

The Pilbara Infrastructure Pty Ltd

Decision in accordance with the requirements of
Section 10 of the *Railways (Access) Code 2000*

14 August 2013

Economic Regulation Authority

WESTERN AUSTRALIA

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Economic Regulation Authority
Perth, Western Australia
Phone: (08) 6557 7900

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Authority Decision

The Authority has made a decision pursuant to section 10(1) of the *Railways (Access) Code 2000* (**Code**).

On 4 June 2013, the Authority published a notice, as required under section 10(2) of the Code, after receiving notification from The Pilbara Infrastructure Pty Ltd (**TPI**) that it was of the view that an access proposal dated 15 May 2013 (**Access Proposal**) received from Brockman Iron Pty Ltd (**Brockman**) would involve the provision of access to railway infrastructure to an extent that may preclude other entities from access to that infrastructure.

For the reasons set out below, and in accordance with section 10(1) of the Code, the Authority approves the commencement of negotiations with respect to the Access Proposal.

Legislative Requirements

Under section 10(1)(b) of the Code, the Regulator's approval is required before negotiations can be entered into with respect to a proposal that the railway owner considers would involve the provision of access to railway infrastructure to an extent that may in effect preclude other entities from access to that infrastructure.

In making a decision under section 10(1) whether to approve the entry into negotiations between TPI and Brockman on the Access Proposal, section 10(4)(b) of the Code requires that the Regulator must have regard to:

- (i) any submission relevant to the decision that is made in accordance with a notice given by the Regulator under section 10(2);
- (ii) what the Regulator determines to be in the public interest; and
- (iii) any other matter that the Regulator considers relevant.

In addition, under section 20(4) of the Act, in performing functions under the Act or Code, the Regulator is to take into account:

- (a) the railway owner's legitimate business interests and investment in railway infrastructure;
- (b) the railway owner's costs of providing access, including any costs of extending or expanding the railway infrastructure, but not including costs associated with losses arising from increased competition in upstream or downstream markets;
- (c) the economic value to the railway owner of any additional investment that a person seeking access or the railway owner has agreed to undertake;
- (d) the interests of all persons holding contracts for the use of the railway infrastructure;
- (e) firm and binding contractual obligations of the railway owner and any other person already using the railway infrastructure;
- (f) the operational and technical requirements necessary for the safe and reliable use of the railway infrastructure;
- (g) the economically efficient use of the railway infrastructure, and
- (h) the benefit to the public from having competitive markets.

The Authority has considered all views in submissions made in accordance with section 10(2) in relation to the above matters and has referred to these where appropriate in the discussions below.

The route subject to Brockman's proposal

The Access Proposal relates to chainage 194.5 km to chainage 23 km as measured from Port Hedland. This route is split, for management and accounting purposes, into two sections either side of the 'Solomon Spur' at chainage 174.5 km.

Role of the Authority

The Authority is responsible for fulfilling a number of roles described in the Code. The Code describes a negotiate-arbitrate approach. The role of the Authority in making a decision under section 10 of the Code is to approve or not approve the parties entering into negotiations in relation to the Access Proposal. The floor and ceiling costs determined by the Regulator affect the price which is offered by the railway owner in negotiations with the proponent. The Authority's role and the administrative requirements of the role are described in Part 2 of the Code.

Submissions received

In response to the Authority's notice under section 10(2) dated 4 June 2013, the Authority received a number of public submissions. A confidential submission was received from BC Iron Ltd. Non-confidential submissions were received from:

- Atlas Iron Ltd (**Atlas**);
- Flinders Mines Ltd (**Flinders**);
- Brockman;
- Fortescue Metals Group Ltd (**FMG**);
- TPI; and
- Winmar Resources Ltd (**Winmar**).

All of the non-confidential submissions were published on the Authority's website on 22 July 2013. Following the publication of these submissions, the Authority received two further submissions from TPI dated 25 July 2013 and 5 August 2013. TPI's further submissions have been published on the Authority's website and, notwithstanding their late filing, the Authority has taken into account these further submissions in making this decision.

Authority's considerations

The Authority has considered all relevant matters raised in the submissions it has received. The matters raised in submissions may be categorised as matters relating to the validity of Brockman's Access Proposal, impact of the Access Proposal on the availability of capacity on the infrastructure subject to the Access Proposal, costs and other adverse impacts on the legitimate business interests of TPI as owner of the railway infrastructure and public interest issues.

