
**Rio Tinto Iron Ore submission to the House
of Representatives Inquiry into Integration of
Regional Rail and Road Networks and their
Interface with Ports**

Supplementary submission

10 March 2006

Table of contents

1.	Executive summary	3
2.	Introduction	4
3.	Overview of RTIO's key issues in rail and port infrastructure	5
4.	Rail and port: detailed issues for consideration by the Committee	7
5.	Recent Developments	11

1. Executive summary

This document is Rio Tinto Iron Ore's further submission to the House of Representatives Standing Committee on Transport and Regional Services' Inquiry into integration of regional rail and road networks and their interface with ports. This is a supplementary submission and it follows Rio Tinto's initial submission, identified as submission 85 on the Committee's website. This supplementary submission provides specific context and further relevant information on rail and port issues in the iron ore industry in the Pilbara.

Rio Tinto Iron Ore (*RTIO*) is the division of the Rio Tinto Group with responsibility for Rio Tinto's iron ore interests. Its Western Australian interests include the Pilbara iron ore mines operated by Pilbara Iron on behalf of Hamersley Iron Pty Ltd (*Hamersley*), which is 100% owned by Rio Tinto, and Robe River Iron Associates (*Robe*), which is 53% owned by Rio Tinto.

RTIO employs 3850 people in the Pilbara and indirectly employs a further 5700. Of these 3850 direct employees approximately 1700, close to 30% of the total, are employed to develop and operate infrastructure, the majority in the operation of RTIO's rail and port infrastructure.

RTIO has a very substantial financial investment in physical infrastructure (including rail, ports, electricity, water, and airports) in the Pilbara. The replacement cost of this infrastructure, over A\$8 billion, is greater than the total replacement cost of the assets at RTIO's mine sites. In this respect, the iron ore business is unique in Western Australia: in no other significant industry sector, including other resource industries, does infrastructure account for such a significant proportion of the total investment.

The main points in this supplementary submission are as follows:

- In developing policy settings for the provision of infrastructure, RTIO considers that government should be mindful that RTIO's shareholders have risked their funds on the development of infrastructure assets as much as they have on the development of mines. As such RTIO's property rights in its infrastructure merit as much protection as RTIO's property rights in its mines.
- The ability to operate and develop mine, rail and port infrastructure in an integrated manner is a source of operational and investment efficiency. This has played a significant role in ensuring that the Pilbara is one of the world's great iron ore provinces. The opportunity for integrated mine-rail-port operation in the sparsely developed and remote Pilbara is an endowment that should be highly valued by government.

2. Introduction

This document is Rio Tinto Iron Ore's supplementary submission to the House of Representatives Standing Committee on Transport and Regional Services' Inquiry into integration of regional rail and road networks and their interface with ports. This supplementary submission follows Rio Tinto's initial submission, identified as submission 85 on the Committee's website. It provides specific context and further relevant details on rail and port issues in the iron ore industry in the Pilbara.

The submission is set out as follows:

- Section 3 provides a high level overview of RTIO's interests in rail and port infrastructure.
- Section 4 discusses in further detail relevant rail and port issues in the iron ore industry in the Pilbara.
- Section 5 addresses some relevant recent developments in relation to rail infrastructure in the Pilbara.

3. Overview of RTIO's key issues in rail and port infrastructure

RTIO is the division of the Rio Tinto Group with responsibility for Rio Tinto's iron ore interests. Its Western Australian interests include the Pilbara iron ore mines operated by Pilbara Iron (which is 100% owned by Rio Tinto), on behalf of Hamersley Iron Pty Ltd (*Hamersley*), which is 100% owned by Rio Tinto, and Robe River Iron Associates (*Robe*), which is 53% owned by Rio Tinto.

RTIO is one of the major iron ore miners in the Pilbara. In 2005, RTIO's Western Australian operations mined 142 million tonnes of iron ore, which accounted for about 61% of total Pilbara iron ore production. In 2005, RTIO generated US\$4,500 million of iron ore revenue from its Pilbara assets and over the past five years RTIO's Western Australian capital expenditure has totalled US\$2,755 million.

RTIO employs 3850 people in the Pilbara and indirectly employs a further 5700. Of these 3850 direct employees approximately 1700, close to 30% of the total, are employed to develop and operate infrastructure.

