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# **FORTESCUE METALS GROUP LIMITED SUBMISSIONS TO THE SENATE ECONOMICS LEGISLATION COMMITTEE**

## **INQUIRY INTO THE TRADE PRACTICES AMENDMENT (NATIONAL ACCESS REGIME) BILL 2005**

**AUGUST 2005**

The New Force in Iron Ore



## 1. APPLICATION FOR DECLARATION UNDER PART IIIA

- 1.1 On 15 June 2004, Fortescue Metals Group Limited ("**Fortescue**") lodged an Application with the National Competition Council ("**NCC**") for a Declaration under Part IIIA of the Trade Practices Act in relation to the Mt Newman and Goldsworthy railway lines (a map of which is attached) for the company's Mindy Mindy joint venture project.
- 1.2 Fortescue's Declaration Application has received unprecedented support from the Western Australian State Government as set out in the State's Response dated October 2004 to the NCC's Preliminary Issues Paper. A copy of the State's Response is attached for your ease of reference.
- 1.3 Not unexpectedly, BHP has claimed that its railway line comprising approximately 300 kilometres is not subject to the provisions of Part IIIA of the Trade Practices Act because BHP alleges that the railway line forms part of its "*production process*".
- 1.4 The NCC has made an initial determination that the major component (the "**Mt Newman Line**") of the BHP railway line does not form part of BHP's "*production process*" and that a minor part (the "**Goldsworthy Line**") does. In its preliminary determination, the NCC stated in effect that it was bound by the 1999 Hamersley Iron decision of Justice Kenny of the Federal Court of Australia. However, the NCC in effect said that on economic grounds, were it not for the Hamersley Iron decision, it would not have found that the "*production process exemption*" applies at all.
- 1.5 Again, not unexpectedly, BHP has appealed this decision of the NCC to the Federal Court. Fortescue and the NCC are jointly responding to that appeal which is being pursued by BHP using anticipated measures of frustration, delay and efforts to overwhelm the parties and the Court with documents, evidence, experts and legal personnel. Fortescue remains confident that it will be successful against the BHP appeal and is expending enormous resources in time, money and expertise in the Federal Court.

## 2. THE PRODUCTION PROCESS EXEMPTION

- 2.1 Section 44B of Part IIIA of the Trade Practices Act sets out the type of services which can subject to a Declaration by the NCC and specifically states that this does not include a service which is used as part of a "*production process*". There is no definition in Part IIIA of the Trade Practices Act of the term "*production process*".
- 2.2 Accordingly, the current definition of "*production process*" is drawn from the decision of the Federal Court in *Hamersley Iron Pty Ltd v National Competition Council (1999) ATPR 41-705* where Justice Kenny of the Federal Court found that a rail track provided by Hamersley Iron Pty Ltd spanning some 400 kilometres was part of Hamersley Iron Pty Ltd's "*production process*". Accordingly, it was held that the rail track was not a "*service*" to which the Declaration process in Part IIIA of the Trade Practices Act could apply. However, it was never intended by the Trade Practices Act for the "*production process*" exception to operate in such a way.
- 2.3 The NCC has stated in its Guidelines on Part IIIA of the Trade Practices Act that "*it would only be in very few instances that the facts would support a conclusion that a service provided by means of an infrastructure facility (such as a railway) is part of a facility owner's production process.*" Nevertheless, because of the Hamersley Iron decision, clearly in virtually every instance, a service provider will claim that the "*production process*



*exemption*” applies because of the very vague language used in Part IIIA of the Trade Practices Act and the widely criticised decision of Justice Kenny in that case.

- 2.4 Fortescue accepts that its Application for Declaration in relation to its Mindy Mindy project will remain subject to the law as it currently is, and as currently set out in Part IIIA of the Trade Practices Act. Fortescue remains committed to pursuing its Declaration Application through to a successful conclusion and standing up against the BHP appeal mechanism, which no doubt will go on from the Federal Court through to the High Court unless this ambiguity and lack of clarity in the Trade Practices Act is rectified.

