NATIONAL
COMPETITION
COUNCIL

Robe Railway
Hamersley Railway
Goldsworthy Railway

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

Summary of key conclusions from the Draft Recommendations

20 June 2008

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1 Introduction

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

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

1.2 A map showing the location of the Pilbara railways that provide these services is attached as Appendix A.

1.3 A declaration application is the first step in a process by which third party access seekers can obtain a legal right to negotiate for use of a monopoly service and gain recourse to arbitration by the Australian Competition and Consumer Commission (**ACCC**) in the event that access cannot be agreed through commercial negotiations between the access seeker and the provider of the service.

1.4 The Council has prepared separate Draft Recommendations in respect of each application. These were released on 20 June 2008 and are available on the Council's website at *www.ncc.gov.au*. This summary covers all three applications and is intended to outline some of the key elements of the Council's assessments of these applications and the conclusions reached in the Draft Recommendations. The summary is not part of the Council's Draft Recommendations and is not a complete statement of the reasons which are contained in those recommendations.

Draft recommendations

1.5 The Draft Recommendations set out the Council's views and recommendations based on information available at this point in time.

1.6 The Draft Recommendations indicate that, in relation to each application, the Council has reached a preliminary view that each service for which declaration is sought satisfies each of the criteria set out in section 44G(2) of the *Trade Practices Act 1974* (**TPA**) and meets the other requirements relating to declaration set out in Part IIIA of the TPA. Accordingly, the Council **intends to recommend to the designated Minister (Hon. Wayne Swan MP, Treasurer) that the Robe, Hamersley and Goldsworthy services each be declared for a period of 20 years.**

1.7 The Council now seeks submissions from interested parties in response to the Draft Recommendations before completing the final recommendations. The closing date for submissions is 21 July 2008. After considering the further submissions it receives, the Council will provide its final recommendations to the Treasurer.

1.8 The Council expects to provide its final recommendations on or before 29 August 2008. The designated Minister then has 60 days to make decisions on each recommendation. If no decisions are made in that time then the applications are deemed to have been declined. The Minister's decisions can be reviewed by the Australian Competition Tribunal. The Council's final recommendations and the Minister's reasons for decision will be published when the decisions are released.

2 The applications

Robe, Hamersley and Goldsworthy applications

2.1 In these applications, the Applicant has sought access to the rail track service provided by the Robe, Hamersley or Goldsworthy railways respectively, in order to be able to offer a rail haulage service to mining companies seeking to move bulk materials between any two points on the railway, including interconnection points with other rail networks and railway lines. The applications also seek access to all associated infrastructure necessary to allow third party trains and rolling stock to move along the railway (for example: track structures, bridges, sidings and passing loops, and train control and maintenance systems). Declaration of each service is sought for a period of 20 years.

2.2 The Applicant has sought declaration of *all points* services allowing access to run trains between any places on a railway rather than *point to point* services which would provide access between two specified points on a railway. The Applicant has sought an *all points* service so that it (and potentially other access seekers) can offer haulage services to a range of potential customers who may wish to have ore transported from different mine locations to one or more ports accessible through use of the particular railway, possibly in conjunction with other railways or means of transport.

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

Other Pilbara railway applications

2.4 The Council previously considered an application by Fortescue Metals Group (the parent company of the Applicant) for a recommendation that a service provided through the use of the Mt Newman Railway (from a rail siding near Mindy Mindy to Port Hedland) (**Mt Newman Service**) be declared. On 23 March 2006, the Council recommended that the Mt Newman Service be declared for a period of 20 years. The Mt Newman Service was deemed not to have been declared after the then Treasurer made no decision within 60 days of receiving the Council's recommendation. On 9

June 2006, Fortescue Metals Group sought review of the deemed decision by the Australian Competition Tribunal. That review is underway.

Issues regarding the applications

Council's power to consider the Hamersley Application

2.5 On 24 December 2007, Hamersley Iron Pty Ltd (**Hamersley**) (a Rio Tinto subsidiary) applied to the Federal Court for orders prohibiting the Council from considering the application for declaration of a service provided by the Hamersley Rail Network.

2.6 This matter was heard by Justice Weinberg in the Federal Court on 26 March 2008. The Court delivered judgment on 5 May 2008, dismissing Hamersley's application.

Production process exception

2.7 Rio Tinto Iron Ore and BHP Billiton Iron Ore submitted that the Council does not have the power to deal with or make a recommendation in respect of these applications because each of the services for which declaration is sought is a production process and excluded from the definition of 'service' by paragraph (f) of section 44B of the TPA, which provides that a service does not include the use of a production process, except to the extent that it is an integral but subsidiary part of the service.

2.8 The extent of the 'production process exception' has been the subject of judicial consideration at several levels. The authority that the Council must apply is that established by the Full Court of the Federal Court's decision in *BHP Billiton Iron Ore Pty Ltd v National Competition Council* [2007] FCAFC 157.[1]

2.9 In that case the Full Federal Court did 'not accept that the phrase "the use of a production process" includes a step in a production process for the purposes of paragraph (f)' (at [172]). The Court found that the production process exception did not apply to the Mt Newman and Goldsworthy railways, because these railways were at most only a part of any production process with which they might be associated and the exception did not apply to parts of any production process.

2.10 In the Council's view the relevant circumstances leading the Full Federal Court's ruling in that case are indistinguishable from the circumstances of these three applications and it is not prevented from dealing with these applications on the grounds that the relevant services are the use of a production process.

