



## *Public Competition Assessment*

*1 October 2008*

### ***BHP Billiton Ltd - proposed acquisition of Rio Tinto Ltd and Rio Tinto plc***

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#### **Introduction**

1. On 1 October 2008, the Australian Competition and Consumer Commission (**ACCC**) announced its decision not to oppose the proposed acquisition (**proposed acquisition**) of Rio Tinto Ltd and Rio Tinto plc (together **Rio Tinto**) by BHP Billiton Ltd. The ACCC was of the view that the proposed acquisition would be unlikely to have the effect of substantially lessening competition in any relevant market in contravention of section 50 of the *Trade Practices Act 1974 (Cth)*.
2. The ACCC formed its view on the proposed acquisition on the basis of the information provided by the merger parties and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed acquisition, subject to confidentiality considerations.

#### **Public Competition Assessment**

3. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:
  - a merger is opposed;
  - a merger is subject to enforceable undertakings;
  - the merger parties seek such disclosure; or
  - a merger is not opposed but raises important issues that the ACCC considers should be made public.
4. This Public Competition Assessment has been issued because BHP Billiton Ltd's proposed acquisition of Rio Tinto is considered to raise issues of interest to the public.

5. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change, because of developments.
6. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
7. Many of the ACCC's decisions will involve consideration of both non-confidential and confidential information provided by the merger parties and interested parties. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources. While the ACCC aims to provide an appropriately detailed explanation of the basis for the ACCC's decision, where this is not possible, maintaining confidentiality will be the ACCC's paramount concern, and accordingly a Public Competition Assessment may not definitively explain all issues and the ACCC's analysis of such issues.

## **The parties**

### **The acquirer - BHP Billiton**

8. BHP Billiton (**BHPB**) is the world's largest diversified resources company. BHPB is a dual listed company comprising BHP Billiton Ltd (listed on the Australian Securities Exchange) and BHP Billiton plc (listed on the London Stock Exchange). Both companies share a single board of directors and management team.
9. BHPB operates ten business units, aligned with the commodities that the company extracts and markets. These business units include Iron Ore, Energy Coal, Metallurgical Coal, Aluminium, Base Metals and Uranium.

### **The target - Rio Tinto**

10. Rio Tinto is a diversified mining group with global interests and operations. Rio Tinto is a dual listed company comprising Rio Tinto Limited (listed on the Australian Securities Exchange) and Rio Tinto plc (listed on the London Stock Exchange).
11. Rio Tinto's activities are concentrated in Australia and North America, but Rio Tinto also operates in South America, Asia, Europe and southern Africa. Through its global operations, Rio Tinto produces a range of minerals including iron ore, thermal and metallurgical coal, bauxite, alumina, aluminium, copper and uranium.

## Timing

12. The following table outlines the timeline of key events in this matter.

Date	Event
6-Jun 08	ACCC commenced review under the Merger Review Process Guidelines. Market inquiries commenced.
17-Jun 08	ACCC requested further information from BHPB. ACCC timeline suspended.
1-Jul 08	Closing date for submissions from interested parties.
4-Jul 08	ACCC received partial response from BHPB to the information request of 17 June 2008.
11-Jul 08	ACCC received outstanding information from BHPB in response to the information request of 17 June 2008. ACCC timeline recommenced.
22-Jul 08	ACCC requested further information from BHPB. ACCC timeline suspended.
30-Jul 08	Former proposed date for announcement of ACCC's findings of 13 August 2008, amended to allow for BHPB's response to the information request of 22 July 2008.
20-Aug 08	ACCC received further information from BHPB. ACCC timeline recommenced.
22-Aug 08	ACCC published a Statement of Issues outlining potential competition concerns.
5-Sep 08	Closing date for submissions from interested parties regarding the Statement of Issues. ACCC timeline suspended pending receipt of further information requested from BHPB.
18-Sep 08	ACCC received further information from BHPB. ACCC timeline recommenced.
1-Oct 08	ACCC announced it would not oppose the proposed acquisition.

