be declared is limited as to annual tonnage, or so as to exclude ore that might access the Mt Newman railway line at a point closer to Port Hedland than the Mindy Mindy siding (as would occur if FMG's Chichester ore were to utilise the Service), this limitation would be ineffective. Not only is there no basis in Part IIIA of the TPA for the Council or the Minister to impose such limitations, but it was clear from FMG's Application that access to the Service was being sought for the possible railing of its Chichester ore as well as railing its

³ As Kenny J explained in the Hamersley Decision: 'On any view the Council is obliged to satisfy itself that the 'Service' to which access is sought does not include any matter in paragraphs (d), (e) and (f) of the definition of service, including 'the use of a production process'. Some preliminary factual enquiry, which may, depending on the circumstances, raise complex issues is unavoidable' (Hamersley Decision, paragraph 58).

Mindy Mindy ore. For example, in paragraph 7.3(5) of FMG's Application, FMG stated that it required access:

... to increase the options available to FMG when determining the optimum method of transporting FMG's iron ore and iron ore products from Chicesters (sic) to Port Hedland.

23. Whilst RTIO queried the appropriateness of this purpose, given FMG's consistent announcements that it intends to build its own railway line to service its Chichester deposits irrespective of the outcome of FMG's Application (paragraphs 2.15 – 2.17 of RTIO's Criteria Submission), the purpose was nevertheless set out in FMG's Application, which defined the Service to which access was sought.
24. It is therefore not open to the Minister to seek to limit the Service. Any purported limitation to this effect is likely to be challenged and the limitation is likely to be declared invalid. Thus, if the Minister declares the Service provided by the Mt Newman railway line, he cannot be satisfied that the demand for the Service will not extend beyond 10mtpa.
25. The essence of a declaration under Part IIIA is that the service is declared for **all** third parties subject only to terms and conditions being agreed or determined. In this matter, neither the Council nor anyone else can accurately predict the extent of the demand over the period of declaration. It is instructive to note that, after talking to 'junior explorers' on a confidential basis, the Council predicted, at paragraph 6.78 of the Draft Recommendation, that the extra demand beyond Mindy Mindy could be up to 40mtpa and indicated that at least some of this could be from 'junior explorers'. Other paragraphs of the Draft Recommendation where the Council stressed the potential third party demand beyond Mindy Mindy include paragraphs 6.74, 6.76, 7.183, 7.190, 7.194, 7.208, 7.209, 11.26 and 11.27.
26. It is therefore not possible for the Council now to credibly claim that the demand will be limited to 5mtpa from Mindy Mindy (noting that this demand was estimated to be 10mtpa in the 'Public Environmental Review' lodged by FMG with the Western Australian Government in respect of the 'Pilbara Iron Ore and Infrastructure Project: Stage A Port and North-South Railway' dated September 2004) and 5mtpa from other potential producers.
27. The potential must also be recognised for FMG to change its plans to build an independent railway line and instead to rail its ore on the Mt Newman railway line. FMG has made seemingly inconsistent statements to the market on the one hand (stating it will build the Chichester Line irrespective of the outcome of FMG's Application) and to the Council (suggesting other outcomes, see below). Whilst RTIO has contended that FMG's conduct should be assumed to be consistent with its market announcements, the Minister cannot ignore the fact that FMG has foreshadowed the prospect of utilising the Mt Newman railway line for railing from its Chichester deposits, if the Service were declared, in the following FMG Submissions to the Council:
 - 6 May 2005:
 - paragraph 3.9:

If Fortescue is successful in its efforts to have the Facility declared, it is entirely possible it will not be necessary for Fortescue to build those sections of its

proposed railway line that will run in close proximity to the Facility. Instead, Fortescue would seek to use the Facility.

- 5 December 2005:

- paragraph 2.8:

- However, a successful declaration of the Mt Newman Service under Part IIIA of the TPA would require Fortescue to seriously reconsider and deliberate as to whether the Mt Newman facility could accommodate the product that Fortescue intends to mine in the Chichester Ranges.

- paragraph 2.10:

- If acting in the best interests of its shareholders involves utilising the Mt Newman Service as a substitute for its main railway, then Fortescue would seek to do so.

28. Therefore, any observations by the Council in the Final Recommendation that depend for their efficacy on the demand being limited to 10mtpa must be disregarded. At paragraphs 6.171 to 6.173 of the Draft Recommendation the Council relied on limited demand for the facility to downplay the interface costs and diseconomies that would be inflicted by multiple usage (notwithstanding that in other parts of the Draft Recommendation the Council forecast substantial third party demand). The reality is that no-one can accurately predict the demand and the Minister must proceed on the assumption that, if the facility were declared, it could be utilised by FMG for up to 70mtpa (10mtpa from Mindy Mindy and 60mtpa from its Chichester deposits) and by other users for an unknown volume.

2.3 The consequences of demand assumptions/limitations

29. It is imperative that the Minister makes a decision on the extent of demand that he will forecast for the Service and the effectiveness of any limitation before he assesses FMG's Application against the criteria in section 44H(4) of the TPA. If, as envisaged in paragraph 11 above, the Council has sought to limit the availability of the Service to 10mtpa of ore, and that it will not be available for FMG's Chichester ore, then the Minister needs to consider the matters set out in paragraphs 20 to 28 above and decide either that such a limitation is effective, or that demand for and utilisation of the Service could exceed 70mtpa (as set out in paragraph 28).
30. If the Minister makes this decision at the outset and consistently applies it, then FMG's Application must fail on either basis.
31. If the Minister decides that the Council's proposed limitation is effective, then two consequences follow:
- (a) The FMG Chichester Line must be built to transport FMG's Chichester ore and approximately 200km of the Mt Newman railway line will be duplicated. In terms of Part IIIA, the effects of this are:
 - (i) that the only demand for the Mt Newman railway line Service will be to serve as a spur line to link Mindy Mindy with the FMG Chichester Line; and
 - (ii) given the limited cost of a spur line the Minister cannot be satisfied that it is 'uneconomical to develop another facility to provide the service'.

Criterion (b) therefore cannot be satisfied. This is explained more fully in paragraphs 44 to 52 below.

