



**NON-CONFIDENTIAL VERSION**

**OUTLINE OF PRINCIPAL SUBMISSIONS TO THE NATIONAL  
COMPETITION COUNCIL  
IN RESPONSE TO DRAFT RECOMMENDATION  
DATED 4 NOVEMBER 2005**

**BHP BILLITON IRON ORE PTY LTD**

**Application by Fortescue Metals Group Ltd for Declaration of Service  
Provided by the Mt Newman Railway Line**

**5 December 2005**

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**1. BACKGROUND**

- 1.1 The Council has erred in a number of respects in reaching its conclusions in the Draft Recommendation. In particular, the Council has:
- (a) relied upon factual material that was either inaccurate or has become outdated;
  - (b) relied upon submissions that are not supported by evidence;
  - (c) failed to take into account a number of relevant considerations and submissions, such as the existence of other constraints on competition and barriers to entry;
  - (d) incorrectly applied established principles and its own interpretations relating to market definition and competition analysis;
  - (e) been inconsistent in its cost benefit approach by assuming limited third party access when assessing costs but considerable third party access when assessing benefits;
  - (f) failed to understand the true nature of the iron ore tenements market in the Pilbara; and
  - (g) in light of the uncertainty surrounding the foreseeable future, failed to undertake any sensitivity analysis or risk assessment to weigh up the potential costs and benefits of declaration.
- 1.2 In light of the above, BHPBIO makes the following submissions in response to the Draft Recommendation. BHPBIO further reiterates its previous submissions to the Council and suggests that the Council revisit these submissions and reconsider its findings in relation to them.

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**2. CRITERION (b) – ECONOMIC TO DEVELOP ANOTHER FACILITY**

**CAPACITY AND DEMAND**

**Capacity of the Mt Newman Service is defined by the capability of the vertically integrated system as a whole**

- 2.1 The most efficient design for BHPBIO's iron ore production system requires that the capability of each of the components is matched.<sup>1</sup> If one component of the system has a lower capability than the others, this restricts the capability of the entire system and results in idle assets. Therefore, the capability of the Mt Newman Line is designed to match the estimated capability of the mine and port components. Consequently, BHPBIO only expands the capacity of the Mt Newman Line in concert with expansions to the capacity of the mine and port systems.
- 2.2 Capability or capacity of the system, however, is limited by a number of factors including physical infrastructure configuration, equipment performance and dynamic variabilities, such as vessel arrival variability and individual product demand variability, ore type variability, component reliability, resource sharing and the interaction of sub-systems, and in the longer term, variability in customer specifications of ore.
- 2.3 In light of growing global demand for iron ore, BHPBIO is continually devising and implementing proposals to increase the sustainable capacity of the system, whether by investment in and change to physical infrastructure configuration or changes to equipment or operational conditions. BHPBIO, however, prefers not to increase the capacity of the Mt Newman system unless that capacity will be utilised by its mine-rail-port system as this would result in unnecessary and inefficient investment.
- 2.4 BHPBIO uses simulation modelling technology to estimate the optimal system capacity, but the figure this modelling provides is no more than an estimate. The model predicts the likely capacity of the system based on assumptions of physical infrastructure configuration, equipment performance and dynamic variabilities where such assumptions are based on historical data relating to the operation of the system. Because the modelling only provides an estimate, and is based on data relating to a pre-existing system, actual throughput after an expansion may be higher or lower than the estimated system capacity. However, BHPBIO uses these estimates to develop plans for system optimisation and expansion.
- 2.5 For example, BHPBIO recently made significant capacity expansions and other operational changes designed to increase the capacity of the Mt Newman system to 100 mtpa. This capacity has not yet been achieved on a sustainable basis. The reasons why BHPBIO has been unable to achieve the modelled throughput of 100 mtpa on a sustained basis are not

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<sup>1</sup> "Traditionally both BHPBIO and Rio Tinto have only increased railing capacity to match anticipated growth of sales over the short term, which is usually less than 5 years. This practice minimises outlay of capital for investment in rolling stock and new track until it is needed." Evans & Peck August 2004 p 26.

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yet fully understood. This differential is believed to be heavily influenced by the complexity of the system and the levels of optimisation being sought, and may occur in all of BHPBIO's proposed expansions.

### *Capacity of the system*

- 2.6 The Council's assessment of the capacity of the Mt Newman Line with double tracking is erroneous. That assessment did not take into account the closed loop system within which the Mt Newman Line exists. As a result, the figure of 400 mtpa relied on by the Council is grossly overstated and unrealistic as it does not consider constraints on the capacity of the Mt Newman Line, which include the requirement to load and unload trains as well as port and mine constraints. Put simply, the estimate used by the Council has no practical relevance.
- 2.7 BHPBIO understands that the figure of 400 mtpa was contained in a study provided to the Western Australian Government by Evans & Peck on the basis of there being no constraints. A copy of the Evans & Peck report is attached to this Outline.<sup>2</sup> The WA Government submission stated that once the Mt Newman line was double tracked the total capacity of the Mt Newman railway system would be around 400 mtpa. This figure represents a calculation based purely on the theoretical number of trains that could run on the track, ignoring the practicalities of loading and unloading trains and any constraints at the mine or port. These practicalities must be taken into account to calculate the actual tonnage that can realistically be accommodated on the system. As a result of the approach taken, the figure relied on has very limited practical relevance and may be misleading.
- 2.8 BHPBIO has now engaged Evans & Peck to undertake a study of the capacity of a double-tracked Mt Newman Line taking into account the necessity to load and unload trains and intrinsic physical limitations at the mine and the port. This study is using actual data from BHPBIO rather than estimates made by Evans & Peck. This data was not available to Evans & Peck at the time that the original study was conducted.
- 2.9 Evans & Peck's preliminary estimate of the capacity of a double-tracked Mt Newman Line after taking into account the practicalities and limitations referred to above is substantially lower than the original estimate. The report by Evans & Peck will be provided to the Council as soon it becomes available but no later than 6 January 2006.

### *Double tracking*

- 2.10 At present, the Mt Newman line operates only on a single track basis. There are no 'running meets' between trains. That is, trains travelling in opposite directions pass each other by one of the trains moving into a siding and remaining stationary until the other train passes. BHPBIO's current expansion plans provide for additional passing loops but not full double tracking.

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<sup>2</sup> Certain confidential information has been omitted from the attached copy of this Report by the WA Government.

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2.11 BHPBIO has not formulated specific plans at this stage for the full double tracking of the Mt Newman Line. If BHPBIO does fully double track the Mt Newman Line, it is clear that this would not occur before 2010. Whether BHPBIO does double track the line will ultimately depend on decisions about the location of future mines and, possibly, future ports. Double tracking of parts of the line is likely to be implemented incrementally by BHPBIO but the extent and timing of that implementation depends on a number of factors, including, critically, port capacity.

**Reasonably foreseeable demand**

*BHPBIO demand*

2.12 In its submission to the Council the WA Government stated that the foreseeable level of demand for the Mt Newman railway service from BHPBIO was 152 mtpa. In citing this figure it appears that the WA Government limited its projection for BHPBIO's future levels of production to the estimate given by BHPBIO for its next expansion phase, as envisaged at that time, due to be met on that estimate in 2010. In its draft recommendation the Council appears to have relied on the figure given in the WA Government submission as the foreseeable demand for the movement of iron ore by BHPBIO on the Mt Newman line.

2.13 Although the Council has recommended declaration of the Mt Newman service for a period of 20 years and notwithstanding that the Australian Competition Tribunal had, in a relevant matter, considered foreseeable demand over an approximate period of 10 to 15 years, the Council indicated in its Draft Recommendation that it had focussed on demand over the next 5 to 10 years only.

