

29 September 2004

Mr E J Hall  
Chief Executive  
Queensland Competition Authority  
Level 19, 12 Creek Street  
BRISBANE QLD 4000

Dear Mr Hall

We refer to the letter dated 22 September 2004 received by Prime Infrastructure from the Queensland Competition Authority ("QCA").

It is important that we raise with the QCA a concern related to the deadline that the QCA appears to have set itself to release a draft determination. Although we support the QCA issuing a draft determination in the shortest possible timeframe, we do not support its hasty completion if this impacts on Prime Infrastructure having a fair opportunity to have its concerns addressed before the draft determination is issued or impacts on the quality of any draft determination issued by the QCA. We note and acknowledge the statement in the QCA's letter of 22 September in relation to tax sharing that "...it (Prime Infrastructure) will still have the opportunity to comment on the Authority's treatment of the matter after the Authority releases its Draft Decision. This opportunity will of course also exist with respect to all other matters dealt with by the Authority in that Decision." However, as you know, Prime Infrastructure is a listed entity and in these circumstances a draft determination which has the potential to be significantly amended as a result of the opportunity to comment process could result in extreme volatility in our security price. This in turn may result in a real cost to our security holders, especially "retail" security holders, commonly referred to as "mum and dad" investors. This is of obvious concern to us.

In this regard, however, we would like to thank the QCA for making the time to meet with us today to discuss some of the issues raised in the QCA's letter dated 22 September 2004 and for the willingness showed in agreeing to meet with us again over the next few days to discuss these issues further. The opportunity to discuss these issues prior to the release of the draft determination goes some way to mitigating our concern in relation to them. In general, however, we would urge the QCA to consider the possibility of significant amendment to any draft determination and to mitigate this possibility as much as possible (for example through further meetings and information requests, if required) before releasing the draft determination.

With respect to issues relating to asset valuation we (together with Connell Hatch) again express our willingness to meet with the QCA and Maunsell as an effective method of resolving any outstanding issues, including concerns raised by us in our Request for Comments paper.

With respect to the Authority's "Matters of Fact" and "Matters for Comment" we provide the following response. For ease of reference we have adopted the numbering contained in the QCA's letter of 22 September 2004.

**Matters of Fact**

**1. Surge Bin 1**

See response 2. below.

**2. Surge Bin 2**

Although SBN1 and SBN2 are of similar basic functionality, if SBN1 were built today it would have to be similar to SBN2. This is mainly because of the access and environmental controls that SBN2 incorporates that SBN1 does not have. For example, the entire feeder area of SBN2 is in a fully enclosed building to minimise dust and noise, however the SBN1 feeders are on an open platform. SBN2 also has a slightly higher volume than SBN1 to help mitigate surge fluctuations. The footprints are in fact similar but are distorted by the large amount of environmental control structure that has been necessitated for SBN2 (and would be necessary for any replacement of SBN1) by EPA requirements. SBN1 would not be compliant under today's environmental requirements and hence it is inappropriate to consider SBN1 as a replacement unit and hence as the basis for an optimized replacement cost. It is, however, appropriate to consider SBN2, which complies with environmental requirements, as the basis for an optimized replacement cost.

**3. Sample Plant - Surge Bins 1 & 2**

The cost of sample plant was erroneously counted twice in the Connell Hatch valuation when valuing SBN1 and SBN2. Correcting this error reduces the ORC for this item (Outloading) by \$3,629,692.

**4. Inloading Conveyors S1 to S4**

The S6A galleries are enclosed to minimise dust and noise, and such construction was required for environmental (dust, noise) reasons when this conveyor was built in Stage 5. Conveyors S1, S2, S3 and S4 were built in Stages 1 and 2, and such requirements did not exist at that time. The replacement cost for these conveyors was calculated based on enclosed galleries to account for the fact that such environmental control would be required if they were built today to make them EPA compliant. We believe that basing the ORC for these conveyors on the cost of an environmentally compliant conveyor is an appropriate basis for estimating an optimized replacement cost.

## **5. Bunds 2, 3 and 4 Rails**

The weight of the yard machines has increased because of the increased access / maintenance needs and higher environmental controls required on machines built today. Also, yard machines are now required to comply with AS4324.1, which also has had the effect of increasing the structural weight of mobile bulk materials handling machinery. Accordingly machine wheel loads are greater today than they were when the Bund 2, 3 and 4 rails were supplied in Stage 1. Hence, the need for 101kg/m rail for current new designs to be compliant to the codes and EPA requirements. Again, we believe that this is an appropriate basis for estimating an optimized replacement cost.

## **6. Conveyors R1 to R4 Drives**

The noted installed powers for conveyors R1 - R6 are correct, except for R2 which has one 405 kW drive and one 375 kW drive. Conveyors R5 and R6 currently operate at 4250 tph but were installed with two 560 kW drives to allow for cost-effective upgrade of these conveyors in the future to 5500 tph (by gearbox ratio change only). If R1 - R4 were all built today, they would all be built with this ability to readily upgrade in the future. This is in line with the overall terminal ORC philosophy used and the slightly higher capital cost to reduce overall operating and maintenance costs.