### 3. TRADE PRACTICES AMENDMENT (NATIONAL ACCESS REGIME) BILL 2005

- 3.1 Commonwealth Parliament currently has before it proposed amendments to the Trade Practices Act (the *Trade Practices Amendment (National Access Regime) Bill 2005*) which was introduced to Parliament shortly before the recent six week recess.

- 3.2 The amendments in the *Trade Practices Amendment (National Access Regime) Bill 2005* are largely procedural in nature, rather than substantive. Those amendments include a proposed new objects clause which is designed to require decision makers to give weight to the effects of their decisions on investment in infrastructure. The clause provides that the object of Part IIIA is to:

- (1) promote the economically efficient operation, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
- (2) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

- 3.3 The *Trade Practices Amendment (National Access Regime) Bill 2005* also proposes certain non-binding time limits including four months for the NCC to make a recommendation to the Minister that a service be Declared and six months for the ACCC to make a final arbitration determination. Fortescue welcomes and applauds these changes given that nearly fourteen months has expired since Fortescue originally lodged its Declaration Application and no determination has yet been made by the NCC. The NCC has also granted BHP substantial extensions of time including a two month extension for the lodgement of response to the NCC’s Issues Paper which Fortescue considers extraordinary and unfair.

- 3.4 Unfortunately however, the amendments in the Bill propose no substantive change to the definition of “*production process*”. As the Committee will be well aware, enormous publicity has recently been given to the infrastructure blockages in Australia and their adverse impact on economic development and export expansion. Both sides of parliament recognise the importance of freeing up infrastructure to promote national competitiveness and economic growth.

- 3.5 Unless clarity is given in the legislation by including a clear and unambiguous definition of “*production process*” in the legislation, then Part IIIA of the Trade Practices Act is effectively rendered nugatory in achieving the Productivity Commission’s original objectives in providing access to nationally important infrastructure. Service providers as a matter of course now claim the “*production process*” exemption in an attempt to defeat third party access claims. They structure the operations to artificially try to bring themselves within the *Hammersley Iron case*, or use litigation as a method to impede, delay and frustrate development of major projects where uncertainty, time and delay is of course the enemy of the creation of these projects.



3.6 As such, Parliament now has a unique opportunity to resolve the current deficiencies in Part IIIA of the Trade Practices Act and the tactical use by service providers of the *“production process exemption”*. This would provide enormous benefit to major resource projects throughout Australia, not least of which in the mineral rich regions of Western Australia which provide substantial government royalties, as well as sustained economic development for the country as a whole.

#### 4. AMENDMENT TO PART IIIA OF THE TRADE PRACTICES ACT

4.1 It is noteworthy that in its Preliminary Issues Paper on the Fortescue Declaration Application the NCC itself foreshadowed the difficulties in Part IIIA of the Trade Practices Act at present. The NCC said that in its view, *“determining whether a service is part of a production process should have regard to the economic issues underlying a production process”*. The NCC went on to state that it considered *“that the benefit of economic thinking should be brought to bear on how the production process exception is applied ... consistent with the statutory requirements and the achievement of economically efficient outcomes.”*

4.2 Accordingly, Fortescue would recommend that a definition of *“production process”* be introduced as an amendment in the *Trade Practices Amendment (National Access Regime) Bill 2005*. It is respectively suggested that this amendment define the *“production process”* to exclude *“railways, ports, roads, power transmissions grids or any other facility where the function involves transportation, distribution or reticulation.”*

