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7 June 2016

Hon Robyn McSweeney MLC  
Chair  
Standing Committee on Legislation – *Pilbara Port Assets (Disposal) Bill 2015 (WA)*  
Legislative Council  
Parliament House  
Perth WA 6000

By Email to:

Ms Lauren Mesiti, Committee Clerk  
Ms Irina Lobeto-Ortega, Advisory Officer (Legal)  
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Dear Ms McSweeney

**UTAH POINT BULK HANDLING FACILITY DIVESTMENT – STANDING  
COMMITTEE ON LEGISLATION – *PILBARA PORTS ASSETS (DISPOSAL) BILL  
2015 (WA)***

I refer to your letter of 19 May 2016 to Pilbara Ports Authority (**PPA**), in which you invited comments from PPA in response to the public hearings held with representatives from the Association of Mining and Exploration Companies (**AMEC**), Atlas Iron Limited (**Atlas**), Consolidated Minerals (**ConMin**), and Mineral Resources (**MinRes**) (collectively the **Respondents**) on 13 May 2016.

We thank you for the opportunity to:

- address various statements made by representatives of the above organisations about PPA's conduct in connection with its commercial relationship with the Respondents and the information it has provided in connection with the sales process being run by the Government's Assets Sales Unit (**ASU**) in relation to the Utah Point Bulk Handling Facility (**UPBHF**); and
- otherwise provide clarity on various matters discussed at the Committee proceedings on 13 May 2016.

**1. INTRODUCTORY COMMENTS**

**PPA's Role in the Divestment Transaction**

PPA notes that the Respondents, in their evidence to the Committee, have asserted that there has been a lack of consultation with users of the UPBHF in connection

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with the UPBHF divestment transaction, including with respect to the proposed access and pricing regime. To the extent that this criticism is directed at PPA, it is important that the Committee appreciate that the UPBHF divestment transaction is being run by the ASU and its external advisors on behalf of Treasury. The role of PPA is generally passive in relation to how key elements of the transaction are structured and the divestment transaction is progressed.

This is particularly the case when a structural aspect of the transaction is determined as a policy matter by the ASU – PPA has little ability to influence the outcome of such a decision made by Government. Criticism (implicit or explicit) of PPA in relation to structural aspects of the proposed divestment transaction, such as the access and pricing regime post divestment, misses this important fact.

Similarly, decisions about how the transaction is progressed – the extent and nature of consultation with stakeholders, including UPBHF users, for example – are made by the ASU and its advisors; for the avoidance of doubt, any criticism about the level of consultation with the Respondents or other stakeholders cannot fairly be directed at PPA by the Respondents.

Rather, PPA is involved in the divestment transaction primarily as the supplier of information on which the ASU and its advisors make decisions on policy and structure etc. This is the role that PPA has been given by Government in connection with the divestment transaction.

PPA notes that the Respondents' stated objective with respect to the UPBHF divestment transaction is to ensure three things: firstly, to ensure that UPBHF is reserved for exclusive use by junior miners; secondly, a clear pricing or charging regime, based on a specified rate of return; and thirdly, for prices to be fixed for the term of the UPBHF divestment. In PPA's view, these are policy matters for Government, rather than matters for PPA's own consideration.

### **Respondent Materials Provided to the Committee**

PPA does not propose to comment on materials supplied by the Respondents to the Committee, and which the Respondents spoke to, which it has not reviewed and considered. Rather, PPA's responses are directed towards the Respondents' comments in their evidence before the Committee, as reflected in the Transcript of Evidence for 13 May 2016.

## **II. DETAILED RESPONSES**

Given the comments made by the Respondents, particularly those which cast PPA's conduct in an adverse light, we consider it appropriate to respond individually and in some detail to a significant number of statements made before the Committee – PPA asserts that a number of statements made by the Respondents are inaccurate or misleading.

In addition to correcting statements that, in PPA's view, are factually inaccurate, misleading or without foundation, PPA also wishes to provide additional clarity on matters discussed, wherever possible, in order to give the Committee a full picture and understanding of events connected with the development and operation of the UPBHF.

In doing so, PPA has tried to respond to comments and issues raised by “theme” or subject matter. There is, accordingly, some unavoidable duplication in our responses.

Comments and statements of the Respondents in their testimony before the Committee, and on which PPA wishes to respond, can be grouped into the following themes or subject matter areas:

1. The return on PPA / UPBHF assets
2. Allocation of UPBHF overheads in management-account data
3. Charges going forward and a return on capital; operating risk and take-or-pay obligations
4. Manganese and the \$2.50 reduction
5. Applying a CPI increase annually
6. Profit from UPBHF
7. Sale requirements; junior miners etc.
8. Freezing of charges
9. The cost of developing UPBHF
10. PPA’s approach to contract renegotiations in 2013
11. Rise and fall provisions – 2013 contract renegotiations
12. Conflicts of interest
13. Lack of consultation in connection with the sale process
14. Sunk-investment by Atlas
15. Discussion in relation to the Harriet Point Agreement
16. Government’s objective – junior miners
17. Access and pricing regime
18. The Bill and the Port Authorities Act
19. Retention value
20. Finucane Road

PPA’s detailed responses are provided below.

## **1. The return on PPA / UPBHF assets**

### **Committee Proceedings**

The Respondents assert that PPA has provided misleading information to the Committee in relation to the return of and on the investment made in the UPBHF.

In short, the Respondents suggest that, once re-engineered, the return obtained by PPA in relation to the development and operation of the UPBHF approaches (at its highest) 61%.

Mr Land (on page 5) provides three reasons to support this position; in summary:

- I. The assets taken into account are inappropriate (extending beyond the UPBHF).
- II. It is wrong to look at average rates of return over the period of operation.

- III. The rates of return that are disclosed by PPA on its assets are entirely misleading. Two specific illustrations were given:
- a. There is a material amount of cash on the balance sheet.
  - b. PPA has inappropriately included 'gifted' capital contributions (\$70 million by BHPB), and have not taken into account \$9 million provided by Atlas.