[1] The High Court has given special leave for an appeal against this decision, but until a decision is made the Council must apply the Full Federal Court's decision.

Section 44F(1) requires a 'particular service'

2.11 Rio Tinto Iron Ore submitted that the applications fail to identify a 'particular service' for which declaration is sought. The company suggested that because the applications provide for rail access between all points on a railway, they involve an 'infinite number of services'. It argued that this does not comply with section 44F(1) of the TPA, which requires that applications under Part IIIA be made in respect of a particular service. Rio Tinto Iron Ore considered that the requirement that applications relate to a particular service is necessitated by the need for the Council to determine whether the declaration criteria are satisfied, and 'the infinite number of services that in substance have been applied for makes it impossible to meaningfully apply the declaration criteria'.

2.12 The Council agrees with Rio Tinto Iron Ore's general submission that an application must be made with sufficient particularity as to the service to which it relates to enable it to understand what is being sought and to make the assessments and judgments required under Part IIIA. However, in the Council's view the approach proposed by Rio Tinto Iron Ore is too narrow and unworkable and the particular service for which the Applicant is seeking declaration is sufficiently described and delineated so that the Council can fulfil its responsibilities under Part IIIA.

Changes or additions to the applications

2.13 Rio Tinto Iron Ore and BHP Billiton Iron Ore submitted that Part IIIA does not include any mechanism to permit declaration applications to be amended and that the various amendments made by the Applicant to correct the identification of parties to the various joint ventures that own or operate the railways invalidates the applications.

2.14 In the Council's view precise information as to the identities and roles of the various parties involved in the provision of a service may be difficult for an applicant for declaration to determine. Accordingly, to require that an application proceed on the exact terms on which it was first submitted, in circumstances such as have arisen in these cases, would not accord with the purpose of Part IIIA and would create anomalous results.

2.15 The Council considers that it may allow an applicant to provide supplementary material, particularly in circumstances where the clarification occurs early in the process and no possible prejudice is suffered by any party. The Council considers that the provision of supplementary information of the type provided in these cases, where no prejudice is suffered by any party, does not invalidate an application for declaration.

3 Access regulation under Part IIIA

Objectives of access regulation

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

3.2 In a limited number of circumstances, however, the underlying economics associated with the provision of specific infrastructure or similar services are such that a single facility can service all current and reasonably anticipated demand at a lower cost than two or more facilities. Where participation in what would otherwise be competitive markets depends on access to such a facility, competition is likely to be significantly constrained with consequent losses in efficiency and innovation, unless mechanisms exist to ensure that access is available on appropriate terms. Alternatively the economy would be burdened with inefficient and wasteful duplication of costly facilities.

3.3 In these situations, access regulation aims to promote effective competition in markets that depend on using the services of facilities that cannot be economically duplicated. The intended outcome is that competition in dependent markets is promoted and inefficient duplication of costly facilities avoided.

Submissions on access regulation policy

3.4 In response to its call for submissions on the three applications the Council received a number of submissions that addressed broader policy issues relating to whether access regulation is appropriate in relation to these railways or more generally. The Council is also aware of calls for the inclusion of an 'efficiency override' in the declaration process to ensure declaration is not available where the efficiency of a service provider's operations would be impaired by access.

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

3.6 The objective of Part IIIA and the provisions governing both declaration decisions and arbitration of access disputes explicitly recognise the relevant interests of the various

parties affected, including the legitimate interest of service providers in preserving their use of a service and making a commercial return on investment in infrastructure and other facilities. Part IIIA also allows for a broad consideration of the public interest that permits consideration of the effects of a declaration on investment activity.

3.7 In relation to the introduction of an efficiency override the Council notes that declaration criterion (f) provides that the Council recommend against declaration unless it is satisfied that access is not contrary to the public interest. In effect, where the Council considers that access is contrary to Australia's public interest it must recommend against declaration.

The declaration criteria

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

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

(b) that it would be uneconomical for anyone to develop another facility to provide the service

(c) that the facility is of national significance, having regard to:

(i) the size of the facility or

(ii) the importance of the facility to constitutional trade or commerce or

(iii) the importance of the facility to the national economy

(d) that access to the service can be provided without undue risk to human health or safety

(e) that access to the service is not already the subject of an effective access regime, and

(f) that access (or increased access) to the service would not be contrary to the public interest.

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

4 Criterion (a) – Promotion of competition

4.1 Criterion (a) provides that the Council cannot recommend that a service be declared unless it is satisfied that access (or increased access) to the service would promote a

material increase in competition in at least one 'dependent market' other than the market for the service.

The dependent market(s)

4.2 The Council considers that the most relevant dependent markets for each application are:

- a market for haulage services for iron ore on the particular railway, and
- the market for tenements that contain iron ore in the Pilbara.

4.3 There may be other markets that might also be relevant, such as a market for mineral tenements more generally or for tenements containing minerals other than iron ore, or for haulage of other mineral ores or mineral ores more generally. However, because iron ore constitutes the vast bulk of Pilbara mineral ore production, the Council has concentrated on haulage for iron ore and iron ore tenements.

4.4 The Council does not accept a variety of arguments from BHP Billiton Iron Ore and Rio Tinto Iron Ore that these and other markets do not exist in their own right and are only parts of a single global market for iron ore. The Council considers that such a broad approach is contrary to established approaches to market definition and would obscure any meaningful competition analysis.