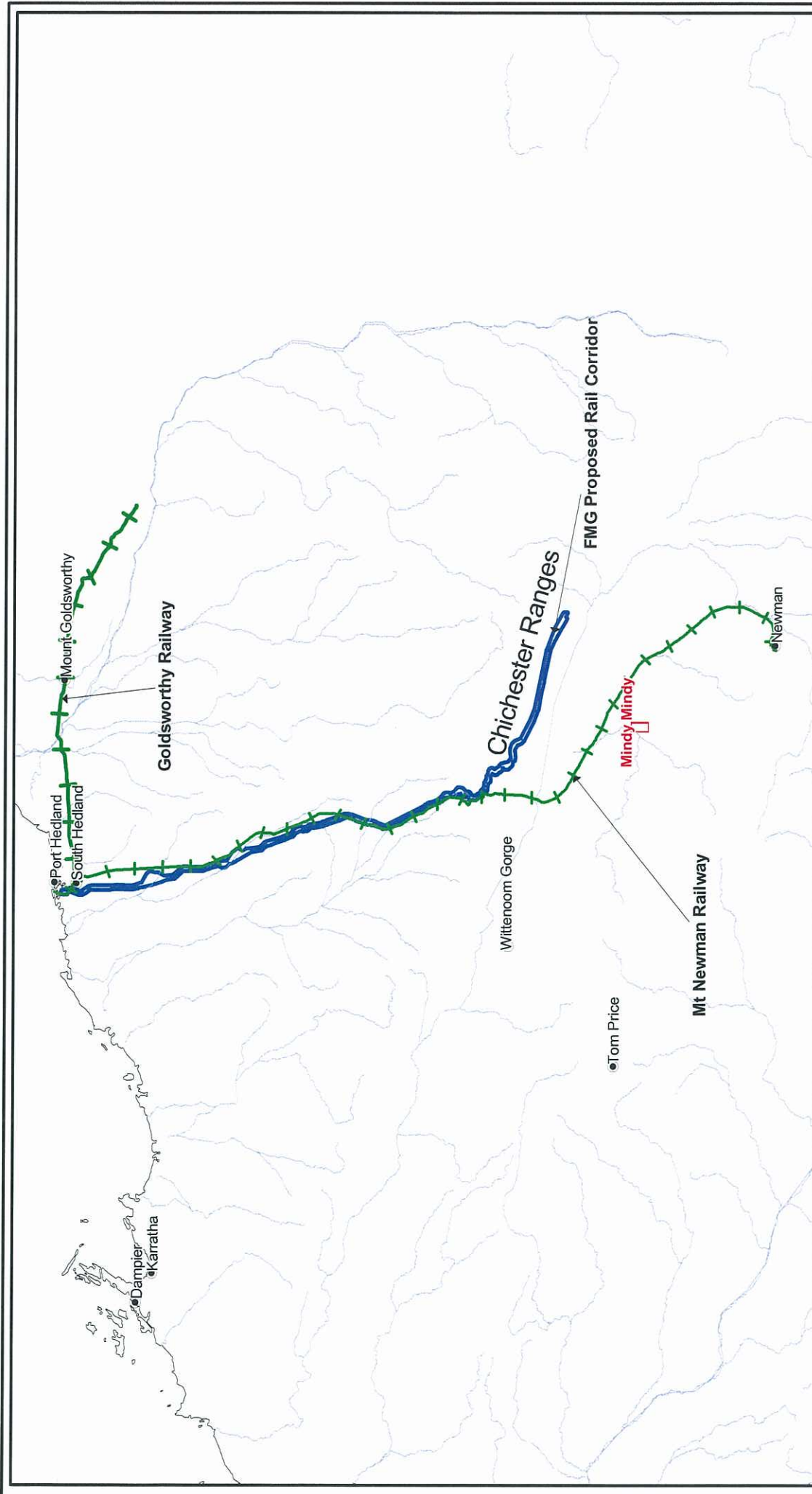
4.3 An amendment of this nature will avoid the litigation tactics which have otherwise been adopted by service providers and the artificial structuring by service providers of their operations in a manner designed to circumvent access under Part IIIA of the Trade Practices Act. Such an amendment will overwhelmingly advance the original object and purpose of Part IIIA of the Trade Practices Act to promote competition and efficiency by establishing legal rights for third parties to share the use of infrastructure services of national significance.