2.14 The assumption of 152 mtpa as the foreseeable demand for the movement of iron ore by BHPBIO is seriously flawed, in that it:

- (a) takes an extremely short term perspective;
- (b) assumes that 'foreseeable' means probable or most likely to occur rather than its generally accepted meaning of predictable or likely;
- (c) ignores the historical growth trends in production of iron ore by BHPBIO;
- (d) relies on estimates which are already out of date; and
- (e) makes no allowance for likely efficiency improvements and increased capital expenditure.

2.15 BHPBIO's anticipated demand must be assessed against its long term expansion plans and objectives. In view of the size of BHPBIO's deposits and potential growth in demand for iron ore, the foreseeable demand for the movement of BHPBIO's iron ore in the Pilbara is potentially up to 300 mtpa within the next 20 years.

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*FMG demand*

- 2.17 The Council has also assumed a very low demand for the Mt Newman service from FMG. A production rate of 10 mtpa from FMG's Mindy Mindy project has been taken into account but the Council has arbitrarily ruled out any demand from FMG's Chichester Ranges project. As FMG does not appear to have secured finance or entered into any contracts for the construction of its proposed Chichester rail line, and as FMG has stated in its public announcements that it will not rule out use of the Mt Newman line, the possible demand for movement of ore from this project should also be taken into account. The Council itself points to the recent experience relating to the Hope Downs iron ore deposit where the proposed rail infrastructure is now not going to be constructed.<sup>3</sup>
- 2.18 On the basis of FMG's latest public announcements, the projected level of production from FMG's Chichester Ranges project is 60 mtpa by 2015. Combined with its output from Mindy Mindy, FMG's foreseeable demand for the Mt Newman service is up to 70 mtpa.

*Estimates are conservative*

- 2.19 The Council has recognised that demand for the Mt Newman service "may rise significantly higher if the recent growth in international demand for iron ore continues".<sup>4</sup> The Council has also suggested that the potential demand for the service from junior explorers is also likely to increase in such circumstances.<sup>5</sup> In these circumstances, as the Council has recognised, total foreseeable demand is likely to be higher than what has been predicted. At the very least, in undertaking this assessment, the Council must envisage the possibility that it is this higher demand that would eventuate.

**Foreseeable demand is likely to exceed capacity**

- 2.20 In light of the above, BHPBIO's demand *alone* may exceed the capacity of the Mt Newman Line when double tracked. In such circumstances, as the Council has recognised, it is likely to be economical to develop another facility, with the result that criterion (b) will not be satisfied.
- 2.21 In circumstances where BHPBIO may need to double track the Mt Newman Line for its own purposes at some point in the future, use of the line by a third party would reduce the capacity of the line available for BHPBIO and therefore limit BHPBIO's production capability on its integrated mine-rail-port system. BHPBIO will be providing up to date modelling and analysis of these third party effects on the system when available and no later than 6 January 2006.

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<sup>3</sup> NCC Draft Recommendation, paras 6.51, 6.53.

<sup>4</sup> NCC Draft Recommendation, para 6.76.

<sup>5</sup> NCC Draft Recommendation, para 6.76.

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**COSTS OF DEVELOPING ANOTHER FACILITY vs COSTS OF ACCESS**

*Direct impacts*

- 2.22 The addition of third party trains to BHPBIO's vertically integrated mine, rail and port production system will impose delays on BHPBIO trains. These delays may take a number of forms including delays on track due to meets, an increased likelihood of failures on track, delays in entering/exiting shared infrastructure and delays in retrieving dumped ore cars. These delays will result in reduced throughput for BHPBIO and ultimately reduced sales. Importantly, third party access will significantly diminish BHPBIO's ability to meet demand spikes, which is when the foregone revenue impacts are likely to be greatest as both volumes and prices will be high. The ability to meet demand spikes contributes to a supplier's reputation with buyers and enhances their willingness to pay.

*Assessment of impacts*

- 2.23 The Council's assessment that FMG is likely to use the Mt Newman Service only for the purpose of transporting 10 mtpa of iron ore from its Mindy Mindy deposit seriously underestimates the potential impact of third party access. Rather, the Council should consider the impact of access and the costs of expansions required to accommodate such access in circumstances in which FMG would use the Mt Newman Service to transport its iron ore from its Chichester Ranges deposits. To the extent that the Council believes that demand may also eventuate from junior explorers, it should take into account that demand in its assessment.
- 2.24 The previous modelling submitted by BHPBIO demonstrates that if FMG used the Mt Newman Service to transport 45 mtpa of iron ore (10 mtpa from Mindy Mindy and 35 mtpa from the Chichester Ranges), the impact of access would be significant. The expansion required to ensure BHPBIO's throughput levels were not affected would be the double tracking of the Mt Newman Line from a place between Shaw and Yandi Junction to Turner River. The cost of this expansion was estimated at about A\$275 million in May 2005. Further, as discussed above, BHPBIO has no specific plans at this stage to fully double track the Mt Newman line.

*Assumptions not unreasonable*

- 2.25 The Council has indicated that TSG's modelling work used two particular assumptions provided by BHPBIO that inflated the cost estimates in respect of the costs of access.<sup>6</sup> The Council's reasoning to support this proposition demonstrates a fundamental misunderstanding of rail operations for an integrated system with more than one user.

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<sup>6</sup> NCC Draft Recommendation, para 6.107.

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- 2.26 Firstly, the Council has suggested that the congestion costs may be less if BHPBIO trains take precedence at meets in Priority 1 conditions. This approach is unrealistic and unworkable because:
- (a) it may be completely unacceptable to other users to have such an unreliable service, especially given the environmental difficulties of stockpiling ore at Port Hedland;
  - (b) if an FMG train is on a single piece of track with no rail sidings and a Priority 1 condition occurs, BHPBIO trains will still have to wait until the FMG train has passed through the relevant section and can run into a passing siding. Accordingly, congestion costs are not able to be avoided; and
  - (c) if BHPBIO trains had precedence at meets for Priority 1 situations, it may be that FMG trains are prevented from running on the Mt Newman Line for a significant period of time, or at all. This will be very difficult to determine given that BHPBIO's rail system does not operate according to set time schedules. This is discussed further below.
- 2.27 This demonstrates the Council's lack of understanding of the way in which BHPBIO's system currently operates and the need for further information and consultation with BHPBIO.
- 2.28 Secondly, the Council has indicated that BHPBIO could invest in port or above rail infrastructure to minimise congestion costs. BHPBIO's other infrastructure, however, is not part of the facility providing the service of which declaration is sought and therefore BHPBIO cannot be required to invest in such infrastructure by the regulatory process under Part IIIA. Indeed, a third party accessing BHPBIO's railway line is unlikely to pay for or contribute towards investments in other assets of which it may not obtain the full benefit. In addition:
- (a) any expansion of stockpiles at the port would be seriously limited by environmental and economic considerations;
  - (b) any port stockpile expansions, were they feasible, would likely take significantly longer than rail expansions because of the sensitive environmental situation existing at Port Hedland. Accordingly, the approach suggested by the Council would almost inevitably result in further delays to expansions, which the Council has not included in its analysis to date; and
  - (c) to the extent the Council believes any such expansions are feasible, the full costs of those expansions (including environmental costs and delay costs) would need to be taken into account by the Council in its assessment of the costs and benefits of duplication and of declaration more generally.

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*Further modelling*

- 2.29 The modelling work undertaken by TSG and provided to the Council was based upon information (relating to the proposed capacity of the Mt Newman system and BHPBIO's foreseeable demand for the Mt Newman Service) which is now out of date and no longer applicable.
- 2.30 Accordingly, BHPBIO has engaged TSG to undertake further modelling to consider the impacts of third party access and the expansions required to accommodate such access on the basis of BHPBIO's planned RGP3 expansion and FMG's most recent public announcements regarding its proposed iron ore operations and its proposed mine, port and above-rail operations. The results of this modelling and analysis of the results will be made available to the Council as soon as possible but no later than 6 January 2006.