RTIO also has a very substantial financial investment in physical infrastructure (including rail, ports, electricity, water, and airports) in the Pilbara. The replacement cost of this infrastructure, over A\$8 billion, is greater than the total replacement cost of the assets at RTIO's mine sites. In this respect, the iron ore business is unique in Western Australia: in no other significant industry sector, including other resource industries, does infrastructure account for such a significant proportion of the total investment.

Ultimately our investment in infrastructure is driven by the demand for iron ore. Therefore to understand our key infrastructure issues, it is helpful to be aware of the dynamics of the market that we compete in.

The iron ore business is a vigorously competitive international commodity business. Global consumption of iron ore used in steel making was over 1.2 billion tonnes in 2005. Of this total, 651 million tonnes were shipped internationally. Other than a small quantity of feed for Rio Tinto's HIsmelt project in Western Australia, all ore mined by RTIO in the Pilbara is exported, mainly to customers in Japan and China. In 2005, RTIO's Pilbara operations accounted for around 24% of global sea-borne iron ore.

The international market for iron ore is subject to rapid changes in demand. When demand exceeds supply, such as has occurred recently, prices can rise sharply. This is attributable to long lead times in the development of significant ore bodies and necessary infrastructure and hence the inevitable lags between demand and supply. However, prices can drop significantly when supply catches up with demand, as it

inevitably does. This market dynamic establishes a critical success factor in the iron ore business: the ability to respond quickly to changes in global demand.

The ability to respond rapidly to changing demand depends on the co-ordinated development and operation of the key infrastructure elements - the rail network and the Dampier and Cape Lambert ports - with the development and operation of the mines. In the Pilbara, the development and operation of these infrastructure elements is strongly integrated with the mining process. This is a significant source of competitive advantage.

Another important infrastructure issue is government regulation affecting the development and operation of this infrastructure. RTIO's operations are controlled through State Agreements and other State legislation, particularly the Mining Act and Environmental Protection Act. Efficient and speedy approval processes to develop and operate infrastructure are important in ensuring that RTIO is able to react efficiently to changes in demand.

It is also important that the regulatory arrangements should facilitate the efficient use of infrastructure across mines. This is a particular issue as the number of RTIO-controlled mine sites in the Pilbara increases and the potential for efficiencies through sharing infrastructure across mines increases.

Finally RTIO draws the Committee's attention to the need for a stable investment environment. As noted, around half the investment in our iron ore business is in long-lived infrastructure assets. The resulting sunk capital expenditure needs to be recovered over a long period. In this context, a stable long-term investment environment is a critical business issue.

4. Rail and port: detailed issues for consideration by the Committee

RTIO has a very substantial investment in dedicated heavy-haul rail infrastructure in the Pilbara. RTIO's Pilbara rail track covers around 1200 kilometres and links the Hamersley and Robe mines to the Dampier and Cape Lambert ports. The current rail infrastructure includes some 6000 wagons and 62 diesel-powered locomotives. In 2005, this rail infrastructure was used to transport about 142 million tonnes (*Mt*) of ore from the mines to the ports.

RTIO also has a substantial investment in port infrastructure at Dampier and Cape Lambert. Dampier currently has an annual capacity of 116Mt/annum and Cape Lambert has a capacity of 58Mt/annum.

The efficiencies available from the integrated operation and development of mine, rail transport and port infrastructure have only been possible because the Pilbara iron ore miners own their own dedicated railway systems and ports. For example, BHP-Billiton Iron Ore (*BHPBIO*), Hamersley and Robe each constructed their own railways and ports.

It is interesting to note that, to the extent possible, new producers also wish to control and operate their own ex-mine infrastructure. Whilst the relevant State Agreement requires the proposed Fortescue Metals Group Limited (*FMG*) Chichester railway line to be an "open access" line, FMG has still chosen to build and operate its own line rather than require BHPBIO to transport its ore pursuant to the obligations set out in the Mt Newman State Agreement and the associated Rail Transport Agreement (*RTA*).

Further, before Hope Downs Iron Ore joined with RTIO in a joint venture to develop the Hope Downs Project, it had decided to build and operate its own railway notwithstanding that the Western Australian Court of Appeal held that Hope Downs Iron Ore had an enforceable right to insist on carriage of its ore pursuant to the RTA¹.

