

COMMONWEALTH OF AUSTRALIA

Trade Practices Act 1974

DECLARATION OF SERVICE UNDER SECTION 44H

I, the Hon Wayne Swan MP, Treasurer, as designated Minister declare the following service under section 44H of the *Trade Practices Act 1974* commencing on 19 November 2008 and expiring on 19 November 2028:

- the use of the facility comprising the Robe Railway from a location near Mesa J to Cape Lambert and all points in between; and
- the use of all associated infrastructure necessary to allow third party trains and rolling stock to move along the Robe Railway between points of interconnection, including, but not limited to:
 - railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway);
 - bridges;
 - passing loops;
 - train control systems, signalling systems and communication systems;
 - sidings and refuges to park rolling stock;
 - maintenance and protection systems; and
 - roads and other facilities which provide access to the railway line route.

Dated: 27/10 2008



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WAYNE SWAN

Treasurer

**STATEMENT OF REASONS CONCERNING THE
APPLICATION FOR DECLARATION OF SERVICES PROVIDED
BY THE ROBE RAILWAY LINE**

Trade Practices Act 1974, s.44H

BACKGROUND

Section 44F of the *Trade Practices Act 1974* (TPA) provides that the designated Minister, or any other person, may make a written application to the National Competition Council (NCC), asking the NCC to recommend that a particular service be declared. After receiving the application, the NCC must, after having regard to the objects of Part IIIA of the TPA and the matters specified in section 44G, recommend to the designated Minister either that the service be declared or that the service not be declared.

On 18 January 2008, the NCC received an application under Part IIIA of the TPA from The Pilbara Infrastructure Pty Ltd (TPI) for declaration of services in the Pilbara region of Western Australia provided by a railway owned by Robe River Iron Associates. TPI is a wholly owned subsidiary of the Fortescue Metals Group Ltd.

The particular service for which TPI has sought declaration (the Robe Service) is:

- the use of the facility comprising the Robe Railway from a location near Mesa J to Cape Lambert and all points in between; and
- the use of all associated infrastructure necessary to allow third party trains and rolling stock to move along the Robe Railway between points of interconnection, including, but not limited to: railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of the railway); bridges; passing loops; train control systems, signalling systems and communication systems; sidings and refuges to park rolling stock; maintenance and protection systems; and roads and other facilities which provide access to the railway line route.

The providers of the Robe Service are the Robe River Iron Associates and Pilbara Iron Pty Ltd (see Attachment A).

On 29 August 2008, I received the NCC's final recommendation. The NCC recommended that the Robe Service be declared for a period of 20 years.

In making this recommendation, the NCC had regard to the objects of Part IIIA of the TPA. As specified in section 44AA of the TPA these are to:

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

The NCC also determined that all of the matters in subsection 44G(2) of the TPA are satisfied, that is:

- (a) that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service;
- (b) that it would be uneconomical for anyone to develop another facility to provide the service;
- (c) that the facility is of national significance, having regard to:
 - (i) the size of the facility; or
 - (ii) the importance of the facility to constitutional trade or commerce; or
 - (iii) the importance of the facility to the national economy;
- (d) that access to the service can be provided without undue risk to human health or safety;
- (e) that access to the service is not already the subject of an effective access regime; and
- (f) that access (or increased access) to the service would not be contrary to the public interest.

Prior to receiving the NCC's final recommendation I met with representatives of Rio Tinto Iron Ore Pty Ltd and Fortescue Metals Group Ltd to discuss the possible declaration of the Robe Service. These meetings provided parties with an opportunity to re-present submissions made to the NCC.

Following receipt of the NCC's final recommendation I visited the facilities of Rio Tinto Iron Ore Pty Ltd and Fortescue Metals Group Ltd in the Pilbara region to contextualise the information presented in submissions and the NCC's final recommendation.

DECISION

Subsection 44H(1) of the TPA provides that on receiving a declaration recommendation from the NCC, I (as the designated Minister) must either declare the service or decide not to declare it.