**Diseconomies of scope**

- 2.31 BHPBIO and RTIO have provided the Council with a considerable amount of information regarding the diseconomies of scope as a result of third party access to BHPBIO's fully integrated mine, rail and port production system. The Council has not been presented with any information disputing the validity of the claims about diseconomies. There does not appear to be any factual basis for the Council's conclusions about those diseconomies.
- 2.32 As acknowledged by the Council, one of the categories of diseconomies of scope to be considered is that concerning interface issues associated with congestion and capacity expansion. The main bases on which the Council appears to have dismissed the significance and quantum of these diseconomies of scope are certain false assumptions and estimates, being:
- (a) an inflated estimation of the capacity produced by double tracking the Mt Newman line and the Council's assumptions about the consequent avoidance of those diseconomies through double tracking;
  - (b) an assumption that the Mt Newman line will be fully double tracked by BHPBIO by 2010; and
  - (c) the adoption of very conservative and short term estimates of foreseeable demand.
- 2.33 The reasoning of the Council in this regard requires, as a minimum, that all three of these assumptions are valid. As has been discussed earlier in this Outline, it is BHPBIO's view that none of the assumptions is correct.
- 2.34 The Council has also identified other categories of diseconomies of scope, being:
- (a) "costs of delayed expansion"; and
  - (b) "costs of sub-optimal investment decisions, including delays to, or avoiding the adoption of cost-saving technologies".

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- 2.35 To negate these diseconomies the Council has relied on assumptions about the ability of the parties to reach a negotiated outcome and the ability of the ACCC as arbitrator to mitigate any interface costs.
- 2.36 The logic of assuming quick and efficient negotiated outcomes between the parties is the same logic that would suggest that declaration is not required.
- 2.37 The conclusion by the Council that the ACCC as arbitrator will be able to ameliorate or avoid costs associated with delays in expansion and implementation of new technology and work practices has no basis in regulatory history and is a matter of pure speculation. There is no precedent for:
- (a) arbitration under Part IIIA, in general;
  - (b) timely decision-making with regard to expansion and investment matters; and
  - (c) application of an access regime to a vertically integrated production system.
- 2.38 In light of the above, the Council needs to consider the likelihood and quantum of these diseconomies explicitly and systematically.

### *Dynamic inefficiency*

- 2.39 Experience on the east coast of Australia and commercial practice suggest that access regulation is likely to delay investment decisions in respect of infrastructure expansion. The costs of such delay are significant. For instance, if BHPBIO's most recently announced future expansion project, RGP3 (which will add approximately 20 mtpa), was delayed by one year as a result of regulatory overlay, the NPV of the opportunity cost of the delay would be **A\$290 million** at current exchange rates, using latest price forecasts and conservatively assuming all capital expenditure could also be deferred by just the one year.
- 2.40 To ensure an optimal sequencing of engineering design and construction services, a gap of at least one year is necessary between the approval of each expansion project. A delay of one year on the first expansion project will therefore cause a delay of one year to the second expansion project even if there was no regulatory involvement in the approval of the second expansion project. If a regulator were to be involved with the second project as well, the delay would then be two years to that project, assuming that the new delay associated with the regulatory process would be only one year. Taking only the next two expansion projects and assuming that they would have progressed one year after the approval of the preceding project (in the absence of further regulatory delay) and applying a 10% nominal discount rate, the NPV of the opportunity cost of the delays would be approximately **A\$800 million**. Even assuming subsequent projects do not suffer from this cascading effect and are each delayed by only one year, the NPV of the opportunity cost of the delays caused by regulation over the period of declaration recommended by the Council would be approximately **A\$1,600 million**. These opportunity costs are only the costs that will be borne directly by BHPBIO. There are also, of course, broader costs, such as

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reduced royalties, foregone taxes and lower employment, which will accrue from regulatory delay in addition to the opportunity costs to BHPBIO.

- 2.41 The significant costs and diseconomies above have not been acknowledged by the Council in assessing the costs of third party access. The Council's expectation that the ACCC can arbitrate terms and conditions of access to ensure that there are no opportunity losses as a result of delayed investment in infrastructure is unrealistic and does not take into account the qualifications made by the ACCC itself in responding to the Council on this issue.<sup>7</sup>

*Interface costs*

- 2.42 The Council's conclusion that diseconomies of scope will not be significant because FMG will be the principal user of the Mt Newman Service and that FMG is unlikely to use that service for more than 10mtpa from Mindy Mindy is erroneous. As recognised by the Council, if the Mt Newman Service is declared, any third party can obtain access to the service.
- 2.43 In these circumstances, it is not only foreseeable that other parties will seek access to the Mt Newman Service but that FMG may use the service to transport 55 to 70mtpa of iron ore from two different geographic locations. Accordingly, interface costs are likely to be substantial and the experiences of multi-user systems such as the Dalrymple Bay Coal Terminal are illustrative.
- 2.44 As recognised by the Council, interface costs are likely to be more significant where the capacity of the facility is constrained. As the Mt Newman Line is likely to be capacity constrained for at least the next 5 to 10 years, interface costs will be amplified.
- 2.45 Even if the Council is uncertain as to the level of future demand and capacity, it must take account of the costs that may eventuate were demand greater than it originally assumed and capacity lower. Even if the probability of this scenario occurring is low (which in BHPBIO's view is the not the case), the costs it would impose would be very high and hence would significantly alter the overall cost-benefit assessment.

**ANOTHER FACILITY TO PROVIDE THE SERVICE**

- 2.46 The Council has erred in not considering BHPBIO's submission that it would be not be uneconomic for anyone to develop the RTA to provide the service. BHPBIO considers that criterion (b) is also not made out on this basis.

**The "service"**

- 2.47 Criterion (b) requires that the Council consider whether it would not be uneconomic for anyone to develop another facility to provide the "service". It is clear that the definition of service for the purposes of this criterion need not necessarily be the exact same service of

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<sup>7</sup> See letter from ACCC to NCC dated 9 August 2005 available on the NCC website.

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which the applicant seeks declaration (ie. use of railway track). Rather, if there is a service that is provided or could be provided by another facility where that service is an "effective substitute" (in an economic sense) for the service sought to be declared, then this suffices under the criterion (b) analysis.

- 2.48 This reading of the legislation is consistent with the underlying rationale of Part IIIA. For example, if a road facility could be constructed economically from Mindy Mindy to a port and the facility could efficiently carry iron ore, it would be nonsensical if the Council considered that this did not constitute another facility to provide the service under criterion (b), even though the service provided by such a facility would be road access service rather than a rail track service. If such alternatives were not taken into account in analysing whether criterion (b) is made out, that criterion will always effectively be satisfied without any consideration.
- 2.49 FMG itself suggests that such alternative facilities could provide a service that is an effective substitute for the one it seeks to be declared. For instance, in its application for declaration, FMG states that:
- (a) the Mt Newman railway line is "a method of transport";<sup>8</sup>
  - (b) declaration of the service will provide third parties with access to "a method of transport";<sup>9</sup>
  - (c) access to the service will allow FMG to transport its iron ore from its mines for sale and export;<sup>10</sup> and
  - (d) alternative methods of transport such as road and air transport are not economically feasible.<sup>11</sup>
- 2.50 Accordingly in this case, while FMG has sought declaration of a railway track service, the relevant service for the purposes of criterion (b) is that service or any effective substitute for that service, namely, a transport service provided by any facility from a point near Mindy Mindy to a port.
- 2.51 The Tribunal's consideration of criterion (b) in *Sydney Airports* and *Duke EGP* is consistent with this approach. In those cases, the Tribunal examined whether other facilities provided an effective substitute for the service sought to be declared.