- (b) If the Service will only serve such a small tonnage then the producers will only be interested in a freight carriage service (which could be provided by BHPBIO under the BHPBIO State Agreement) as such a small tonnage will not warrant the purchase and operation of trains. Further, if the tonnage is so limited, it is inconceivable that this quantity could have any impact on competition in the asserted rail haulage and iron ore tenements market (which the Council has claimed will be impacted by declaration of the Service). There will either be no impact on competition (assuming no producer utilises such a limited service) or there will be a trivial impact. Accordingly Criterion (a) cannot be satisfied. This is explained more fully in paragraphs 77 to 86 below.
32. In addition, even if the demand is limited to 10mtpa, turning a facility from a single user facility to a multi-user facility would still result in significant diseconomies (discussed in paragraphs 59 to 71 below). The Minister therefore cannot be satisfied that declaration would not be contrary to the public interest. Accordingly the Service should not be declared, on the basis that Criterion (f) cannot be satisfied.
33. If the Minister decides to adopt the position proposed in paragraph 28 above (ie, accept that there can be no basis for so limiting the tonnage and assume that the demand could extend to in excess of 70mtpa with FMG's Chichester ore included), then RTIO considers that at least Criteria (b) and (f) cannot be satisfied. In its Final Recommendation, the Council presumably relies on the limited demand as a means of downplaying the diseconomies and interface costs that will be incurred. If there is 70mtpa or more of third party ore being transported on the Mt Newman railway line, the diseconomies will be very substantial and the impacts outlined in paragraphs 59 to 71 below are virtually certain to occur. Further the Council has not conducted any analysis of the costs of providing track access for FMG's Chichester ore because it expressly excluded this scenario from the instructions that it gave to G13 & Associates Pty Ltd for the purpose of the preparation of the G13 Report. There is therefore no basis, in terms of the analysis under Criteria (b) and (f), for the Minister to be satisfied that the costs of sharing are lower than the costs of building and operating a separate facility when demand is in excess of 70mtpa.

3. CRITERION B – UNECONOMICAL TO DEVELOP ANOTHER FACILITY

34. Section 44H(4)(b) of the TPA provides that the Minister cannot declare a service unless he is satisfied:
- ... that it would be uneconomical for anyone to develop another facility to provide the service.
35. There are numerous issues that arise in relation to this Criterion. In summary they are as follows:
- The section means what it says – whether it is **uneconomical** (in the ordinary sense of the word – ie, could private investment in another facility be justified) for **anyone** to develop another facility to provide the service. Instead of applying the ordinary meaning of 'uneconomical', however, the Council applies a 'natural monopoly test', which asks whether it would be cheaper to share the relevant facility or build a separate facility. This approach is flawed. The section does not ask whether it is **less economical** or **economically less efficient** to build another facility; it simply asks whether it is **uneconomical** to develop another facility. Not only is this interpretation supported by the ordinary meaning of the subsection, but the economic rationale for such an interpretation is supported by eminent economists such as Professor Baumol from New York University and Professor Kalt from Harvard University.
 - Even if a natural monopoly test does apply, it has been wrongly applied in this instance. FMG has announced that it intends to build its Chichester Line irrespective of the outcome of FMG's Application and the Council has apparently issued its Final Recommendation on the basis that the Chichester Line will be built (as it seems to have excluded any demand for the Service in respect of ore from FMG's Chichester deposits). Therefore the situation being assumed is that, for some 200km, the Mt Newman railway line will in fact be duplicated by FMG's Chichester Line. In these circumstances it is inconceivable that the Minister could be satisfied that, at least for the 200km of duplication, '... it would be uneconomical for anyone to develop another facility to provide the service'. Professor Ordovery from New York University and Professor Willig from Princeton University support this position. Professor Ordovery is the expert upon whom the Council has previously relied for the use of its natural monopoly test. The only section of the Mt Newman railway line that could therefore conceivably satisfy Criterion (b), is that section that could be used by Mindy Mindy as a spur line to enable Mindy Mindy ore to be railed to the nearest point where it could be diverted onto FMG's Chichester Line. Not only is this scenario supported by economic theory, but it is the only practical scenario. Mindy Mindy on its own will not justify the investment in and operation of independent trains. Accordingly, it will only utilise a rail track service if its trains are part of FMG's rail system. In such event the trains will divert to FMG's less congested Chichester Line at the first opportunity so as to avoid paying unnecessary access fees to BHPBIO and to enhance operational flexibility within FMG's rail system. Therefore, if any natural monopoly analysis is

undertaken, it should be confined to the approximately 80km section of the Mt Newman railway line that could be used as a spur line (the ***Mt Newman Spur Portion***). This section of the Mt Newman railway line is highlighted on the map, attached in Annexure A, which also depicts FMG's proposed Chichester Line (marked in blue and purple) and the Mt Newman railway line (one of the railway lines marked in green).

- In any event, even if a natural monopoly test is applied, Criterion (b) cannot be satisfied, whether the analysis is confined to the Mt Newman Spur Portion or the entire Mindy Mindy to Port Hedland section of the Mt Newman railway line. Independent modelling demonstrates that the direct costs of sharing the relevant section of railway line are greater than FMG's estimates of the cost of building an alternative facility. When the interface costs and diseconomies that necessarily flow from a single user facility being converted into a multi-user facility are added to these direct costs, there is overwhelming support for the conclusion (as explained in paragraphs 59 to 71 below) that it is not cheaper or economically more efficient to share the Mt Newman railway line than to build and operate an independent facility over the relevant distance.

36. RTIO has delivered to the Council extensive submissions and expert opinions in relation to each of the above issues. These are in section 6 and Annexures A to E of RTIO's Criteria Submission, section 3 of RTIO's Draft Recommendation Submission, and sections 2 and 3 of RTIO's G13 Submission. Whilst RTIO does not intend to traverse the issues in the same detail, for the assistance of the Minister, the substance of each issue is further amplified below.

3.1 'Uneconomical' means what it says

37. The Council has developed its own interpretation as to what is meant by the term 'uneconomical'. The Council takes the view that Criterion (b) requires an analysis as to whether the relevant facility exhibits natural monopoly characteristics (ie, whether it can serve the range of reasonably foreseeable demand for the services provided by the facility at less cost than that of two or more facilities (see paragraphs 5.2 and 5.3 of the Issues Paper published by the Council on 11 March 2005)).
38. An interpretation of this nature requires a very strained reading of section 44H(4)(b) of the TPA. The section does not ask whether it would be **more** economical or whether it would be economically **more efficient** to use the same facility. It simply asks whether it would be 'uneconomical' for anyone to develop another facility. The natural meaning of these words is whether it would not be economically feasible, using normal investment criteria, to build another facility. In contrast, at section 44X(1)(g) of the TPA, the term 'economically efficient' is used, demonstrating that the draftsman drew a distinction between the expressions 'economically efficient' and 'economical'.

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39. This ordinary interpretation of the section is consistent with the test applied in the United States in connection with the 'essential facilities doctrine', upon which Part IIIA is based.⁴ Under this regime access is only mandated if the facility cannot be practically or reasonably duplicated. In other words, it only applies when there is an actual bottleneck that cannot in practice be overcome.
40. Moreover, as Professors Baumol and Kalt attest, there is a sound economic and public policy rationale for this test. The market will always find the most efficient result if the facility can in fact be duplicated. The cost of duplication sets the ceiling as to the price the access seeker will pay. If access cannot be obtained at below this price then it is likely that the true cost is higher. An outcome that is dictated by market forces is much more likely to be sustainable and fair than one 'mandated' by government. As Professor Baumol points out:
- To mandate access in such a situation runs the risk, not only of second guessing the market as to the true cost of access (and hence whether it would be 'more efficient' to use another facility than to share), but also of encouraging into the market an inefficient operator who needs subsidization to survive.⁵
41. In applying section 44H(4)(b) the Minister needs to be satisfied that he is applying the section properly. If the Minister decides that he will adopt the ordinary and natural meaning of the section then he will need to address whether it would be economical for a private investor to build another facility for transporting iron ore from the iron ore province in the vicinity of Mindy Mindy to the coast for shipment to overseas customers (which facility need only provide a link to FMG's Chichester Line – discussed at paragraph 57 below). Given the Council's determination to apply a natural monopoly test, it is unlikely that the Council will have provided the Minister with material for him to make this determination.
42. The facts, however, speak for themselves. Both RTIO and BHPBIO have railway lines from the Pilbara region to the coast and FMG has announced that it will build another from its Chichester mines to Port Hedland.⁶ It is therefore impossible to conclude that it would be uneconomical for **anyone** to build another facility to provide the Service. The Pilbara, being a remote region, does not present the same barriers that exist in more densely populated areas, such as the east coast of Australia, that make the construction of a new railway line practically and economically unattainable.
43. Therefore, on this basis alone, the Minister should decide that Criterion (b) has not been satisfied.