## Market inquiries

13. The ACCC conducted extensive market inquiries with interested parties. A range of interested parties provided responses, including other suppliers and customers of iron ore, thermal and metallurgical coal, aluminium, alumina and bauxite, base metals (including copper and gold), uranium and steel, as well as suppliers of mining inputs. The ACCC also consulted industry associations, government departments and overseas competition regulators. Submissions were sought in relation to the substantive competition issues.
14. On 22 August 2008, the ACCC published a Statement of Issues regarding the proposed acquisition. The Statement of Issues identified potential competition concerns in relation to the global seaborne supply of iron ore lump and iron ore fines. The ACCC was concerned that to the extent the proposed acquisition lessens competition in the global seaborne supply of iron ore, it would be likely to have the effect of increasing global iron ore prices, which in turn would increase prices paid by steel makers in Australia. Based on the ACCC's initial market inquiries, all other areas of aggregation arising from the proposed acquisition were considered unlikely to raise concerns.
15. Subsequent to the publication of the Statement of Issues, the ACCC conducted further market inquiries. While interested parties primarily focused on the global seaborne supply of iron ore lump and iron ore fines, issues were also raised in relation to coal port terminal infrastructure.

## Iron ore

### Industry background

16. Iron ore is a globally traded commodity used almost exclusively in the manufacture of steel. Steel makers generally use a mix of the following three forms of iron ore:
  - lump – a ‘direct shipping’ form, between six and 30 mm in diameter;
  - fines – a ‘direct shipping’ form, less than six mm in diameter; and
  - pellet – a processed form, generally between 16 and 20 mm in diameter.
17. Iron ore lump may be fed directly into a steel making blast furnace without further processing. Smaller iron ore particles tend to clog blast furnaces and must be sintered or pelletised before being fed into a blast furnace. Sintering generally occurs at a steel mill, whereas pelletising can occur at either the mine or the steel mill.
18. Of the approximately 1,600 million tonnes of iron ore produced globally in 2007, over half was exported and traded, typically via sea freight.<sup>1</sup> Much of the iron ore that is not exported is produced at mines with integrated or co-located steel-making facilities, giving rise to a distinction between landborne or ‘captive’ iron ore supply and seaborne iron ore supply.
19. The main global seaborne suppliers of iron ore lump and iron ore fines are BHPB, Rio Tinto and Brazilian supplier Companhia Vale do Rio Doce (**Vale**). The main global suppliers of iron ore pellet are Rio Tinto, Vale and Luossavaara-Kiirunavaara Aktiebolag (**LKAB**).
20. The vast majority of traded iron ore is supplied under long term contracts. Steel makers and iron ore miners typically prefer long term contracts for security of supply and investment certainty. While a small proportion of global iron ore trade occurs on a spot market basis, the volume traded on the spot market has increased in recent years.
21. Most of the iron ore supplied under long term contracts is currently priced with reference to global benchmark prices. Global benchmark prices for each form of iron ore (identified in paragraph 16 above) are determined by annual negotiations between the main global suppliers and the main steel makers and generally reflect a consensus as to the balance between supply and demand over the coming year. The first price settlement has traditionally formed a reference point for all iron ore supplied under contracts. While there is some uncertainty as to whether the benchmark process will be replaced by an index system for price discovery, it appears likely that prices would continue to reflect the overall supply and demand balance for each form of iron ore.
22. Significant quantities of iron ore are supplied in Australia at prices that are linked to global iron ore prices. Global iron ore prices therefore have a direct effect on Australian steel makers. Furthermore, since iron ore is a significant input into the production of steel, the price of iron ore also has an impact on the price of steel and other steel-based products consumed in Australia.

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<sup>1</sup> UNCTAD press release, “Iron ore market review says production, exports, and prices all climbed in 2007,” 8 July 2008.

23. The recent rapid industrialisation of China and India has resulted in unanticipated growth in the demand for iron ore. With the production of most incumbent seaborne iron ore suppliers being fully committed, this demand growth has triggered substantial increases in benchmark and spot prices for all forms of iron ore and increased iron ore exploration activity in Australia and elsewhere. This has resulted in new entry by small iron ore suppliers with relatively high marginal costs.

### **Market definition**

24. Market inquiries confirmed that:
- there are practical limitations on the ability of steel makers to significantly alter the mix of the different forms of iron ore they use, once their facilities have been configured, without incurring significant sunk costs;
  - iron ore mines that are co-located with, or wholly owned by steel makers and iron ore mines that do not have access to appropriate transport infrastructure are unlikely to provide an effective competitive constraint on seaborne suppliers of iron ore lump and iron ore fines; and
  - suppliers of iron ore lump and iron ore fines are likely to face competitive constraints from suppliers located outside their geographic region, although the extent of this competitive constraint will vary depending upon fluctuations in sea freight prices.
25. In addition, market inquiries indicated that currently high sea freight prices are likely to make it unfeasible for particular steel makers, including steel makers in Australia, to source iron ore lump and iron ore fines from seaborne suppliers in other geographic regions. To the extent that sea freight prices were to remain high in the medium to long term, narrower geographic markets are likely to be appropriate.
26. Given this uncertainty and consistent with the ACCC's purposive approach to market definition, the ACCC considered the impact of the proposed acquisition on competition for:
- the global seaborne supply of iron ore lump;
  - the global seaborne supply of iron ore fines;
  - the national (Australian) supply of iron ore lump; and
  - the national (Australian) supply of iron ore fines.

