

President - Iron Ore
Carbon Steel Materials



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25 August 2005

Mr Peter Hallahan
Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
Parliament House
Canberra ACT 2600

Dear Mr Hallahan,

**Re: Senate Economics Committee Inquiry into the provisions of the
Trade Practices Amendment (National Access Regime) Bill 2005**

I refer to the Committee's Inquiry into the provisions of the above-mentioned Bill.

BHP Billiton Iron Ore (BHPBIO) did not initially respond to the Committee's invitation for written submissions on the provisions of the Bill on the basis that we considered that we had no worthwhile additional views on these prospective amendments. However, we believe that some of the evidence submitted to the Committee by Fortescue Metals Group Limited is potentially misleading.

Accordingly, we would like to assist the Committee with its Inquiry by correcting some of the potentially misleading information provided by FMG to the Committee to ensure that the Committee's evidentiary record to the extent that it is relevant to its Inquiry, is accurate. In this regard, the Committee may wish to disregard the evidence provided by FMG as outlined below.

The following observations are made about FMG's written submissions to the Committee dated August 2005.

Paragraph 2.2

FMG indicates to the Committee that the decision of Kenny J in *Hamersley Iron Pty Ltd v National Competition Council* (1999) APTR 41-705 in relation to the exception "production process" under Part IIIA of the Trade Practices Act is contrary to the manner in which that exception was intended to operate.

This assertion may be misleading because the Hilmer Report suggests that the intention behind the "production process" exception is to ensure that a company is not required to provide access to its production facilities on the basis that such an outcome would create a disincentive for companies to invest in such facilities. This intention is supported by the findings of Kenny J.

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Paragraphs 2.3 and 3.5

FMG submits to the Committee that, as a result of the decision of Kenny J in *Hamersley*, in virtually every instance under Part IIIA a service provider will claim the "production process" exception.

This proposition is incorrect. There have been seven applications for declaration lodged with the NCC since the *Hamersley* decision. In only three of these has the service provider referred to the "production process" exception. That is, the record to date shows that the "production process" exception is invoked in fewer than half of the declaration applications considered by the Council. Indeed, the exception is quite properly available to any service provider under the legislation.

Even in applications since the *Hamersley* decision in which the exception has been argued, there is yet to be a matter in which the exception has precluded declaration.

Paragraphs 4.1 – 4.3

FMG asserts to the Committee that its proposed definition of "production process" will overwhelmingly advance the "original" intention and object of Part IIIA of the Act.

While BHPBIO disagrees with this assertion, it is in any case irrelevant in light of the new "objects" clause to be inserted into Part IIIA (which FMG applauds). In this regard, it is the view of BHPBIO that FMG's broad proposed definition of "production process" will significantly deter investment in, and adversely affect the economically efficient use and operation of, some particular types of infrastructure, which have the characteristics of a "production process". Such an outcome is inconsistent with the new objects clause proposed to be inserted into Part IIIA.

Paragraph 4.4

FMG asserts to the Committee that the State Agreement between BHPBIO and the State of Western Australia requires BHPBIO to carry the ore of third parties provided that it does not unduly interfere with or prejudice its own operations. This representation is correct but the Committee should note that the Rail Transport Agreement which specifically requires BHPBIO to carry the iron ore of third parties significantly curtails this qualification. In addition, for the sake of good order, the Committee should note that the provision to carry ore requires BHPBIO to provide third parties with a "rail carriage service". That is, BHPBIO arranges and effectively controls most aspects of the transport of iron ore. This is to be distinguished from "railway track services" whereby a third-party operates its locomotives and wagons on BHPBIO's rail track. It is the latter, and far more intrusive, approach that is the subject of FMG's application for declaration.

FMG has also indicated to the Committee that BHPBIO has resisted all attempts of third parties to gain legitimate access to its railway lines (that is, rail carriage services under the Rail Transport Agreement).

This is potentially misleading.

The Rail Transport Agreement as construed by the WA Court of Appeal provides that a third party may seek a rail carriage service if its plans for mining are sufficiently "well advanced". In

addition, the Agreement provides for a dispute resolution process before an independent expert, should the parties not be able to reach commercial agreement in respect of the provision of the service.

Two parties, FMG and Hope Downs Management Services Pty Ltd, have each sought a rail carriage service from BHPBIO under the Agreement. FMG's mining plans were clearly not sufficiently well advanced at the time that it sought a rail carriage service and accordingly it did not meet the requirements under the Agreement. Since that time, FMG has not sought provision of a rail carriage service pursuant to the Agreement.

Hope Downs engaged in extensive negotiations as to the terms of supply of a rail carriage service. Those negotiations progressed meaningfully and Hope Downs did not at any stage seek to invoke the dispute resolution process readily available to it under the Agreement. Ultimately, of course, Hope Downs decided to undertake a different commercial approach to exporting its iron ore.