A number of other statements are made in support of the Respondents' position, including:

**Mr Flanagan:** *It says they have invested \$235 million in a port, which is delivering them a return of \$70 million a year.*

**Mr Ellison:** *So whoever decided that they could step outside of this charter where it says they have to firstly facilitate trade before they make a profit—someone should be held accountable for that. Whoever decided that they could—I was going to say "mislead" us all with the lack of information or the way they have compiled the information, but I think, Ken, you may have a better word for that. ... Yes, they do, but they have got guidelines to operate under and they are not operating under those guidelines.*

**Mr Flanagan:** *Actually the port and the Treasury should be embarrassed by the rates of return they are making, and they are forcing guys like Cons Min to close down while they are making a 65 per cent rate of return.*

**Mr Rushton:** *We actually put forward, we said, we should have a sliding scale and that would ensure that the rate of return targeted is met irrespective of volumes but we are not penalised when the volumes are high to the benefit of you making a windfall, which would then be in breach of section 30(2)(aa) of the Port Authorities Act.*

### **PPA Response**

At the outset, PPA rejects, categorically, any assertion or imputation that it is in breach of its statutory duties and functions under the Port Authorities Act 1999. PPA is acutely aware of its statutory duties and functions, including trade facilitation.

Similarly, PPA categorically rejects any assertion or imputation that it has withheld information to which the Respondents have any legitimate expectation or entitlement, and notes that there are various mechanisms available (such as under the Port Authorities Act 1999 and the Freedom of Information Act) to the Respondents to seek the release of relevant information from PPA.

PPA reiterates that the Return on Asset (ROA) calculations that have been prepared by both Incenta (Page 6, Table 1) and HoustonKemp (Page 21, Table 2) are broadly in line with those calculated by PPA.

PPA's financial statements are subject to an annual external audit by KPMG on behalf of the OAG. An audit of the financial ratios forms part of this annual audit. PPA's preparation of the ROA calculations is consistent with prescribed Accounting Standards.

[REDACTED]

The accumulated IRR for the UPBHF to date does not exceed the original business case IRR.

PPA has no knowledge of the alleged \$9 million contribution or ‘gift’ by Atlas.

## **2. Allocation of UPBHF overheads in management-account data**

### **Committee Proceedings**

The Respondents challenge the management-account data and profit and loss data for the years 2013 through 2016 to date provided by PPA to the Committee.

In particular Mr Land asserts that PPA has incorrectly allocated \$12m in annual overheads to the UPBHF<sup>2</sup>; in re-engineering the allocation Mr Land suggests the appropriate allocation to the UPBHF is \$3m per annum. This reallocation has the effect of increasing the return received by PPA; and incorrectly included within its management-account data “\$8 million or \$9 million per year that are to do with pilotage and areas that are not relevant [to the UPBHF]”<sup>3</sup>.

### **PPA Response**

A copy of the FY 2014/15 and FY 2015/16 (YTD April 2016) UPBHF overhead allocation models were submitted as part of PPA’s submission to the Standing Committee on 31 May 2016.

[REDACTED]

## **3. Charges going forward and a return on capital; operating risk and take-or-pay obligations**

### **Committee Proceedings**

The Respondents assert that charges going forward should not contain a return on capital; they also suggest that the operating risk premium should be similar to that of Western Power (around six per cent) and that they are subject to take-or-pay obligations.

Mr Land<sup>4</sup> says:

*Our analysis shows that for the current year Utah Point costs are around \$1.70 per tonne. But we know that the facility that was built has already recovered its capital and its return, so we do not believe that the charges going forward should contain a return on the capital. What we believe is that the charges going forward should*

1 [REDACTED]

2 Testimony of Mr Land – page 8.

3 Testimony of Mr Land – Page 8.

4 Testimony of Mr Land – page 10.

cover a return on the operating risk to the facility, and that operating risk, we believe, is somewhere between six and eight per cent.

In relation to charges, at page 20 the following discussion is recorded:

**Hon KEN TRAVERS:** *Sorry, before you go off that point, the question I was going to ask you is, in your submission you talk about \$1.80 per tonne being the charge that you think should be the reasonable charge at Utah Point. If you had that figure, would you still be in care and maintenance at Woodie Woodie or would you be an operating mine employing people today?*

**Mr Muller:** *That is entirely the point I was about to make, which is absolutely—we made a decision in Q1 this year when the price of manganese ore dropped quite dramatically. It has since then, in the last few months, rebounded somewhat, albeit still quite volatile. Had we been charged a reasonable price, had we not been price gouged, we would have generated over the past few years a cash buffer that would have seen us through that stage of the cycle. At the current price, we would be profitable if we were operating at today's price. Had we been charged properly, had we not been price gouged, then we would be continuing to operate. We would be pumping hundreds of millions of dollars into the WA economy, we would be paying royalties, and 400 additional Western Australians would still have jobs today. So we are an absolute example of what happens when we get it wrong.*

*[At page 21] It should not be costing us \$11 to \$12 a tonne to put ore on a ship. It should not be.*

In relation to operating risk, a discussion occurs at page 22 in relation to (the absence or presence of) take-or-pay obligations (which are related to the level of operating risk associated with the facility).