In deciding whether to declare the service or not, I must consider:

- the objects of Part IIIA of the TPA (subsection 44H(1A));
- whether it would be economical for anyone else to develop another facility that could provide part of the service (subsection 44H(2)).

Further, I cannot declare a service:

- that is subject to an access undertaking in operation under Division 6 of Part IIIA of the TPA (subsection 44H(3));
- provided by means of the facility that was specified under paragraph 44PA(2)(a), while a decision of the Australian Competition and Consumer Commission (ACCC) is in force under subsection 44PA(3) approving a tender process, for the construction and operation of a facility, as a competitive tender process; and
- unless I am satisfied of all matters specified under paragraphs 44H(4)(a) to (f), which mirror the criteria under subsection 44G(2) outlined above.

I have determined that all relevant matters for declaration are satisfied and have decided to declare the Robe service for a period of 20 years.

My consideration of the NCC's final recommendation, and my conclusions on that recommendation, are described below. In making my decision I have drawn on the evidence relied on by the NCC and the findings of the NCC.

Consistent with the approach of the NCC, my decision has been made concurrently with separate decisions on applications for declaration by TPI for two other railways:

- the service provided by certain railway lines owned by Hamersley Iron Pty Ltd (and other entities); and
- the service provided by certain railway lines owned by the Mt Goldsworthy Joint Venture.

I agree with the NCC's position that a 'particular service' has been identified and the 'production process' exemption does not apply here. I note the 24 September 2008 High Court decision on the 'production process' exemption in *BHP Billiton Iron Ore Pty Ltd v The National Competition Council* affirmed the authority relied on by the NCC in reaching this position.

I also agree that the provision of supplementary information by TPI in making its application on the identities and roles of the parties involved in providing the Robe Service does not invalidate TPI's application.

REASONS

Matters specified under subsection 44H(4) of the TPA

a) Would access promote a material increase in competition in a dependent market?

Criterion (a) requires that access (or increased access) to the service would promote a material increase in competition in at least one market (whether or not in Australia), other than the market for the service.

In assessing this criterion, I first considered whether there are any separate but dependent markets in which competition may be promoted. Then, I determined whether access would promote a more competitive environment in any of these markets, where the increase is non-trivial.

I have accepted arguments that there are two, functionally distinct, dependent markets relevant to access to the Robe Service:

- the market for iron ore tenements in the Pilbara; and
- the market for rail haulage services in the vicinity of the Robe Railway.

These markets are identified as separate from the global iron ore market due to their low degree of substitutability, operation at different functional levels, economic separability and use of distinct assets.

Market for rail haulage services in the Pilbara

In considering whether access would promote a material increase in competition in the market for rail haulage services, I found the following to be material:

- i) the Robe Service providers have an incentive to exercise market power due to their status as vertically-integrated operations and as potential providers of rail track and haulage services;
- ii) there is potential demand for haulage services, and there is the potential for new entry into the market;
- iii) factors such as capacity constraints may be dealt with effectively through commercial negotiation of terms and conditions or where necessary through arbitration of a specific access dispute by the ACCC; and
- iv) there are considerable barriers to implementation of a draft rail haulage access regime proposed by the former Western Australian Government and the scope of the regime is uncertain (see criterion (e) below).

Market for iron ore tenements in the Pilbara

In considering whether access would promote a material increase in competition in the market for iron ore tenements, I found the following to be material:

- i) there is a reasonable basis for the Robe Service provider to have an incentive to constrain development of competing tenements;
- ii) access would provide greater opportunities for tenement-owners to develop their tenements. Conversely, without rail access there is a reduced ability for owners to develop tenements, and with incentives to invest decreased there is likely to be a consequential reduction in acquisitions; and
- iii) any mine tenement development without rail access is likely only to occur in limited circumstances. While there are limitations on the extent of the competition effects available through access to the Robe Service these do not appear to be overwhelming.