4.5 The Council notes that it considered the global market for iron ore in its 2006 Mt Newman Recommendation and found that it was effectively competitive and no party suggested these applications would change that situation.

The market for haulage services

4.6 The Council considers that there is a separate market for haulage services for iron ore associated with each railway, largely determined by the area within which it may be economic to access a haulage service provided on the particular railway.

4.7 The Council notes arguments, principally by Rio Tinto Iron Ore and BHP Billiton Iron Ore, that access would not promote competition because port facilities are not available to allow exports of iron ore and there are other means of transporting iron ore in the Pilbara. However the Council generally agrees with the Western Australian Government, which submitted that the Council 'should not examine issues of port access in deciding whether to [recommend that the designated Minister] declare the Pilbara iron ore railways'.

4.8 The Council does not consider that certainty regarding specific port access is a necessary precondition to satisfying criterion (a). While there are capacity constraints in relation to port facilities that may impact on haulage services, at least in the short term, there are a range of prospective port developments under consideration and

such constraints are unlikely to persist in the medium or long term. There are strong commercial drivers for expansion of port facilities to support continued growth in iron ore exports from the Pilbara.

4.9 The Council concludes that the availability of third party access to the Robe, Hamersley and Goldsworthy services would have a material effect on competition in the market for iron ore haulage services on the each railway. At present there is no haulage service available for use by parties that are independent of the service providers. At best without access there would be only a single provider of iron ore haulage services on each railway. With access there is the likelihood of new entry—the Applicant has indicated that it would provide a rail haulage service and there is the prospect that other entities would also offer such a service. On any reasonable view these outcomes would constitute a material promotion of competition beyond what would be, without third party access, at best a monopoly.

The market for iron ore tenements

4.10 A 'tenement' is the right under licence to carry out prospecting, exploration or mining activity in respect of a specific piece of land. Tenements in the Pilbara are traded in a variety of ways, including a transfer of the licence (for consideration, and subject to official approval in some cases) or the formation of joint venture arrangements whereby the entity holding the licence shares the proceeds from exploiting the tenement with another entity, usually in return for capital for further development or to construct the mining infrastructure. These transactions are in effect different ways of transferring the right to develop a proven deposit. In some situations the sale of shares in the corporate entity that holds the licence to exploit the tenement can in effect amount to a transfer of rights in respect of a tenement or group of tenements, but generally the Council does not regard trading in the shares of mining companies as transactions within the iron ore tenements market.

4.11 The Council considers that the geographic dimension of the market for tenements containing iron ore is Pilbara wide and focuses on the trading of tenements that are likely or shown to contain a defined ore reserve.

4.12 Without third party access to rail infrastructure services, a business's capacity to mine a tenement and export iron ore depends on it entering an arrangement with the owner of the proximate rail infrastructure for the sale of ore at the mine or an agreement to establish a joint venture development/marketing arrangement. While such arrangements might be commercially negotiated they are likely to occur only on terms that suited the owner of the rail infrastructure. Without access to rail infrastructure services, tenement owners will have a reduced ability to develop their tenements (because returns will be less without access to rail transport, and tenement owners will be less likely to be able to raise the funding necessary to develop a deposit). Moreover potential purchasers of iron ore tenements (other than BHP Billiton Iron Ore and Rio Tinto Iron Ore) will have less incentive to purchase a

tenement if there is no viable means of transporting the mined ore for export. This is likely to lessen the value of tenements and generally make acquisition of tenements by third parties less attractive than in a competitive market.

4.13 While there are some exceptions where tenements may be developed without access to the one of the railway lines which are the subjects of these declaration applications, these exceptions are likely to be relevant for only a small proportion of iron ore tenements in the Pilbara and are unlikely to constrain to any great extent the ability of entities that both provide rail infrastructure services and compete in the tenements market from exercising their market power in the tenements market. In particular, road transport is viable only for shorter distances and small quantities.

4.14 In the Council's view access to the Robe, Hamersley and Goldsworthy services is likely to reduce the ability and incentives for large integrated iron ore producers/haulage service providers to limit competition for the acquisition of tenements by refusing to offer haulage services to non-associated parties.

4.15 The Council considers that third party access will have a material effect on competition in the market for tenements. Access would generally allow significantly greater choice for tenement owners. It would allow them greater opportunity to develop their tenements and market iron ore in their own right. It would enable a greater array of potential purchasers of tenements and joint venture partners, reducing the scope for the exercise of market power in relation to the acquisition of tenements. This would likely increase the worth of tenements and stimulate exploration for iron ore, feasibility testing to define ore reserves, project construction and the production and export of additional iron ore. Access would therefore be likely to promote a material increase in competition in the Pilbara iron ore tenements market.

Conclusions on criterion (a)

4.16 The Council concludes that access to each service for which declaration is sought would promote a material increase in competition in both the market for haulage services for iron ore on the particular railway and the market for iron ore tenements in the Pilbara and that each application satisfies criterion (a).

5 Criterion (b) – Uneconomical to develop another facility

5.1 Criterion (b) requires that the Council be satisfied that 'it would be uneconomical for anyone to develop another facility to provide the service' sought to be declared. This criterion seeks to ensure that declaration is limited to situations where the development of additional facilities would increase costs, waste economic resources and generally be contrary to Australia's national interest.