⁴ Report by the Independent Committee of Inquiry into National Competition Policy for Australia, August 1993 (the **Hilmer Report**).

⁵ Annexure B, Criteria Submission, page 6.

⁶ For example, after the release by the Council of its Draft Recommendation FMG announced that '[t]he positive recommendation does not affect Fortescue's firm intention to build its own railway from Anderson Point at Port Hedland to its Chichester Range deposits...' (Positive NCC Recommendation of Declaration of BHPB Rail Line', announcement by FMG to the ASX, 4 November 2005).

3.2 Criterion (b) cannot be satisfied for duplicated section

44. As noted above, FMG has consistently announced to the market that it will build and operate its own railway line to service its Chichester deposits at Cloud Break, Christmas Creek, Mt Lewin and Mt Nicholas. Moreover, the Council has apparently decided that the ore from these Chichester deposits will **not** be railed on the Mt Newman railway line (discussed at paragraphs 20 to 28 above). This is only consistent with an assumption that FMG will build and operate its railway line as announced.
45. FMG's Chichester Line is to run west until it meets the alignment of the Mt Newman railway line, and will then follow the Mt Newman alignment until it approaches Port Hedland and then diverts to Anderson Point (the site of FMG's proposed berth at Port Hedland). The Chichester Line has been declared by the relevant State Agreement (the *Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004 (WA)*) to be an open access line.
46. If the Council and the Minister make the assumption that the Chichester Line will be built, for the purpose of determining that there will be no demand in respect of the Chichester Line or for the Service provided by the Mt Newman railway line, then it is **imperative** that this assumption be applied in all other analysis relating to FMG's Application. It is simply unsustainable to assume that the Chichester Line will be built when assessing demand for the Service, but to assume it will not be built when deciding whether the facility is or will be duplicated.
47. Once it has been decided that FMG's Application will be determined in all respects as if the Chichester Line will be built, Criterion (b) cannot be satisfied, at least in respect of the 200km of duplication. It is inconceivable that the Minister (or anyone else) could be satisfied that it is uneconomical to develop another facility when a key assumption upon which the decision depends is that another facility will be developed. It is the same analysis as would be undertaken if the second facility had already been built. If a facility is in fact duplicated, or it is assumed that it will be duplicated, it cannot be asserted that it is 'uneconomical' to duplicate the facility. The market has spoken and no theoretical test is required. This is the gist of the opinions from Professors Ordovery and Willig. On the other hand, because of its strained interpretation of the term 'uneconomical' (ie, that a theoretical 'natural monopoly' test should be applied, divorced from reality), the Council maintains that it is possible to find that Criterion (b) is satisfied (ie, it is 'uneconomical for anyone to develop another facility') **notwithstanding** that the facility has in fact been duplicated.⁷
48. From an economic perspective, for the reasons advanced by Professors Ordovery and Willig, the Mt Newman Spur Portion is the only section of the Mt Newman railway line that should be assessed against the declaration criteria. It is the only section that does not manifestly fail the 'uneconomical to develop another facility' test. As Professor Ordovery said:

Indeed, the decision whether it is uneconomical to develop a facility that runs from the Junction to the Mindy Mindy Connection Point should not be based on the assumption that the pertinent costs include the costs of building the 200km railroad facility from the Junction

⁷ The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, December 2002, paragraphs 4.35 and 4.87.

to Port Hedland. The proper assessment should focus on whether that part of the Mount Newman line that could be used as part of a spur line to connect to the FMG line at or in the vicinity of the Junction is a natural monopoly or not.⁸

49. There is an added practical reason as to why this should be the only section of the Mt Newman railway line that is assessed against the declaration criteria. Mindy Mindy is a mine that the Council now says will rail a maximum of 5mtpa of ore. According to the Part B Public Environmental Review lodged in January 2005 it has a resource of 68mt (not Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (**JORC Code**) compliant). Undoubtedly, mineable reserves would be considerably lower than this. A mine of this size is unlikely to be able to purchase, operate and maintain its own trains (this involves marshalling and maintenance facilities, communication systems, training and safety systems as well as the capital cost of the trains and spare parts). The logistics challenges would be impossible. What happens if the only train is out of service (eg, after a derailment that damaged the locomotives and/or ore cars)? What equipment and manpower would be 'on standby' to retrieve an unserviceable train hundreds of kilometres from the maintenance base? Therefore, it is clear that Mindy Mindy will only use a rail track service if it can combine with FMG's Chichester rail system and utilise or share FMG's trains. Otherwise Mindy Mindy will use a freight carriage service for which rail track access is not required. The same applies to any other small producer. This was recognised when the Council spoke to junior explorers, who favoured a freight carriage service over track access (paragraph 5.13 of Draft Recommendation). An effective freight carriage service already exists, having been put in place by the Western Australian Government (discussed further at paragraphs 87 to 91 below).
50. If Mindy Mindy and other small producers will use trains operated by FMG there is no prospect that they will use the Mt Newman railway line over the 200km that is duplicated by FMG's Chichester Line. By switching to its own railway line FMG will save access fees payable to BHPBIO and will enhance operational flexibility (eg, have the ability to divert trains to its Chichester mines from Mindy Mindy and vice versa).
51. In summary, in considering whether it is uneconomical for anyone to duplicate the Mt Newman railway line, it is abundantly clear that it is economical for someone to duplicate at least 200km of that railway line from Port Hedland to the Chichesters; that is precisely what FMG is in the course of doing. The only question left is whether it would be uneconomical for anyone to duplicate the Mt Newman Spur Portion from Mindy Mindy to FMG's proposed Chichester Line. For the reasons discussed in section 3.3 below the costs of duplicating the Mt Newman Spur Portion would be far outweighed by the costs of mandating access.
52. Further, the fact that it is clearly economical for someone to duplicate two thirds of the facility is a fact that the Minister must take into account in exercising his residual discretion not to declare a facility even if each of the criteria are met. This is because section 44H(2) of the TPA provides:

⁸ Annexure C, Criteria Submission, page 12.

In deciding whether to declare the service or not, the designated Minister must consider whether it would be economical for anyone to develop another facility that could provide part of the service. This subsection does not limit the grounds on which the designated Minister may make a decision whether to declare the service or not.