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<sup>8</sup> FMG Application, para 5.8(2).

<sup>9</sup> FMG Application, para 5.10.

<sup>10</sup> FMG Application, para 7.3(1).

<sup>11</sup> FMG Application, paras 7.3(3), 13.

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- 2.52 In *Sydney Airports*, the Tribunal found that the alternative facility was not an effective substitute for the service sought to be declared because, not only was the facility incapable of providing effectively substitutable services, but also those services could not be made available within any meaningful commercial timeframe. The Tribunal's reasoning in *Sydney Airports* can be distinguished from the current application where the RTA provides a service that is an effective substitute for railway track services<sup>12</sup> and can be made available once a third party has demonstrated that it has well advanced plans for mining.
- 2.53 In *Duke EGP*, the Tribunal defined the relevant service as a point to point service so that any effective substitute for that service would need to exhibit the same point to point characteristic and follow the same route. In this case, the RTA provides the same point to point service as the Mt Newman Service and follows the same route.

### **Another facility that provides an effective substitute**

- 2.54 A rail haulage service on the Mt Newman Line from a point near Mindy Mindy to the port is an effective substitute for the service sought to be declared. There is considerable support for this in that:
- (a) both HDMS and FMG have at one point indicated a willingness to seek rail haulage services from BHPBIO rather than railway track services; and
  - (b) rail haulage from a location near Mindy Mindy to the port performs the same function as railway track services pursuant to declaration.
- 2.55 In addition, the combination of BHPBIO's above-rail and below-rail assets constitutes another facility for the purposes of criterion (b). That facility consists of a minimum bundle of assets capable of providing a rail haulage service as an effective substitute for the service sought to be declared by FMG.

### **Anyone can develop this facility**

- 2.56 The Council has acknowledged that in considering whether criterion (b) is made out, the term "develop" has a broad meaning. That is, if a facility could be modified or enhanced economically, then criterion (b) is not met. Indeed, the ordinary meaning of the term "develop" means "*to bring to a more advanced or effective state*".
- 2.57 In *Duke EGP*, the Tribunal not only considered whether another facility could be developed to provide an effective substitute for the service sought to be declared, but whether the other facility already provided (without development of any sort) an effective substitute for the service sought to be declared. The Tribunal stated that:

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<sup>12</sup> See *Laurel Sand & Gravel Inc v. CSX Transporter Inc* [1991] 1 Trade Cases 69,312. In that case, when considering whether the plaintiff could duplicate a rail facility, the Court found that the plaintiff's ability to pursue a haulage service was an effective substitute for the rail facility when it held that the plaintiff had failed to show that it could not reasonably duplicate **or pursue a reasonable alternative to the essential facility**.

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*"[t]here is no logic in excluding existing pipelines from consideration in the determination of whether criterion (b) is satisfied. The policy underlying the Code would not be advanced if the Tribunal were to proceed in that blinkered way. We therefore think it appropriate to enquire whether the MSP or the Interconnect **provide or could be developed to provide the services provided by means of the EGP**" [emphasis added].<sup>13</sup>*

- 2.58 In light of the broad definition to be attributed to the word "develop" under criterion (b), it is clear that:
- (a) the above rail and below rail facility provides a service that is an effective substitute for the Mt Newman Service; or
  - (b) at the very least, any third party could "develop" the above-rail and below rail facility by proving its deposits to meet the threshold and then by enforcing its rights to acquire rail haulage services under the RTA to the full extent permitted by the law.

**It would not be uneconomic to develop this facility**

- 2.59 The costs of developing BHPBIO's above-rail and below-rail assets by meeting the relevant thresholds under the RTA are likely to be significantly less than the costs of accommodating third parties on the Mt Newman Line (which have been detailed above).
- 2.60 The costs of developing BHPBIO's above-rail and below-rail assets to provide rail haulage services are likely to comprise the costs of proving up a deposit so that it is sufficiently well-advanced to meet the threshold under the RTA, and could range from anywhere between \$5 million and \$10 million depending on geology, scope of drilling program and success of drilling. However these costs will need to be incurred in any event if the deposit is going to be exploited.
- 2.61 Any other costs (such as costs of negotiation or arbitration, management or other miscellaneous costs) are also all likely to be incurred in any event that the Mt Newman Service were declared. In addition, the substantial costs and diseconomies imposed by access to railway track services on the Mt Newman Line would be avoided.
- 2.62 It may be that the Council believes that the RTA would provide less favourable terms to FMG than it could obtain through declaration. While BHPBIO does not know on what basis the Council could reach such a view, any such belief is irrelevant to the test being applied. In effect, as the test is (in the Council's view) a social test, it cannot have regard to the distribution of income between the parties. Rather, all that matters in applying the test is the quantum of the social costs and benefits, not their distribution as between BHPBIO and FMG.

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<sup>13</sup> At para 57.

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- 2.63 For the reasons above, BHPBIO considers that its above-rail and below rail assets constitute another facility that provides an effective substitute for the Mt Newman Service which could economically be "developed" by any third party through use and enforcement of the RTA.

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**3. CRITERION (a) – PROMOTION OF COMPETITION**

3.1 The Council has erred in finding that access to the Mt Newman Service would promote competition in the following markets:

- (a) the market for iron ore tenements in the Pilbara; and
- (b) the market for rail haulage services in the Pilbara.

*Relevant Markets*

3.2 The relevant markets are not properly defined. The market for iron ore tenements is not distinct from the global market for iron ore nor from the global minerals exploration market. The market for rail haulage services is not distinct from the market for the service sought to be declared. BHPBIO refers to the extensive submissions which it has already made on these issues.

**MARKET FOR IRON ORE TENEMENTS**

3.3 Even if the market for iron ore tenements exists, the Council cannot be satisfied that access to the Mt Newman Service would promote competition in that market. This is because of:

- (a) the existence of other significant constraints and barriers to entry which preclude competition being promoted even if the Mt Newman Service is declared; and
- (b) the availability of several alternatives to suppliers of iron ore tenements in exploiting their iron ore deposits that do not require access to the Mt Newman Service under Part IIIA. That is, access to the Mt Newman Service is not essential for effective competition between potential purchasers of iron ore tenements.

3.4 Additionally, even if such a market existed BHPBIO and RTIO are major participants not only on its demand side but also on its supply side. Further, they compete actively not only on the demand side but also on the supply side and any proper analysis of the activity would need to take account of that effective and continuing competition.

**Constraints on competition other than access to the Mt Newman Service**

3.5 The Council recognises that where another barrier to entry exists declaration may not promote competition.<sup>14</sup> In this case, even if the Mt Newman Service is declared, competition between potential purchasers of iron ore tenements will not be promoted because of the following constraints:

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<sup>14</sup> NCC Guide to Part IIIA, Part B para 5.75.

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- (a) the size, quality and location of the deposits owned by suppliers of iron ore tenements; and
- (b) the lack of port capacity or facilities for the export of iron ore.