Both of these examples illustrate that there are perceived efficiencies and economies that flow from owning and operating ex-mine infrastructure, albeit that it is likely that these efficiencies and economies will be significantly eroded in FMG's case, if third parties in fact operate trains on its line as well as FMG (discussed further below).

¹ *Hancock Prospecting P/L v BHP Minerals P/L [2003] WASCA 259.*

The operational and investment efficiencies available from the integrated operation of rail and mine are significant.

- In operational time frames, integrated operation of mine, rail and ports provides flexibility to run additional trains or alter train timetables at short notice to meet shipping and customer requirements. Similarly risk attributable to break downs, accidents or events of force majeure can be most effectively managed when mine, rail and port operation are integrated. Control of the day-to-day operation of the railway line also allows the mine operator to respond to the small changes in operations that are a normal feature of any production environment. For example, the grade or tonnage of ore available from a particular mine may be different from that expected, in which case the entire recipe for the specification being produced may need to be revised with consequent changes to train scheduling. In short, operational changes to train control, signalling systems, maintenance, scheduling, track protection, train speed, prioritisation etc can be implemented virtually immediately to meet current requirements, thereby optimising the system.
- In investment time frames, the integration of rail, mine and port facilitates the efficient and timely augmentation of rail and port capacity in step with the development of mine capacity. This provides a strong competitive advantage to the Pilbara iron ore producers in the international iron ore market. Various of their overseas competitors enjoy many advantages including lower wages and/or higher iron ore content, so efficiencies are important to maintain competitive advantage. The ability of the Pilbara iron ore producers to expand rapidly to capture new opportunities has been demonstrated starkly over the last few years since the China led boom in demand for commodities became apparent. Capacity expansions totalling 122Mtpa have been announced by BHPBIO and RTIO since 2002, much of which has already been commissioned resulting in exports increasing from 173 Mt of ore in 2002 to 244 Mt of ore in 2005. Contrast this performance with the response of coal producers dependent on multi-user facilities on the east coast of Australia.

Exporting iron ore from Australia has been one of this country's great resource industry success stories. The Australian Bureau of Statistics has reported that Australian iron ore exports grew from 130Mt in 1995 to 240Mt in 2005 – a 6% average annual growth rate. This average growth rate masks the recent change in the market to which Australian suppliers have been able to respond, led by Chinese demand, and almost 50% of this growth in exports has occurred in the last 2 years. This pace in export growth is expected to pick up even further over the next 2 years as capacity expansions, which were committed to after the extent of China growth become apparent in 2002, come on line. Australian iron ore exports are expected to reach 286Mt in 2006. This is a 60% increase in exports from 2002, and at current prices, these additional volumes will provide extra revenue to Australia of over US\$4.5 billion annually. Australia's share of world seaborne iron ore exports is expected to rise from 37% to 41% over this period.

Success is not guaranteed and it is important to identify and preserve those factors that allow opportunity to be translated into sustained world-class performance. A key success factor for iron ore exports from Australia has been highly efficient

infrastructure. Private sector decisions on infrastructure development are often financially substantial and delays can incur heavy financing costs. The WA Government has a commitment to ensure approval processes operate to minimise the impediments to project development.

The ability of the integrated iron ore producers to respond rapidly to increases in demand has been noted recently by both the Reserve Bank of Australia² and the Prime Minister's Exports and Infrastructure Taskforce³. Each has contrasted the success of the Pilbara iron ore industry in responding to rapid demand changes, with the comparative failure to respond to demand changes in the coal export industry in New South Wales and Queensland.

The fact that the coal industry has failed to respond in a similar manner, notwithstanding a similar increase in demand for coal, has been almost entirely the result of the impediments imposed by the multi-user infrastructure (both rail and ports) on which the coal industry depends. There are inevitably disagreements between users as to the extent of expansion (if any), the relative contributions and entitlements of users in respect of any expansion, and the impact of the expansion programme on ongoing operations etc. Moreover, negotiations are often protracted and may require the intervention of a regulator or an arbitrator. Meanwhile the expansion is delayed, at a huge cost to export revenue (and royalties). These impediments do not exist with single user dedicated facilities.