Given the significant risk to Australia that declaration would entail (as discussed in section 5 below) and the fact that revealed market behaviour indicates it is economical to duplicate at least two thirds of the facility, the Minister should exercise his discretion not to declare the Service.

3.3 The natural monopoly test is not satisfied

53. If, contrary to RTIO's position, a natural monopoly test is applied, the issue is whether 'over the relevant range of demand, it is cheaper for a single facility rather than multiple facilities to provide the service' (paragraph 6.11 of Draft Recommendation). Applying this test to the Mt Newman railway line or the Mt Newman Spur Portion, the issue is whether it is cheaper to build and operate a separate railway line for the relevant distance than to share the Mt Newman railway line.

54. When the true costs of turning the Mt Newman railway line or the Mt Newman Spur Portion into a multi-user facility are taken into account, this test is manifestly not satisfied. This position applies whether the analysis is confined to sharing the Mt Newman Spur Portion or the entire 295km of the Mt Newman railway line.

(a) Direct costs

55. Even if only the direct costs are taken into account (ie, those costs that will necessarily be incurred to restore BHPBIO to the same nominal capacity as it had available to it prior to access) the costs exceed FMG's estimate of building a separate railway line. This was demonstrated by modelling done by consultants to BHPBIO that was submitted to the Council on 6 January 2006. The same position applied whether the comparison was confined to the Mt Newman Spur Portion or the entire 295km of the Mt Newman railway line to which access was sought. The same relative comparison applied when consultants retained by RTIO undertook the analysis in respect of the Mt Newman Spur Portion (paragraphs 7.40 and 7.41 and Annexure E in RTIO's Criteria Submission).

56. The Council's only rebuttal of this exhaustive modelling was a thirteen page report (ie, the G13 Report). This report was prepared in a hurry, was heavily qualified by a disclaimer and was prepared without consultation with, or input from, those who had direct and current experience in the Pilbara rail systems. It was heavily criticised, not just by RTIO in its G13 Submission, but also by TSG Consulting Pty Limited (**TSG Consulting**) and Evans & Peck as well as BHPBIO (see submission by BHPBIO dated 10 March 2006 and attachments).

57. In fact, if the matter is determined on the basis that the Chichester Line will be built, then, even if the Minister is considering declaring the entire 295km of the Mt Newman railway line, the only relevant cost that can be compared with the cost of sharing the Mt Newman railway line is the cost of duplicating the Mt Newman Spur Portion. This is because this is all that Mindy Mindy, or other users in the vicinity of Mindy Mindy, need to build so as to achieve alternative rail track access to Port Hedland (as FMG's Chichester Line is an open

access line). Therefore, the costs against which both the direct costs and the indirect costs of sharing need to be weighed are not the cost of building and operating a 295km section of railway line. They are, in all cases, confined to the 80 to 90km that would need to be built to duplicate the Mt Newman Spur Portion. Notwithstanding this the Council did not seek an estimate of these costs from G13 & Associates. It chose instead to limit its enquiry to the cost of constructing an alternative facility the entire distance from Mindy Mindy to Port Hedland.

58. Given the weight of evidence on the direct costs of sharing the Mt Newman railway line (and the relatively small costs of building a spur line to link Mindy Mindy to the Chichester Line), it is submitted that the Minister could not be satisfied that the cost of sharing the Mt Newman railway line would be lower than the cost of building a separate facility, even if he confined the comparison to the direct costs.

(b) Diseconomies

59. However when also taking into account the indirect costs (commonly referred to as the 'diseconomies' throughout the submission process), there is overwhelming evidence that the costs of building and operating a separate facility are insignificant by comparison.
60. Before examining these costs it is important to take a step back from the process to understand the nature of the change that would be brought about if access were declared. The Mt Newman railway line is not a common carrier railway line. It is a dedicated privately owned and operated piece of infrastructure that is used by BHPBIO to produce iron ore to a specification that is required by its customers. It is wholly integrated with the rest of BHPBIO's production process. Further, by analogy with the RTIO rail system, we assume it was never intended to be built or operated as a multi-user facility. Every feature of the RTIO rail system, and we assume BHPBIO's system, (eg, track protection, signalling, communication, rail/wheel profile designs, safety procedures, maintenance systems, passing loops etc) has been built and is operated on the basis that it is dedicated to a single user and is subservient to the overriding purpose of the production of iron ore by that single user.
61. If BHPBIO wishes to change any aspect of how the railway is run it can do so without having to consult other users. If there are co-users the situation changes. By necessity the co-users must be involved in any proposal that will affect those users. For example, a change that will disrupt usage of the track must be negotiated with all users. Similarly any proposal to change the interface between trains and central control (perhaps entailing new communication systems) or any change to locomotive specifications (eg, driverless trains so as to reduce cycle time) would require negotiation with all users.
62. When there is significant capital expenditure involved, such as an expansion programme involving an upgrade to the railway facilities, the process is even more complex and time consuming if there are multiple users. The co-users need to be consulted as to whether they wish to participate in the expansion. After a period of time they will decide whether they will do so. Usually this will entail negotiations as to the nature of the expansion, the cost, the impact on user fees, the impact on usage during the expansion programme and how the project will be financed. Documentation then needs to be drafted and agreed between users, board approvals have to be obtained and financing put in place. Even if

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- this proceeded at a rapid pace it is unlikely that it would take less than six months. This is a six month delay that will not be incurred if the facility retains its single user status.
63. The above scenario assumes goodwill and eagerness to participate on the part of all parties. If one or more of the co-users does not wish to participate in the expansion (a decision that is likely only to be made after months of negotiation), that user is then likely to focus on how the expansion will impact on it and whether it will receive adequate compensation for disruptions or other inconvenience caused. There is scope for gaming as well as seeking to accommodate genuine concerns. Regardless of the motive, time will be lost while these matters are resolved. It may even be necessary to resort to arbitration.
64. The Council in its Draft Recommendation argues that delays of this nature will be minimised if BHPBIO 'retains operational control of the facility' (paragraph 6.177). However this overlooks the fact that, if one or more co-users are involved, there can be no certainty that a decision once taken can be implemented in a timely manner. In the next sentence the Council inadvertently identifies the problem. The Council states that the 'provider' (ie, BHPBIO) should retain the 'ability to make **reasonable** decisions on capacity expansion, technological change, maintenance and scheduling'. In other words the ability is qualified so that it only extends to **reasonable** decisions. Whilst this on its face seems appropriate, one knows from experience that something that is perceived to be reasonable by one party can be seen (or claimed) to be unreasonable by another party. The ingredients are present for a long dispute by co-users who perceive their interests will be served by such a dispute.
65. The delays to expansion caused by multi-usage are highlighted in the Report to the Prime Minister by the Exports and Infrastructure Taskforce (18 May 2005) and were also identified by the Reserve Bank of Australia in its 7 February 2005 Statement on Monetary Policy. Both documents contrasted the east coast coal industry that was dependent on multi-user infrastructure with the Pilbara iron ore industry that had dedicated integrated infrastructure and noted how much more rapidly the iron ore industry had captured opportunities presented by the surge in demand from China. The statistics demonstrating the difference are set out at paragraphs 3.30 and 3.31 of RTIO's Draft Recommendation Submission.
66. The Council in its Draft Recommendation also sought to downplay the impact of delays of this nature by arguing that there will be fewer users of the Mt Newman railway line than at the east coast coal facilities (paragraph 6.172 of the Draft Recommendation). No doubt if the Council has now sought to limit the tonnage to be transported on the Mt Newman railway line to a maximum of 10mtpa, it will also plead this as a reason that such delays are not likely to be significant.
67. To this RTIO has two responses:
- As outlined at paragraph 28 above, no-one can know how many users or how much tonnage might utilise the Mt Newman railway line if it is declared. As noted at paragraph 27 above, FMG has made inconsistent statements about whether its Chichester ore will be railed on the Mt Newman railway line, if declared, and the Council in its Draft Recommendation emphasised the potential for demand for the Service beyond Mindy Mindy without suggesting a cap on this demand. In