For both markets, I note that some parties who made submissions suggested that capacity concerns at port facilities may mitigate the likelihood of a material increase in competition. I note that the former Western Australian Government supported the development of common use port facilities. Further, I note the NCC's view that it is able to be satisfied that this criterion is met without examining issues of port access. I agree that it is not necessary to examine port access issues for making my decision on this criterion.

On the basis of these findings, I have reasoned as follows:

- i) effective competition does not currently exist in the markets for iron ore tenements and rail haulage services in the Pilbara; and
- ii) access to the Robe Service would promote a material increase in competition in the markets for rail haulage services and iron ore tenements in the Pilbara.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(a).

b) Is it uneconomical to develop another facility?

Criterion (b) requires that it be uneconomical for anyone to develop another facility to provide the service.

Consistent with the approach of the NCC and the Australian Competition Tribunal, I have construed 'uneconomical' in a social cost benefit sense. This approach considers the costs and benefits to the community as a whole rather than to private and commercial interests.

In assessing this criterion, I considered whether there are alternative facilities that could provide a substitutable service. In doing so, I found potential alternative facilities comprise the use of other railways, that is, the Hamersley, Chichester or proposed Kennedy Railways. While these may provide track services from different

facilities (with common pick up points), I do not consider they provide equivalent access to locations available via access to the Robe Service.

I therefore concluded there are no alternative facilities that could provide a substitutable service for the Robe Service.

I next considered whether it is uneconomical to develop another facility to provide the service having regard to reasonably foreseeable demand for the service. This involves consideration of whether the facility exhibits natural monopoly characteristics.

I agree with the NCC's finding that the Robe Railway is a heavy haul rail system and exhibits features that suggest it is likely to be a natural monopoly.

I note that modelling presented to the NCC suggests that there is likely to be limited surplus capacity on the Robe Railway as currently configured or as modelled for expansion. Accordingly, I formed the view that under its current configuration the Robe facility is close to its capacity to meet expected demand over the medium to long term. Access seekers could, however, negotiate and fund any required expansion.

In these circumstances, I considered whether it is less costly, from a social cost perspective, to expand or modify the Robe facility or to construct another facility to meet foreseeable demand. In doing so, I found the following to be material:

- i) the estimates provided of construction costs for augmentation and duplication;
- ii) the natural monopoly characteristics of the Robe Railway and associated major contribution of construction costs to overall expenditure; and
- iii) the expansion of facilities of this nature is likely to be less costly than constructing a new facility for many demand levels.

On the basis of these findings, I reasoned that expansion of the Robe Railway to accommodate third party demand is likely to be more economical than duplicating the facility.

In making my decision, I agree with and have accepted the NCC's position on the ability of the ACCC to require a service provider to 'expand' a facility as part of the determination of an access dispute.

On the basis of these findings, I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(b).

c) Is the Robe facility of national significance?

Criterion (c) requires that the facility be of national significance having regard to:

- i) the size of the facility; or
- ii) the importance of the facility to constitutional trade or commerce; or

- iii) the importance of the facility to the national economy.

While noting a lack of substantive arguments against this criterion, I found the following to be material:

- i) the Western Australian iron ore industry is a significant export industry for the nation — in 2006-07, being valued at \$15.75 billion and generating \$851 million in royalties;
- ii) the Pilbara region is the source of the majority of iron ore produced in Western Australia, and accounts for 95 per cent of Australia's iron ore production; and
- iii) the Robe Railway is a significant component of the Pilbara rail network, in terms of the amount of iron it transports, its size and estimated value to duplicate.

On the basis of these findings, I reasoned that the Robe facility forms a major part of the Pilbara rail network which is integral to the iron ore industry in Western Australia and that the Western Australian iron ore industry, of which the Pilbara is a major contributor, is of importance to Australia's exports and economy.