**Size, quality and location of the deposits**

- 3.6 Iron ore tenements in the Pilbara will not (even with declaration) be attractive to potential purchasers unless those deposits can either be developed as stand alone product (ie, sufficiently high grade to be saleable in its own right) or as a satellite deposit of a lower grade that requires blending with higher grade product to be saleable in the global iron ore market.
- 3.7 In either case, these deposits must be:
- (a) of sufficient size to render them economically viable to exploit;
  - (b) of a grade that renders them marketable either on their own or if blended with a higher grade of ore; and
  - (c) located sufficiently close to:
    - (i) facilities to transport the ore to a port; or
    - (ii) in the case of ore that requires blending, complementary ore with which it can be blended.
- 3.8 If all of these conditions are met, potential purchasers are likely to compete to acquire the iron ore tenement. Given the nature and history of iron ore exploration and production in the Pilbara, however, such "finds" are irregular and highly infrequent. For example:
- (a) McCamey's Monster, which was discovered over 30 years ago, met these conditions when sold to BHPBIO in 1992;
  - (b) the Hope Downs deposit, which was also discovered about 30 years ago, met these conditions when RTIO acquired a 50% interest in the deposit. In addition, BHPBIO understands that there was competition for the purchase of this deposit between various parties and HDMS itself was considering construction of independent infrastructure;
  - (c) Cazaly Resources Ltd's (Cazaly's) Shovelanna deposit, which was discovered about 20 years ago, met these conditions when BHPBIO entered into conditional arrangements to purchase iron ore from Cazaly. In addition, there was competition between BHPBIO, FMG and possibly others for this iron ore tenement; and
  - (d) AusQuest's "Nameless" deposit appears to have met these conditions and RTIO has recently entered arrangements with AusQuest to investigate the development of the deposit.

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*No deposits of sufficient size in the Pilbara*

- 3.9 It is unknown and uncertain whether junior suppliers of iron ore tenements hold iron ore deposits of a sufficient size. Indeed, the Council recognises that the deposits owned by such suppliers "fall at the smaller end of the spectrum".<sup>15</sup> The Council also states:

*"If the inferred resources [of potential entrants to the iron ore market] are confirmed, most of these deposits will apparently be large enough to support their own mining infrastructure . . . ."*<sup>16</sup>

- 3.10 There is, however, no certainty that inferred resources will be confirmed. That is, even on proving an iron ore deposit, it may be the case that the size (and/or quality) of the deposits will not support the construction of mining infrastructure. In such circumstances, the Council's assumption that inferred resources will be confirmed is highly speculative.
- 3.11 A report provided to the Western Australian Government by Evans & Peck in August 2004 indicated that there may be few, if any, economically viable deposits in the Pilbara that have not already been identified. BHPBIO notes that currently there are no proven<sup>17</sup> iron ore deposits in the Pilbara apart from those held by BHPBIO and RTIO/HD.<sup>18</sup>
- 3.12 The 2004 Evans & Peck report also indicated that 85% of the identified iron ore resources in the Pilbara were controlled by BHPBIO or RTIO, with HD and FMG holding 10%, and other suppliers holding the remaining 5%.<sup>19</sup> Most other identified deposits which have not met JORC reporting requirements are largely held by BHPBIO and RTIO.<sup>20</sup> According to the Evans & Peck report, the holdings of junior explorers are too small to have a measurable competitive impact on iron ore sales<sup>21</sup>.
- 3.13 The Council has given insufficient weight to the possibility that there may not be (or there may be very few) other economically viable deposits in the Pilbara. Similarly, the Council has not properly taken into account the uncertainty as to whether there could be any potential vendors of proven iron ore deposits apart from BHPBIO and RTIO/HD. Even if such deposits exist, as junior explorers have apparently suggested to the Council, it is

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<sup>15</sup> NCC Draft Recommendation, para 7.79.

<sup>16</sup> NCC Draft Recommendation, para 7.79.

<sup>17</sup> "Proven" for the purposes of the JORC Code.

<sup>18</sup> On 1 December 2005 FMG announced an increase to its "probable reserve", however it is yet to announce any proven reserve.

<sup>19</sup> Evans & Peck August 2004, p 20.

<sup>20</sup> Evans & Peck August 2004, p 20.

<sup>21</sup> Evans & Peck, August 2004, p 4.

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possible that these deposits would be uneconomic to exploit even if the Mt Newman Service is declared.

- 3.14 In this regard, BHPBIO refers the Council to Confidential Annexure 3 to its submission dated 3 June 2005 as an example of an iron ore deposit that is unlikely to be economically viable.
- 3.15 The Council has also not considered the temporal dimension of this market. It is likely that in the next 5 years, supply and demand for iron ore will be brought into balance through increased production.<sup>22</sup> If this occurs, deposits which may appear economically attractive today, will not be so in 5 years time.

*Known deposits of marketable grade that are sufficiently close to the Mt Newman Line*

- 3.16 On present knowledge, there are no economic iron ore deposits in the Pilbara held by junior explorers that are both sufficiently close to the Mt Newman Line and are of a grade that would allow the ore to be marketed on a sustainable basis over the life of the project without blending.
- 3.17 It is unknown and uncertain whether iron ore deposits held by junior suppliers are of a grade that can feasibly be blended with higher quality iron ore to produce a product which meets current customer specifications. That is, iron ore tenements are only likely to be attractive to potential purchasers if the iron ore can be blended with the ore of BHPBIO, RTIO and/or Hope Downs (or potentially FMG).<sup>23</sup>

*Location*

- 3.18 Unless an iron ore deposit justifies construction of independent mine, rail and port facilities, the deposit must be sufficiently close to existing transport and processing equipment for the deposit to be of any interest to a potential purchaser. BHPBIO understands that there is a very limited number of iron ore deposits, if any, that are sufficiently close to the Mt Newman Line and that meet the conditions relating to size and quality of iron ore.

**Lack of port capacity and facilities**

- 3.19 Limited spare port capacity at Port Hedland restricts the attractiveness of iron ore tenements to potential purchasers. The Council recognises that access to port facilities is

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<sup>22</sup> "The short term forecast (5 years) indicates that exports will continue growth through 2010 with a possibility of world oversupply between 2006 and 2009 depending on China's growth rate." Evans & Peck, August 2004 p 8.

<sup>23</sup> Cazaly's Shovelanna deposit contained iron ore of lower quality but it could be blended with BHPBIO ore to produce a marketable product.

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an essential requirement for potential purchasers of iron ore tenements.<sup>24</sup> This limitation would not be affected by declaration.

*Public berths*

- 3.20 The Port Authority of Port Hedland (**PHPA**) owns and operates 3 public berths at Port Hedland through which various commodities and goods are handled. Presently, none of these berths handle iron ore. The PHPA has indicated to BHPBIO that these existing berths are unlikely to have any spare capacity for iron ore in the foreseeable future.
- 3.21 Construction of a new Panamax berth is required to allow export of iron ore from a public berth. Any new such berth that would be capable of handling iron ore is unlikely to be operational within the next 3 or 4 years. BHPBIO understands that any such development would also be conditional on a number of factors including:
- (a) clear title to a port site being granted by the State of Western Australia to PHPA;
  - (b) environmental approvals being granted; and
  - (c) financing for the berth being obtained.
- 3.22 A copy of a letter from the PHPA to BHPBIO dated 2 December 2005 concerning public berth capacity at Port Hedland is annexed to this submission.

*Proposed FMG Port facilities*

- 3.23 The construction of the FMG Port is dependent on the economic viability of FMG's Chichester Ranges project. The FMG Port is not economically justifiable on the basis of 5 to 10 mtpa from Mindy Mindy alone.
- 3.24 FMG has indicated that the initial capacity of its port will be 45mtpa. The initial capacity of the FMG Port is likely to be fully utilised by iron ore from FMG's Chichester Ranges deposits which are initially forecast to produce 45mtpa. In general, port facility costs are significantly greater than rail construction costs. Accordingly, any expansion of FMG's port will entail significant capital cost, and is another significant barrier to entry for any junior explorer. There are also significant operational issues and costs associated with the shipping of multiple products from the same berth.