assessing the likelihood of diseconomies occurring, the Minister cannot disregard the prospect that up to 60mtpa of Chichester ore could be on the Mt Newman railway line as well as significant tonnage from other sources.

- It does not take significant tonnage or a significant number of users to insist on being involved in expansion decisions in the manner outlined above and to take action that has the effect of frustrating the progress of an expansion program, whether for gaming or genuine purposes.
68. The cost of the extra time that will be taken to undertake expansions due to the change in the nature of the Mt Newman railway line from a single user to a multi-user facility has the potential to be huge. RTIO has commissioned the independent management consulting firm Port Jackson Partners Limited (**PJP**), to conduct a study to demonstrate the costs involved (the **PJP Report**). Based on analyst forecasts of the demand for iron ore over the next twenty years and the likely ore price, PJP has estimated the expansion programmes that will need to be undertaken for current Australian producers to maintain or increase market share. Against this, it has assumed that, because of the changed status from single user to multi-user, each expansion project takes three years instead of two years, or that an expansion is missed because a foreign competitor seized the opportunity before the multi-users could resolve their differences and commence the expansion that targeted that opportunity.
69. The PJP Report, which has been made available to the Minister, estimates that lost export revenue from these scenarios is between \$18 billion and \$43 billion and the lost capital investment is between \$2.5 billion and \$13 billion. Whilst this is a significant issue for Criterion (b), it is an overwhelming issue for Criterion (f) and is discussed further below.
70. The numbers are staggering, but this flows from the fact that a delay to any expansion means a loss of export revenue for the period of delay. Even six months delay for a 20mt expansion involves a loss of about \$500 million, without taking into account the effect of that delay on the size or timing of the next expansion.
71. When the Minister takes account of costs of this type it is clear that the cost of building and operating a separate railway line is very much lower. It is extraordinary that anyone could contemplate that costs and risks of this magnitude could be warranted in order to 'save' the cost of building a separate facility (which, as noted at paragraph 57 above, only need be the spur line from Mindy Mindy to the Chichester Line). It is noteworthy that the Council in its Draft Recommendation recognised that diseconomies were a factor (paragraphs 6.164 and 6.189) and, notwithstanding its attempts to argue that these should be minimised, the Council was still not able to produce a stronger recommendation than that contained at paragraph 6.194, namely that '**o**n balance, the Council is satisfied that the interface costs would not outweigh the capital and operating cost savings from access'. Without engaging again on the fact that RTIO considers that sharing the Mt Newman railway line will not generate capital and operating cost savings, the Council and the Minister should be much more firmly committed to their view that the benefits outweigh the costs than an 'on balance' opinion. The cost to Australia, if the 'on balance' view is wrong is far too high a risk to take.

4. CRITERION A – PROMOTION OF COMPETITION IN ANOTHER MARKET

72. Section 44H(4)(a) of the TPA provides that the Minister cannot declare a service unless he is satisfied:

... that access (or increased access) to the service would promote competition in at least one market (whether or not in Australia), other than the market for the service.

4.1 Market definition

73. In its Draft Declaration the Council identified the market for the Service was the 'market in which heavy haul railway track and associated infrastructure services ('track services') are provided in the Pilbara' (paragraph 7.5). The Council went on to postulate three other markets which it claimed were different from the track services market. These were identified at paragraph 7.20 as:

- the market for (production of) iron ore;
- the market for iron ore tenements; and
- the market for (rail) haulage services.

74. RTIO disputes that these markets are separate from the market for the Service. In fact because the Pilbara iron ore producers are integrated the only relevant market is the iron ore market. This market embraces the asserted iron ore tenements market and haulage market as well as the track access services market. This is considered in greater depth in paragraphs 8.17 – 8.26, 8.56 – 8.61 of RTIO's Criteria Submission and paragraphs 4.9-4.33 of RTIO's Draft Recommendation Submission.

75. Assuming the Council in its Draft Recommendation asserts the same separate markets, RTIO again submits that they are not separate from, but are all part of the market for the Service and the Minister should therefore refuse the declaration on this ground. In fact RTIO is sceptical of the entire 'market definition' process in this matter. As a participant in the industry RTIO knows that there is only one relevant market, the global iron ore market (in which the Council has found that access would not affect competition). Any attempt to segregate this market into separate markets is an artificial exercise seemingly undertaken solely for the purpose of trying to satisfy the technical requirements of Criterion (a).

(a) Iron ore market

76. As regards the dimensions of the iron ore market RTIO agrees with the observations of the Council at paragraphs 7.21 - 7.27 and 7.39 - 7.44 of the Draft Recommendation. In short RTIO agrees that the iron ore market is a global market for all iron ore products (fines, lump and pellets) and that there is no separate 'sea-borne' market from any 'domestic' market. RTIO is making this submission on the assumption that the Council has not changed its position in this regard and the Minister is encouraged to accept these findings.

(b) Rail haulage market

77. As regards the rail haulage market (ie, the market for freight carriage), even if the Minister is not satisfied that it is part of the iron ore market, he is urged to find that there is no

distinction between the rail haulage market and the track access services market. The only market is for the transport of iron ore to port for loading onto vessels. How this is achieved is irrelevant and parties such as FMG and other potential iron ore producers are indifferent to the means by which the ore is transported. As is made clear in paragraph 49 above, Mindy Mindy will in fact utilise a freight carriage service even if track access were declared, as it would utilise trains from FMG's Chichester deposits rather than operate separate trains.

78. Further, as the Council noted at paragraph 5.13 of its Draft Recommendation, most junior explorers are in fact only interested in rail freight carriage services (for the same reason as Mindy Mindy – ie, their tonnage is not sufficient to warrant purchasing and operating independent trains). If the Council is now asserting that the total demand for the track access service from the Mt Newman railway line is limited to 5mtpa from Mindy Mindy and 5mtpa from all other sources, this makes it even more certain that the only demand from the potential iron ore producers will be for a freight carriage service. One train costs about \$50 million and the minimum spares would cost about \$10 million. On top of this, there would need to be spent about \$20 million on marshalling and maintenance facilities to service the train as well as very significant operating costs, on a unit train basis, given that there would only be one train to service. In addition there are all of the logistical challenges described in paragraph 49 above, that make it unrealistic for a 5mtpa or 10mtpa producer to operate its own trains.
79. The Council's apparent rethink on the extent of demand for the Service (ie, its limitation to a total of 10mtpa) means that Mindy Mindy and any other potential iron ore producer would not wish to acquire track access services; the only demand would be for a freight carriage service. As discussed below, BHPBIO is already obliged to provide freight carriage services to third parties pursuant to the BHPBIO State Agreement and its RTA.