5.2 Criterion (b) is concerned with Australia's national interest not the private interests of any particular parties. The Council and the Australian Competition Tribunal have consistently found that the appropriate test for assessing whether criterion (b) is met is a social (national benefit) test.

5.3 The assessment of criterion (b) centres on identifying whether a facility exhibits natural monopoly characteristics such that a single facility is capable of meeting likely demand at lower cost than two or more facilities such that it is 'uneconomical' to duplicate the facility and society's resources are most efficiently used and costs minimised if additional facilities are not developed.

5.4 In considering whether criterion (b) is satisfied the Council:

- considers whether there are any alternative facilities that could provide the service for which declaration is sought
- considers the economic characteristics of heavy haul railways, including the characteristics of the Pilbara railways, to determine whether each railway exhibits natural monopoly characteristics
- considers the likely current and forecast demand for the various services arising from the service provider's haulage needs and those of third parties were access available
- examines whether foreseeable demand can be met within the capacity (current and planned) of the relevant railway, and
- where access is likely to result in demand exceeding capacity, compares the likely costs of expanding the relevant railway to meet the excess demand with the costs of constructing an alternative facility to meet the extra demand of access seekers.

Alternative facilities that could provide the service

5.5 Rio Tinto Iron Ore and BHP Billiton Iron Ore both submitted that there are other railways that could provide the rail access services sought by the Applicant. However it appears to the Council that any rail access service that might be provided by other Pilbara railways would not permit the Applicant (or another access seeker) to connect at the majority of the points that would be accessible if there is access to the track service provided by the railway which is the subject of the particular application. The Council considers that the provision of track services from different facilities allowing haulage from some common pick up points but not others, and transport to different ports via different routes does not amount to provision of the service for which access is sought by way of an alternative facility.

Presence of natural monopoly characteristics

5.6 A natural monopoly exists if, given the level of demand for a good or service, one facility can produce the required output at lower cost than can two or more facilities. The basic conditions for natural monopoly generally relate to the nature of costs and investment—such as the 'lumpiness' of investment and related economies of scale and/or economies of scope. It is generally accepted that a natural monopoly is more likely to exist where capital costs are large relative to variable costs (implying high average costs compared with marginal costs).

5.7 Heavy haul railways appear to have relatively high capital costs relative to variable costs and investment tends to be of a discrete and 'lumpy' nature. It appears that heavy haul rail systems are able to achieve significant economies of scale that persist as output levels increase. These features of heavy haul railways indicate that the Robe, Hamersley and Goldsworthy railways are likely to be natural monopolies—such that a single rail track operator is likely to be able to deliver services at lower cost than two or more track operators over a wide range of demand levels.

Demand and capacity

5.8 Demand for the services for which declaration is sought will arise from the haulage requirements of the service providers and other parties with iron ore resources in the vicinity of the particular railway. This could include a mining company that wishes to haul on its own account or that seeks to use haulage services offered by other rail operators that have access—this potentially includes the Applicant, the existing service provider (if it chooses to provide haulage services) and other iron ore haulers or specialised rail operators.

5.9 The Council accepts there are difficulties in determining with any precision the likely future demand for the various services. However, the Council does not believe that precise numeric estimates of demand requirements are an essential element of criterion (b). The Council does not accept that if precise calculations cannot be made then criterion (b) can never be satisfied and an application must fail.

5.10 In order to estimate third party demand for each service in the short and medium term, the Council has sought to identify the parties who could potentially use the each service (directly or indirectly) over the next five to ten years.

5.11 The Council acknowledges that there is scope for demand to grow beyond the levels identified by the Council in the longer term given the continuing high demand for iron ore and consequent price increases, but at this stage it is unclear where this demand might occur and at what levels.

5.12 In the short term, the Council considers that it may be possible to accommodate some additional third party demand on some sections of the various railways as

currently configured. However, over the medium and long term it is unlikely that demand can be accommodated within currently configured capacity. In that eventuality, Part IIIA allows for a facility to be expanded to meet demand, with access seekers funding that expansion.

The cost of expansion compared to duplication

5.13 Even where a particular railway cannot accommodate likely demand, it will still be uneconomical to duplicate a facility where the railway can (continue to) be expanded to meet the additional demand at a lower cost than building a new railway could. Criterion (b) therefore requires an assessment of whether it is less costly to meet the demand for the service sought to be declared by expanding the existing facility or by developing and operating another facility.

5.14 Given that the Pilbara iron ore railways generally exhibit natural monopoly characteristics, the Council concludes that the continued expansion of an existing facility will involve less cost than the construction of a new facility, across a wide range of demand levels. Because some of the major construction costs of a railway, such as the acquisition of land for the railway easement, earthworks, signalling infrastructure, construction of bridges and tunnels are avoided when expanding an existing railway, it is likely that expansion will almost always be cheaper than duplicating a railway facility. It is only when a railway is at or approaching the maximum scope of its potential capacity that economies of scale are exhausted and it becomes economical to develop a duplicate facility.

5.15 The Council found that there is no evidence to suggest that the Robe, Hamersley or Goldsworthy railways are distinguishable from other heavy haul railways that exhibit natural monopoly characteristics or that these railways are close to, or at, maximum potential capacity. Therefore expanding these railways to accommodate third party demand is likely to be more economical than duplicating the facility.