Validity of Brockman's proposal

TPI claims that, pursuant to section 20(4)(a) of the Act, the Authority has an obligation to protect the legitimate business interests of the railway owner, and must only approve *bona fide* proposals, capable of giving rise to binding agreements, and compliant with the Code. TPI says that it is evident from the Access Proposal that Brockman has not verified the economic feasibility of the proposed rail operations and does not have the capital to carry out the proposed operations. On this basis, TPI considers Brockman is incapable of entering an agreement giving rise to a binding legal commitment to access TPI's railway and that Brockman is merely seeking an option to access TPI's railway. TPI says this inference is supported by a public statement by Brockman that its preferred infrastructure solution is the East Pilbara Independent Rail solution.

The Authority does not agree with TPI's submission that the fact that Brockman has not undertaken a process to verify the technical and economic feasibility of the proposed rail operations indicates that Brockman is incapable of entering an agreement giving rise to a binding legal commitment if negotiations were to proceed. Nor is any evidence provided by TPI in support of its assertion that Brockman does not have the financial capacity to carry out the proposed rail operations.

There is no requirement in the Code or the Act that a proponent must have undertaken feasibility studies or must include evidence of its financial standing in its access proposal. The Authority is of the view that each of the concerns raised by TPI is capable of being addressed if negotiations were to proceed.

In this regard, the Authority notes that TPI is required under section 9(1) of the Code to inform Brockman of TPI's requirements under sections 14 and 15 of the Code as part of TPI's response to the Access Proposal. Pursuant to section 14(b), a railway owner can require a proponent to show that it has the necessary financial resources to carry on the proposed rail operations. Pursuant to section 15(1), the railway owner can require the proponent to show how its proposal for access can be accommodated on the route or how it could be accommodated if a specified extension or expansion (or both) were undertaken by the railway owner. In a case where an extension or expansion (or both) is specified, under section 15(2), the railway owner is also entitled to require the proponent to provide a preliminary assessment showing that the extension or expansion can be carried out in a technically and economically feasible way and will be consistent with safe and reliable rail operations on the route.

If TPI is not satisfied with the adequacy of information provided to it by Brockman for the purposes of sections 14 and 15, TPI can utilise the procedures under section 18 of the Code to give notice of its dissatisfaction and seek further information from Brockman.

Further, the Authority does not regard the fact that Brockman is considering other options for accessing rail infrastructure for its projects at the same time as making the Access Proposal as being contrary to the objectives and requirements of the Code, as alleged by TPI. The Authority is aware from Brockman's ASX announcement on 2 July 2013 that Brockman has entered into a relationship agreement with Aurizon under which Aurizon is appointed as its exclusive supplier to develop and operate the infrastructure required for Brockman's Marillana and Ophthalmia Projects. However, it appears that the agreement does not lock in a preferred development option for the transport infrastructure and Brockman says the agreement "will complement and support" its proposal for access to TPI's rail infrastructure, which suggests that Aurizon could procure and operate rolling stock to use on TPI's railway.

Available capacity on the route

Pursuant to section 20(4)(d) and (e) of the Act, the Authority is to take into account:

- the interests of all persons holding contracts for the use of the railway infrastructure;
- firm and binding contractual obligations of the railway owner and any other person already using the railway infrastructure.

TPI and FMG submit that FMG is fully utilising the available capacity of TPI's railway and that its existing use of the railway will be displaced by the Access Proposal. Submissions were also made to the effect that Brockman's proposed access will impact on the interests of BC Iron and other partners of FMG who have existing contracts for the use of the railway.

The Authority notes that TPI is the owner of the railway and that, currently, TPI is the only above-rail operator on the railway. On this basis, there are no existing third party access agreements in relation to the railway beyond those of TPI itself. However, the Authority accepts that there are existing contractual arrangements between TPI, FMG and its partners and joint venturers in relation to rights to the utilisation of the railway.

The Authority notes TPI's opinion that the provision of access (i.e. capacity) to Brockman would preclude other entities from access to the route and TPI's alternative assertion that there is currently no available capacity on the route.

Submissions from Atlas, FMG and Winmar suggest that there is currently, and may be further, significant demand for access to train paths apart from Brockman's proposal. However, the Authority has not been made aware of any additional current or prospective proposals for access to the TPI network.

Notwithstanding the assertions contained in submissions, the Authority does not have sufficient information before it to reach a conclusion as to whether there is sufficient current capacity on the route to accommodate the Access Proposal.

There is nothing in TPI's submission to support the conclusion that the provision of sufficient capacity to accommodate Brockman's proposal would preclude further expansion of the railway infrastructure that is not funded by FMG. Further, there is no evidence in TPI's submission, or in any of the other submissions before the Authority, that would support a conclusion that such expansion is not technically or economically feasible.