4.4 To the extent that BHP is likely to argue that it paid for the installation of the Mt Newman and Goldsworthy railway lines, it should be remembered that BHP was granted substantial royalty concessions in exchange for these installation costs which royalty concessions still enure to the significant advantage of BHP today. Furthermore, the State Agreement between BHP and the State of Western Australia itself provides that BHP is required to carry the ore of third parties provided it does not unduly interfere with or prejudice its own operations. As the Committee is no doubt well aware, BHP has increased its capacity from 5 million tonnes in the mid 1960's to over 100 million tonnes today, but has resisted all attempts of third parties to gain legitimate access to its railway lines.



ANDREW FORREST  
CHIEF EXECUTIVE OFFICER  
FORTESCUE METALS GROUP LIMITED





**Fortescue Metals Group Limited**

Mt Newman and Goldsworthy Railway Lines

Author: FMG	Date: 17/06/05
Drawn By: A.Gregory	Revised:
Plan No.: FMG 05087	Report No.:
Projection: GDA94 zone50	Scale: 1:25,000,000

**Location Map**

**Legend**

- Town (represented by a black dot)
- Proposed FMG Rail Corridor (represented by a blue line with green cross-ticks)
- Railway (represented by a green line with cross-ticks)
- Drainage (represented by a thin blue line)
- Highway (represented by a black line)







Department of Treasury and Finance  
Government of Western Australia

# **Western Australian Government Submission to the National Competition Council**

**Response to Preliminary Issues Paper:  
Fortescue Metals Group declaration application  
threshold issue**

**October 2004**



*Western Australian State Government Response to the  
National Competition Council's September 2004 Preliminary  
Issues Paper*

*Application to declare a rail service for access*

**Background**

On 15 June 2004, the National Competition Council (NCC) received an application under Part IIIA of the Trade Practices Act 1974 (TPA) from Fortescue Metals Group Limited (FMG) to recommend the declaration of a service provided by part of the Mt Newman Railway Line and part of the Goldsworthy Railway Line managed by BHP Billiton Iron Ore Pty Ltd (BHPBIO) on behalf of Joint Venture participants.

The NCC is conducting a public consultation process on one threshold issue — whether the service to which FMG seeks access is a service for the purposes of Part IIIA of the TPA. Service is defined in s. 44B of the TPA. At issue here is whether the “production process exception” applies.

Should the exception apply, then the service in question is considered to be part of BHPBIO's production process and the NCC cannot consider FMG's application for declaration.

**Issues**

The Western Australian Government has a significant interest in the issue given that:

- the railways covered by this application operate under the auspices of State Agreement Acts entered into by the Government and BHPBIO;
- similar State Agreements and provisions apply to Rio Tinto, the other major iron ore producer in the Pilbara; and
- the future operation and expansion of iron ore railways in the Pilbara will have a major influence on the development of the State's iron ore industry.

Although the NCC is not seeking submissions on other aspects of the FMG submission at this stage, the Western Australian Government believes it is important to put the application in context.

*History*

The establishment of the Pilbara iron ore industry in the 1960s required companies to incur major costs to establish significant infrastructure, such as towns, ports and railways. State Agreements between the Government and iron ore producers acknowledged these costs and established the responsibilities of each party.

It is clear that the intent of State Agreements was that Pilbara iron ore producers would carry freight for third parties. Obligations were included in the State Agreements whereby companies would agree mutually acceptable arrangements for giving other users access to their rail facilities, provided it did not unduly prejudice, or interfere with, the State Agreement company's operations.

To date, no access seeker has been able to negotiate satisfactory access arrangements with a State Agreement company. The State Agreement access provisions, therefore, have not been effective.

### *Importance of Railways for the Future Development of the Pilbara Iron Ore Industry*

Railways are a critical component of the State's iron ore industry and provide a major competitive advantage to existing producers, including BHPBIO.