**Mr Rushton:** *And the other salient point that we wish to raise on this is that Treasury, in a number of instances, which are detailed in the document that we are going through, has said that the users begrudge take-or-pay, they refuse take-or-pay. There is take-or-pay. Both Atlas and Mineral Resources do have take-or-pay at Utah Point. I think that is a crucial distinguishing fact that we wish to make today, both to the committee and anyone else who wishes to understand this issue.*

**Mr Flanagan:** *Just to emphasise the point on the take-or-pay, getting the recent relief, that \$2.50 in yard one and we got \$1.73 in yard two, we had to agree to accept take-or-pay obligations in order to get that relief.*

**Hon KEN TRAVERS:** *Over what period of time is that take-or-pay?*

**Mr Flanagan:** *That was for calendar 2016.*

**Hon KEN TRAVERS:** *For the length of the period of the \$2.50 reduction.*

**Mr Hancock:** *Extended beyond the \$2.50 and then there was a step-down version that also applied to 2017 and 2018.*

**Mr Rushton:** *Ours runs until the end of the term of our agreement, which is currently 2020.*

Mr Rushton, further into the Committee Meeting, comes back to the point about commercial risk:

**Mr Rushton:** *I am moving on now to the Treasury's submission "Background—Key Points" on page 3 of our document. The quote that I wish to scrutinise is —*



*The State previously assumed the risk on the development of the Utah Point BHF and continues to be exposed to a high level of commercial risk.*

*I think that the words used are completely untrue. The construction risk on a budget cost was \$225 million. It was materially reduced by the \$70 million gift and the \$51 million of prepayments by users—that is us sharing the risk. The 40 per cent cost blowout that occurred during construction was passed on to the users when they unilaterally ramped up the prices in 2013. We have been paying for it ever since. And as demonstrated through Nigel's financial analysis, it is our position that they have recovered their initial \$235 million investment, plus a 12 per cent return and satisfied all of the commercial objectives of Treasury in making a return on the investment, and any risk moving forward is no longer a risk on the capital invested; it is an operational risk. As we have also attested to today, we do not believe there is any operational risk, because with the assistance of a properly founded pricing regime, our businesses will continue to occupy and utilise that port.*

**Mr Flanagan:** *And we would argue that the single biggest innovation and investment that has taken place to increase the throughput at Utah has been by Atlas. We invested \$73 million in developing yard 2 infrastructure, with sub-base infrastructure that is going to be there forever and allow that thing to be upgraded to install massive big reclaimers for the massive benefit of this state forever, and that is a massive amount of risk sharing. To state that they are the ones taking all the risk is very misleading.*

**Hon KEN TRAVERS:** *So that \$73 million, is that part of that \$315 million or is it extra?*

**Mr Flanagan:** *It is in addition.*

**Hon KEN TRAVERS:** *That is your money over and above the prepayments and the equity you put in—the \$9 million you put in upfront?*

**Mr Flanagan:** *Yes. So there is no-one to give us that money back if the iron ore price falls.*

### **PPA Response**

The Respondents position, in particular those expressed by Mr Land (Page 10 of Testimony) that the “operating risk... is somewhere between six and eight per cent” is not an accurate assessment of the risk associated with the UPBHF.

A detailed analysis undertaken by Incenta in relation to the Weighted Average Cost of Capital (WACC) (on a pre-tax basis) assesses the UPBHF as being “between 10.77% and 12.65%, which averages at 11.71%” (Page 33).

Incenta's calculation of a WACC for the UPBHF broadly aligns with the Western Australian Treasury Corporation (WATC) estimated pre-tax nominal WACC of 11.6% for PPA.

The risk profile of the UPBHF is best highlighted in Table 1, page 9 of the Incenta report. The table provides an annual ROA and a cumulative IRR calculation for throughput scenarios including and excluding Atlas. The annual ROA is negative for the UPBHF when Atlas volumes are not shipped. This table highlights the risk associated with the UPBHF and why a significantly higher rate of return than 6-8% is ascribed.

The HoustonKemp report affirmed these views, “the risk of the assets at Utah Point is likely to be much higher than that for the wider port facilities due to:

- The nature of its customers, i.e. a small number of customers account for a large portion of throughput;
- Those customers operate with a very fine tolerance to downward fluctuations in the iron ore price; and
- Consequently, Utah Point has significant exposure to iron ore export volume risk

The WACC for Utah Point is more likely to reflect the cost of capital that would typically be faced for junior miners, which is likely to be considerably higher than 12 per cent”<sup>5</sup>.

PPA notes that neither the Houston Kemp nor the Incenta pricing reviews were commissioned by PPA. Instead, they were commissioned by third parties (Department of Finance and Treasury), at arms-length from PPA, and PPA played no part in determining the terms of reference for either pricing review.

Any capital investments that proponents make (i.e. \$73 million leasehold improvements at UPBHF Stockyard 2) are subject to the internal business cases of the proponent. Capital investments are subject to risk (and return). The merits (or otherwise) of individual capital investments by proponents are not a matter for PPA to comment on.

In relation to contractual take or pay obligations (“Material Deficit Charge”) on the part of Atlas and MinRes respectively, [REDACTED]

#### **4. Manganese and the \$2.50 reduction**

##### **Committee Proceedings**

The Respondents assert that a clerical mistake (implying incompetence on the part of PPA) resulted in ConMin not benefitting from the \$2.50 reduction for its manganese exports, resulting in the operation being shut-down.<sup>6</sup>

##### **PPA Response**

On 9 June 2015, PPA received a Ministerial Direction from the Minister for Transport, pursuant to section 72 of the Port Authorities Act 1999, directing PPA to negotiate reductions in port charges, within specified parameters, for all exporters of iron ore

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<sup>5</sup> HoustonKemp Report - P24.

<sup>6</sup> Testimony of Mr Ellison – page 4.



from Stockyard 1 of the UPBHF. The Ministerial Direction is clear on its face that it applies to iron ore exporters only. It does not apply to manganese exporters such as ConMin.

PPA has not made a “clerical mistake” in implementing the Ministerial Direction in accordance with its terms.