Conclusion on criterion (b)

5.16 The Council is satisfied that each application satisfies criterion (b).

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

6.1 Criterion (c) seeks to ensure that only those facilities that the Council is satisfied are of national significance can be the subject of a declaration under Part IIIA of the TPA. The Council must be satisfied that the facility is of national significance, having regard to one or more of the following matters:

- the size of the facility
- the importance of the facility to constitutional trade or commerce, or
- the importance of the facility to the national economy.

6.2 Criterion (d) requires that the Council be satisfied that access can be provided without undue risk to human health or safety. This involves a consideration of:

- the nature of the potential risks associated with access, and
- whether access can be provided in a manner that removes or appropriately manages any such risks.

6.3 No party submitted that these railways are not of national significance given their size and critical role in a major export industry.

6.4 There were some submissions raising possible safety issues but the Council is unaware of any evidence to suggest that regulation of rail safety would be made less effective as the result of access.

6.5 The Council is satisfied that both these criteria are met in respect of each application.

7 Criterion (e) – Effective access regime

7.1 Criterion (e) provides that the Council must not recommend that a service be declared unless it is satisfied 'that access to the service is not already the subject of an effective access regime'.

7.2 The Council has considered whether any service for which declaration is sought is already subject to an effective access regime in terms of:

- the Western Australian Rail Access Regime
- the relevant State Agreement Act(s), or
- the proposed Pilbara Rail Haulage Regime.

7.3 The Western Australian Rail Access Regime does not apply to any of the railways covered in these applications.

7.4 While various State Agreement Acts provide for haulage of ore on the Pilbara railways, none of these have been certified as an effective access regime under

Part IIIA and as noted by the Western Australian Government, 'no independent access seeker has been able to negotiate satisfactory access arrangements with the [State] Agreement companies'. In any case, any access rights provided under the State Agreement Acts are haulage rights, not rail track access rights as sought in these applications.

7.5 Neither the Western Australian Rail Access Regime, nor the various State Agreement Acts provide effective access regimes for the rail access services sought by the Applicant.

7.6 The Western Australian Government has recently commenced public consultation on a proposed Pilbara Rail Haulage Regime, which might provide for access to haulage services provided by the service providers on their particular railways. The Western Australian Government has released an issues paper and exposure draft of the regime and will decide whether to proceed with the proposal once it has considered the submissions it receives.

7.7 At this stage the Council cannot be confident as to the content and timing of the proposed Pilbara Rail Haulage Regime and, as the Western Australian Government recognises, considerable barriers exist to the regime's ultimate implementation. In any event, the proposed Pilbara Rail Haulage Regime would apply to haulage services, not rail access services. The regime cannot therefore be an effective access regime for rail track services. However, the implementation of a demonstrably effective regime regulating the availability and pricing of haulage on the Robe, Hamersley and Goldsworthy railways might be a significant factor in considering the benefits from access under criterion (f) and may also be relevant to considering whether access would promote a material increase in competition under criterion (a).

7.8 To the extent that haulage is an acceptable substitute for running trains and meets the requirements of tenement owners to transport ore, it may be that the extra competition that would arise from access to rail track services may be immaterial. Alternatively it may be the access to rail track services would enhance the operation of the proposed regime relating to haulage services by maintaining competitive options for parties to run their own trains if haulage prices are unreasonable. At this stage, however, these issues are speculative as the Western Australian Government is yet to make a decision and any regime has not been implemented.

8 Criterion (f) – Public interest

8.1 Criterion (f) provides that the Council cannot recommend that a service be declared unless it is satisfied 'that access (or increased access) to the service would not be contrary to the public interest'.

8.2 Rio Tinto Iron Ore and BHP Billiton Iron Ore submitted that access to their railways will convert efficient single user vertically integrated infrastructure operations into regulated multi user facilities with 'inevitable losses in efficiency'. They point to comparisons between the 'uncoordinated and ineffective' responses of eastern Australian coal exporters and the 'effective' responses of their iron ore export facilities to the sudden upturn in demand from China as evidence of this.

8.3 In the Council's assessment, the reasons for the problems in Australia's east coast coal export chain are varied and complex and there is no single reason for the apparently less responsive performance of the east coast coal industry in meeting additional demand. In particular, there are significant differences in ownership structures, public sector involvement, planning arrangements and regulation. The Council does not consider the comparison drawn by the service providers is valid.

8.4 Rio Tinto Iron Ore and BHP Billiton Iron Ore set out a range of consequences they consider would arise from access to their Pilbara railways and commissioned reports from Port Jackson Partners and Access Economics that suggest these consequences would lead to costs to the Australian economy in the tens of billions of dollars.

8.5 The Council considers that such claims are an inevitable consequence of the improbable scenarios and the unsubstantiated or overly pessimistic assumptions the consultants were instructed to apply.

8.6 Part IIIA is designed to ensure the access provides a positive national benefit. The TPA contains a range of provisions governing arbitration of access disputes and specific limitations on arbitration determinations by the ACCC, which are directly aimed at avoiding the outcomes that Rio Tinto Iron Ore and BHP Billiton Iron Ore claim will result from the declaration of their Pilbara railways. Notably, when the ACCC is making a determination on an access dispute regarding a declared service, it:

- does not have to allow access
- cannot prevent an existing user from obtaining a sufficient amount of the service to meet its current and reasonably anticipated future requirements, as at the time of the dispute
- must have regard to the service provider's legitimate business interests
- cannot make the service provider pay for extensions or interconnections to the facility

- must, in setting any access price, take into account the need to give a return on investment commensurate with relevant regulatory and commercial risks, the direct costs of providing access and the economically efficient operation of the facility
- can make a determination dealing with any matter relating to the dispute
- must use its best endeavours to resolve the dispute within six months
- can terminate arbitrations of vexatious or trivial disputes and must use its best endeavours to complete arbitrations within a six month period.