The opportunity for integrated and dedicated mine, rail and port operation has been made possible by the remoteness and sparse population of the Pilbara. The opportunity for similar mine-rail-port integration is diminished in other parts of Australia where greater development, higher land values, environmental factors and historic factors, including the existence of government-owned railway lines and ports, make such vertical integration virtually impossible regardless of the efficiencies that it may deliver. This historical and natural advantage to Western Australia, the nation and the producers should not be lost by regulatory intervention.

In light of the above, RTIO reiterates the proposal made by Rio Tinto in its 8 June 2005 submission that Part IIIA of the Trade Practices Act should be amended so as to permit key export infrastructure such as that in the Pilbara to be exempted from third party access applications. This is consistent with the recommendations made by the Exports and Infrastructure Taskforce. It follows, of course, that pending the introduction of any such amendments, RTIO is strongly of the view that no 'declaration' under Part IIIA should be made in respect these key facilities.

In relation to the operation of railways, a further consideration is the excellent record RTIO has in occupational health and safety. RTIO sees this as both an obligation to its valued workforce and an asset in the maintenance of its competitive advantage.

² *Reserve Bank of Australia's Statement on Monetary Policy, 7 February 2005.*

³ *'Australia's Export Infrastructure', Report to the Prime Minister by the Exports and Infrastructure Taskforce, May 2005.*

However, RTIO recognises the public policy concern that the ownership and control of rail infrastructure by mine operators should not provide an unfair advantage. This has been addressed in the original Hamersley Iron State Agreement dating back to 1963 and also in the various subsequent State Agreements (e.g. Robe, Mount Bruce, and Yandicoogina) which impose an obligation on RTIO and Robe to provide freight haulage services to third parties in the Pilbara, subject to certain conditions.

Some interested parties have countered that the absence of third party iron ore haulage in the Pilbara points to the failure of these existing arrangements. However the reason there has been no concluded rail haulage arrangement between unrelated parties (other than through joint ventures of which there are many examples) is because there has been no third party producer that was in a position to commence development if rail haulage was negotiated. Hope Downs Iron Ore went closest to reaching this point, but decided that the advantages of owning and operating its own railway outweighed those of a freight carriage arrangement with BHPBIO.

RTIO considers that the opportunity for mine-rail-port integration in the Pilbara is an endowment that should be treasured by the government and community of Western Australia. This endowment plays a significant role in ensuring that the Pilbara is one of the world's great iron ore provinces. RTIO considers that the iron ore industry provides an outstanding example of infrastructure efficiency and urges that all necessary steps are taken to preserve the advantages Australia thereby enjoys.

5. Recent Developments

Since June 2005, when Rio Tinto lodged its original submission to this Inquiry, the National Competition Council (the *Council*) has published a draft recommendation in respect of the application made by FMG under Part IIIA of the Trade Practices Act for access to the Mt Newman rail line owned and operated by BHPBIO in the Pilbara (the *Mt Newman Facility*).

The Council's draft recommendation was that the Mt Newman Facility should be declared, notwithstanding extensive submissions by BHPBIO and RTIO as to why the relevant 'declaration criteria' (which must be met to justify access) had not been satisfied. In particular, in the Council's draft recommendation document, there was little (or no) regard for the adverse impact on the national interest that would result from the conversion of the Mt Newman Facility into a multi-user facility. Various models were produced to demonstrate the cost of access, not just the engineering and other direct costs involved, but also the cost to the Australian and Western Australian economies flowing from the inevitable efficiency loss if the Mt Newman Facility were declared. For example, if an expansion opportunity were missed because of the inevitable disagreements between co-users, the cost could be in the order of A\$12 billion.

Further submissions have been made to the Council, and the parties now await a final recommendation from the Council to Federal Treasury. A determination needs to be made by Treasury within 60 days of the final recommendation by the Council.

RTIO urges members of this Inquiry to support a refusal by Treasury to declare the Mt Newman Facility under Part IIIA. Further, for the reasons set out above (and enunciated by the Exports and Infrastructure Taskforce), the Inquiry is urged to support an amendment to Part IIIA so that there is scope for exemption of such key export facilities.