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ATTENTION: LYNDON ROWE

The Chairman
Economic Regulation Authority
PO Box 8469
PERTH WA 6849

Dear Mr Rowe

PUBLIC SUBMISSIONS ON THE PILBARA INFRASTRUCTURE PTY LTD'S FLOOR AND CEILING COSTS

We refer to the submissions made by Brockman Iron Pty Ltd (**Brockman**) and Flinders Mines Limited (**Flinders**) on 11 June 2013 in relation to the Economic Regulation Authority's (**ERA**) determination of The Pilbara Infrastructure Pty Ltd's (**TPI**) floor and ceiling costs under clause 10 of Schedule 4 of the *Railways (Access) Code 2000 (Code)*. These submissions were made available by the ERA on its website on 27 June 2013.

To assist the ERA in reviewing TPI's floor and ceiling costs, TPI makes the following comments in relation to the Brockman Submission and the Flinders Submission.

1. PROVISION OF COSTS FOR PROPOSED ACCESS

Contrary to the assertions made in the Brockman Submission, TPI has provided floor and ceiling costs on a route basis in accordance with TPI's current Costing Principles. Further, TPI's floor and ceiling costs do in fact include the infrastructure of the current expansion works (that will expand TPI's railway to a name plate capacity of 155mtpa) as if those expansion works were complete.

However, as TPI has advised both Brockman and the ERA previously, it is not possible for TPI to provide floor and ceiling costs which comply strictly with section 9(1)(c) of the Code because the values of the assumptions contained in Schedule 4 and the Costing Principles are unknown for the date from which access is sought by Brockman (i.e. late 2016). Further, the Weighted Average Cost of Capital (**WACC**), on which the floor and ceiling prices rely, is determined by the Regulator on an annual basis and will not be determined for the relevant period until on or after 1 July 2016.

2. PROVISION OF COSTING MODEL

Brockman claims that the Costing Principles require TPI to provide Brockman and other "interested submitters" with its 2013 Costing Model. This claim has no basis and neither

section 9(1)(c) of the Code nor section 2 of the Costing Principles require that TPI provide a copy of the 2013 Costing Model to Brockman or other “interested submitters”.

As TPI has previously advised the ERA, TPI’s 2013 Costing Model is confidential commercially sensitive, and proprietary to TPI and the disclosure or release of that information has the potential to cause irreparable damage to TPI and its parent company, Fortescue Metals Group Limited (**Fortescue**).

3. FACTORS RELEVANT TO ASSESSMENT OF COSTS

The Brockman Submission seeks to apply to the calculation of floor and ceiling costs principles which are only relevant in the negotiation of access charges. This is inconsistent with the provisions in the Code and TPI’s Costing Principles.

The floor price and ceiling price are the sums equal to the costs referred to in clauses 7(1) and 8(1) of Schedule 4 of the Code respectively. The components of the floor and ceiling costs and the approach used in estimating these costs are based on the hypothetical Gross Replacement Value (**GRV**) of a Modern Equivalent Asset (**MEA**), assuming efficient practices. The ERA must ensure that TPI’s floor and ceiling costs as approved or determined by the ERA reflect the objectives and intentions of the Act and the Code and apply the principles set out in TPI’s Costing Principles.

The floor and ceiling costs, once approved or determined, are used as the parameters by which a railway owner negotiates access charges with a proponent. It is only once the floor and ceiling costs have been approved or determined by the ERA and the parties are at negotiation stage that the principles set out in clause 13 of Schedule 4 of the Code become relevant. These principles are not, as Brockman asserts, relevant to the determination of the floor and ceiling costs.

In performing its functions under the Code, including approving or making a determination on TPI’s floor and ceiling costs under clause 10 of Schedule 4 of the Code, the ERA must take into account the eight criteria listed in section 20(4) of the Act. However, contrary to the assertion made at page 4 of the Brockman Submission, section 20(4) of the *Railways (Access) Act 1998 (Act)* does not require the ERA to take account of “a railway owner’s role as a provider of regulated infrastructure” in performing its functions under the Act or the Code.

Relevantly, pursuant to section 20(4) of the Act, in approving or making a determination on TPI’s floor and ceiling costs, the ERA must have regard to the following factors:

- a reduction in the ceiling price proposed by TPI will reduce the incentive to TPI to make future investments in maintaining and expanding TPI’s railway contrary to sections 2A and 20(4)(a) of the Act;
- the cost to TPI of providing access under section 20(4)(b) of the Act, including the reduction in capacity of TPI’s railway, the inefficient use of TPI’s railway system; and

- the inefficiencies that will arise as a result of the introduction of trains operated by Brockman on TPI's railway contrary to section 20(4)(g) of the Act.

4. FLOOR AND CEILING COSTS EXPRESSED AS AN ANNUAL AMOUNT

TPI states that the floor and ceiling costs should be expressed as an annual cost, not a dollar per tonne amount as Brockman and Flinders have proposed.