The Pilbara iron ore industry is in a major expansionary phase due to strong supply growth in global iron ore demand, especially from China. This has led to a number of new mine and infrastructure developments being proposed in recent times.

Investment in railway capacity is a major component of the expansions that are planned by the existing Pilbara producers. In 2003, the Pilbara iron ore producers transported 194 million tonnes of iron ore on two major rail systems. The BHPBIO system carried 84 million tonnes and the Pilbara Rail Company system (Hamersley Iron (HI) and Robe lines) carried 110 million tonnes. The BHPBIO and the HI/Robe lines are both being progressively upgraded in the current round of capacity expansions to meet increased customer demand for iron ore.

New iron ore mine and associated railway developments are also possible. Hope Downs is considering a stand alone 45 million tonnes per annum railway north to Port Hedland from its Hope Downs deposits (it is also understood to be in negotiations with BHPBIO for access to BHPBIO's railways under provisions of the Iron Ore (Mount Newman) Agreement Act and related Rail Transport Agreement (RTA)). FMG is seeking environmental approval for a 45 million tonnes per annum open access railway along a similar alignment. Both proposed new railways would track the existing BHPBIO Mt Newman line for a major part of the route.

Independent advice to the State Government indicates that the addition of new single track railways is not as cost effective as double tracking the existing rail systems. The increase in capacity as a result of an additional single line is nowhere near as large as could be achieved from double tracking, due to the logistic advantages of up and down lines in an integrated dual track operation.

The addition of a third and even of a fourth single track could still see the rail system starting to constrain iron ore exports by as early as 2015 on current market forecasts. Double tracking has, however, the potential to provide a quantum leap in capacity which could meet all foreseeable market demand.

The most efficient way for the Pilbara rail system to be expanded to meet increased levels of demand is to increase capacity on the existing Pilbara rail lines (ultimately leading to double tracking) with short spur lines to new mines. This is also likely to be the best outcome from an environmental and social perspective.

The involvement of the existing producers is essential to achieving long term efficient use of iron ore railways in the Pilbara. New players will only benefit from this expansion if they can get access to existing and future railways on a reasonable commercial basis.

### **State Government Position on Rail Access to the Pilbara Iron Ore Railways**

The Government's over-riding objective for the Pilbara iron ore industry is to provide the economic, social and environmental conditions for the Pilbara iron ore industry to capitalise on the rapid growth in global iron ore demand and increase its market

share. This will ensure continued growth in industry exports, new jobs and increased royalties which will allow the Government to deliver services and facilities.

An effective rail access regime is essential to give effect to the Government's intention for existing railway owners to share their facilities on a commercial basis and is designed to strike a balance between the interests of the community, existing producers and access seekers. By promoting access to existing facilities improved industry efficiency and competitiveness should be achieved and the sub-optimal development of rail infrastructure and its consequential adverse environmental and social impacts avoided.

With regard to the above, it is also noted that the Productivity Commission recommended in its Review of the National Access Regime that:

*While the current exclusions from the coverage of Part IIIA should be retained, developments in relation to the 'production facility' exemption should be monitored by the National Competition Council. Should judicial interpretation of that exemption lead to outcomes that detract from efficiency, it may be necessary to remove the provision or clarify its intent.*

*Hamersley Iron Ore Pty Ltd v NCC [1999]*

The NCC in its Issues Paper has referred to the *Hamersley Iron Ore Pty Ltd v NCC [1999]* case.

In considering the State's future policy position relating to rail access on Pilbara iron ore railways, the State Government obtained independent advice on the *Hamersley Iron* and other cases that may have a bearing on this application.

The advice received by the State Government indicates that, should the issue be tested again, there is a high probability of a different result. It is clear that Justice Kenny relied heavily on the mine management technique of "batching" deployed by Hamersley Iron, together with the blending of the ores produced by the various mines comprising the Hamersley Iron operations, to heavily influence Her Honour's conclusions. Yet blending of consignments amongst mines (under different ownership) in a region to produce an export product is standard practice in, for example, the coal producing regions of the Hunter Valley and the Bowen Basin.