**Access not essential for effective competition<sup>25</sup>**

- 3.25 The Council's finding that declaration of the Mt Newman Service is essential for effective competition in the iron ore tenements market is erroneous. Potential purchasers will

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<sup>24</sup> NCC Draft Recommendation, para 7.192.

<sup>25</sup> See NCC Guide, Part B, para 5.61

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compete for iron ore tenements whether or not they have access to the Mt Newman Service. The most significant factor in competition for iron ore tenements is the level of iron ore demand and prices.

- 3.26 The recent experience with Cazaly's Shovelanna iron ore deposit highlights this proposition. FMG and BHPBIO (and possibly others) competed vigorously to obtain the rights to exploit that deposit. Ultimately, Cazaly entered a conditional arrangement with BHPBIO under which Cazaly maintained its rights to exploit its deposit. All of this occurred without declaration of the Mt Newman Service. Likewise, there was competition for the Hope Downs deposit without declaration of the Mt Newman Service.
- 3.27 These recent examples demonstrate that suppliers of iron ore tenements already have a number of options available to them for exploiting their deposits and such options do not require access to the Mt Newman Service. Indeed, the Council has recognised that transactions in this market may take a number of different forms.<sup>26</sup>
- 3.28 As a result, BHPBIO does not have the ability or incentive to use its market power to adversely affect the ability of suppliers of iron ore tenements to exploit their deposits. Rather, BHPBIO, RTIO and FMG have strong incentives to seek out and efficiently exploit iron ore tenements and, as evidenced by recent activity, competition between them to do so is intense. That competition will in no way be enhanced by declaration and may, in fact, be weakened if declaration increases the risk of 'free riding' and deters BHPBIO and potentially RTIO from investing in a timely manner.
- 3.29 Specifically, a holder of an iron ore tenement has the following options to exploit its iron ore deposits, none of which are reliant upon access to the Mt Newman Service:
- (a) develop its own rail infrastructure (if the size and quality of the deposit permits);
  - (b) acquire a rail carriage service under the terms of the RTA or alternatively outside the terms of the RTA;
  - (c) enter into a joint venture arrangement with an existing iron ore producer or with a third party to construct a rail line;
  - (d) sell its deposit to an existing producer;
  - (e) sell its deposit to a diversified mining house (other than BHPBIO or RTIO) or a global steel mill; or
  - (f) sell ore at the mine gate to an existing iron ore producer.

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<sup>26</sup> NCC Draft Recommendation, para 7.60

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*Construction of independent facilities*

- 3.30 HDMS and FMG provide recent examples of iron ore explorers whose deposits have justified consideration of construction of independent mine, rail and port facilities. While HDMS ultimately decided to exploit the Hope Downs deposit by a different means, FMG is still proposing to construct independent facilities. This means of exploiting an iron ore deposit is available with or without declaration of the Mt Newman Service.

*Rail Transport Agreement*

- 3.31 Any third party with well advanced mining plans can acquire a rail carriage service under the terms of the RTA. That is, the RTA constrains the ability and incentive of BHPBIO to adversely affect competition in the iron ore tenements market. In this regard, the Council's finding that the RTA is not effective is erroneous on a number of counts.
- 3.32 Firstly, the fact that no iron ore producer has obtained access under the RTA does not reflect its efficacy or BHPBIO's market power. This is apparent from both instances where RTA negotiations have occurred with third parties:
- (a) in relation to the negotiations between HDMS and BHPBIO, the parties were in the process of negotiating terms of access under the RTA but HDMS then decided to exploit its iron ore deposits by alternative means, initially by construction of independent mine, rail and port facilities and later by joint venture arrangements with RTIO; and
  - (b) in the case of the discussions between FMG and BHPBIO, FMG did not meet the threshold under the RTA of having well advanced plans. Once FMG reaches this threshold, BHPBIO will be legally obliged to negotiate terms and conditions of a rail carriage service under the RTA.
- 3.33 Secondly, the Council's proposition that the access regime under the RTA cannot be a constraint on BHPBIO's supposed market power because the RTA is not an effective access regime under s 44G(2)(e) is wrong. This is because such a regime can act as a constraint on the use of market power even where that regime is not "an effective access regime" under s 44G(2)(e). A further limitation on BHPBIO's supposed market power is intervention from the WA Government.
- 3.34 Thirdly, as discussed above, the absence of other third party approaches for RTA access is a function of the port and deposit issues.

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*Joint venture*

- 3.35 The recent Hope Downs joint venture arrangements with RTIO illustrate the opportunity for new producers to develop their projects. This is another means of a new producer, who is located sufficiently close to existing infrastructure, and who has an economically viable deposit, gaining access to transport and processing equipment, port facilities, marketing infrastructure and other high grade ore for blending if required.

*Sale of tenement*

- 3.36 As identified by the Council, McCamey's Monster is an example of the sale of a deposit by a tenement holder to an existing producer that occurred regardless of declaration. The lack of other transactions of this sort is due to other factors, such as the size, location and quality of the deposit.

*Sale at mine gate*

- 3.37 BHPBIO has recently entered into a conditional arrangement with Cazaly to purchase ore from its Shovelanna deposit. Cazaly will mine and supply the ore to BHPBIO. In this way, rail and, importantly, port access have been secured for the Shovelanna deposit.
- 3.38 In any event, competition for iron ore tenements exists before the tenement is proven (for the purposes of the JORC Code). Cazaly's Shovelanna deposit has demonstrated an inferred iron ore resource (sufficient to attract strong interest from FMG, BHPBIO and possibly others), but it is not yet proven.

**Impact of iron ore prices**

- 3.39 The recent activity in sales of tenements, joint venture arrangements and mine gate sale of ore has arisen predominantly from the current high level of iron ore demand and prices. The relatively low level of transactions in the tenement market in the past was a function of the different market conditions for iron ore that persisted for many years, rather than the absence of rail access.

**MARKET FOR RAIL HAULAGE SERVICES**

**No demand for rail haulage services**

- 3.40 The only parties who would have a demand for rail haulage services are those who have deposits which can be developed as stand alone products. In relation to ores that need to be blended, existing producers will prefer to purchase those ores at the mine gate rather than after haulage to the port. An example of this situation is the recent conditional agreement between Cazaly and BHPBIO.
- 3.41 As stated above, on present knowledge, there are no iron ore deposits in the Pilbara held by junior explorers that are both sufficiently close to the Mt Newman Line and are of a grade that renders the ore marketable without blending.

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- 3.42 The absence of this demand is reflected in the absence of approaches to BHPBIO by junior explorers for rail haulage services under the RTA.
- 3.43 Even if the market for rail haulage services exists, the Council cannot be satisfied that access to the Mt Newman Service would promote competition in this market because:
- (a) other constraints exist that restrict competition irrespective of whether the Mt Newman Service is declared; and
  - (b) there are several alternatives available to holders of iron ore tenements that allow them to exploit their iron ore deposits but do not depend on access to the Mt Newman Service under Part IIIA.

**Constraints on competition other than access to the Mt Newman Service**

- 3.44 As indicated above, there are constraints related to the characteristics of the deposits (size, quality and location) and port constraints, which are likely to preclude any promotion of competition in the iron ore tenements market by declaration of the Mt Newman Service. These constraints also preclude any promotion of competition in the rail haulage services market by declaration of the Mt Newman Service. The demand for rail haulage services is only theoretical where there are no available port facilities. As these constraints are likely to persist, there is no reason to expect an increase in the demand for rail haulage services for the foreseeable future.

**Other alternatives**

- 3.45 In light of the various alternatives available to holders of iron ore tenements in exploiting their iron ore deposits, access to the Mt Newman Service is unlikely to increase demand for rail haulage services or competition between potential providers of rail haulage services.