(c) Iron ore tenements market

80. The Council in its Draft Recommendation provided a limitation to the iron ore tenements market, such that the market was confined to the market for tenements containing proven iron ore deposits. Apart from the fact that this limitation makes it more likely that the market is part of the iron ore market, if there is any such limited market it is clearly a global market, not confined to the Pilbara. This is the market in which RTIO, BHPBIO, Companhia Vale do Rio Doce (**CVRD**), Anglo American plc and other existing international producers as well as potential producers such as FMG actively participate. These matters are discussed in paragraphs 4.21 – 4.33 of RTIO's Draft Recommendation Submission.

4.2 Promotion of competition

81. The change in the Council's position, whereby it now states that potential demand will be no more than 10mtpa (5mtpa from Mindy Mindy and 5mtpa from other producers), means that the Minister cannot be satisfied that access would promote competition in any market.
82. In its Draft Recommendation the Council correctly decided that access to the Mt Newman railway line would not promote competition in the market for iron ore (paragraph 7.169). RTIO agrees with this position and assumes that the Council takes the same position in the Final Recommendation. This is particularly the case now that the Council has apparently

decided that the potential demand for the Service is no more than 10mtpa. In a world market of more than 1.6 billion tonnes of iron ore (650mt of which is seaborne trade) it is inconceivable that another 10mtpa could have any impact on competition.

83. In this respect the issue of whether FMG's Chichester ore will in fact utilise the Mt Newman railway line (as foreshadowed at paragraphs 20 to 28 above) is not relevant. FMG has made it abundantly clear that it intends to build its own railway line to Port Hedland and the only equivocation on this has been dependent on access being granted. Therefore this ore will be in the market whether there is a declaration or not.

(a) Rail haulage and tenements markets – promotion of competition

84. In its Draft Recommendation the Council relied heavily on the potential demand beyond Mindy Mindy to justify its conclusion that access to the Mt Newman railway line would promote competition in the rail haulage market and the iron ore tenements market.

Examples are as follows:

- Paragraph 6.74 – 'The movement of ores from these sites is therefore likely to generate demand for the Mt Newman Facility'.
- Paragraph 6.76 – '...demand arising from the development of new tenements in the vicinity of the Mt Newman Facility, including Mindy Mindy and tenements held by junior explorers'.
- Paragraph 7.183 – 'Many potential entrants to the iron ore market – including Iron Ore Holdings limited, Aquila/API Group, Poondano Exploration Pty Ltd and Ausi Iron Pty NL – will still be reliant on BHPBIO or RTIO's infrastructure to get their iron ore to market'.
- Paragraph 7.190 – 'Accordingly even if the FMG railway is built, there will remain a large number of iron ore tenements south of the Chichester ranges which, absent declaration, will continue to rely on access to the rail infrastructure of RTIO and BHPBIO'.
- Paragraph 7.194 – 'Declaration would expand the pool of potential purchasers to include "group (b) participants"'.
- Paragraph 7.208 – 'Potential entrants to the iron ore market have indicated to the Council that access to haulage services is pivotal to their ability to export iron ore'.
- Paragraph 7.209 – 'A third party could gain access to the Mt Newman Service and use its own trains to provide haulage services to other parties'.
- Paragraph 11.26 – 'The Council notes, however, that should declaration occur, it would "open the door" to any party that wished to negotiate access to the Mt Newman Service. The implications of declaration would therefore extend more widely than Mindy Mindy'.
- Paragraph 11.27 – 'Western Australia, FMG and junior explorers consider that the availability of this service would encourage new entry in the Pilbara iron ore industry'.

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85. Given the importance of the potential demand beyond Mindy Mindy to the Council's conclusion that access would promote competition in these markets, it is inconceivable that the Minister could have the same view now that the potential non-Mindy Mindy demand has apparently been limited to 5mtpa. With total Pilbara production of about 250mtpa in 2005 (and expanding rapidly) and with no-one being able to accurately predict the potential non-BHPBIO production that could eventuate, the availability of 5mtpa of capacity for railing on the Mt Newman railway line is unlikely to make any difference to the competitive forces in any asserted rail haulage or tenements market.
86. Further, for the reason outlined in paragraphs 49 and 78 above, no-one will be able to justify setting itself up as a train operator if all that it carries is 5mtpa (or 10mtpa). Therefore the impact on competition will be non-existent.

(b) BHPBIO's freight carriage obligations

87. BHPBIO has an obligation to carry third party freight under the BHPBIO State Agreement, which has been amplified by the RTA. BHPBIO's freight carriage obligations under these agreements were recently the subject of court proceedings and it was determined by the Western Australian Court of Appeal that BHPBIO had an enforceable obligation to carry third party iron ore and that it was obliged to enter into good faith negotiations with potential producers.⁹ In the event the parties do not reach agreement the matter can be determined by an arbitrator.
88. Thus, there is already in place a means for third parties to have their iron ore transported to Port Hedland – a means which, according to the Council at paragraph 5.13 of its Draft Recommendation, junior explorers would prefer to utilise rather than direct rail access (not surprisingly for the reasons set out in paragraphs 49 and 78 above). Now that the Council has apparently determined that the demand for access to the Mt Newman railway line will not exceed 10mtpa, both Mindy Mindy (5mtpa) and the other junior explorer(s) that will produce the other 5mtpa will equally only be interested in (and only able to justify) utilising a freight carriage service.
89. The BHPBIO freight carriage obligations are an effective and enforceable means for third parties to transport their ore. They were put in place by the State of Western Australia and, based on discussions that RTIO has had with State Government representatives, constitute the preferred means (as opposed to direct track access) whereby those third parties without the tonnage to justify building a separate railway line are able to procure the transport of their ore to port.
90. Under this regime, BHPBIO cannot capriciously refuse to negotiate or demand unreasonable carriage terms. Its market power (if it had any and if there were a market in which it could exercise such power) has been effectively constrained.
91. The Council has not presented any cogent reason as to why BHPBIO's freight carriage obligations are not a complete answer to hypothetical concerns about market power in the asserted rail haulage and iron ore tenements markets. The Council argues that because an unrelated third party has not yet concluded such an agreement the process does not

⁹ *Hancock Prospecting P/L v BHP Minerals P/L* [2003] WASCA 259.

work. However, there has to date been virtually no demand for such services. Until recently the price of iron ore was about half its current level and no small producer was interested in searching for, proving up and developing small deposits of iron ore. Transport availability was only one of many obstacles – in fact with the freight carriage obligations that are in place this was the aspect of development that probably presented the lowest barrier. The main obstacle was that, until recently, there was over-capacity in the iron ore industry, resulting in low prices.