### **Competition analysis**

#### *Global seaborne supply*

27. The proposed acquisition would combine two of the three major global suppliers of iron ore lump and iron ore fines in circumstances where the merger parties have highly similar operations in terms of the quality of deposits, scale, cost base and distance to key customers.
28. The proposed acquisition would also result in the number of firms participating in the annual benchmark negotiations process for iron ore lump and iron ore fines being reduced from three to two. However, market inquiries indicated that this, in and of itself, would be unlikely to significantly impact competition given

that iron ore prices are likely to continue to be determined by the global seaborne supply and demand balance for iron ore lump and iron ore fines.

29. The merged firm would face competition from the remaining major iron ore lump and iron ore fines supplier, Vale, which has an established network of port and rail infrastructure and a range of expansion plans. In addition, as steel makers commonly use a blend of iron ore from a range of sources, it is likely to be possible for a significant proportion of steel makers to purchase from a number of smaller alternative seaborne iron ore lump and iron ore fines suppliers. In most cases this would require smaller alternative suppliers to undertake significant capacity expansions.
30. Market inquiries indicated that barriers to entry and expansion in the seaborne supply of iron ore lump and iron ore fines are substantial, involving long lead times and significant sunk investments in exploration, mine development and the establishment of associated power, rail and port infrastructure. In relation to entry and expansion in the Pilbara region of Western Australia (WA), market inquiries indicated that these high barriers to entry are unlikely to be significantly affected in the event the merged firm decided to withdraw its participation in the proposed port terminal expansion of the outer harbour at Port Hedland.
31. Despite these high barriers, there is evidence of new entry and expansion in response to the recent increase in global demand and corresponding very high prices for iron ore lump and iron ore fines. This entry and expansion, which has included new large scale Australian operations with associated rail and port infrastructure, has in most cases been supported by:
  - commitments to long-term contracts by steel makers in order to underpin investments in new iron ore lump and iron ore fines capacity;
  - investments by steel makers in iron ore lump and iron ore fines production operations; or
  - vertical integration by steel makers through the establishment or acquisition of iron ore lump and iron ore fines production operations.
32. Accordingly, market inquiries indicated the potential for buyer power and countervailing power to be exerted by steel makers based on the interdependency of iron ore producers and steel makers, the large scale operations of steel makers and their ability to facilitate iron ore lump and iron ore fines capacity expansions through long term contracts and investments in iron ore production operations.

33. The ACCC considered whether the availability of alternative suppliers and the ability of steel makers to facilitate capacity expansions would be likely to undermine any incentive the merged firm may have to seek to influence the global supply and demand balance of iron ore lump and iron ore fines in:
- the short term (i.e. the next two years), by withholding existing capacity; or
  - the medium to long term (i.e. the next three to 10 years), by delaying production and infrastructure capacity expansions.
34. Market inquiries indicated that given the size of the merged firm, its likely cost base and the nature of iron ore production costs across the industry, it may be profitable for the merged firm to withhold capacity or delay capacity expansions in some limited circumstances. However, market inquiries indicated that the merged firm would be likely to face significant uncertainty in identifying opportunities to profitably withhold capacity or delay capacity expansions.
35. In particular, there are a number of capacity expansion projects that are likely to be undertaken by alternative suppliers of iron ore lump and iron ore fines in the short term, including by independent suppliers operating in Australia. In addition, there are a number of likely and potential medium to long term capacity expansion projects that may be undertaken by alternative suppliers. If these expansion projects proceed, the costs to the merged firm of withholding production and infrastructure capacity in terms of foregone opportunities to supply iron ore lump and iron ore fines are potentially long lasting and significant.
36. Market inquiries indicated that these independent capacity expansion projects would be likely to undermine the profitability of any withholding strategy by the merged firm because:
- independent capacity expansions would be likely to mitigate any increase in the prices of iron ore lump and iron ore fines (and any corresponding increase in profits) resulting from withholding of supply; and
  - uncertainty regarding which independent capacity expansions would be undertaken in the medium to long term and the total extent of independent supply would be likely to introduce significant uncertainty in relation to the profitability of any withholding strategy of the merged firm.
37. As a result, there do not appear to be clear incentives for the merged firm to unilaterally limit the supply of iron ore lump and iron ore fines in the short term or to delay investment in production and infrastructure capacity expansions in the medium to long term.
38. In terms of coordinated conduct, market inquiries indicated that the ability of large suppliers such as the merged firm and Vale to manipulate the supply and demand balance by withholding capacity on a coordinated basis would be unlikely to increase as a result of the proposed acquisition. This is because increasing demand, the heterogeneous nature of iron ore production and infrastructure expansion projects and the corresponding threat of non-compliance would be likely to destabilise any potential tacit or explicit consensus between the merged firm and Vale.

