The Pilbara Infrastructure

Railways (Access) Code 2000

Overpayment Rules

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TABLE OF CONTENTS

DEFINITIONS

Table 1: Glossary

Word/Term	Definition
Access Agreement	Means an agreement in writing under the Code between the railway owner and an entity for access by that entity.
Access Related Function	Means the functions involved in arranging the provision of access to Railway Infrastructure under the Code
Access Revenue	Means all income received by TPI for the provision of track access to Operators and other entities
Act	Means the Railways (Access) Act 1998
Ceiling	Means the sum of costs equal to Total Costs
Ceiling Price Test	Means the Ceiling Price Test as defined in Clause 8, Schedule 4 of the Code
Code	Means the Railways (Access) Code 2000
Costing Principles	Means the principles, rules and practices determined by the ERA in accordance with section 46 of the Code
ERA	Means the Economic Regulation Authority, the Western Australian Independent Rail Access Regulator under Section 13 of the Act
Entity	Means a corporation, partnership, trustee or other person
Floor	Means the sum equal to the total of Incremental Costs
Floor Price Test	Means the Floor Price Test as defined in Clause 7, Schedule 4 of the Code
Incremental Cost	Means Incremental costs as defined in Clause 1, Schedule 4 of the Code
Network	Means the track and infrastructure controlled by TPI to which access has or can be granted under an Access Agreement
Non-access Revenue	Means revenue received by TPI that may include private and government contributions in accordance with the ERA’s approved Costing Principles to apply to TPI
Non-regime Operator	Means entities to which track access is provided under arrangements outside of the Code
Operator	Means an entity to which access is provided under an access agreement
Railway Infrastructure	Has the meaning assigned to Railway Infrastructure in Section 3 of the Code
Railway Owner	Means the person having the management and control of the use of the Railway Infrastructure
Route	Means those parts of the railways network and associated infrastructure to which the Code applies, and includes part of a route
Route section	Refers to the sections of the railway network as divided for management and costing purposes
Total Cost	Means Total Cost as defined in Clause 1, Schedule 4 of the Code
Total Revenue	Means the sum of Access Revenue and Non-Access Revenue
TPI	Means The Pilbara Infrastructure Pty Ltd

1. INTRODUCTION

These Over-payment Rules are prepared to meet the requirements of section 47 of the Railways (Access) Code 2000 (the Code), which requires that the Railway Owner will submit to the Regulator a statement of rules ('the over-payment rules') that are to apply where breaches of the Ceiling Price Test occur that could not be reasonably avoided.

The Ceiling Price Test is defined in clause 8 of Schedule 4 of the Code. This provides that an Operator, or a combination of Operators, provided with access to a Route and associated railway infrastructure must not pay more for access than the Total Costs attributable to that Route and that infrastructure. The Code provides under Section 8(4) of Schedule 4, that where payments to the railway owner exceed Total Costs, this provision is not breached if the Over-payment Rules approved or determined are complied with.

These Over-payment Rules give effect to the requirements in the Code that

- the excess referred to in clause 8(4) of Schedule 4 in respect of an Operator or group of Operators must at all times be within a limit – being a percentage of the relevant costs – from time to time notified by the Railway Owner to the Regulator; and
- at the end of each successive 3 year period from the commencement of access by an operator or group of operators, there must be no such excess in respect of that operator or group of operators.

TPI's Over-payment Rules provide a mechanism to:

- calculate the amount by which Total Revenue earned on a particular Route Section exceeds the Total Costs attributable to the Route Section and infrastructure; and
- reimburse Operators who are provided with access under the Code to that Route Section in the event of an over-payment.

2. BASIS OF THE OVER-PAYMENT RULES

2.1. Definition of Route Sections

In accordance with the Code, the railway network is divided into sections (Route Sections) for management and costing purposes.

It is proposed that the railway constructed by TPI consists of three route sections, being:

1 The route section from the loadout at the Christmas Creek mine to chainage 174.875, measured from Port Hedland,

2 The route section from the loadout at the Solomon mine to chainage 174.875, measured from Port Hedland, and

3 The route section from chainage 174.875 to the dump station servicing TPI's port facilities and additional infrastructure at Anderson Point, Port Hedland.

2.2. Regulatory Ceiling

Each Route Section has a regulatory Ceiling that will apply to all Operators when negotiating access prices and will be the basis of determining whether Total Revenue earned on the Route Section has exceeded the Total Costs.

These Total Costs will be calculated by TPI using methods set out in TPI's Costing Principles, as approved by the ERA.

2.3. Revenue for the purposes of the Ceiling Price Test

In determining the extent of over-payments, all Access Revenue and Non-access Revenue received by TPI for a Route Section, or part of a Route Section, and associated railway infrastructure will be included to calculate the Total Revenue attributable to that Route Section of the network.

