PORTMAN IRON ORE LIMITED

A.C.N. 001 892 995

Portman Iron Ore Limited's ("Portman") Submission and Comments on the Draft Determination of the Western Australian Independent Rail Access Regulator on WestNet Rail Pty Ltd's ("WestNet") Proposed Costing Principles

1. The Draft Determination refers to the PricewaterhouseCoopers audit of the WestNet Costing Model. This audit reveals deficiencies in WestNet's access pricing modelling which should not be acceptable to the Regulator even during a temporary period:

   (a) First the approach used by WestNet to calculate ceiling access prices would give little confidence in the integrity of the base data and in the accuracy of the calculations. The audit reveals 9 fundamental deficiencies in either the collection or updating of base data or the calculation of the total costs – or ceiling prices. This may be to an extent remedied by WestNet's proposed move to a new single model pricing system to replace the existing multiple file system. However, once the single model pricing system is implemented by WestNet, Portman suggests that the Regulator require a further audit to be conducted to ascertain the continuing potential to materially compromise data integrity and calculation accuracy.

   (b) The methodology used by WestNet in setting the floor test price is fundamentally inconsistent with the requirements of the Railways (Access) Code 2000 (the "**Code**") of which is based upon the theory of avoidable costs. The Regulator must require WestNet to restructure the approach to the floor test price so that the approach is consistent with the definition of "incremental costs".

2. Section 4.2 - Operating Costs. The approach of estimating efficient costs for parts of the network that WestNet is able to demonstrate are MEA should not be derived from competitive tenders for providing comparable services, but should be derived from competitive tenders for actual services. If the relevant parts of the network are MEA then WestNet can competitively tender the provision of actual services. If WestNet wishes to carry out the services itself it must do so at a cost not exceeding the cheapest tender for the actual services.

3. Section 4.2 – Operating Costs. For parts of the WestNet network that are not considered to be MEA, the Regulator should indicate against which other comparable assets he will benchmark their costs.

4. Section 4.2 – Operating Costs. The items suggested by the Regulator's independent railway engineer as areas that could be considered in assessing whether WestNet is operating at efficient costs, in many instances do not indicate how the item is to be tested or weighted to achieve the required efficiency, eg contrast "strategies to reduce contamination of ballast and sleepers" (which has no objective criteria) with "reduce overhead costs to less than 10% of total costs". All items should have criteria against which WestNet's efficiency can be evaluated.

5. Section 4.2 – Operating Costs. The Regulator has indicated his requirements as to what WestNet must do to enable a continuous assessment of whether it is operating at efficient levels. That is, principally to develop and update annually an efficient cost model based on operating the GRV network that has the function or capacity to provide concise KPI benchmarking reports so as to compare results against those achieved by other track owners. These requirements are likely to be beyond the scope and capacity of the existing costing systems of WestNet as indicated in the PricewaterhouseCoopers audit. The Regulator must be convinced that WestNet's methodologies and costing systems have the capacity to achieve the Regulator's requirements in these matters otherwise the tests will be inaccurate and largely meaningless.

6. Section 4.2.2. The Regulator proposes that MPM should not be included as an operating cost, as compensation for depreciation to enable network renewal is included within the capital cost annuity. However, there are instances where MPM could have a specific and

limited application. One situation is where differences between track standards are something which could and should be eliminated by more frequent MPM rather than accepting a static specification. For example, it can be argued that the West Kalgoorlie-Esperance route could now be at a standard of 23 tonne axle load (rather than 21 tonne) if WestNet were to accelerate future MPM (re-railing). In this case, the true cost to WestNet (for which users should pay by an operating cost) is the time cost of the accelerated MPM and not the notional cost of the total track re-railing today as the track re-railing cost is an expenditure that WestNet must undertake in time and is compensated for by the depreciation which is already allowed in the MEA valuation.

7. Section 4.2.2. The requirement that WestNet provide a detailed methodology including key assumptions on how routine and cyclical maintenance costs are calculated on different sections of its network must be supported by a detailed breakdown and itemisation of those routine and cyclical maintenance costs. Additionally an individual indication of the maintenance savings, or where maintenance is not required, deriving from the fact that the network is assumed to be an MEA network should be required to be specified by WestNet.

8. Section 4.3.1. The MEA definition for rail proposed by the Regulator is appropriate in so far as it defines an optimised reconfigured network that uses current modern technology serving the current load. However, the definition must also:

   (a) link the MEA capital value to the actual standard of rail service to be provided by the relevant route on the Network. For example, if the West Kalgoorlie-Esperance route is to have a maximum speed of 50 km per hour for 21 tonne axle load, the MEA definition should relate to this standard. Users should not be paying charges that include capital costs that reflect a higher standard of service than they actually receive; and

   (b) require WestNet to commit to capital expenditure to accommodate reasonably projected demand growth for up to 5 years, before the MEA can include allowances for that demand growth. Although the definition of GRV in the Code mentions reasonably projected demand, this is only a valid inclusion in the capital base of the network if the network can currently accommodate reasonably projected demand, or the owner commits to making the capital expenditure to enable the network to accommodate reasonably projected demand. At present the

Koolyanobbing-Esperance route does not accommodate reasonably projected demand, and accordingly the MEA valuation, or network capital base, should not include a capital value for accommodating reasonably projected demand.