39. Accordingly, the evidence provided to the ACCC in market inquiries did not establish that the proposed acquisition is likely to substantially lessen competition in the global seaborne supply of iron ore lump and iron ore fines.

#### *National supply*

40. Based on the analysis above in relation to the global supply of iron ore lump and iron ore fines and the evidence available to the ACCC from interested parties, the ACCC considers that the proposed acquisition is unlikely to have a significant impact on prices paid by Australian steel makers for iron ore lump and iron ore fines in the foreseeable future. The ACCC also considered whether the proposed acquisition would be likely to result in the prices paid by Australian steel makers increasing from export parity levels to import parity levels.
41. Market inquiries indicated that, post-acquisition, there are likely to be alternative domestic suppliers of iron ore lump and iron ore fines available to Australian steel makers, including suppliers with established rail and port infrastructure. It is likely that these alternatives would ensure that Australian steel makers will be able to continue to source iron ore lump and iron ore fines at export parity prices.
42. As a result, the ACCC formed the view that the proposed acquisition is unlikely to result in a substantial lessening of competition in the national supply of iron ore lump and iron ore fines.

## **Coal port terminal infrastructure**

### **Market definition**

43. The ACCC considered whether the proposed acquisition would be likely to raise competition concerns in relation to:
- the provision of coal loading services at the Port of Hay Point in Queensland;
  - the provision of coal loading services at the Port of Newcastle in New South Wales;
  - the global seaborne supply of thermal coal; and
  - the global seaborne supply of metallurgical coal.

### **Provision of coal loading services**

44. At the Port of Hay Point, BHPB and Mitsubishi Development Pty Ltd own and operate the Hay Point Coal Terminal (**HPCT**). Rio Tinto has an interest in Dalrymple Bay Coal Terminal Pty Ltd (**DBCTPL**), the operator of the Dalrymple Bay Coal Terminal (**DBCT**). The long term lease holder of DBCT is Babcock & Brown Infrastructure (**BBI**). DBCT is operated on an open access basis and coal producers have long term contracts with BBI with respect to coal loading services at DBCT.
45. At the Port of Newcastle, BHPB has an interest in the Newcastle Coal Infrastructure Group coal port terminal (**NCIG**) which is currently under construction. Rio Tinto has an interest Port Waratah Coal Services Limited

which owns and operates the Carrington and Kooragang Island coal terminals (jointly referred to as **PWCS**). In accordance with the terms of the lease with the NSW government, PWCS is operated as a 'common user' facility.

46. The proposed acquisition would result in the merged firm having an increased interest in the operation of coal port terminals in the Port of Hay Point and the Port of Newcastle. However, market inquiries indicated that:
  - at the Port of Hay Point, BHPB has maintained exclusive use of the HPCT and would be likely to continue to do so; and
  - at the Port of Newcastle, for the foreseeable future, all NCIG coal loading capacity is likely to be exclusively contracted to NCIG shareholder coal producers.
47. Accordingly, market inquiries indicated that competition between HPCT and DBCT and between PWCS and NCIG is likely to be limited for the foreseeable future, irrespective of the proposed acquisition.
48. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in the provision of coal loading services at the Port of Hay Point and the Port of Newcastle.

#### **Ability and incentive to foreclose competition for the supply of coal**

49. The ACCC considered whether the proposed acquisition would be likely to raise competition concerns in relation to the supply of thermal coal or metallurgical coal as a result of the merged firm having the ability or incentive to limit capacity at open access coal port terminals at the Port of Hay Point and the Port of Newcastle.
50. In particular, the ACCC considered whether the merged firm would have the ability and incentive to:
  - influence the operation of DBCT and PWCS to enable the merged firm to access additional coal loading capacity at the expense of rival metallurgical coal and thermal coal suppliers; and/or
  - limit coal loading capacity expansions at DBCT and PWCS in order to:
    - further constrain coal loading capacity at DBCT and PWCS with the objective of profitably withholding metallurgical coal and thermal coal export capacity; or
    - limit rival metallurgical coal and thermal coal suppliers' access to coal loading services in circumstances where the merged firm would have access to additional coal port terminal export capacity through HPCT and NCIG.