Whilst it is acknowledged that in its 2010 floor and ceiling cost calculation TPI expressed its floor and ceiling costs as a dollar per tonne amount, the Code and normal regulatory convention requires the floor and ceiling costs to be expressed as an annual amount. Relevantly, the floor and ceiling costs determined by the ERA for both Brookfield Rail and the Public Transport Authority are expressed as annual amounts, not dollar per tonne amounts. Therefore, the assertion made in the Brockman Submission that "it is conventional to calculate proposed rail access costs on a per tonne basis" is without merit.

Brockman surmises that TPI's floor and ceiling costs equate to a price of \$3.67/tonne and \$4.79/tonne respectively. This is incorrect and not a valid representation of TPI's floor and ceiling costs. Further, Indec's analysis results in a ceiling price of \$0.88 - \$1.23 per tonne. These numbers are a nonsensical derivation.

5. 2010 TPI COSTING MODEL

Both the Brockman Submission and the Flinders Submission wrongly seek to rely on TPI's 2010 Costing Model, which is out dated and invalid. Indeed, the ERA stated that its review of TPI's 2010 floor and ceiling costs was "redundant" due to the construction of a new route section following the submission of TPI's 2010 Costing Model. As a consequence, the ERA's review was suspended and cannot, along with the draft 2011 reports prepared by the ERA's consultants, AECOM and PriceWaterhouse-Coopers, be relied upon or bind TPI. It is, therefore, neither appropriate nor reasonable for the ERA to seek to rely on the 2010 Costing Model or the PriceWaterhouse-Coopers Draft Report, as is suggested by Brockman and Flinders.

Further, given the expansion to TPI's railway that has occurred since July 2010 and the increased complexities associated with a larger capacity railway, the capital and operating costs contained in the 2010 Costing Model are not representative of the current capital and operating costs of TPI's railway. Thus, the extrapolations made in the Brockman Submission and the Flinders Submission are incorrect and should not be taken into consideration by the ERA.

Rather, the focus of any cost determination of replacement costs by the ERA should be based on current 2013 costs, as defined in the Code, and should be reflective of current Pilbara efficient costs.

7. INDEC CONSULTING – GROSS REPLACEMENT VALUE REPORT

In order to ensure that the most appropriate and current costs were incorporated into TPI's proposed Floor and Ceiling Cost Model, TPI engaged Calibre Global Pty Ltd

(**Calibre**) as an independent engineering consultant. Calibre has designed and delivered many of the largest rail infrastructure and heavy haul projects in Australia, including rail projects in the Pilbara for BHP Billiton Iron Ore, Rio Tinto Iron Ore and Fortescue. Further information about Calibre's relevant experience is included in the Capability Statement in **Attachment 1**.

The Brockman Submission relies on a Gross Replacement Value Report prepared by Indec Consulting (**Indec Report**). Calibre has reviewed the Indec Report and provided a confidential report (**Calibre Report**), which sets out the shortcomings of the Indec Report. A copy of the Calibre Report is included in **Attachment 2**.

For the reasons set out in the Calibre Report, the Indec Report should not be preferred to TPI's 2013 Costing Model, which was prepared by Calibre on behalf of TPI.

We note that three years ago, in September 2010, in an ASX release, Brockman stated that it estimated that the cost of constructing an 80km rail spur from its Marillana Mine would cost AU\$474 million, which would equate to a direct rail spur capital cost of \$5.9 million per kilometre, excluding contingency. Applying the same inflation rate that was assumed in the Indec Report of ~2.4%, this is equivalent to \$507 million today, which equates to a direct rail spur capital cost of \$6.3 million per kilometre. This figure is considerably higher than the capital costs now estimated by Indec in the Brockman Submission. The ERA could seek a copy of Brockman's costing model, which underpinned this estimate.

In view of the obvious shortcomings with the Indec Report, the ERA should disregard the analysis contained in the Indec Report and should exercise caution in taking into account any of matters raised in the Brockman Submission and the Flinders Submission when reviewing TPI's floor and ceiling costs.

Finally, we note that Aurizon Holdings Limited (**Aurizon**) has publicly stated that it is assessing the viability of constructing a new rail line in the Pilbara and is in talks with miners, including Brockman, regarding the proposed railway. Aurizon's current cost estimate for the construction of this new railway is likely to assist the ERA in reviewing TPI's floor and ceiling costs. As such, the ERA should take steps to obtain a copy of Aurizon's cost estimates, or at least a copy of Brockman's own internal costing model and any correspondence between Brockman and Aurizon regarding the construction of the railway.

We would welcome further discussion with the ERA in relation to TPI's floor and ceiling costs and why TPI's Costing Model must be preferred to the Indec Report.

Yours sincerely



SPENCER DAVEY
Commercial Compliance Officer