(c) Protected contractual right

92. If a declaration is made then terms and conditions for access are to be set. If they are not agreed then the Australian Competition and Consumer Commission (**ACCC**) sets the terms as arbitrator. Under section 44W(1)(c) of the TPA the ACCC is precluded from making a determination on terms of access that has the effect of 'depriving any person of a protected contractual right'. A 'protected contractual right' is defined in section 44W(5) of the TPA as 'a right under a contract that was in force at the beginning of 30 March 1995'. The 'protected contractual rights' provision is a means to protect pre-existing property rights. The same considerations apply here as those discussed at paragraph 114 below, namely that there is a conflict between Part IIIA and private property rights, especially those that were in existence prior to the enactment of Part IIIA.
93. This represents a further reason why Criterion (a) cannot be satisfied. This result ensues because, ultimately, access will not be able to be mandated without depriving BHPBIO of contractual rights that it had prior to 30 March 1995 under its Special Lease (Port Hedland to Mt Newman (Lease No. 3116/3687)) and under the BHPBIO State Agreement. Under these contracts BHPBIO is given the right of exclusive possession of the rail corridor. Track access by a third party would infringe this right.
94. The Council has argued in paragraphs 7.108 – 7.128 of its Draft Recommendation that this section does not necessarily preclude access, although it concedes in paragraph 7.115 that, in appropriate cases, it may have regard to section 44W(1)(c) of the TPA in considering Criterion (a). RTIO set out, in paragraphs 4.35 – 4.48 of its Draft Recommendation Submission, its position on why the Council's arguments did not change the conclusion that the section precluded access being enforced. In sum, BHPBIO has made it abundantly clear that it will not consent to access terms and will take the matter to arbitration before the ACCC.¹⁰ No argument presented by the Council rebutted the fact that access would deprive BHPBIO of this right of exclusive possession.
95. Accordingly, as access terms cannot be imposed on BHPBIO, there will not be any right to access the Mt Newman railway line. The Minister should therefore conclude that a declaration will not promote competition in another market.

¹⁰ Footnotes 147 and 148, BHPBIO Submission, June 2005.

5. CRITERION F – PUBLIC INTEREST

96. Section 44H(4)(f) of the TPA provides that the Minister cannot declare a service unless he is satisfied:
- ... that access (or increased access) to the service would not be contrary to the public interest.
97. This is the Criterion where the Minister is not constrained by technical arguments as to the meaning of the various criteria, the appropriate economic principles to apply or the competition principle that is or is not satisfied by a particular outcome. This is the section where the Minister can take a step back and decide whether the access that is sought would or would not be in Australia's interest.
98. RTIO has made extensive submissions on this Criterion and the Minister is respectfully invited to review section 5 of RTIO's Draft Recommendation Submission. The Minister's attention is drawn particularly to paragraph 5.2 of that Submission, where it is pointed out that the Council's assertion that '[w]here Criteria (a)-(e) are met, there is a presumption that declaration would promote the public interest by promoting competition in dependent markets and by avoiding wasteful duplication of infrastructure' (paragraph 11.2 of the Draft Recommendation) is contrary to law and wrong as a matter of public policy. As mentioned above, this is the criterion where the Minister is not constrained and looks at the broader picture. He is not restricted by the prism of competition focused criteria.
99. In deciding whether access would not be contrary to the public interest, the Minister does not need to be as prescriptive as he may need to be in relation to the other criteria. For example, if the Minister adopts the position advocated by the Council in applying Criterion (b), the Minister is required to be **satisfied** that the costs of sharing the Mt Newman railway line **will** be lower than the cost of building an alternative facility in order to be satisfied that it is 'uneconomical to develop another facility to provide the service'. This requires the Minister to make a decision as to the nature of the alternative facility and the likely cost of sharing the existing facility versus the likely cost of building and operating the alternative facility.
100. On the other hand, under Criterion (f) the same precision is not required. If the Minister is concerned that the costs that **could** be imposed on Australia by the granting of access outweigh any benefits that might be gained by the access, then he **cannot be satisfied** that declaration (or access) 'would **not** be contrary to the public interest'.
101. The section is framed in the negative deliberately. This is a 'fail safe' criterion. It does not matter whether advisers or economists argue that some principle should or should not be applied. The Minister still has to be satisfied that the declaration and the access that this will give rise to is not contrary to the public interest. If he is not so satisfied then he must refuse the declaration, even if he does not feel sufficiently certain of the position in respect of each of the other criteria to refuse the declaration on one of these grounds.

5.1 Australia cannot take the risk

102. The iron ore industry is perhaps Australia's most successful export industry. According to the latest forecast published by the Australian Bureau of Agricultural and Resource Economics (**ABARE**)¹¹ the value of Australia's iron ore exports will overtake the value of coal exports in 2006. Further ABARE predicts that capacity from Australia's iron ore exports will increase from 241mtpa in 2005 to 375mtpa by 2011, based on the expansion programmes that ABARE believes will be undertaken by BHPBIO and RTIO over the next five years.
103. These projections are consistent with the forecasts by analysts that were relied on by PJP to produce the PJP Report referred to in paragraph 68 above. If Australia does not undertake the expansion path that is assumed by ABARE and PJP, the costs are huge. The PJP Report demonstrates how there need only be a slight interruption to the required expansion path and the cost is measured in tens of billions of dollars over the next twenty years. The PJP Report, which has been made available to the Minister, estimates that lost export revenue from these scenarios is between \$18 billion and \$43 billion and the lost capital investment is between \$2.5 billion and \$13 billion. Doubtless proponents of access will argue that these costs will not occur, or that they will not be as high as this. To counter assertions of this nature one of the scenarios chosen anticipated only one abandoned investment and that all other expansions would proceed as quickly as they would have if the facilities had been single user (a most optimistic and unlikely scenario). However, PJP found that even this scenario would involve a loss of export revenue of between \$18 billion and \$26 billion over 20 years and a loss of capital investment of \$2.5 billion to \$3.6 billion.
104. As RTIO set out in paragraph 5.6 of its Draft Recommendation Submission, the expansion projects undertaken by BHPBIO and RTIO in response to China's increased demand have been remarkable both in terms of speed and size. 75mtpa of capacity has been added and further expansions have been announced that will increase exports by another 35mtpa. This has all happened since 2002. The **extra** export revenue at 2005 prices will be \$3.75 billion in 2006 and will increase to \$5.5 billion a year when the further expansions come on stream.
105. There is therefore no doubt about the ability or willingness of the current Pilbara producers in their current configuration (ie, dedicated and integrated mine, port and rail infrastructure) to expand their operations so as to capture new opportunities. ABARE is apparently expecting that the rate of expansions over the last four years will be maintained or increased over the next five years. For the reasons set out in paragraphs 59 to 71 above, in paragraphs 5.6 – 5.13 of RTIO's Draft Recommendation Submission and in paragraph 4.1 of the PJP Report, the environment will have changed significantly if the Pilbara facilities that need to be expanded are changed from single user to multi-user facilities. Delays to this anticipated expansion path are inevitable.
106. No-one can accurately forecast the extent of such delays. The only proxy available from which an analogy may be drawn is the position of the multi-user facilities in the coal industry on the east coast of Australia, where very little extra capacity has been added in

¹¹ 'Australian Commodities', ABARE, March Quarter 2006.

response to China's increased demand for commodities. The Exports and Infrastructure Taskforce and the Reserve Bank of Australia drew the analogy and concluded that the streamlined, single user, integrated facilities in the Pilbara accounted for the difference in response.