I therefore concluded that the matters specified in subparagraphs 44H(4)(c)(i)-(iii) are satisfied and that the facility is of national significance.

d) Can access be provided without undue risk to human health or safety?

Criterion (d) requires that access to the service can be provided without undue risk to human health or safety.

I found the following to be material:

- i) the facility owner would retain control over the operation of the Robe Service;
- ii) terms and conditions of access, whether via commercial negotiation or arbitration under Part IIIA, could provide for maintaining appropriate standards to safeguard human health and safety and make available essential rail safety technology;
- iii) rail haulage services on the Robe Service would be subject to existing occupational health and safety legislation and the safety regime embodied in the *Rail Safety Act 1994* (WA), whether provided by third parties or the existing operators; and
- iv) access could reduce risks to human health or safety due to the reduced transport of ore by road.

On the basis of these findings, I reasoned that mechanisms exist to ensure that any additional risks can be effectively managed and therefore that access to the Robe Service can be provided without undue risk to human health or safety.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(d).

e) Is the Robe Service already subject to an effective access regime?

Criterion (e) requires that access to the service is not already the subject of an effective access regime.

In considering this criterion, I found the following material facts, based on the evidence relied on by the NCC in its findings in the final recommendation:

- i) Currently the only access regime which governs access to track services in Western Australia, that is, services of the kind subject to the declaration application in question, is the Western Australian Rail Access Regime (the WA Regime) established by the Western Australian Government through the enactment of the *Railways (Access) Act 1998* (WA) and the *Railways (Access) Code 2000* (WA).
 - However, I note that the WA Regime does not apply to the Robe Railway, or any other of the Pilbara iron ore railways.
- ii) The *Iron Ore (Robe River) Agreement Act 1964* (WA) includes a provision regarding the operation of the Robe Railway that requires the railway operator to carry the freight of third parties in certain circumstances, including where to do so would not unduly prejudice the operations of the joint venturers.
 - However, I note that to date no independent access seeker has been able to negotiate access arrangements under this Act.
- iii) The former Western Australian Government had proposed a draft Pilbara Railways (Third Party Haulage) Regime.
 - I note that the introduction and operation of the proposed Regime is not guaranteed, and may not apply to all rail infrastructures in the Pilbara.
- iv) The rail haulage service provided for by the *Iron Ore (Robe River) Agreement Act* and the draft Pilbara Railways (Third Party Haulage) Regime involves the carriage of iron ore by the infrastructure provider for a third party — they do not allow an access seeker to operate its own rolling stock.

On the basis of these findings, I have reasoned that neither the WA Regime, the *Iron Ore (Robe River) Agreement Act* or the draft Pilbara Railways (Third Party Haulage) Regime provide an effective access regime in relation to the Robe Service. I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(e).

f) Is access contrary to the public interest?

Criterion (f) requires that access (or increased access) would not be contrary to the public interest.

In considering this criterion, I had regard to the potential costs and benefits that may arise from providing access to the Robe service. I note that this criterion does not require that I be affirmatively satisfied that access be in the public interest.

I note the significant potential benefits arising from access to the Robe Service, including:

- i) material promotion of competition in the identified separate and dependant markets;
- ii) accelerated development of iron ore tenements in the Pilbara;
- iii) avoidance of inefficient duplication of railway facilities or use of less economic transport options;
- iv) avoidance of further impacts on native title rights; and
- v) a reduced adverse impact on the environment.

These benefits need to be weighed against the potential costs of access, which include:

- i) investment costs — expansion costs, deterring or delaying efficient investment;
- ii) regulatory costs and impacts;
- iii) operational costs — potential loss of production, diseconomies and inefficiencies, deterring or delaying optimisation of rail operations;
- iv) loss of ‘facilities-based’ competition; and
- v) environmental costs.

