



Australian
Competition &
Consumer
Commission

22 August 2008

Statement of Issues — BHP Billiton Ltd's proposed acquisition of Rio Tinto Ltd and Rio Tinto plc

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition (**proposed acquisition**) of Rio Tinto Ltd and Rio Tinto plc (together, **Rio Tinto**) by BHP Billiton Ltd.
2. A Statement of Issues published by the ACCC is not a final decision about the ACCC's assessment, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at www.accc.gov.au) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by 5 September 2008 and anticipates making a final decision by 1 October 2008. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

The parties

BHP Billiton

5. 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.

6. 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.

Rio Tinto

7. 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).
8. Rio Tinto activities are concentrated in Australia and North America, but Rio Tinto is also present 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.

Market inquiries

9. On 6 June 2008 the ACCC commenced market inquiries regarding the proposed acquisition. 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 including earthmoving equipment, tyres, explosives and blasting services, contract mining, drilling and engineering/project management services. The ACCC also consulted industry associations, government departments and overseas competition regulators.

Statement of issues

10. For the purposes of this Statement of Issues, the issues in this matter are divided into two categories, 'issues that may raise concerns' and 'issues unlikely to raise concerns.'

Issues that may raise concerns – Iron ore

Industry background

11. 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.
12. 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.

13. Of the approximately 1,600 million tonnes of iron ore produced globally in 2007, over half was exported and traded, typically via sea freight.¹ 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 production and seaborne iron ore supply.
14. 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. A small proportion of global iron ore trade occurs on a spot market basis.
15. Iron ore supplied under long term contracts is currently priced according to global benchmark prices. Global benchmark prices for each form of iron ore 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 flowed through to all iron ore supplied under contracts.
16. The main global 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 Vale, Rio Tinto and Luossavaara-Kiirunavaara Aktiebolag (**LKAB**).
17. 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 increased iron ore exploration activity in Australia and elsewhere and necessitated the commencement of supply by small iron ore suppliers with relatively high marginal costs. As a result of high cost iron ore coming into production, there have been substantial increases in spot and benchmark prices for all forms of iron ore.
18. 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.

Supply of iron ore lump and iron ore fines

19. The ACCC's market inquiries indicated that the proposed acquisition may raise competition concerns in relation to the global seaborne supply of iron ore lump and iron ore fines. 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

¹ UNCTAD press release, 08/07/2008, "Iron ore market review says production, exports, and prices all climbed in 2007."

increasing global iron ore prices, which would in turn increase prices paid by steel makers in Australia.

20. Market inquiries to date have indicated that:

- there are practical limitations on the ability of steel makers to significantly alter the mix of the different forms of iron ore they consume, once their facilities have been configured, without incurring significant sunk costs. As a result, steel makers are unable to easily switch to alternative forms of iron ore in the event of an increase in the price of either iron ore lump or iron ore fines;
- suppliers of seaborne 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; and
- 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.

21. The proposed acquisition would bring together two major global suppliers of iron ore lump and iron ore fines. Interested parties indicated that as a result of their highly similar operations in terms of the quality of deposits, scale, cost base and distance to key customers, BHPB and Rio Tinto are each other's closest competitor, in particular for steel makers in Australia and Asia.

22. Competition between BHPB and Rio Tinto in relation to expanding iron ore production and infrastructure capacity appears to have a direct impact on the outcome of annual seaborne iron ore price negotiations and thereby influences the prices of iron ore lump and iron ore fines, including in Australia. Moreover, by reducing the independent supply options available to steel makers in Australia, the proposed acquisition may enable the merged firm to increase domestic prices of iron ore lump and iron ore fines by more than any increase in global iron ore prices.

23. While iron ore exploration activity has increased and there are recent examples of new entry in response to a strong increase in global demand and high prices, it is uncertain whether the threat of new entry is an enduring and effective competitive constraint on large, low-cost incumbent suppliers. In particular, the ACCC's market inquiries have indicated that entry into the seaborne supply of iron ore lump and fines involves:

- long lead times; and

- significant sunk investments in exploration, mine development and the establishment of associated power, rail and port infrastructure.²
24. Interested parties also expressed concern that there would appear to be few alternative suppliers capable of supplying significant quantities of iron ore lump and iron ore fines at a cost that would be likely to impose an effective competitive constraint on the merged firm across the anticipated business cycle. In particular, Vale would be the only other supplier involved in annual benchmark price negotiations.
 25. While a number of small and medium suppliers have publicly announced a range of expansion plans, it is not clear that alternative suppliers would have the ability and incentive to counteract any attempt by the merged firm to achieve higher prices for iron ore lump and iron ore fines, including in Australia.
 26. Given the merged firm's significant portfolio of low-cost iron ore projects and relatively high barriers to entry and expansion, the merged firm may have the ability and incentive to influence global supply and global prices for iron ore lump and fines. To the extent that the merged firm could profitably time future production and infrastructure capacity expansions so as to maintain a global shortfall of supply, steel makers in Australia and overseas could face significantly higher prices for iron ore than BHPB and Rio Tinto would achieve in the absence of the proposed acquisition.
 27. The ACCC notes that steel makers appear to have the ability to facilitate the introduction and expansion of independent sources of supply by offering long term contracts and investing in iron ore mines. Indeed, many steel makers appear to have sponsored the recent entry of new Australian iron ore suppliers. Steel makers also appear to use a blend of iron ore from a range of sources, which may indicate some scope to switch to alternative suppliers.
 28. However, interested parties indicated significant uncertainty as to the extent to which such sponsorship by steel makers would effectively constrain the merged firm across the anticipated business cycle. In particular, given the relatively high barriers to entry and expansion in the supply of iron ore lump and iron ore fines and transport costs to major markets, steel makers may only have the incentive to sponsor entry and expansion in the context of supply shortages and very significant price increases.
 29. The ACCC requires further information from interested parties to determine whether the proposed acquisition is likely to result in a substantial lessening of competition in the supply of iron ore lump and iron ore fines.