In the Hunter Valley, for example, there are often several producers who collectively are responsible for the cargo that ultimately fills the hold of a vessel. The process in the Hunter Valley operates in a way that requires that coal be blended into stockpiles at the terminal (essentially to a "recipe" as described by Justice Kenny).

This process in turn requires careful scheduling of trains throughout the system to ensure that each train arrives at the rail receipt facilities at the port terminal in sequence. This is precisely the state of affairs relied upon by Hamersley to infer that the rail link in the process justified a finding that it formed part of a production process.

This system is being operated by a number of mines, all under different ownership. There is also a second above rail operator who has secured a contract to haul coal in the Hunter Valley to the same terminal and therefore will operate within this existing framework.

Accordingly, the processes for the transportation and blending of other bulk commodities in Australia operate in much the same way as indicated by the evidence



in the Hamersley case – and these systems are characterised by a number of mines interacting as part of a common logistics system that involves some co-ordination of the movement of trains by the terminal (or some other independent entity responsible for system control).

The fact that blending occurs essentially complicates the logistics process but has little to do with transforming a logistics process into a production process.

### *The Mount Newman Railway*

It is important to note that BHPBIO is already in effect transporting the freight of third parties on the Mount Newman railway. The rail service managed by BHPBIO operates for a number of mines which have differing joint venture arrangements with companies other than BHPBIO being minority stakeholders.

As an example, mining of iron ore from Mining Area C (MAC) commenced in 2003. The MAC ownership structure is different to that of the Mount Newman Joint Venture and is also covered by a separate State Agreement (the *Iron Ore (Mt Goldsworthy) Agreement Act*).

Under the terms of the Rail Transport Agreement, ore from MAC is required to be treated as third party ore when carried on the Mt Newman line.

There is no blending of ore from MAC at Port Hedland with ore from any of the other railheads managed by BHPBIO and carried on the Mt Newman line.

The transport of ore from MAC to Port Hedland, via the Mt Newman railway, can therefore be considered to be a separate process from that of other BHPBIO operations, which makes use of a common infrastructure service/facility as part of the process. The transport of ore from MAC on the Mt Newman line has been managed in a way which does not interfere or unduly prejudice the carriage of ore from other joint ventures using the line.

A similar case applies to ore transported from the Yandi mine, although it is not considered to be third party ore under the terms of the RTA.

Based on the above, it is apparent that the Mt Newman railway is not part of a single production process but rather is a facility used to provide differing rail services to a number of separate processes.

Even if the Mount Newman line is considered to be an integral part of BHPBIO's production process, it can not be automatically concluded that parties seeking access to the railway are seeking access to that production process. For example, if an access seeker were to undertake any necessary blending and screening of ore at its minesite/railhead, and thereby create a marketable product, then in seeking access to the Mt Newman railway they would be seeking access to a track/transport service, not the use of a production process. The track may form part of BHPBIO's production process but it is not a production process in its own right.

### **Conclusion**

The State Government has long recognised the need for an efficient and effective rail access regime for the Pilbara iron ore railways. The inclusion of third party access clauses in State Agreements places an obligation on Agreement companies to carry third party freight, provided it does not unduly prejudice, or interfere with, their operations.

The Government believes that the NCC's consideration of this issue is an important part of developing an effective third party access policy for Pilbara iron ore railways. Resolution of this issue will provide greater certainty to existing and potential iron ore producers and hence will be of public benefit.

The advice received by the State Government suggests that the use of the Pilbara railways to blend product does not in itself constitute a production process, rather it appears to be a logistics process.

With respect to the threshold issue – whether the production process exception applies – the Western Australian Government is not convinced that the production process exception applies and is therefore of the view that it is appropriate for the NCC to further consider FMG's application for declaration under Part IIIA of the Trade Practices Act.