107. The Council in its Draft Recommendation argues that the coal facilities can be distinguished because there are more users at the coal facilities (paragraph 6.172 of the Draft Recommendation). On the assumption that the Final Recommendation argues that total non-BHPBIO demand for the Mt Newman railway line will not exceed 10mtpa, the argument that the two are not analogous is presumably pushed even more strongly. As demonstrated in paragraphs 59 to 71 above, turning a single user facility into a multi-user facility is likely to lead to diseconomies, irrespective of the relative tonnage of the other users. Further, as also addressed in paragraph 28 above, the Minister cannot be certain of the fact that the tonnage will not be significantly in excess of this assumed limit.
108. In short, the Minister does not need to make a decision as to how often and how costly delays occasioned by the change in status of the Mt Newman railway line will be. It is sufficient if the Minister is not satisfied that these delays and costs will not be a necessary consequence of declaration, and – on this basis – determines that he is not prepared to take the risk. In this scenario, the Minister could not be satisfied that 'access ... would not be contrary to the public interest'.

5.2 Other public interest issues

(a) Loss of capacity and operational flexibility

109. Separate from the impact on expansion programmes, there is the impact on day to day operations that will flow if third parties are on the railway line. This is further explained at paragraphs 5.14 and 5.15 of RTIO's Draft Recommendation Submission and paragraphs 11.7 – 11.12 of RTIO's Criteria Submission. It is certain that flexibility and, therefore, capacity will be lost if there is more than one user on the Mt Newman railway line. The Pacific National and Hunter Valley examples referred to in paragraphs 11.9 – 11.10 of the Criteria Submission demonstrate the inevitability of this capacity loss. For example it was estimated that for the limited time that there were two coal hauliers on the Hunter Valley line there was a capacity loss of about 8% over the entire system.
110. The Council may argue that this can be catered for by building in spare capacity (or latent capacity). However, in practice, this does not happen. Theoretical studies demonstrate a certain capacity can be achieved and parties rely on this. The problem is that the 'human factor' is introduced when there is more than one user and clashes that should not have occurred (and would not be modelled) in fact occur, because one or more of the users does not or cannot achieve what the model assumed. It is an anathema to an investor that it should build capacity that its modelling says is not required, but which ends up being required because of the failing of another party. No board of directors would approve such an 'indulgence' – instead the instruction would be to ensure compliance.
111. Thus there will be a cost for this lost capacity that Australia will have to bear. Projections such as those of ABARE assume exports will match 'nameplate' capacity. This is unlikely if there are multiple users.

(b) Chilling effect on investment

112. The impact on investment of having an access regime imposed on privately owned infrastructure has been something that has troubled commentators and committees from the inception of Part IIIA of the TPA in 1995. Indeed the Hilmer Report, which ultimately led to the enactment of Part IIIA, recognised this. At page 248 of the Hilmer Report it is noted:

The Committee is conscious of the need to carefully limit the circumstances in which one business is required by law to make its facilities available to another. Failure to provide appropriate protection to the owners of such facilities has the potential to undermine incentives for investment.

113. Similar comments were made in *Tracking Australia*, a report by the House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform, published in 1998, and in various Productivity Commission reports since 1999.
114. The issue of concern is that Part IIIA affects property rights. It is one thing for it to be applied to public infrastructure such as State owned railways. It is another to apply it to privately funded and operated infrastructure that was built and is operated as part of an integrated iron ore production process that has been in existence since long before the inception of Part IIIA.
115. Until the advent of FMG's Application, integrated producers had every reason to be confident that the Part IIIA regime did not apply to them. This belief was based on the decision by Justice Kenny in the Hamersley Decision. When and if the Federal Court hears the jurisdictional dispute relating to FMG's Application, that confidence might be restored. However an unequivocal statement by the Minister that declaration of the Mt Newman railway line is being refused because he is not satisfied that declaration would not be contrary to the public interest would help to restore confidence.
116. The extent of the impact of this chilling effect on investment, if a declaration is made, is yet to be determined. As the PJP Report states towards the end of section 4.1:

there are many stages in the expansion paths where the investments are likely to be marginal, particularly where major investments in port and rail facilities are required.

If the investor cannot be certain that it will retain the full benefit of the investment, this might be the difference between making the investment and not making it. In the multi-user scenario, this can mean that the proposed investment or development may not even be proposed to the co-users.

(c) Lack of benefit

117. There has been no quantification of the benefits (if any) that the access sought would yield. Competition in itself is not a benefit. The effects that flow from competition are the benefit, but no-one has demonstrated any such beneficial effects in this case. In the global iron ore market (which is the only real market), it is agreed that there would be no pro-competitive effect. From Australia's perspective, RTIO firmly believes it would have a negative effect on exports because of the interruptions that would flow to the necessary expansion path. RTIO therefore cannot understand the apparent determination of the Council to press for a declaration.

(d) Alternatives are available

118. If the Minister is concerned that there must be some means available to small potential producers to develop their deposits and transport their ore, such means already exist. There is the freight carriage service that BHPBIO and RTIO are obliged to provide under their State Agreements. There are joint ventures (such as RTIO has recently entered into in respect of Hope Downs), there are mine-gate ore sale arrangements, and there is also about to be an open access railway built by FMG. These options are far preferable to interfering with the facilities that are operating so successfully in their current configuration.

(e) Conclusion on public interest

119. There has been no real quantification (at least in the public domain) of the benefits that will flow from a declaration. If the Council is now saying that the demand for access to the Service is limited to 10mtpa, then although this limitation is not likely to be effective and cannot be relied upon, it reflects how small any likely benefit is estimated to be.
120. Against this the Minister has to weigh the very considerable risks and costs that are likely to flow if the Mt Newman railway line becomes a multi-user facility. As noted earlier, the highest that the Council could put its position in its Draft Recommendation, after conceding that significant costs could be imposed, was to say that on balance the benefits of the declaration are likely to outweigh the potential costs (paragraph 11.36). This is hardly a robust position and, without more, the Minister would be justified in not being satisfied that access would not be contrary to the public interest.
121. In fact, however, there is significant evidence that the costs heavily outweigh the benefits of access. All of this evidence supports the same conclusion; only the Council seems to reach a different conclusion. The evidence includes the reports of the Exports and Infrastructure Taskforce and the Reserve Bank of Australia; the consistent expressions of concern by the Productivity Commission; the reports from independent experts, TSG Consulting and Evans & Peck whose knowledge and experience of the Pilbara operations are unquestioned; and the PJP Report that outlines the cost to Australia if the rapid expansion path in the Pilbara is interrupted.
122. The Minister is urged to refuse the declaration on the basis that Criterion (f) is not satisfied.

13 April 2006

Annexure A

Map showing the Mount Newman Spur Portion

