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Mr. Lyndon Rowe
Chairman
Economic Regulatory Authority
GPO Box 8469
Perth Business Centre
Perth WA 6849 Via Facsimile: 9213 1999

Dear Mr. Rowe,

Review of the Western Australian *Railways (Access) Code 2000*

The purpose of the review of the *Railways (Access) Code 2000* (the "Code") is to assess the suitability of the provisions of the Code to give effect to the Competition Principles Agreement ("CPA") in respect of railways to which the Code applies.

One of the key issues to be covered by the review is the impact of the Code on investment in the rail network infrastructure. As is acknowledged (s.6.3 - Issues Paper), the regulation of greenfields projects needs to deal appropriately with the ex-ante risks facing investors, otherwise incentives to invest may be lower. In particular if the ceiling price is set too low new investment will be deterred.

The Code was designed around assets that were already in existence at the time the Code was introduced. It was originally written to cover previously public sector assets that had been privatised and therefore the risks faced were considerably less given that construction risk and initial demand risk were ex post and not factored into the price of the assets at the time of privatisation. Moreover, in the case of greenfield investments there is often a significant lag between when the investment is made and the time when the assets, once constructed, start to earn a return. Therefore any assessment of return which merely considers the revenues against the gross replacement value of the assets ignores the dilution to the investors' actual rates of return caused by this difference in timing.

There is also a real risk that incentives to invest and in particular to innovate will be undermined through the fact that any resulting lowering of operating or capital costs will lower the revenue ceiling effectively transferring the full benefit to the end customer and thus preventing the owner of the assets appropriating any of the benefits of the investment and/or innovation.

It is clear that since the Regulator determines the appropriate weighted average cost of capital to be used in calculating the ceiling price the additional risks facing greenfield investors could be factored into the calculation of the risk involved. However issues relating to both the time lag between investing and earning a return and enabling investors and innovators to appropriate some of the benefits they have created are not necessarily best addressed through adjustments to the interest rate used. It is therefore important that the Regulator is given sufficient discretion to adjust the Gross Replacement Value or any other costs where appropriate to reflect the detrimental affect on returns caused by the time lag between investing and receiving a return and to allow some of the benefits of investment or innovation to be retained by the party responsible for their implementation.

Finally, the over-payment rules do not allow for carry forward in the case of underpayment. This has a distorting effect on the effective ceiling rate in that since cyclical fluctuations in demand may result in variations around that ceiling rate the absence of any carry forward provisions means that the average rate actually achieved will always be lower that that theoretically allowed since when revenues exceed the ceiling the excess is refunded, but when they fall short the amount cannot be clawed back.

Yours sincerely,
Fortescue Metals Group Ltd

Julian Tapp