**No promotion of competition in rail haulage market**

- 3.46 The only demand for the Mt Newman Service in the foreseeable future is likely to arise from BHPBIO and FMG. As stated above, it is unlikely that junior explorers are going to be in a position to develop or ship stand alone products. Consequently, there is no evidence to support the view that a specialist rail haulage provider will enter the rail haulage market.
- 3.47 Further, if BHPBIO wished to compete in the supply of rail haulage services, BHPBIO would not be able to provide port facilities to junior explorers on a cost effective basis because of the operational issues and complexities of maintaining separate product stockpiles at its port site.
- 3.48 Consequently, any ore hauled by BHPBIO for junior explorers would need to be delivered to the FMG berth for shipment. In view of these practical and economic limitations, it is impossible to envisage why any competition is likely to develop for the provision of rail haulage services.

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- 3.49 If FMG were to use the Mt Newman Service for quantities greater than its production rate at Mindy Mindy:
- (a) declaration would be unjustified in terms of criterion (b) and would most likely *lessen* competition by reducing the incentives for FMG to build its own line;
  - (b) the diseconomies of scope of shared use imposed on BHPBIO would be materially greater (as the volumes for which access was used would be materially greater, increasing the risk of interference and other negative externalities), so that access prices would need to be higher, reducing the competitive constraint associated with track access; and
  - (c) given the greater diseconomies of scope, the Council could not properly conclude that rail track and rail haulage were in separate markets and hence could not in any event find that competition had been promoted.
- 3.50 It seems doubtful that there are any parties other than FMG seeking to use the Mt Newman service and so a finding by the Council that competition would be promoted in the market for rail haulage services would amount to mere speculation.
- 3.51 Further, if there were such parties, the Council would still need to have sound reason to believe that the quantities supplied by those other parties would:
- (a) be sufficient to make such a rail haulage service economic and an effective competitive discipline on the RTA; and
  - (b) not be so great as to create significant diseconomies of scope, as such diseconomies would negate the Council's premise that rail track services and rail haulage services are in separate markets.
- 3.52 Accordingly, for the reasons above, competition would not be promoted.

**IN ANY EVENT, ANY PROMOTION OF COMPETITION WOULD BE TRIVIAL**

- 3.53 Even if access would promote competition in one of the relevant markets, any such promotion of competition would be trivial due to the existence of other constraints identified above and due to the availability of other options for junior suppliers of iron ore deposits.
- 3.54 In addition:
- (a) any junior explorers are likely to be too small to make any impact that is more than trivial in the relevant markets; and
  - (b) on the Council's analysis, declaration of the Service could only affect tenements within a narrow corridor of the Newman Line.

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*Junior explorers too small*

- 3.55 In relation to the Council's proposed iron ore tenements market, clearly BHPBIO, RTIO and FMG are potential suppliers in that market, despite the vertically integrated nature of their operations. Their size alone makes it unlikely that the addition of junior explorers would change the level of competition in that market. Further, the fact that these large players compete in an effectively competitive iron ore market implies that they would operate in an effectively competitive manner in the markets posited by the Council.

*Narrow corridor of the Newman Line*

- 3.56 The Council has recognised that new iron ore tenements are likely to be small deposits. To be economically viable, small deposits must be located close to transport. Therefore, to the extent that declaration of the Service removes a barrier to entry (and BHPBIO maintains that it would not, given the existence of the RTA), this would only be of benefit to those deposits close to the Mt Newman Line.
- 3.57 Given the Council has defined the market as Pilbara-wide, this impact is likely to be trivial.

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**4. CRITERION (f) - PUBLIC INTEREST**

**No quantitative analysis by Council**

- 4.1 The Council cannot reasonably satisfy itself that declaration is not contrary to the public interest without doing a quantitative comparison of the public costs and benefits associated with declaration, as compared to the most likely counterfactual. That counterfactual would involve third party access to a haulage service under the RTA. Such quantitative comparisons must take account of the fact that outcomes are uncertain by employing probability-weighted assessments of costs and benefits.
- 4.2 The Council has done none of these assessments, having simplistically concluded that when criteria (a) and (b) are met it simply presumes that declaration is not contrary to the public interest. However in this particular case, such a presumption is very dangerous because the Council has construed the criteria (a) and (b) tests so that they are trivially met for any vertically integrated or sole-user railway system.

**Heightened importance of criterion (f) in this case**

- 4.3 Previous recommendations of the Council concerning declaration and related matters<sup>27</sup> have adopted the view that criterion (b) (concerning whether it would be uneconomic to develop another facility to provide the service in question) is always met for facilities such as natural gas pipelines and railway infrastructure that exhibit natural monopoly characteristics.
- 4.4 The stance adopted by the Council in its draft recommendation on the FMG application, that declaration of the Mt Newman Service would promote competition in the Pilbara rail haulage market, would imply that declaration would promote competition for every vertically integrated or single-user railway line.
- 4.5 The significance of this approach is that, if the Council's logic on criterion (a) as outlined in its draft recommendation is not successfully challenged, both criteria (a) and (b) would virtually always be met, *by definition*, for vertically integrated or single-user railway lines and other transportation systems exhibiting natural monopoly characteristics and vertical integration. The only protection remaining to the property rights of the owners of such systems<sup>28</sup> resides in the public interest test, criterion (f).

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<sup>27</sup> Related matters include coverage and revocation decisions under the Gas Code, which rely on criteria which are virtually identical to the declaration criteria under Part IIIA.

<sup>28</sup> On the generally met assumptions that the facility is of national significance and access can be provided without risk to human health and safety.

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- 4.6 When criterion (f) is the only one of the declaration criteria that is not trivially met, the Council cannot reasonably satisfy itself the tests are met without performing a quantitative assessment of the net public benefit of declaration.
- 4.7 It is noted, in this respect, that the benefits the Council appears to ascribe to declaration are slight. Thus, given the scope for use of the RTA, there is little or no saving in social costs from track access. Additionally, the social benefits from the promotion of competition in the markets the Council has identified seem at most negligible. As a result, even a very low probability of material efficiency costs being imposed must overwhelm those claimed social benefits.
- 4.8 Set against this standard, the Council's current discussion of the public interest criterion does not, in BHPBIO's view, reflect as serious an assessment as that criterion deserves and demands. Rather, the discussion assumes that the promotion of competition in the markets the Council identifies could be sufficient for the criterion to be met. In BHPBIO's view, that is incorrect because:
- (a) firstly, the Council must assess the materiality of the claimed benefits;
  - (b) secondly, it must compare those benefits to the quantum of possible costs; and
  - (c) thirdly, it must engage in an evaluation of the risks arising from the uncertainty inherent in the estimates.
- 4.9 Until the Council carries out such an assessment, it cannot be satisfied that the criterion is met. BHPBIO believes such an assessment shows that declaration would, on balance, impose costs rather than benefits on Australia, with the result that the criterion cannot be held to be met.
- 4.10 It is axiomatic that a declaration that had the effect or likely effect of reducing the efficiency and competitiveness of the Australian economy without proportionate countervailing benefits to the community would be contrary to the public interest.
- 4.11 BHPBIO believes that the public benefits that are likely to arise from promotion of competition (if any) in the markets identified by the Council will be manifestly insignificant in comparison to the potentially overwhelming costs to the Australian economy in the form of lost iron ore exports and lost revenue. An analysis of these costs is being undertaken on behalf of BHPBIO and the results will be provided to the Council as soon as they are available and no later than 6 January 2006.
- 4.12 It is almost a universal experience that the processes involved in an access regime add significant delay to investment and innovation decisions and implementation. There are abundant examples of this in the Australian regulatory scene.<sup>29</sup> The delays in these cases

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<sup>29</sup> These examples include the Queensland Competition Authority's determination of reference tariffs for the Dalrymple Bay Coal Terminal, the development and application of the regulatory tests for electricity transmission

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are not due simply to multiple user status but involve a number of generic issues relating to the facility, such as asset valuation and rate of return.