## **5. Applying a CPI increase annually**

### **Committee Proceedings**

As a specific sub-set of the issues in relation to ongoing operating charges, the Respondents challenge the notion that a CPI increase should apply each year.<sup>7</sup>

### **PPA Response**

Charges under the Multi-Users Agreements are subject to adjustment in accordance with the rise and fall formula set out in a schedule to the Agreement. CPI is a component of the formula used to calculate the “Contract Rise and Fall rate”. Atlas called for and ConMin and MinRes also agreed to, the application of the Contract Rise and Fall rate to the applicable contract charges in the course of (protracted) commercial negotiations between the parties. One of the benefits that the UPBHF users obtained in agreeing to the rise and fall is that any future adjustments to charges during the term are limited to the amount calculated in accordance with the formula, rather than an amount determined by PPA in its discretion (which was PPA’s previous right). In other words, the Contract Rise and Fall rate provides certainty for the UPBHF users on any future adjustments or changes to applicable charges during the term.

Whilst PPA was within its commercial rights to apply the Contract Rise and Fall rate in September 2015, it elected to not apply the escalation. PPA made this election to ensure that rates were not escalated, in line with PPA’s Board’s resolution, at its meeting on 3 December 2015, to freeze port shipping charges until the end of the 2016/17 financial year. This decision followed the Board’s previous resolution, on 4 December 2014 to hold charges at current levels for the Port of Port Hedland (and the Port of Dampier) until at least 1 July 2016.

## **6. Profit from UPBHF**

### **Committee Proceedings**

Mr Ellison makes a series of assertions about the profit extracted from the UPBHF; implicit (perhaps explicit) in the statements is an assertion that PPA is breaching its statutory duties. He says (on page 9):

**Mr Ellison:** *We know that the profit they are pulling off this is clearly outside of their guidelines. ... Someone needs to tell them there is a set of guidelines to run the port that the people of Western Australia have laid down. They are employed to fulfil those obligations – it is as simple as that – and the benefit to Western Australia comes from the tonnes that are exported.*

Mr Flanagan at page 37 expresses the point as one of over-charging.

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<sup>7</sup> Testimony of Mr Ellison – page 4.

Mr Flanagan: *We have paid more than \$350 million or thereabouts to the Port Hedland Port Authority in port charges, and we think that we have been overcharged by between \$100 million and \$150 million—overcharged by between \$100 million and \$150 million.*

### **PPA Response**

PPA rejects, categorically, any assertion or imputation that it is in breach of its statutory duties and functions under the Port Authorities Act 1999, or any other applicable Government (e.g. Treasury) or Ministerial guidelines or directions.

Additionally, PPA categorically rejects the assertion that it has overcharged Atlas by between \$100 and \$150 million. PPA has charged Atlas (only) in accordance with the agreed charges set out in the commercial documentation between the parties: the Facility Agreements, Multi-Users Agreements and relevant Leases.

Those agreements were entered into between sophisticated parties on arms-length commercial terms, with each party taking (or having the opportunity to take) advice from well versed experts.

If and to the extent that Mr Flanagan believes that Atlas has not negotiated an appropriate commercial arrangement for Atlas, then, in PPA's view, that is a matter for Mr Flanagan and Atlas.

The fact that the Respondents express dissatisfaction with the commercial outcomes that have been achieved, and laying blame for this outcome at the feet of PPA (with the unfounded assertion that PPA has acted in breach of its statutory duties and functions), conveniently ignores the reality that the original arrangements entered into from 2007 to 2010, and amendments to those arrangements (particularly during 2013), were the result of complex discussions and reflected, what was considered at the time by all parties, to be an appropriate commercial resolution of competing interests. Commercial discussions which seek to resolve competing interests involve compromise – the fact that a Respondent has been required to compromise, and accordingly might not like some part of the commercial outcome, does not mean that they have been extorted or unfairly taken advantage of by PPA.

## **7. Sale requirements; junior miners etc**

### **Committee Proceedings**

The Respondents state that they ask for three things:<sup>8</sup>

**Mr Ellison:** *We want to make sure that the port is only ever for junior miners, so there is never any line of sight allowed for the majors. Secondly, we would like there to be a clear regime on how much the users are charged, and if that is based on the return of assets, plus 10 or eight or 12 per cent, I think the port should be given that clear direction. Thirdly, for the sale process, we simply want to make sure that the charges going forward cannot be changed or manipulated as has been done on almost every other port where it can get to the balance sheet of the juniors and it can destroy a company.*

### **PPA Response**

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<sup>8</sup> Testimony of Mr Ellison – page 11.

As indicated at the outset, PPA considers that these issues raise matters of policy for Government, and accordingly, PPA does not express a view on these issues, other than to note that the Port Authorities Act 1999 includes various mechanisms for Government to direct PPA in the manner in which it carries out its statutory mandate.

## **8. Freezing of charges**

### **Committee Proceedings**

The Respondents challenge the decision by PPA to “freeze” charges, as opposed to instigating further discounting.

Mr Flanagan<sup>9</sup> says:

*We find it quite unusual that the Port Hedland Port Authority would freeze its charges while everyone else in the industry has been able to cut them by 30 to 50 per cent. And they call that a price freeze.*

### **PPA Response**

PPA’s Board resolved, at its meeting on 3 December 2015, to freeze port shipping charges until the end of the 2016/17 financial year. This decision followed the Board’s previous resolution, on 4 December 2014 to hold charges at current levels for the Port of Port Hedland (and the Port of Dampier) until at least 1 July 2016. Given the UPBHF divestment transaction and PPA’s obligations under the relevant Ministerial Direction (the Pilbara Port Assets (Pre-Divestment) Direction of 20 July 2015) from the Minister for Transport, PPA’s Board cannot, of its own accord, instigate further discounting, specific to the UPBHF, without first seeking Treasury’s views on the potential impact of any further discounting of charges on the divestment process.

In addition to the discount applicable to iron ore exports from Stockyard 1, pursuant to the Ministerial Direction received by PPA on 9 June 2015 from the Minister for Transport, PPA also, of its own initiative, following representations from Atlas, obtained Treasury’s concurrence to the instigation of a discount for Atlas’ iron ore exports from Stockyard 2. So, in this respect, PPA has done more than simply “freeze” charges, it has also “cut” them at Stockyard 2.