8.7 None of these requirements was considered by the service providers when making submissions on the results of access.

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

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

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

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

8.10 In the Council's view a number of the postulated costs are unlikely to result from access as they are precluded from arising by provisions of the TPA that specifically address the concerns raised. Other costs are overstated or are based on unrealistic and improbable assumptions. A table setting out the Council's analysis of each suggested cost category is included in appendix B.

8.11 The Council considers that access will give rise to some costs in complying with regulatory requirements and in participating in regulatory processes that follow from declaration and/or access to the service. There will also be a small cost arising from a risk of regulatory error.

8.12 The Council considers that in each case the likely benefits of access to the Robe, Hamersley and Goldsworthy services will outweigh the likely costs and that access is not contrary to the public interest. The Council is satisfied that the each application satisfies criterion (f).

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

9.1 Section 44F(4) of the TPA provides that:

> In deciding what recommendation to make [in relation to an application for declaration], the Council 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 Council may decide to recommend that the service be declared or not be declared.

9.2 In relation to the Finucane Island section of the Goldsworthy Railway and the eastern section of the Robe Railway, the Council considered whether congestion on these sections of railway, and the costs and limits on further expansion might require the development of a new facility to provide these parts of the Goldsworthy and Robe services respectively.

9.3 The Council accepts that if a part of a facility that provides a service for which declaration is sought is more congested than other parts, then it may be more likely to require expansion as a result of access being available but that this in itself is not a barrier to declaration. The Council considers that it would only be where the costs of expanding the particular part of a facility are so large that it becomes viable to develop and then use a new facility, instead of expanding and using the existing facility, that an issue would arise under section 44F(4).

9.4 At this stage it is not clear to the Council that the likely costs of any necessary expansion of these particular sections of railway are such that it is economical to develop an alternative facility to provide those parts of the relevant services.

9.5 In the Council's view even if the circumstances described above amount to the development of a facility to provide part of the Goldsworthy or Robe services, and it might be economical to do so, they would not necessarily give rise to situations where the Council should not recommend declaration when the declaration criteria are otherwise met.

9.6 The Council has considered the Explanatory Memorandum to the Competition Policy Reform Bill 1995. This notes:

> If the Council decides that it would be economical for someone to develop a facility that could provide part of the service, it could decline to recommend declaration of the service as defined by the applicant. The applicant could then seek declaration of the service redefined to exclude that part that is economical for someone to provide.

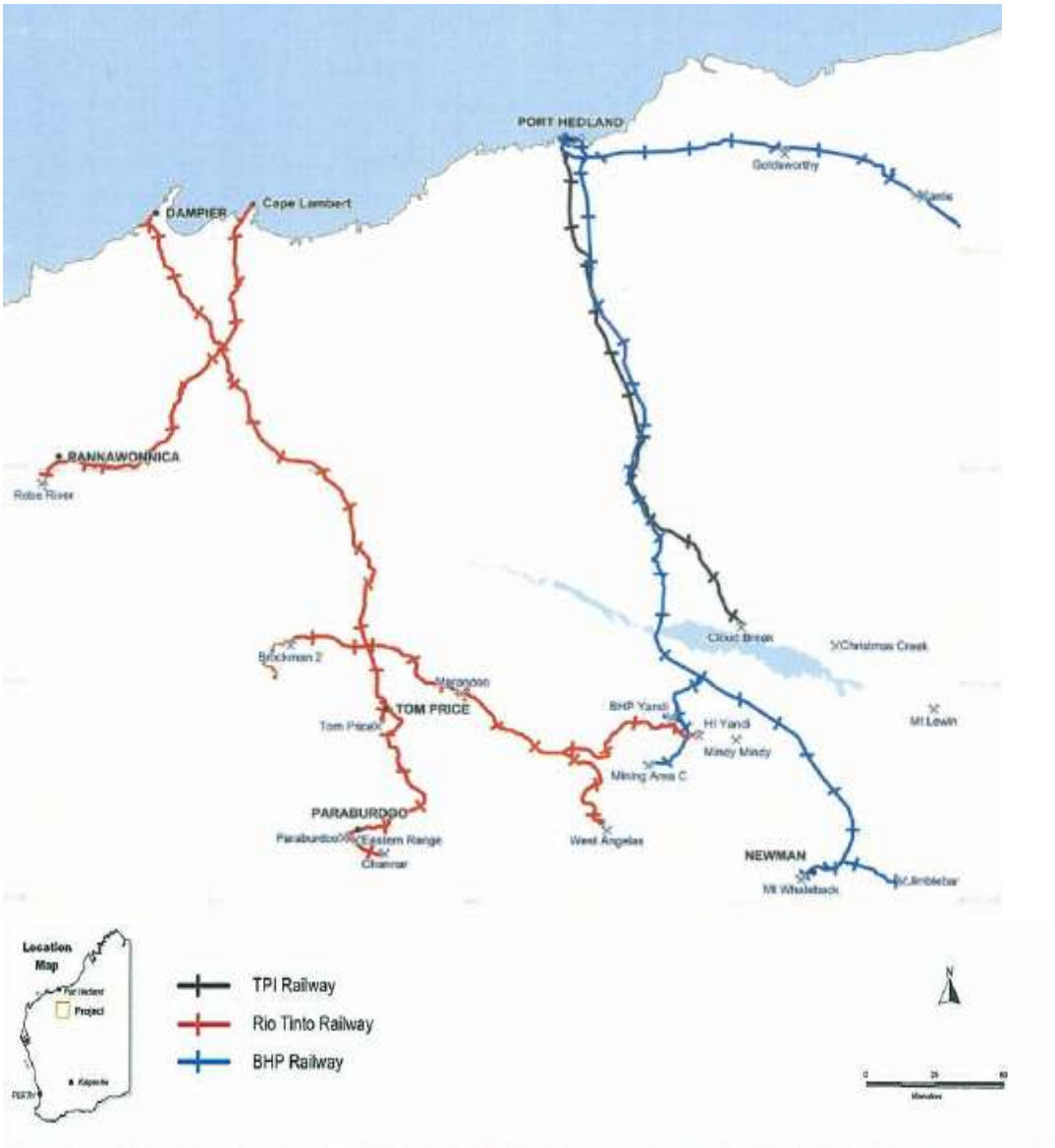
9.7 While this explanation identifies one course of action open to the Council it is clear from the words used in the memorandum and the second sentence of section 44F(4) that the Council is not obliged to follow that particular course and the Council must apply its discretion in accordance with the objects of Part IIIA.