I note that the NCC has indicated that the potential risks of declaration and costs of access can be substantially mitigated as:

- i) the Service provider will continue to own and operate the Robe facility (it will remain vertically integrated) and will retain control over decisions affecting the facility such as the timing of capacity expansions;
- ii) access terms and conditions for the Service can be applied that reflect the dynamics of investment;
- iii) arbitrated outcomes can account for the costs of access and provide certainty to all parties; and
- iv) the arbitration provisions of Part IIIA contain clear and sufficient safeguards designed to protect the legitimate business interests of service providers and ensure that they are compensated for the costs of providing access.

I have also reflected on the submissions made by of BHP Billiton Iron Ore and Rio Tinto Iron Ore in relation to the magnitude of potential costs and their criticism of the NCC's draft recommendations. On balance, however, I am satisfied that the overall costs of access would not outweigh the potential benefits due to the mechanisms available to manage the risk of costs that may result from access. Accordingly, I agree with the NCC that access would not be contrary to the public interest.

I am therefore satisfied in relation to the matter specified in paragraph 44H(4)(f).

Consequently, following consideration of the final recommendation by the NCC, I am satisfied of all matters specified under subsection 44H(4).

Objectives of access regulation

In making my decision, I have had regard to the objects of Part IIIA (section 44AA) and I am of the opinion that access to the Robe Service is consistent with their intent. In particular, I consider that:

- access would promote the economically efficient operation and use of infrastructure, as the potential use of the existing facilities or expansion of facilities would be more efficient than duplication; and
- access would promote effective competition in the markets for rail haulage services and iron ore tenements.

Economical to develop another facility that could provide part of the service

This section provides the designated Minister with the scope to decide not to declare a service, even where the criteria in subsection 44H(4) are satisfied, if the Minister considers that it would be economical to develop another facility that could provide part of the service.

I note that the NCC found that it is unclear whether the costs of expansion of sections of the Robe Railway, in particular the more heavily used eastern section, are sufficient to demonstrate the viability of the economic duplication of that section.

I agree with and have accepted the NCC's argument that questions regarding the expansion or duplication of the eastern section of the Robe Service do not provide sufficient reason to decide against declaring the service.

Access undertaking and ACCC decision under subsection 44PA(3) of the TPA

I note that the service is not subject to either an access undertaking under Division 6 of Part IIIA of the TPA nor is it facility specified under paragraph 44PA(2)(a) of the TPA.

Subsection 44H(8) — Duration of declaration

I have determined that declaration of the Robe Service should be for a period of 20 years. I consider that this duration would provide sufficient certainty for all parties to undertake investment and other decisions in response to declaration, recognising the expected timeframes for development and operation of the associated mining operations and the long term nature of investment in the iron ore industry generally.

I note that under section 44J of Part IIIA, a declaration can be revoked in the event that one or more of the declaration criteria contained in subsection 44H(4) are no longer satisfied. A recommendation to revoke is made by the NCC to the designated Minister.



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WAYNE SWAN

Treasurer

Dated: 27/10 2008

ROBE SERVICE PROVIDERS

The Robe River Iron Associates own the railway line from a location near Mesa J to Cape Lambert.

The Robe Railway is managed by Pilbara Iron Pty Ltd (Pilbara Iron) (a wholly owned subsidiary of Rio Tinto Limited).

The Robe River Iron Associates is an unincorporated joint venture comprising the following participants:

- Robe River Mining Co Pty Ltd;
- Mitsui Iron Ore Development Pty Ltd;
- North Mining Limited;
- Cape Lambert Iron Associates; and
- Pannawonica Iron Associates.

The Cape Lambert Iron Associates consist of:

- Nippon Steel Australia Pty Ltd;
- Sumitomo Metal Australia Pty Ltd; and
- Mitsui Iron Ore Development Pty Ltd.

The Pannawonica Iron Associates consist of:

- Nippon Steel Australia Pty Ltd; and
- Sumitomo Metal Australia Pty Ltd.

Robe River Mining Co Pty Ltd and North Mining Limited are wholly owned subsidiaries of Rio Tinto Limited.