51. The merged firm would have an increased involvement in the operation of DBCT and PWCS. However, market inquiries indicated that allocations of capacity at DBCT and PWCS have not been determined by DBCT and PWCS management and are unlikely to be in the future. Further, market inquiries did not identify scenarios in which the merged firm would be able to substantially frustrate rivals' access to coal loading capacity through the day to day management of DBCT and PWCS.
52. In relation to capacity expansions at DBCT, the merged firm appears unlikely to have the ability to influence capacity expansion proposals. Market inquiries indicated that the process for capacity expansions is principally administered by BBI as the owner of DBCT.
53. In relation to capacity expansions at PWCS, in which the merged firm would have an increased interest, market inquiries indicated that:
  - competition from alternative metallurgical coal and thermal coal suppliers, including alternative suppliers operating in regions other than the Port of Newcastle would be likely to limit the incentive of the merged firm to withhold metallurgical coal and thermal coal export capacity; and
  - given the merged firm's significant metallurgical coal and thermal coal expansion plans and the foreseeable capacity of NCIG, the merged firm is unlikely to have an incentive to limit capacity expansions at PWCS in the foreseeable future.
54. Accordingly, the ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the supply of thermal coal or metallurgical coal as a result of the merged firm having the ability and/or incentive to limit capacity at open access coal port terminals at the Port of Hay Point and the Port of Newcastle.

## **Other issues**

### *Acquisition of iron ore tenements in the Pilbara, WA*

55. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the acquisition of iron ore or rights to extract iron ore, from owners of tenements in the Pilbara, WA. Market inquiries indicated that such competition between BHPB and Rio Tinto appears to be limited.

### *Supply of port and rail services in the Pilbara, WA*

56. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the supply of iron ore rail haulage and port terminal services in the Pilbara, WA. Market inquiries indicated that such competition between BHPB and Rio Tinto appears to be limited.

### *Supply of metallurgical coal*

57. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the supply of metallurgical coal. Market inquiries indicated that although the merged firm would account for a

large proportion of the supply of metallurgical coal, it would continue to face competition from significant alternative suppliers with access to transport infrastructure, both in Australia and overseas. As a result, the merged firm is unlikely to have the ability and incentive to profitably withhold metallurgical coal capacity.

#### *Supply of thermal coal*

58. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the supply of thermal coal. The ACCC's market inquiries indicated that significant alternative suppliers are likely to constrain the merged firm.

#### *Acquisition of rail haulage services in NSW and QLD*

59. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the acquisition of coal rail haulage services in NSW and QLD. Market inquiries indicated that although the merged firm would be a major acquirer of coal rail haulage services in NSW and QLD, there are a number of rival coal producers that are willing and able to acquire additional rail haulage capacity in the event that the merged firm sought to extract non-competitive terms and conditions from rail haulage providers.

#### *Acquisition of coal loading services*

60. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the acquisition of coal loading services. The merged firm would be a major acquirer of coal loading services. However, market inquiries indicated that there are a number of rival coal producers that would be willing and able to acquire additional coal loading capacity in the event the merged firm sought to extract non-competitive terms and conditions from coal loading providers.

#### *Supply of bauxite*

61. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the production and supply of bauxite. Notwithstanding the significant interests of BHPB and Rio Tinto in bauxite production in Australia, there is limited competition between BHPB and Rio Tinto as a result of their vertical integration into downstream alumina production, differences in bauxite properties and transport differentials.

#### *Supply of alumina*

62. The ACCC formed the view that the proposed acquisition is unlikely to substantially lessen competition in relation to the production and supply of smelter grade alumina, as significant alternative suppliers would be likely to impose an effective competitive constraint on the merged firm.
63. In addition, notwithstanding the significant interests of BHPB and Rio Tinto in smelter grade alumina production in Australia, BHPB does not currently supply domestic Australian customers and the competitive constraint imposed by any potential for BHPB to supply Australian customers appears to be limited.

*Other areas of overlap*

64. The ACCC formed the view that the proposed acquisition would be unlikely to result in a substantial lessening of competition in relation to the supply of iron ore pellet, copper concentrates, copper cathode, gold or uranium or the acquisition of mining inputs.

**Conclusion**

65. Based on the analysis set out above, the ACCC formed the view that the proposed acquisition would not be likely to result in a substantial lessening of competition in any of the relevant markets.