- 4.13 The delays in this circumstance may be even greater as the present case involves application of an access regime to a vertically integrated, complex production system and this is without precedent. It is noteworthy, as acknowledged by the Council, that there have not been any arbitrations conducted by the ACCC under Part IIIA of the Trade Practices Act. It can be expected that it will take a considerable period of time for the ACCC to become acquainted with the intricacies of this system.
- 4.14 In particular, the costs of regulatory delays to expansions, which have been discussed in detail earlier in this Outline, would be considerable (A\$1.6 billion). As noted above, there are, of course, broader costs, such as reduced royalties, foregone taxes and lower employment, which will accrue from regulatory delay, in addition to the opportunity costs to BHPBIO.
- 4.15 Delay in expansion is likely to have significant impacts on the volume of iron ore exports other than just by lost production. Delayed investment responses to demand and a reduced ability to deliver products in a timely and efficient manner are likely to affect the reputation and international competitiveness of BHPBIO specifically, and the Pilbara iron ore industry generally.
- 4.16 Further to the discussion above, even if there were only a reasonable probability of such losses occurring, those losses are sufficiently high and the detriment of such a magnitude that the Council could not be satisfied that it was in the public interest to declare the service.
- 4.17 Apart from these losses, there are a number of other issues associated with the application of Part IIIA to infrastructure. These issues, which are heightened in the case of export infrastructure, include:
- (a) the imposition of delays or barriers to the introduction of new technology and work practices;
  - (b) the deterrent to investment in infrastructure because of the real risk of:
    - (i) expropriation of latent capacity; and
    - (ii) possible failure to receive compensation for all of the costs imposed due to the limitations of the regulatory process; and
  - (c) the costs imposed by the regulatory process, both direct and in foregone revenues.

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interconnectors, the telecommunications access arbitrations conducted under the Trade Practices Act 1974, the ACCC's consideration of access pricing for Telstra's ULL service and the Queensland Competition Authority's approval of Queensland's Rail's rail track access undertaking.

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- 4.18 There is further discussion of these issues, and related issues, in BHPBIO's Submission to the Council of Australian Governments (12 October 2005) in connection with the Review of National Competition Policy. A copy of this submission is attached.

*Lack of appreciation of inefficiencies*

- 4.19 The reference by the Council to the ability of BHPBIO to avoid interference efficiencies by the timetabling of trains demonstrates a lack of appreciation of the current mode of operation of BHPBIO's railway system and the associated problems. There is such a dynamic variability in the departure and arrival of BHPBIO's trains that the use of a train schedule is for rough planning purposes only. Moreover, BHPBIO has recently adopted a "run when ready" system rather than set time scheduling in order to optimise use of the system and reduce constraints. There are a number of other operational issues which have also been glossed over. BHPBIO proposes to provide data to the Council on these issues.

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**5. IDENTIFICATION OF THE RELEVANT SERVICE**

- 5.1 FMG's application seeks declaration of the service provided by that part of the Mt Newman Line which runs from a rail siding near Mindy Mindy to port facilities at Nelson Point in Port Hedland.
- 5.2 As stated in *re Application by Virgin Blue for Declaration of Airside Services at Sydney Airport*, the Council has some scope to amend the definition the subject of an application to ensure that the service description is appropriate.
- 5.3 FMG has stated in the Affidavit of Julian Tapp dated 17 August 2005 that it only intends to use the service to carry iron ore mined at Mindy Mindy to the point where the Mt Newman Line intersects the Goldsworthy Line. There is no question of FMG seeking to use port facilities at Nelson Point in Port Hedland. The purpose of FMG's application for declaration of the Goldsworthy line was to enable the raling of ore to its proposed port facilities at Anderson Point.
- 5.4 BHPBIO accordingly submits that the service in question should be taken by the Council to include only that part of the Mt Newman Line which runs from the rail siding near Mindy Mindy to the point where the Mt Newman Line intersects the Goldsworthy line. This intersection point is approximately 28 kilometres from Nelson Point.

*Associated infrastructure*

- 5.5 The facility providing the service to be declared comprises no more than the *minimum bundle* of assets required for the access seeker to use the service. The associated infrastructure referred to in FMG's application is too vague and broad, and includes assets other than the minimum bundle of assets required for FMG to use the service. BHPBIO proposes to make detailed submissions on what associated infrastructure is necessary for the use of the service.

*Use of Goldsworthy Line*

- 5.6 In its Statement of Reasons dated November 2004, the Council found that the service provided by the specified part of the Goldsworthy line was not a service to which Part IIIA applied and that the Council had no jurisdiction to further consider this part of FMG's application.
- 5.7 As a result, FMG no longer has a means to transport iron ore to be mined at its Mindy Mindy mine from the point where the service terminates (the intersection of the Mt Newman and Goldsworthy lines) to FMG's proposed port facilities at Anderson Point.
- 5.8 As that part of the Goldsworthy line between the intersection of the Mt Newman and Goldsworthy lines and FMG's proposed port facilities will be heavily congested after the implementation of proposed expansion projects, BHPBIO considers that there will be substantial costs and difficulties associated with accommodating FMG on that line. In the

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event that the service were to be declared, BHPBIO considers that other access seekers would also have difficulties transporting ore to available port facilities using that line.

- 5.9 BHPBIO considers that the difficulties and costs associated with transporting ore from the point where the service terminates to available port facilities is a relevant consideration that the Council should take into account in determining whether or not it is satisfied that it would be uneconomic for anyone to develop another facility to provide the service, that access to the service would promote competition, and that access would not be contrary to the public interest.

### *Use of intellectual property*

- 5.10 In relation to criterion (d) (Health and Safety) the Council has stated that "BHPBIO's submissions suggest that a third party cannot operate its trains on the Mt Newman Facility efficiently and safely without the use of BHPBIO's rail technologies, including the intellectual property in such technologies". On this basis the Council concluded that:
- (a) the use of BHPBIO's intellectual property is essential to the use of the service and therefore is likely to constitute part of the service and is therefore capable of being declared; and
  - (b) the intellectual property in question is an integral but subsidiary part of the service.
- 5.11 Contrary to the Council's assertion, BHPBIO does not consider that the use of all of BHPBIO's rail technologies, or the intellectual property in these technologies, is required or essential for FMG to use the service. This is evident from the statement of Robert Ridley, previously submitted to the Council, that: "[I]n general terms, another user could run its rolling stock on the Newman line without using any of the special technology described above".
- 5.12 Rather, BHPBIO's previous submissions related to the efficiencies or benefits that BHPBIO has achieved through use of this technology, and the inefficiencies that shared use of the Facility by another party who does not have access to this technology may impose on BHPBIO.
- 5.13 BHPBIO contends that there is a material difference between the *minimum bundle* of assets required for FMG to use the service, and those that would enable FMG to use the service as efficiently as BHPBIO. Any assets that enhance efficiency but which are not necessary for access should not be included in the minimum bundle of assets used as part of the service.
- 5.14 Accordingly, BHPBIO proposes to make submissions what associated infrastructure is required for access to the service, and the extent to which the use of any intellectual property is an integral but subsidiary part of the service. In particular, BHPBIO proposes to submit that the Mt Newman service, properly defined, cannot include:
- (a) the maintenance of rolling stock by BHPBIO;

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- (b) the machining of rolling stock wheels;
- (c) the use of automatic train protection systems; or
- (d) the use of rolling stock fault detection systems.

**BHP BILLITON IRON ORE  
5 December 2005**