Revenue earned from non-regime operators will also be included in evaluating TPIs compliance with Floor and Ceiling Price Test. It will also be included in assessing the extent of over-payment. However, since the Code does not provide non-regime operators with a legal entitlement to any refund for any over-payment, so such over-payments will be retained by TPI, unless otherwise specified in the access agreement with the Operator.

2.4. Breaches of the Ceiling Price Test

Section 47(1) of the Code states that the Over-payment Rules are to apply where breached occur on the part of that owner that 'could reasonably be avoided'.

TPI will assess revenues earned on particular Route Sections on a periodic basis to determine whether there is likely to be a breach of the Ceiling Price Test. Where it is possible to forecast potential over-payment, TPI will seek to negotiate new access prices with affected Operators to ensure that Total Revenue remains within the Ceiling.

If breaches of the Ceiling Price Test occur as a result of variations in traffic volumes or revenues that are considered to be temporary or unpredictable in nature, then TPI will advise the ERA of the circumstances and will follow the procedure set out in these over-payment rules to deal with such over-payments.

2.5. Over-payments and under-recoveries

Over-payment is defined as the amount of Total Revenue received by TPI for a Route Section that exceeds the Total Costs attributed to the Route Section for a one-year period.

Under-recovery is the shortfall of Total Revenue to the Railway Owner on a Route Section for a one year period relative to the Total Costs attributed to that Route Section.

Net over-payments will be assessed over a successive three year period, during which over-payments in a particular year may be balanced out by under-recoveries in a subsequent year. Net over-payment at the end of a three year period will be paid back to Operators according to these Over-payment Rules.

Where under-recovery occurs, the Operator is not required to pay TPI compensation for such under-recovery. However, where a net under-recovery occurs in a particular 3 year period, there are circumstances in which TPI will be allowed to carry-over this net under-recovery as an "accounting balance" into the subsequent 3 year period, which may be used to offset over-payments in that subsequent three year period. This particular case is outlined below:

2.5.1. Carry-over of under-recovery

An under-recovery may be carried over where, as a result of having to reimburse Operators during the three year period because the breach is greater than 10% of the Ceiling, there are insufficient funds in the over-payment account for TPI to recoup an under-recovery that has occurred during the same three year period. In this case, TPI will put a case to the ERA to carry the under-recovery credits over to the next three years up to the amount TPI has been required to refund to Operators as a result of exceeding the 10% limit. If allowed, the carry-over will only apply for that one additional successive three year period.

2.6. Allocation of Access Revenue

The ceiling price provided by TPI to access seekers under section 9(1)(c)(i) of the Code will apply from the origin to the destination of the Route proposed by the access seeker, potentially traversing multiple Route Sections. As Total Costs are allocated on a Route Section basis, it is necessary to distribute Access Revenue earned over a particular route to individual Route Sections. This will be done in accordance with the following rules:

1. Access Revenue derived from a Route can only be allocated to the Route Sections on that Route.

2. TPI will allocate Access Revenue to cover the costs attributed to the applicable Route Section in the following order:

   a. Incremental Costs against all applicable Route Sections;

   b. up to the Ceiling on all applicable branch or feeder (dedicated) Route Sections; and

   c. up to the Ceiling on all applicable shared Route Sections.

The above principles ensure that there will be no cross-subsidisation between Route Sections. Access Revenue allocated to each Route Section must at least cover the Incremental Cost.

Recovery of capital costs on branch or feeder lines ranks ahead of shared lines on the basis that there is no other traffic on these lines to fund the dedicated infrastructure and unless these costs are covered the line may close.

Where TPI and the Operators have reached agreement to a different Access Revenue allocation arrangement in an Access Agreement that arrangement would prevail.

2.7. Allocation of Non-access Revenue

For TPI's operations, Non-Access Revenue will consist of contributed capital (government or private). The allocation of Non-Access Revenue will only be allocated to the Route Section for which the contribution was received. Where a capital contribution is made, the value of the contribution to be used in the Ceiling Price Test is to be expressed as an annualised amount taking into account the total cost, expected life and Weighted Average Cost of Capital (WACC) determined by the ERA. Where capital expenditure occurs over multiple Route Sections the actual expenditure will be allocated to each Route Section at the time the expenditure is incurred. The above allocation principles for Access Revenue do not apply to Non-Access Revenue.

2.8. Allocation of an over-payment

Where an over-payment on a Route Section occurs as a result of a breach of the Ceiling Price Test, all Operators [who have negotiated their access agreement inside the Code] who have contributed to the total revenue on that Route Section will be entitled to receive a share of the over-payment. The proportion of over-payment to be paid to each Operator will be determined by each Operator's annual Access Revenue and Non-Access Revenue above the floor recorded on the Route Section, divided by the aggregate of all Operator's Access revenue and Non-Access Revenue above the floor recorded on the Route Section, over the preceding 12 month period from July to June. An Operator paying only the Incremental Cost on the Route will not be eligible to receive any refund.