10 Duration of declaration

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

National Competition Council
20 June 2008

Appendix A – Major Pilbara railways



Appendix B – Analysis of suggested costs of access

Suggested costs of access	Council's assessment
Delays to expansion - It was argued that access to the Pilbara railways under Part IIIA would 'inevitably' result in delays to expansions. Rio Tinto Iron Ore argued that delays would result because it would need to obtain the consent of access seekers before conducting expansions, either because terms of access would require the consent of other users, or because access terms would 'always' guarantee other users minimum track access rights, which would result in a de facto requirement for consent for any expansion or optimisation plan that affects those rights.	The Council considers that access under Part IIIA would be unlikely to have these effects given the legislative scheme of Part IIIA. The Council considers the extent and impact of any such delays to have been over-stated. To the extent that access disputes and the need for arbitration may require time to resolve, the TPA provides for arbitrations to be conducted within a six month period, and any access related issues can be dealt with in parallel with other project planning activities and within overall planning timeframes so as to minimise delay. There is no requirement for access terms set by an ACCC determination to require the consent of third party users before expansions are undertaken nor is there any requirement for access terms to guarantee minimum access rights, although it is likely that third party users would need to be notified of a service provider's expansion and optimisation plans.
Displacement costs – It was submitted that access to railways by third parties under Part IIIA would displace a service provider's capacity. Rio Tinto Iron Ore submitted that it is expanding its rail and port facilities as fast as possible to cater for its needs and that therefore, any access rights given to third parties, or expansions done for their benefit, would occur at the expense of capacity or expansion plans that would otherwise be used for the benefit of Rio Tinto Iron Ore.	Where a service provider establishes that access would prevent it obtaining sufficient access for itself, such access could not be granted. Part IIIA contains specific provisions that prevent access reducing an existing user's use of a declared service. Labour and facility shortages currently prevailing in the Pilbara will have an impact on the ability to expand rail and other infrastructure, but the Council does not see how forcing access seekers to add to demand for such resources by constructing unnecessary additional facilities would assist with that issue.
Loss of system capacity - Rio Tinto Iron Ore submitted that multi-party usage of a rail network results in operating inefficiencies and therefore lost overall capacity when compared to single-usage. Rio Tinto Iron Ore noted that it had announced plans to introduce 'driverless trains' on its rail network on a progressive basis from mid-2009, and asserted that the introduction of third party trains on its railways would adversely impact these plans.	The Council accepts that access to a railway by third parties is likely to result in some costs in the form of lost system capacity, flexibility and other diseconomies. These costs will be reflected in access charges so that service providers are compensated for these costs. If the costs are large, then it is likely that the costs of access will be correspondingly high and the demand for access lower. In some cases the costs and hence access charges may be so large that access will not occur. In relation to Rio Tinto Iron Ore's intentions to introduce driverless trains, the Council notes that the company has stated any intermingling of manned trains and driverless trains would deprive it of capacity, but that such trains will be introduced by it on a progressive basis. To the extent that an access seeker's use of manned trains imposes additional costs on a service provider these can be included in the relevant access terms and conditions. In some situations such costs or other access conditions might oblige an access seeker to also use driverless trains.