## **9. The cost of developing UPBHF**

### **Committee Proceedings**

The Committee sought the Respondents’ views on what the Utah Point facility should have cost – “if it had been done by somebody who had the skill-base in the first place?” Messrs Ellison and Flanagan provided a response to this (leading) question:

**Mr Ellison:** *One of our skill-sets in our business is building substantial sites, but sub-\$200 million—\$175 million is about the range we thought the number was. That is the sort of number that we would have built it for. But in saying that, we have a lot of skill-sets in-house, a lot of capability. But certainly \$225 million was an acceptable number, but it was an easy number to achieve, and it should have been delivered for*

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<sup>9</sup> Testimony of Mr Flanagan – page 18.

*somewhere around—that was a padded out number, so the expectation was that it would come in slightly less than that. And look, it was not properly managed from a project management point of view. In all fairness to the port, that is not their skill set, but they tackled it and they got themselves caught up.*

**Mr Flanagan:** *Just to add to Chris, at that time Atlas injected our people in to complete a review of the project, which was a good thing that we were let to go in and do, and then we went and spent \$9 million of our own money to get the thing built.*

The assertion made, plainly put, is that PPA was not capable of efficiently developing the UPBHF.

### **PPA Response**

The construction of the UPBHF commenced in or about March 2009 (the then Minister for Transport officially opened the UPBHF project on 13 March 2009) and was commissioned in September 2010. It is widely acknowledged that during this period the State of Western Australia experienced a ‘resources boom’ which resulted in a significant increase in wages and salaries, rents and cost of construction generally. Specifically, Port Hedland experienced an acute labour shortage and significantly higher escalation in costs (relative to the rest of the State of Western Australia).

The cost to construct the UPBHF, whilst being over budget was not unforeseeable given the then-current state of the market. The construction ‘boom’ was led by a period of high commodity prices and a significant number of commodity producers seeking production expansion at the same time.

As the Committee is no doubt aware, this resulted in a majority of capital construction projects being delivered late and over budget.

The assertion that the capital construction cost could be completed for \$200 million to \$175 million is unrealistic in the context of the market at the time, given the cost pressures that existed at that time.

Additionally, PPA notes that the increase in project cost may be attributed, in significant part, to the change in scope of the project as originally conceived, in order to facilitate larger vessels (from 70,000 DWT to 120,000 DWT) and faster load-out requirements (from 5,000 tonnes per hour to 7,500 tonnes per hour), with such scope changes largely driven by the UPBHF user requirements.

PPA would also note that, following commissioning of the UPBHF in September 2010, PPA has implemented continuous improvements, enhancements and operational efficiencies, with the result that the UPBHF is today performing above its nameplate capacity, and potentially capable of achieving tonnages of up to 23 million tonnes (actual throughput of 19.3 million tonnes for 2014/15) on an annualised basis (versus its original design or nameplate capacity of 15 to 18 million tonnes per annum).

PPA reiterates that it is unaware of the \$9 million of Atlas funds that Mr Flanagan claims were spent on UPBHF. Atlas may wish to provide additional information to PPA to clarify this point.

## 10. PPA's approach to contract renegotiations in 2013

### Committee Proceedings

The Respondents assert that “there was no renegotiation” at the time that multi-users agreements were renegotiated in 2013.

**Mr Rushton:** *The other point that we wish to make is that all through these two submissions from PPA and Treasury you see the terms “we negotiated with the users; the users accepted revised terms; we successfully negotiated a better outcome for the port”. There was no negotiation. I am not going to sugar-coat this. There was no negotiation. Myself and Chris, on behalf of Mineral Resources, were intimately involved in negotiating with senior people at the port. There was no negotiation. It was basically almost words to this effect, “You take these charges, otherwise you do not export through the port. If you do not pay them, we will stop you bringing your products into the port.” Now, if that is a negotiation, it is a dictatorship. And that is what it was. They were forced upon us. It was, “Take it or leave it and if you don’t like it, leave.”<sup>10</sup>*

Mr Rushton further during the proceeding (at page 31) states:

*I am still on that page within section 5.5, the summary of the independent review—*

*However, it was noted that Atlas Iron, Minerals Resources Limited and Consolidated Minerals Limited negotiated the Multi-Users Agreements with PPA and were involved in and agreed on the charges and nature of the charges*

*Through fear of repetition, there was no negotiation. We did not agree with the charges; they were forced upon us. It was a take-it-or-leave-it attitude with an ultimatum. I think that is probably the key points that we wish to make in respect of the Treasury submission.*

*Section 5.6, “Independent Review by Houston Kemp (2016)”, the very first quote there—*

*... the absence of any take-or-pay obligation in the facility agreements imposed an unusually high level of demand risk on the PPA*

*As we have said, and I will say it again, there is take-or-pay in the contracts. I will just quickly flick through to the PPA—*

A series of other adverse comments were also made about the make-up of PPA's Board at the time (alleged conflicts of interest), and the behaviour of a commercial representative of PPA.

### PPA Response

PPA categorically rejects the assertion that there was no negotiation with the UPBHF users prior to the introduction of the Multi-Users Agreements in 2013.

As a general observation, the Respondents throughout their testimony, either explicitly or implicitly, suggest that PPA has unfairly or unconscionably treated its customers, including an assertion that PPA has breached its statutory duties. The statement that “there was no negotiation” is often repeated.

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<sup>10</sup> Testimony of Mr Rushton – page 23.



Contrary to the assertion that there was “no negotiation”, PPA conducted protracted negotiations (commencing in or about March 2012 and concluding in or about February 2014), with all of the then-users of the UPBHF, including MinRes.

By way of background, PPA’s objectives in entering into these negotiations with the UPBHF users included formalising the arrangements in respect of users’ additional allocations (“Additional Throughput Quantity”), rationalising the terms of use of the UPBHF in respect of all throughput, and implementing a new pricing model that more accurately reflected, amongst other things, the cost base of the asset (as a significant capital investment of PPA) and a reasonable rate of return.