In light of these matters, it is potentially misleading for FMG to submit to the Committee that BHPBIO has resisted attempts by third parties to obtain a rail carriage service under the Rail Transport Agreement when we have clearly negotiated or been open to negotiate terms of supply with relevant parties..

Hearing before the Committee, 11 August 2005

Page E30

Mr Tapp indicates to the Committee that BHPBIO is under an obligation pursuant to the Rail Transport Agreement to carry the iron ore of third parties on the Mt Newman railway line. As previously advised, this statement is correct in so far as it relates to the supply of a "rail carriage service" and not "railway track services" which are the subject of FMG's application for declaration.

Mr Tapp then states that BHPBIO has "never allowed unrelated third parties to get access to those railways". Mr Tapp makes similar comments on pages E33 and E35 of the Hansard transcript. This assertion is fundamentally incorrect. This is because the Rail Transport Agreement provides that BHPBIO is obliged to provide a "rail carriage service" to "third parties" with sufficiently advanced projects and this obligation has been upheld and clarified by the WA Court of Appeal. Accordingly, BHPBIO is not in a position to refuse negotiating the provision of a rail carriage service to relevant third parties under the Rail Transport Agreement.

On this basis, there is a clearly available right to access to the Mt Newman railway line. Further, the provision of a "rail carriage services" is much less intrusive than providing rail track access (as is now sought by FMG) – the provision of rail track access is much more inefficient as it introduces very significant diseconomies of scope into BHPBIO's otherwise highly efficient iron ore production process.

Page E32

Mr Tapp represents to the Committee that railways were not intended to fall under the "production process" exemption. There is no evidence for this in so far as a railway system property constitutes a production process.

Page E34

Senator Murray suggests that the FMG application for declaration in relation to BHPBIO rail infrastructure before the NCC is one of the cases with which the Government is concerned in light of its investigation into the regulation of export bottlenecks.

The Senator's view is correct. In this regard, we refer the Committee to the comments of Mr O'Neill on page E17 of the Hansard transcript, who referred to BHPBIO Pilbara systems as "excellent logistical operations", and to the findings of the Export and Infrastructure Taskforce. In short, the Taskforce found that access regulation should be applied sparingly to export infrastructure on the bases that multi-user systems give rise to significant inefficiencies and deter or delay investment, and the associated regulatory uncertainty and delay adversely affect efficient investment.

The Committee may also find the following comments of the Taskforce particularly relevant (at p40 of the Taskforce's Report):

[T]he taskforce believes it would be desirable to clarify the 'production process' exemption. More specifically, it should be made clear that the purpose of the exemption is to prevent the imposing of third party access in vertically integrated, tightly managed, logistics chains, especially those related to our export industries. This would minimise the risk that access regimes would disrupt and undermine the very areas of the economy that have performed best in the management of export related infrastructure.

It is noteworthy that the BHPBIO Pilbara rail infrastructure, which is fully integrated into a mine/rail/port production system, is an excellent example of a "vertically integrated, tightly managed" production chain dedicated to Australian exports.

Page E35

Mr Tapp submits that the BHPBIO Mt Newman railway line has spare capacity because it can handle more trains.

This assertion is overly simplistic.

The iron ore operations of BHPBIO are a fully integrated mine, rail and port production system under which capacity at any point in time is only as good as the sub-system component capacity that is the constraint at that point in time. Dynamic demand and variability within the sub-systems translates into operational performance impacts that travel up and down the production chain dependant on the contents and storage capacities of the buffering between the sub-systems.

In light of this, we advise the Committee that the BHPBIO Mt Newman production system, of which the railway line is an integral part, is currently operating at maximum capacity. That is, no additional iron ore can currently be transported on the existing Mt Newman system.

Other comments

It seems clear from the hearing on 11 August 2005 that the Committee was also interested in issues relating to access pricing, return on investment for service providers who own infrastructure and the costs and benefits of access generally.

While BHPBIO does not seek to make submissions to the Committee in relation to these and other matters raised at the hearing more generally, we refer the Committee to the extensive submissions made by BHPBIO to the National Competition Council in connection with FMG's application for declaration of services provided by BHPBIO's Mt Newman line. In those submissions, which are available on the NCC website, it is made abundantly clear that there are very significant net social costs involved in declaring a service provided by infrastructure such as the fully integrated, dedicated single-user Mt Newman line, especially where the access seeker, in this case FMG, proposes to build its own railway line.

In summary, we firmly believe that the "production process" exception has a proper role to play in this case. In any case, BHPBIO considers that there are clear grounds on which FMG's application for declaration of the service provided by the Mt Newman line should properly be rejected.

We appreciate the opportunity to clarify these matters for the Committee and are happy to discuss any of these issues further if requested.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'G. P. Hunt', written over a horizontal line.

Graeme P Hunt

President Iron Ore