Suggested costs of access	Council's assessment
BHP Billiton Iron Ore submitted that third party access would result in a loss of operational flexibility because its ability to adjust its operations 'within real time' to capitalise on circumstances of high demand spikes would be restricted. It submitted this would result in lost production and potentially indirect costs related to reduced reliability of supply. It further submitted that operational failures by third party users would occur from time to time, which would lead to further lost production.	The Council considers that generally the costs to the service provider resulting from lost system capacity and diseconomies of scope that would occur as a result of access can be anticipated and compensated for through access pricing. It is also possible for access arrangements to require an access seeker to accept flexible scheduling arrangements under the overall control of the service provider, and third party access seekers can be incentivised to minimise their impact on the service provider through access terms. For example, penalty payments where a train breaks down could be used to provide a strong incentive to avoid breakdowns and promptly clear track blockages.
Disincentives to invest - Rio Tinto Iron Ore submitted that access to the Hamersley Service or the Robe Service would create a disincentive to future investments in infrastructure. This would arise, Rio Tinto Iron Ore submitted, from changing from single-user, vertically integrated infrastructure to a multi-user system. BHP Billiton Iron Ore submitted that the likely differing commercial objectives of it and third party users such as the Applicant would also deter or delay investments in export infrastructure. It submitted that such delays in responding to increased demand for iron ore would result in substantial opportunity costs. The potential for such costs would enable the Applicant to 'game' the regulatory process for its own ends increasing the potential for opportunity costs, inefficient investment and regulatory error. BHP Billiton Iron Ore argued that mandatory access provision results in a less than commercial return because it fails to properly recognise and price the 'real option' available to infrastructure investors from being able to determine whether and when to expand an existing facility or undertake some similar investment, and the ability to defer such a decision.	The Council accepts submissions that it is important for Australia's economy that there is sufficient investment in infrastructure. This is consistent with the objectives of Part IIIA. Part IIIA provides for service providers to receive a risk-adjusted commercial return on declared infrastructure. The ACCC is a sophisticated regulatory body. In a range of decisions, across a range of industries, the ACCC has accepted the importance of maintaining appropriate commercial returns for investment lest such investment be inefficiently deterred. Under the TPA the ACCC is obliged to allow appropriate commercial returns and to consider investment effects in determining access prices and other terms of access. A 'real options' approach to stating some of the potential costs of access is becoming more common in consideration of regulatory issues. There is ongoing debate as to the validity of this approach, and in particular the circumstances where it may be relevant. In principle the costs of a lost opportunity to undertake a railway expansion for its own benefit, because that expansion opportunity is used to meet the requirements of an access seeker, can be incorporated in access prices and terms but, this is appropriately a matter for consideration by parties in an access negotiation or in an ACCC arbitration.
Costs of expansion to meet access seekers' demand - BHP Billiton Iron Ore submitted that at least the Finucane Island section of the Goldsworthy Railway would need to be double tracked in order to accommodate third party access to the Goldsworthy Service and the costs of this should be considered as cost of access.	This appears to suggest that the costs of railway expansions to meet the needs of access seekers should be considered as a cost of access in assessing criterion (f). While these are costs that might flow from access, in the circumstances where declaration might be available, these costs will be less than the costs of building an alternative railway facility or the benefits forgone if access is unavailable. Avoiding the extra costs of building an unnecessary new railway is a benefit not a cost of access.

Suggested costs of access	Council's assessment
Regulatory costs - BHP Billiton Iron Ore submitted that the Council should consider regulatory costs, including the direct costs of the Part IIIA access regime and opportunity costs. It submitted that the costs of regulation are likely to be very significant given the range and complexity of issues that can arise under an access dispute, the availability of appeal mechanisms and 'the opportunity to "game" the system'.	The Council accepts that access creates regulatory costs that must be considered. These are the costs that service providers may incur in conducting negotiations with access seekers and responding to arbitration of access disputes. They also include the costs of the ACCC and other public bodies in carrying out their functions in relation to a declared service. However, the Council does not accept that the system is easily 'gamed' by access seekers. Part IIIA contains provision to limit unnecessary or repeated arbitrations and the ACCC can terminate arbitrations it considers to be vexatious, misconceived or lacking in substance.
Deterrence or delay to optimising rail operations - BHP Billiton Iron Ore submitted that third party access would deter or delay optimisation of railway operations because third parties with smaller operations would have no incentive to agree to investments in new technologies or innovative operating practices. Such delay and deterrence would be likely because of the need for consultation, the lack of agreement and regulatory intervention between BHP Billiton Iron Ore and third party users, who would be likely to have different commercial objectives.	The Council does not accept that access to Pilbara railways is likely to deter or delay optimisation of rail operations and investment in new forms of technology. It is not correct that third parties with smaller operations than the service providers would have no incentive to make investments in new technologies or innovative operating practices. All users of the railways are likely to have some incentive to maximise the quantity of ore they carry and minimise the cost of doing so, or at least to minimise the costs of their gaining access and hence the access charges they face. This is likely to provide access seekers with incentives to support operational optimisations and technological advances.
Environmental costs - BHP Billiton Iron Ore submitted that access will lead to environmental costs in the form of construction of expansions and increased train traffic on the railways.	While it is true that expansions to existing railways and increased rail traffic are likely to have some adverse environmental impact, such impacts are likely to be substantially less than the environmental impacts from constructing entirely new railways. Similarly, while increased train traffic on a railway may lead to adverse environmental impacts, the Council considers that such impacts are likely to be much lower than the environmental and social costs of using road transport to move equivalent amounts of iron ore. An increase in rail transport that lowers the volume of road transport is a public interest benefit.
Loss of facilities based competition - BHP Billiton Iron Ore submitted third party access would create a cost in the form of lost 'facilities-based competition', which, it argued would otherwise provide an incentive for an increase in production.	The Council does not agree with BHP Billiton Iron Ore's view that Part IIIA access leads to a cost in the form of lost 'facilities-based competition'. Part IIIA access is only provided to facilities that are uneconomical to duplicate. In these circumstances any facilities based competition would be from an inefficient source. It is economically inefficient and wasteful for Australia to duplicate such facilities; avoiding multiple and competing 'natural monopoly' facilities is a public interest benefit to Australia, not a cost.