PPA notes that following these negotiations, in all cases, the resultant Multi-User Agreements were approved by the senior management or Boards of the UPBHF users, all of whom are sophisticated commercial entities. The dates on which the Multi-User Agreements for Stockyard 1 were entered into, following the conclusion of negotiations and corporate approvals from the respective parties, are as follows:

- Moly Metals: [REDACTED]
- Atlas: [REDACTED]
- ConMin: [REDACTED]
- MinRes: [REDACTED]
- Mesa Minerals: [REDACTED]

There was no inherent disadvantage or disability on the part of the UPBHF users, or unconscionable conduct or misuse of power on the part of PPA, in these negotiations.

The mere fact that a UPBHF user has not been able to negotiate all terms and conditions, including those with respect to charges, to achieve an outcome entirely to its own satisfaction, and instead has had to make various commercial compromises, is not evidence of an absence of negotiation; on the contrary, such compromises are a central feature of most negotiations conducted at arms’ length between commercial entities.

The Committee would appreciate, in this regard, that:

- Throughout the commercial relationship, the UPBHF users have been represented by counsel, either internal or, in some cases, external counsel well versed in the development of complex projects.
- At no stage did any of the UPBHF users raise the issue of unfair treatment or unconscionable conduct with Government and Ministerial stakeholders who had and continue to have the power to intervene, including ultimately through the statutory right to issue directions under the Port Authorities Act 1999.
- PPA was not in a position to achieve all its desired commercial outcomes: the fact that the contractual structure did not include ‘water tight’ take-or-pay obligations, that would underpin the ongoing cash-flows for the UPBHF, illustrates this.

Commercial bargaining power influences the propensity of a well-advised entity to compromise on its desired commercial or transaction outcomes. It is clear that the present state (i.e. deterioration) of the global sea-borne iron ore market has impacted on the commercial bargaining power of UPBHF users across the board (i.e. with all stakeholders), at the same time as increasing the risk around ongoing



revenue to PPA. However, the fact that the commercial bargaining power of a Respondent might have changed over time – which may have caused them to agree to more recent commercial arrangements (e.g. take-or-pay) that they would rather not have (or would not have agreed to had they retained their previous level of commercial bargaining power) does not mean that they have been taken advantage of, or that PPA has misused its commercial bargaining power, as the level of risk assumed by PPA increased with the deterioration in the market.

Putting the matter differently: does the fact that a particular Respondent (such as, for example, Atlas) must compromise with its debt providers (as its bargaining power changes) mean that those debt providers act unconscionably or misuse their power when they act to protect their interests?

In summary, negotiations were protracted and undertaken in a commercial manner, to assert otherwise is misleading.

It should also be noted that HoustonKemp's independent review of all UPBHF contracts found that a "bilateral exchange of obligations between the parties reflects an absence of asymmetric bargaining power" (page 19).

## **11. Rise and fall provisions – 2013 contract renegotiations**

### **Committee Proceedings**

Related to the matters discussed at paragraph 0 above, the Respondents seek to provide some background about the inclusion and operation of rise and fall provisions in the Multi-User Agreements.

**Mr Rushton:** *The next key point we consider that we wish to highlight, and it comes through in a number of places through both the PPA submission as well as the Treasury submission, the first place it comes up is 1.3.4 of the Treasury submission. The quote is —*

*Prices were originally set in 2007, prior to construction of Utah Point BHF, and were subsequently renegotiated with users in the 2013 Multi-Users Agreements once Utah Point BHF became operational*

*There are a couple of points I wish to make there. In the agreements for us—I cannot speak for Atlas or Consolidated Minerals, but I am sure these two gentlemen next to me can—the contracts actually were not executed until late 2009 in respect that it locked in a fixed \$1.79 for the facility charge and \$1.79 for the ship-loader charge. There was no rise and fall. It was fixed for the five-year term, with a five-year option to extend. The agreements themselves had in them a built-in additional term or charge that was called the special-purpose levy, and that said that if the throughput of the facility reduced below eight million tonnes, then there was an incremental increase to a maximum of an additional surcharge of \$2 a tonne if the throughput dropped below five million. Since its inception, the facility on a financial year total throughput has always been above eight million tonnes per annum. So that is the first point that we wanted to make.*

### **PPA Response**

PPA rejects Mr Rushton's characterisation of the original Facility Agreements as having "locked in" or "fixed" all charges for the term of those agreements, including the optional additional term. PPA does not wish to publicly disclose the individual

negotiating position of particular UPBHF users during the relevant period, however PPA asserts that this position (i.e. that all charges are fixed for the full duration of the contract term, and cannot be adjusted by PPA) was never consistently advanced during the negotiations in relation to the Multi-Users Agreement. The Contract Rise and Fall rate, calculated in accordance with the relevant formula, was the compromise struck between the parties, so that any future adjustments (increases or decreases) to applicable contract charges would be limited by that rate.

## **12. Conflicts of interest**

### **Committee Proceedings**

The Respondents assert that a conflict of interest existed at the time that the UPBHF was developed – in that the Board of PPA was comprised at that time of representatives of BHPB and FMG.<sup>11</sup>

### **PPA Response**

Any suggestion or imputation that PPA's management of conflict of interests has prejudiced the position of a Respondent is categorically rejected.

As the Committee will appreciate, prior to the amalgamation of Port Hedland with other export ports pursuant to the Ports Legislation Amendment Act 2013, industry representatives (including BHPB and FMG) were appointed by the responsible Minister to the Board of a port authority (they were not appointed by the Board itself). In the case of the then Port Hedland Port Authority, at all times during the term of those arrangements, the management of conflicts, actual or apparent, was managed in accordance with standard corporate governance practice, and, fundamentally, in a way that did not compromise the interests of either PPA or any of its transaction counterparties.