TPI submits that, as the Access Proposal states that an expansion or extension of TPI's railway is not required, the Authority cannot infer that an expansion or extension would permit other entities to access TPI's railway nor that an expansion or extension would be technically and economically feasible.

Under section 8(3)(a) of the Code, Brockman is required to specify in its proposal the railway infrastructure to which access is sought. Section 8(4) of the Code permits an access proposal to specify an expansion of the railway infrastructure that would be necessary to accommodate the proposed rail operations. However, section 8(5) of the Code expressly provides that the fact that an extension or expansion is not specified in a proposal does not prevent the proposal of such an extension or expansion being made in the course of negotiations under Part 3 of the Code on the basis that such an extension or expansion would be necessary to accommodate the proposed rail operations.

In the circumstances, the Authority is of the view that the failure to specify an extension or expansion in an access proposal does not invalidate the Access Proposal. Nor does the Authority consider that Brockman's failure to specify an extension or expansion in the Access Proposal means the Authority cannot take into account the possibility that an expansion or extension may be required to accommodate the proposal.

The Authority accepts TPI's submission that section 10 of the Code does not require a railway owner to demonstrate that its railway is incapable of being expanded. However, the Authority notes that the submissions of TPI and FMG both refer to current expansion works due to be completed in the second quarter of the financial year 2014 and plans for future economic expansion of the rail infrastructure to accommodate FMG's further production targets.

Further, the Authority is aware of statements and releases by FMG in the public domain which indicate plans to expand the TPI railway network beyond 155mtpa.¹

In these circumstances, and where there is no evidence before the Authority that an extension or expansion is not technically or economically feasible to accommodate the Access Proposal, the Authority is of the view that it is appropriate, in making its decision under section 10(1) of the Code, that it take into account that an extension or expansion of the railway infrastructure may be possible.

TPI's legitimate business interests

Pursuant to section 20(4) of the Act, the Regulator is to take into account:

- (a) the railway owner's legitimate business interests and investment in railway infrastructure; and
- (b) the railway owner's costs of providing access, including any costs of extending or expanding the railway infrastructure, but not including costs associated with losses arising from increased competition in upstream or downstream markets.

The Authority has considered submissions made by FMG to the effect that provision of access to Brockman by TPI will reduce the incentive for FMG to invest in TPI's railway, displace existing users' entitlements, and cause inefficient use of the railway by reason of delays caused by having to negotiate with Brockman and operating disadvantages. TPI also relies on recent submissions made to the Productivity Commission by BHP Billiton² and Rio Tinto Iron Ore³ to the effect that there are significant costs and risks to railway owners associated with third party access, including:

- Loss of flexibility in, and efficiency of, operations and the consequential reduction in effective capacity;
- Additional maintenance, compliance, regulatory and administration costs;
- Costs of unplanned congestion and delays;
- Costs of delays to future expansion;
- High likelihood of disputes and the costs of litigation and adjudication; and
- Reduction in investors' ability to make productive use of their investment.

¹ "Miners to boost Hedland capacity" THE WEST AUSTRALIAN, Monday 25 February 2013, "Fortescue Studying Expansion Options to 200MTPA" Letter to the Australian Stock Exchange Ltd 18 June 2007

² BHP Billiton Submission to the Productivity Commission's Inquiry into the National Access Regime dated 12 July 2013

³ Rio Tinto Submission in reply to the Productivity Commission Draft Report in the National Access Regime Review dated 5 July 2013

The Authority has considered the matters raised in the submissions to the Productivity Commission made by BHP Billiton and Rio Tinto Iron Ore. However, the Authority notes that these costs and risks are not specific to Brockman's Access Proposal. Rather, managing the displacement of alternative investment proposals, costs and delays associated with negotiations, potential disputes and operating allowances are unavoidable elements of any open-access railway, and are considered normal business costs associated with owning an open access railway.

In this regard, although the Authority acknowledges that these are real disadvantages that may result from third party access arrangements, the Authority is of the view that TPI's business interests must be considered in a context where TPI knew, at the time it decided to proceed with its investment in the railway infrastructure, that it would be subject to third party access proposals. In particular, in order to obtain the State's assistance with development of multi-use rail and port infrastructure, TPI made commitments to the State Government in Schedule 1 of the *Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004 (TPI State Agreement)*, including a commitment to operate the railway under open third party access arrangements and to use all reasonable endeavours to promote access to, and attract above-rail customers for, the railway in accordance with the Act⁴ and the Code.

The Authority is of the view that, in circumstances where TPI owns a regulated railway, any adverse cost impacts to TPI, FMG or other interested users of the railway must be considered in the context of TPI having contractual obligations in relation to providing third party access.