² The ACCC notes the Western Australian Government and National Competition Council processes in relation to establishing rail track access or third party rail haulage services using BHPB and Rio Tinto infrastructure in the Pilbara region of Western Australia. These initiatives have the potential to ameliorate barriers to entry with respect to the rail component of supplying iron ore from the Pilbara.

30. In particular, the ACCC seeks further information on:

- the extent to which current and potential suppliers are able to supply iron ore lump and iron ore fines to steel makers in Australia and overseas that is substitutable for iron ore lump and iron ore fines supplied by BHPB and Rio Tinto, in terms of quality and marginal cost of production. The ACCC is interested in the impact of declining grades of iron ore lump and iron ore fines as high grade resources are depleted;
- the minimum requirements for independent supply of iron ore lump and iron ore fines on a scale that would, on an individual or combined basis, provide an effective competitive constraint on the merged firm across the anticipated business cycle, in terms of size and quality of deposits, infrastructure arrangements and marketing arrangements. The ACCC is interested in the extent to which alternative suppliers of iron ore lump and iron ore fines are likely to:
 - cease supply in response to a reduction in demand growth and a decrease in the price or increase in the availability of higher grades of iron ore lump and iron ore fines; and
 - be influenced by the pricing and expansion decisions of the major iron ore lump and iron ore fines suppliers, such as to follow the price leadership of the major suppliers or be deterred by announcements regarding capacity expansions by major suppliers;
- the extent to which barriers to entry for independent iron ore suppliers in the Pilbara region of Western Australia (WA) may be increased in the event the merged firm decided to withdraw its participation in the proposed port terminal expansion of the outer harbour at Port Hedland, WA;
- the extent to which steel makers are able to influence production and infrastructure capacity expansions by suppliers of iron ore lump and iron ore fines by entering into long term contracts or otherwise sponsoring independent sources of supply. In particular, the ACCC is considering the extent to which such sponsorship and consequent loss of long term supply for the merged firm, would undermine any incentive of the merged firm to withhold future production and infrastructure capacity expansions;
- the extent to which iron ore supply is inelastic such that small supply shortages would be likely to lead to significant price increases and higher profits for low-cost incumbent iron ore suppliers;
- the extent to which the expected high demand for iron ore would have a destabilising effect on any incentive incumbents might otherwise have to withhold future production and infrastructure capacity expansions. In particular, the ACCC is interested in the extent to which independent supply of iron ore lump and iron ore fines would need to replace capacity expansions withheld by the merged firm in order to defeat any withholding strategy of the merged firm;

- the extent to which high freight prices would limit the effectiveness of any competitive constraint the merged firm would face from suppliers of iron ore lump and iron ore fines located in other regions (such as Brazil). In particular, the ACCC is interested in understanding why freight differentials have not been fully reflected in the prices of iron ore lump and iron ore fines in the past and the extent to which freight differentials would be likely to influence price negotiations in the future; and
- the extent to which alternative Australian suppliers of iron ore lump and iron ore fines would constrain the merged firm from increasing prices to Australian steel makers above global prices.

Issues unlikely to raise concerns

31. Based on market inquiries, the proposed acquisition appears unlikely to pose substantial competition concerns in relation to the issues set out below.
32. Nonetheless, the ACCC will accept further submissions from interested parties on any of the following issues and will revisit them if it considers further consideration is warranted.

Acquisition of iron ore tenements in the Pilbara, WA

33. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns 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

34. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns 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

35. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns 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

36. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns in relation to the supply of thermal coal. The ACCC's

market inquiries indicated that significant alternative suppliers are likely to continue to constrain the merged firm.

Acquisition of rail haulage services in NSW and QLD

37. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns in relation to the acquisition of coal rail haulage services in New South Wales (**NSW**) and Queensland (**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 port terminal services

38. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns in relation to the acquisition of coal port terminal services. The merged firm would have significant involvement in coal port terminals jointly operated by coal producers and would be a major acquirer of coal port terminal services. However, market inquiries indicated that the proposed acquisition is unlikely to result in the merged firm having unilateral control or significant influence over coal port terminals jointly operated by coal producers. In addition, there are a number of rival coal producers that are willing and able to acquire additional coal port terminal capacity in the event the merged firm sought to extract non-competitive terms and conditions from coal port terminal providers.

Supply of bauxite

39. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns 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

40. The ACCC considers that the proposed acquisition appears unlikely to raise competition concerns 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.
41. 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

42. The ACCC's market inquiries did not identify significant issues in relation to the supply of copper concentrates, copper cathode, gold or uranium or the acquisition of mining inputs.

ACCC's future steps

43. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
44. The ACCC now seeks submissions from interested parties on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
45. Submissions are to be received by the ACCC no later than **5 September 2008**. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
46. The ACCC intends to publicly announce its final view by **1 October 2008**. However, the anticipated timeline may change in line with the *Merger Review Process Guidelines*. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.