For example, it was standard procedure at the then Port Hedland Port Authority, prior to amalgamation with Dampier Port Authority to form PPA on 1 July 2014, that:

- the “board pack” distributed to “conflicted directors” would be redacted to remove any “conflict information” – for example, information of commercial sensitivity to an entity that competes with a conflicted director. Often several different board packs had to be prepared by the Corporate Secretary; and
- conflicted directors would not participate in board deliberations involving conflict matters, and would not therefore be involved in decision making.

The fact is that the then statutory arrangements, for industry representatives on port authority boards, while less than ideal (industry representation was removed as part of the recent amendments to the Port Authorities Act 1999), were nonetheless appropriately managed in the circumstances is evidenced by the fact that none of the “majors” that were represented on the Board of the Port Hedland Port Authority at the time have, to PPA's knowledge, made the same assertions made by the Respondents' to impugn the conduct of PPA.

PPA notes that a conflict of interest related to the resourcing of a project management role connected with the development of the UPBHF was identified and

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<sup>11</sup> Testimony of Mr Ellison - page 24.

dealt with in the Port Hedland Port Authority Board Meeting of September 2006. The conflict was declared and the individual concerned was excluded from voting on the matter. In PPA's view, the matter was dealt with appropriately from a corporate governance perspective.

### **13. Lack of consultation in connection with the sale process**

#### **Committee Proceedings**

The Respondents criticise the lack of consultation which has occurred. They specifically challenge a statement by Treasury that "The Government has consulted with Junior Miners during the preparation for the divestment of Utah Point ...".

#### **PPA Response**

For the avoidance of any doubt, PPA reiterates that at no time has it controlled or determined the strategy for engagement with the UPBHF users and other stakeholders in connection with the UPBHF divestment transaction (including in relation to the *Pilbara Ports Assets (Disposal) Bill 2015* (WA)).

### **14. Sunk-investment by Atlas**

#### **Committee Proceedings**

A discussion takes place at page 26 in relation to the further \$73 million invested by Atlas to develop the Stockyard 2 infrastructure.

The point is made that Atlas has recently invested this amount, but has no clear understanding of its rights going forward.

**Hon KEN TRAVERS:** *So that \$73 million, is that part of that \$315 million or is it extra?*

**Mr Flanagan:** *It is in addition.*

**Hon KEN TRAVERS:** *That is your money over and above the prepayments and the equity you put in—the \$9 million you put in upfront?*

**Mr Flanagan:** *Yes. So there is no-one to give us that money back if the iron ore price falls.*

**Hon KEN TRAVERS:** *So what happens if it is sold? How do you have access to that investment?*

**Mr Flanagan:** *We do not really understand, because we only met with Treasury after the bill was introduced.*

**Hon ROBIN CHAPPLE:** *So your investment —*

**Mr Rushton:** *We would expect that the rights within the term of the agreement would be preserved, but the rates and charges for accessing that facility are uncertain.*

Further in the Proceedings Hon Ken Travers (at page 28) makes the following comment in relation to the investment of this amount:

**Hon Ken Travers:** *On that issue about the \$73 million, it strikes me that, to the best of my knowledge, Treasury has never made a comment about a discounted rate for Atlas as a consideration of that \$73 million, but surely a pricing and access regime,*

*apart from anything else, should at the very minimum ensure that you are given a discount rate as a result of that original investment in that stockyard?*

### **PPA Response**

Atlas elected to invest in the development of the UPBHF Stockyard 2 infrastructure for its own, exclusive use. Atlas' rights and obligations in respect of its access to, and utilisation of, Stockyard 2 are set out in its contractual documentation with PPA: Facility Agreement, Multi-Users Agreement and Lease. [REDACTED]

It should be noted that certain charges (i.e. Facility Charge) applicable to Stockyard 2 are set at a lower rate than the equivalent charges applicable to Stockyard 1.

As previously noted, PPA is unaware of the \$9 million contribution referred to by Mr Flanagan above and invites Atlas to provide it with additional information to clarify this matter.

## **15. Discussion in relation to the Harriet Point Agreement**

### **Committee Proceedings**

A discussion takes place (recorded at page 27) in relation to the Harriet Point Agreement, the benefit to BHPB of that agreement and speculation as to why BHPB would 'gift' \$70 million to PPA for the development of the UPBHF.

The Hon Ken Travers also comments at page 27: *If this committee gets a copy of the Harriet Point Agreement, that will be a decision for the committee to make it public, but not at the moment.*

### **PPA Response**

PPA confirms that public disclosure of the Harriet Point Agreement, including its terms and conditions and any transaction contemplated by it, would adversely affect the commercial interests of PPA and other persons, and notes that the above information [REDACTED]

[REDACTED] remains subject to the confidentiality regime under that Agreement [REDACTED]

## 16. Government's objective – junior miners

### Committee Proceedings

The Respondents express a number of views about the objective of facilitating trade and the role that junior miners play in that, in relation to the UPBHF.

**Mr Muller:** *The starting point for the pricing regime are existing rates, exclusive of any discount.*

**Mr Rushton:** *And indexed by CPI. That does give you some answer. I think to be completely transparent, the Treasury has in their submission said that the current user agreements will continue. So, Atlas has some peace of mind for at least the short term, but three or four years when you are talking about operational mines that run for 10 to 15 years, offers no peace of mind at all really, I would submit.*

*Section 2.7.1, "Monetisation of Past Capital Investment and Future Dividends": the quote that Treasury makes, and it makes it in a number of parts of its submission, we have already touched on that, but I would just like to get the point highlighted—*

*There is strong rationale to privatise Utah Point BHF, as the Government's objective of facilitating trade by Junior Miners has been achieved*

*Paul did touch on this earlier. That was a short period of time. Utah Point has been around for four or five years and it has facilitated the trade of three junior miners. What about the rest of the junior miners? What about continuing to facilitate our ongoing trade for as long as we remain junior miners? It is not a finite objective. The facility was built. It is one of 47 ports dedicated to the junior users. That objective, we would submit, is never accomplished; it is ongoing; it is perpetual. For as long as there are junior miners who have deposits to export, the objective to facilitate the trade of that export by the junior miners is ongoing.*

### PPA Response

PPA considers that these issues raise matters of policy for Government, and accordingly, PPA does not express a view on these issues, other than to note that

## 17. Access and Pricing Regime

### Committee Proceedings

Appearing throughout the discussion are concerns raised by the Respondents about the proposed access and pricing regime.