Further, whilst the Authority notes TPI's submissions with respect to the costs associated with reaching an access agreement with Brockman, the Authority is of the view that there are mechanisms available to TPI within the Code, in particular the procedures in section 18 of the Code, to facilitate the negotiation process and to make that process more efficient.

Public Interest Issues

Pursuant to section 10(4)(b)(ii) of the Code, the Regulator must have regard to what the Regulator determines to be in the public interest.

Further, pursuant to section 20(4)(g) and (h) of the Act, the Regulator is to take into account:

- the economically efficient use of the railway infrastructure; and
- the benefit to the public from having competitive markets.

Brockman has submitted that allowing negotiations on the Access Proposal will be in the public interest because access would generate significant economic activity and employment opportunities, and the infrastructure will play an important role in the continued development of Port Hedland and the region.

FMG has submitted that allowing Brockman access to the railway will adversely impact employment in the Pilbara region and will result in a reduction in federal taxes and royalties paid to the Western Australian Government.

The Authority notes that under the terms of the TPI State Agreement, it is acknowledged that the State, for the purpose of promoting development of the iron ore industry and employment opportunity generally in Western Australia, and for the purposes of promoting

⁴ See sub-clauses 16(2)(a), (3), (5) and (7) of the TPI State Agreement

the development of multi-user infrastructure facilities in the Pilbara region of Western Australia, has agreed to assist the development of the multi-user railway and port facilities at the Port of Port Hedland.⁵

The Authority notes the potential community and social benefits associated with the Brockman access proposal include training and employment opportunities for persons living in the Pilbara region, regional development and local procurement of goods and services. The Authority is of the view that the Access Proposal has potential for such public benefits as are outlined above and that it would be contrary to the public interest to disallow negotiations between TPI and Brockman.

FMG has submitted that allowing Brockman access to the railway will only produce a small increase in the production of iron ore and this will not have an impact on the competitiveness of what is a global market. However, FMG's website contains contrary statements, expounding the competitive and efficiency benefits of open access to the rail infrastructure:

PORT AND RAIL INFRASTRUCTURE

Fortescue purpose-designed and constructed rail and port facilities to support the development and sale of the Pilbara's stranded iron ore bodies...

THIRD PARTY ACCESS

The infrastructure philosophy is to provide open third party access regime for other mining users as espoused by the Government. Fortescue's open access infrastructure will increase the throughput capacity of Port Hedland and remove a fundamental barrier to entry for junior mining companies. As a result, increased production, competition and efficiencies will result for the bulk mineral exports in the Pilbara region.

The Authority notes that, pursuant to section 20(4)(f) of the Act, the operational and technical requirements necessary for the safe and reliable use of the railway infrastructure must not be impacted. Further, TPI is obliged, under the TPI State Agreement, to ensure the Railway and Additional Infrastructure are operated in a safe and proper manner and in compliance with all applicable laws, including the *Rail Safety Act 1998* (WA). There is no evidence in the submissions to support the view that the operational and technical requirements for the safe and reliable operation of the railway will be affected, other than an assertion that delays may occur.

Summary

The Authority has had regard to the matters referred to in section 10(4)(b) of the Code, and has taken into account all of the matters in section 20(4) of the Act.

The Authority is of the view that the scheme of the rail access regime does not require a proponent to undertake feasibility studies or include evidence of its financial standing in its access proposal. Rather, it is clear from Part 3 of the Code that there are opportunities, after commencement of negotiations, for the railway owner to require a proponent to provide information with respect to its financial resources to carry on the proposed rail operations and how its proposal for access can be accommodated on the route.

The Authority has considered the submissions of TPI and FMG in relation to the potential cost and operational impacts on the railway infrastructure associated with the Access Proposal. However, the Authority is of the view that the potential public interest benefits associated with the furthering of Brockman's access proposal are not outweighed by the legitimate business interests of TPI as the owner of a regulated railway. In this regard, the Authority is of the view that any adverse cost impacts to TPI, FMG or other existing users of the railway must be considered in the context of TPI's contractual obligations to provide

⁵ See recital D of the TPI State Agreement

third party access as outlined in the TPI State Agreement, which is a binding contract between TPI and the WA State Government.

In circumstances where there is evidence that the TPI is currently considering expansion of the railway to accommodate future use by FMG, the Authority is unable to conclude that the provision of access to the railway infrastructure under the Access Proposal would involve the provision of access to such an extent that may preclude other entities from access to that infrastructure. On this basis, for the reasons set out above, the Authority approves the commencement of negotiations with respect to the Access Proposal.