4. OVER-PAYMENT RULES

These Over-payment Rules apply where breaches of the ceiling could not reasonably be avoided.

1. TPI will calculate over-payments in respect of each Route Section for a financial year. For the purposes of the Overpayment Rules, the financial year commences on 1 July and finishes on 30 June. The commencement date for the Overpayment Rules will be 1 July of the Financial Year following completion of the approval process for all regulatory documents required to be put in place under the Act and the Code (being the segregation arrangements, the four Part 5 instruments and the floor and ceiling costs).

2. Where an over-payment is greater than the 10% allowed for breaches of the Ceiling for that Route Section for the financial year, TPI must reimburse the Operators on that Route Section of the amount of over-payment, calculated on a pro-rata basis according to the formula in rule 3 below, within 3 months of the end of the financial year.

3. Payments to Operators will be allocated based on the total annual Access Revenue above the Floor by each Operator on the Route, in accordance with the following formula:

$$\frac{\text{An Operators}^{1}\text{ annual Access Revenue above the Floor, plus Non-Access Revenue (received from that Operator) for the Route Section} \quad * \quad \text{Amount of Net Overpayment plus interest accrued for the Route section}}{\text{Total Annual Access Revenue}^{2}\text{ above the Floor, plus total Non Access Revenue, for the Route Section}}$$

4. TPI is to establish an Over-payment account.

5. The Over-payment account is to be credited with all over-payments that are equal to or less than the 10% amount allowable for breaches of the Ceiling level for the financial year.

6. Any over-payment for the previous financial year shall be calculated by 31 July of each year and credited to the over-payment account. The over-payment will be treated as if it were credited to the Over-payment account on 1 July of each year.

7. TPI will credit interest to the Over-payment account, calculated daily on the balance in the account, using a rate equal to the 10 year long term bond rate calculated on 30 June each year, or if 30 June falls on a day which is not a business day, the rate published on the first business day after that date.

[1] Includes Regime and non-Regime Operators.
[2] Only Operators who have negotiated inside the Code are eligible for a share of the net over-payment.

8. At the end of the initial three year period (from the commencement date of these Rules) and the end of each subsequent three year period, TPI will distribute the funds in the Over-payment account to Operators who have negotiated inside the regime in accordance with the formula in Rule 3, within three months of the end of the Financial Year.

9. The ERA must approve any payments from the Over-payment account prior to disbursement.

10. The Over-payment account will be audited each year, completed by 31 August, by an independent auditor appointed by TPI, at TPI's expense. The audit will ensure each amount credited to the account is correct and that the interest credited and payment of amounts to Operators from the account is correct and consistent with these Rules. TPI will provide the auditors report to the ERA when it is completed.

11. If there is a discrepancy between the audited and confirmed over-payment and that calculated by TPI, an adjustment is to be made to the Over-payment account as if it occurred on 31 July.

12. TPI must enter into a legally binding agreement with those operators with Access Agreements negotiated inside the Code and the person or persons described in Part 1 of Schedule 1 to these Over-payment Rules. That agreement should contain the provisions described in Part 2 of Schedule 1 of the Over-payment Rules. The agreement must remain in force and effect and bind the parties to the agreement so long as any amount remains standing to the credit of the Over-payment Account and have not been distributed in accordance with paragraph 8.

13. The Over-payment Rules shall apply where breaches of the ceiling could not reasonably be avoided.

5. APPLICATION OF THE OVER-PAYMENT RULES

The examples shown in Table 1 below demonstrate how these rules apply. Years 1, 2 and 3 show over-payments and under-recoveries (denoted by a minus sign) for a route section. All Operators are also assumed to be in the Regime and have met their Floor costs.

The annual interest rate assumed is 5% compounded, which given the deposit occurs annually would only apply to year one and two deposits. It is also assumed that the Ceiling cost for the route section in the examples below is $100,000, and over-payments in excess of $10,000 are reimbursed immediately.

Example 4 refers to the one exception, the carrying over of under-recovery credits to the next three-year period may apply. In this example, TPI incurred a breach of 20 percent above the ceiling in year 1. At the end of year 1, it has to reimburse operators $10,000 and deposit $10,000 into the interest bearing account. However, in year 2, TPI incurred an under-recovery of 15 percent. Assuming that the revenue from access is exactly at the ceiling in year 3, there are now insufficient funds to compensate TPI in the interest bearing account for the three-year period. In this example, the ERA may approve a carry-over in under-recovery credits of $5,000.