The concerns are broadly captured in a discussion recorded at page 29.

**Mr Rushton:** *... The next section I would like to bring your attention to is section 2.7.5, "Balances Private Sector Innovation with Public Sector Regulatory Oversight". I have flipped over on to the next page, and it is the third box down —*

*The access and pricing regime, outlined in section 4, provides Junior Miners with priority to access the facility and includes other protections to incentivise TerminalCo to ensure the asset continues to be utilised for productive purposes*

*When we read the scant detail that has been provided by Treasury in respect of the regulatory regime proposed to continue post-privatisation, that does not provide for a priority of access at all. It provides a priority to negotiate, not access. It is negotiations. If we cannot come to a deal with the incoming operator, we can go to a binding arbitration. But, as Graham helpfully pointed out, page 32, the fifth paragraph, of the Treasury submission clearly says if the parties cannot agree, they can enter into binding arbitration for the terms of access other than price. And the last sentence of the first paragraph on page 32 says the arbitrator is empowered to determine all terms—that is, all terms that were offered to the junior to which they could not come to a deal on—other than price of the service. We would submit that price is pretty much the single most important thing as to whether a junior miner can afford to go over it or not. If the price is through the window, then all of the other terms make no sense. We must appreciate that if we cannot come to a deal on price, we have no right of appeal, no deal can be done, the priority of negotiations stop and at that point TerminalCo goes to the regulator and says, “I couldn’t do a deal with any junior miners; now I want to go to the majors.” So it is not, we would submit, a priority to access; it is a priority to negotiate that is bound to fail because there is no right of appeal on the price offered.*

The Respondents also criticise the independent report procured by the ASU from Incenta (at page 30) and by Houston Kemp (at page 31).

### **PPA Response**

PPA considers that access and pricing issues are a matter of policy for Government, and accordingly, PPA does not express a view on these issues, other than to note that the Port Authorities Act 1999 includes various mechanisms for Government to direct PPA in the manner in which it carries out its statutory duties and functions.

## **18. The Bill and the Port Authorities Act**

### **Committee Proceedings**

A query is raised (at page 32) about the interaction between the *Pilbara Ports Assets (Disposal) Bill 2015* (WA) and the application of the *Port Authorities Act 1999* (WA) - in particular, the statutory duties and functions imposed on PPA – section 30(2).

**Hon KEN TRAVERS:** Yes, and the focus that you put on section 30(2) —

**Mr Rushton:** Section 30(2)(aa)—*facilitating trade*.

**Hon KEN TRAVERS:** *And the focus you put on that in terms of the balance between profit and trade facilitation.*

**Mr Short:** *Mr Travers, that is an absolutely valid comment and, again, it was a point that we would have had to have made at some point. But that provides significant protection for the juniors at the moment in terms of that section within the Port Authorities Act. The question is: if there is the sale and it proceeds under the current arrangement, what happens to that protection?*



**Hon KEN TRAVERS:** *The challenge is, does this bill, the bill we are dealing with, override that section of the Port Authorities Act or will the port authority, when selling the asset, still be required to comply with that section of the Act? That is probably a question that we will need to seek advice on, I suspect.*

**Mr Short:** *Mr Travers, you asked that of the Treasurer's representative when he was here last week and his legal counsel, sitting in the seat that I am sitting in now, answered that it would not be. That applies to a port authority; it will not apply to the private operator.*

**Hon KEN TRAVERS:** *I am not convinced, because the Act does not specifically exclude that clause in the Port Authorities Act. The lease is still a lease of the port authority. So it becomes an interesting question at law, in my view, as to whether or not this bill does exclude an obligation under that section of the Port Authorities Act or whether the lease will be still required to comply with it. But then the question becomes: How do you meet the terms of that? How do you measure that?*

### **PPA Response**

The issues raised in this discussion are of fundamental importance to PPA. PPA is acutely aware of its statutory functions and responsibilities. At no time in its commercial relationship with the UPBHF users, has it ever acted contrary to its statutory duties.

The Committee and Respondents will be aware, however, that the *Pilbara Ports Assets (Disposal) Bill 2015* (WA), like all legislation facilitating the divestment of public assets, seeks to include a mechanism under which PPA can be directed by the responsible Minister (the Treasurer) to implement certain transactions. The draft legislation specifically provides that PPA (and its officers) cannot be said to have breached the Port Authorities Act if they act, in good faith, on a disposal direction.

## **19. Retention Value**

### **Committee Proceedings**

The Committee discusses the issue of a retention value at pages 33 and 34. Various figures are discussed.

### **PPA Response**

PPA wishes to confirm that, so far as it understands, PPA has no (and will have no) role in relation to the determination of a retention value. This is a matter for the ASU and its external advisors, as is the selection of the preferred proponent.

## **20. Finucane Road**

### **Committee Proceedings**

A discussion is recorded at pages 38 and 39 in relation to Finucane Road – questions are raised about contributions to that road, and indeed whether it is part of the sales process.

### **PPA Response**

PPA's development plans continue to include Finucane Road as a multi-user road for retention and management by PPA. It should also be noted that PPA has power

under the Port Authorities Act 1999 to levy and collect fees and port charges, including, for example, for roadworks and any necessary maintenance and repair of roads within port vested lands.

I trust that the additional information provided above by PPA in its responses is of assistance to the Committee. PPA remains available to clarify any matters currently before the Committee.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Roger Johnston', is written over the printed name and title.

Roger Johnston  
**Chief Executive Officer**