The Regulator is aware of the provisions of section 12(6) of the *Rail Freight System Act* 2000, which made it a requirement of the sale of the rail freight business that the Koolyanobbing-Esperance route be upgraded to the standards specified in that section if a contract for the haulage of 3 million tonnes or more per year operates on that route. The Regulator is referred to the separate and confidential submission and request made by Portman on the issue of section 12(6). For the purposes of this public submission, Portman submits, that if WestNet is obliged by the implementation of the requirements of clause 12(6) to upgrade the track on the Koolyanobbing-Esperance route, it is not able to include in the GRV of that route the capital expenditure required to undertake the upgrade. This submission does not address the issue of whether the obligation to upgrade the Koolyanobbing-Esperance route has been triggered.

9. Section 4.3.1. The Regulator's proposal that the track configuration for the WNR mainlines on the MEA network should be broadly consistent with the ATC target standard for new track must be qualified. Track configuration in the MEA network should be that configuration required to service the users economically on each route. The IRAR acknowledges that ATC standards are not applicable to, for example, grain lines for which a standard lower than the ATC standard is appropriate. Likewise, the ATC standard should not apply to the Koolyanobbing-Esperance route because on that route the required standards (in terms of axle load) are higher than the ATC standard.

10. Section 4.3.1. The MEA for the network for an identified route must be based upon the lowest standard of the service offered by any sector on that route, where the standards differ for different sectors of that route. For example, the West Kalgoorlie-Esperance route should have an MEA which is based upon a service of 21 tonne axle load. The route sector West Kalgoorlie-Hampton is rated a 23 tonne axle load but the route sector Salmon Gums- Esperance is limited to 21 tonne axle load. Accordingly, a user on the West Kalgoorlie-Esperance route is limited for the whole of that route to 21 tonne axle loads and the MEA definition should recognise this. Users should not be paying charges based on capital costs that reflect a higher standard of service than they actually receive for the whole of the route they use.

11. Section 4.3 – Asset Valuation. In the Regulator's description of the key steps to completing a GRV estimate based on an MEA, the reference to "expected future demand" should be replaced by a reference to the concept of "reasonably projected future demand". Further, as outlined earlier in this submission (see 8 above), the MEA should only include reasonably projected future demand if the network can accommodate that demand or if the owner commits to make the capital expenditure to accommodate that demand.

12. Section 4.3 – Asset Valuation. There does not seem to be any basis upon which earthworks should be included in the GRV. Earthworks does not fall within the definition of "railway infrastructure" under the Code and clause 2(2) of the Code indicates that land of which railway infrastructure forms part, as well as land on which railway infrastructure is situated, is not to be included within railway infrastructure. The reference to the land of which the railway infrastructure forms part is a reference to work to the underlying land to accommodate structures and facilities, such as bridges, culverts etc. The structures and facilities do form part of railway infrastructure, but the earthworks themselves do not. This appears to align within New South Wales Rail Access Regime which excludes earthworks, and earthworks should accordingly be excluded.

13. In section 4.3.2, the total margin for design, construction and project maintenance fees should not be in any event higher than 20%. The Regulator must insist that 20% is a cap for WestNet and the Regulator should not accept a rate that is "closer" to but exceeds 20%.

14. Concerning section 4.3.3, the construction rate at an average of 1 kilometre per day is too low and it should be somewhere between 1.3 and 1.5 kilometres per day.

15. Concerning section 4.4 the Regulator should not assume that the salvage value for rail assets is zero. There is usually scrap value in the rail etc which should be included in the total cost calculation.

16. Section 4.4.1 – Annuity Formula. The Regulator's views and comments on the annuity formula do not clarify precisely how the recovery stream for WestNet is to be structured and how the adjustment necessary to meet the requirements of the Code is to be calculated. In other words, the Regulator should make it clear that the annuity calculation must be done on an annual basis with an end of period assumption (as is required by the Code), and that WestNet may charge fees on a monthly basis but with a discount for the

fact that WestNet is receiving the money earlier than the annuity calculation contemplates.

17. Section 4.4.4. Escalating the ceiling price at CPI minus 25% allows an escalation of 75% of CPI on an annual basis. This is too high for the initial three year period and should be at most 67% of CPI.

18. Section 4.4.5. As the Regulator needs to assess the standards and services provided on each particular route section to ensure that it is consistent with the expected standards and services of an MEA and are standards and services equivalent to the ceiling price which has been set, the KPI reporting system should include performance indicators relating to the number of times services have failed to leave on scheduled timetables or have been interrupted during scheduled train paths or have otherwise not met the contractual requirements of the access parties, and the reasons for such matters, where they are caused by or contributed to by WestNet.

Norm Marshall
GENERAL MANAGER, FINANCE & COMMERCIAL
Portman Iron Ore Ltd

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