If an Operator has negotiated access outside the Regime then its share of the overpayments would go to TPI. For instance, if in Example 3 that route section comprised only non-Regime operators then the total accrued principal in the interest bearing account, ie. $15,000, and interest earned, ie. $1,275, would go to TPI.

Table 1. Examples illustrating operation of the trust account

	Example 1	Example 2	Example 3	Example 4
Net annual over or under payment				
Year 1	$10,000	$10,000	$10,000	$20,000
Year 2	-$10,000	-$30,000	$5,000	-$15,000
Year 3	$0	$0	-$10,000	$0
Total of the 3 year period	$0	-$20,000	$5,000	$5,000
Reimbursed to operators	$0	$0	$0	$10,000
Accrued Principal in Trust	$10,000	$10,000	$15,000	$10,000
Accrued Interest in Trust	$1,025	$1,025	$1,275	$1,025
Refund to TPI	$10,000	$10,000	$10,000	$10,000
Refund to operators	$1,025	$1,025	$6,275	$1,025
Carry forward of credit	$0	$0	$0	$5,000

6. COMPLIANCE AND REVIEW

TPI agrees to the monitoring by the ERA of its compliance with the Over-payment Rules through an audit of TPI's obligations under its Over-payment Rules conducted every three years after the commencement date of an access agreement inside the Code.

This audit will be carried out by an Independent Auditor approved by the ERA, with TPI managing and funding the audit. The scope of the audit will be determined by the ERA.

The final audit report will be provided to the ERA. The ERA will publish this report on its web site (excluding confidential information).

In addition to the three-yearly audit cycle, TPI will provide the results of its annual Over-payment audits to the ERA.

The ERA can also commission special audits at any time on any Over-payment Rules issue where additional assurance is required.

These Over-payment Rules may be amended or replaced by TPI with the approval of the ERA.

Stakeholders have the ability to express any concern to the ERA which may arise at any time and the ERA will investigate such claims.

The ERA has the power under the Code to amend these Over-payment Rules at any time and Access Seekers and Operators can at any time request the ERA to consider amendments.

7. REFERENCING BETWEEN OVER-PAYMENT RULES AND ACCESS AGREEMENTS

TPI will ensure, where possible, that those sections of access agreements under the Code which relate to requirements set out in the Over-payment Rules are referenced to the relevant clauses in the Over-payment Rules in order to ensure that consistency is maintained between these access agreements and the Over-payment Rules.

SCHEDULE 1

TO BE ATTACHED TO TPI'S TRACK ACCESS AGREEMENT AS A SCHEDULE FOR OPERATORS WHO HAVE NEGOTIATED AN ACCESS AGREEMENT INSIDE THE REGIME

PART 1 – ADDITIONAL PARTIES

Fortescue Metals Group Ltd (A.C.N. 109 264 262) of Level 2, 87 Adelaide Terrace East Perth WA 6004 (being hereinafter in this Schedule referred to as the "Guarantor")

PART 2 – PRESCRIBED PROVISIONS

1. Establishment of Over-payments Account

Within seven (7) days of the date of this agreement TPI must, in accordance with Rule (4) of the Over-payments Rules, establish within its books of account an account to be styled "Over-payments Account" and must maintain at all times during the continuation of this agreement.

2. Operation of Over-payments Account

TPI must at all times operate the Over-payments Account in a manner consistent with the requirements of the Over-payment Rules and must make payments to the operator in a manner and at the times contemplated by the Over-payment Rules.

3. Guarantee and Indemnity

In consideration of TPI and the Operator entering into this agreement:

(1) The Guarantor guarantees the due and punctual payment by TPI of the payment to be made by TPI to the Operator pursuant to the Over-payment Rules.

(2) The Guarantor agrees that if TPI shall go into liquidation the following provisions shall apply:

   (a) the Guarantor will not prove in such liquidation in competition with the Operator to the extent of any amount due and payable to the Operator from the Over-payments Account.

   (b) The Guarantor will forthwith if required by the Operator in writing prove in any such liquidation for all monies owed by the Guarantor to Operators hereunder in such event will not exercise or attempt to exercise any right of set-off against or realise any security taken from TPI;

   (c) Moneys recovered by the Guarantor from any such liquidation shall be received and held in trust for the Operator to the extent of the unsatisfied liability of the Guarantor hereunder;

   (d) The Guarantor authorises the Operator to prove for all moneys which are payable by TPI to the Guarantor and to retain and carry to a suspense account and appropriate at the discretion of the Operator any amounts received until the Operator shall with the aid thereof have been paid the whole of the amounts payable to it by TPI pursuant to the Over-payment Rules; and

   (e) The Guarantor waives in favour of the Operator all rights whatsoever against TPI so far as necessary to give effect to anything contained in this agreement.