## **7. RRP1 Dust Extraction System**

It is correct that the RRP1 dust extraction system is currently not used, however a new rail receival pit could not be constructed without one due to EPA requirements for the site. As part of the next inloader upgrade, the current plan is to replace or retrofit an effective system to RRP1.

## **8. RRP1 and RRP2**

Cost of water services for RRP1 and RRP2 was erroneously included twice. Correcting this reduces the ORC for Rail Receival by \$810,590.

Cost of preliminaries, S1, S2, S3 and S4 footings, Sub 2A, and Receival Pit Amenities building were also erroneously included twice. Correcting this reduces the ORC for Rail Receival by \$3,194,570.

## **9. Berth 3 Dredging**

Preliminaries were erroneously included twice and GST was included for Berth 1 and Berth 3 dredging. Correcting this reduces the ORC for Outloading by \$8,396,169.

## **10. Interest During Construction**

The cost of capitalised interest has been calculated by taking the July 04 replacement cost of the facility and spreading over the nominal construction period of 48 months following a standard S-curve – this represents the construction cost 'draw-down'. Capitalised interest is then calculated by aggregating the product of the total balance of the replacement cost drawn down and the nominal WACC on a month-by-month basis.

Arguably the amount drawn down should be multiplied by a real WACC rather than a nominal WACC due to the replacement cost already incorporating an inflation adjustment. Prime Infrastructure does not agree with this view.

Prime Infrastructure has adopted a consistent approach to calculating the DORC. That is, it has assessed DORC as a forward looking concept seeking to proxy the market value for the DBCT assets, were a competitive market for those assets to exist.

The ORC seeks to establish what a competitor would pay to replace the DBCT capacity in the present market context, i.e. having regard to the future volumes of coal to be shipped from the Bowen Basin. The discount from ORC to give DORC reflects the discount for loss of serviceability of the second hand DBCT assets when compared to the serviceability of new assets.

What is relevant to regulated prices today is the cost of replacing the assets today. In practice, the July 04 replacement cost is meant to represent the price that someone would have to pay to replace the DBCT facility in its entirety on an efficient basis as if they signed a design/build contract on 1st July 2004. To the extent that the amount was drawn down over the subsequent 48 months, then additional costs would be incurred should input costs inflate over that period. This inflated cost is picked up in the nominal WACC - i.e. this entire process is 'forward-looking'.

To take the July 04 replacement cost and then backwardly apply a construction profile in effect argues that the actual cost is less than the July 04 replacement cost because some of the expenditure was committed in the previous four years. If we are interested in the cost of a terminal that is to be commissioned in July 2004, then the replacement cost at 1st July 2000 is relevant as the basis for the calculations (when the commitment would have been made) with capitalized interest calculated at a nominal WACC. But what should govern regulated prices today is the current replacement cost – not the replacement cost of 4 years ago.

## **Matters for Comment**

### **11. Computer Systems**

We have reviewed the ERP Coal Management System and determined that the cost of software and development for this specific application should be in the order of \$1.7million. Correcting this reduces the ORC for this item (Electrical Services) by \$4,300,000.

### **12. Various Assets**

We understand that the original cost of providing the original assets was a capital cost met by the owners of the facility. Accordingly in a replacement cost scenario we have assumed that the cost associated with the provision of these assets would be met by the owners of the facility.

However, we have reviewed the cost to replace these assets. We initially estimated the replacement cost based on historical actual costs. We would acknowledge that given the type of assets this approach would overstate the ORC. Accordingly, we have reviewed the various assets and determined that the replacement cost of these items is lower than originally estimated. Correcting this over estimate would reduce the ORC for this item (Electrical Services) by \$1,096,235.

### **13. Corporate Overhead Costs**

Prime Infrastructure did not propose an allocation of 90/10 for corporate costs in its letter to the QCA dated 24 August 2004. Prime Infrastructure proposed that it was appropriate that those costs that could be avoided had Prime Infrastructure only had an investment in DBCT, rather than in DBCT and a number of other assets, be removed from any corporate overhead costs. Budgeted corporate overhead costs relating to other assets or to non-DBCT activities were then highlighted. In addition, it was acknowledged that it was likely that some non-specific costs would also be incurred relating to non-DBCT assets or activities. To take this into account we proposed that a **further** 10% be deducted from the budgeted corporate overhead costs for the year ended 30 June 2005.

In summary, we deducted \$1.592 million from our total budgeted corporate overhead costs of \$8.060 million an effective allocation of almost 20% of total corporate overheads to non-DBCT assets and activities.

In addition, investment management fees are payable to Babcock and Brown in relation to the provision of management services in respect of some of these assets. These investment management fees are detailed at attachment 3 to our letter of 24 August 2004, are not included in the \$8.060 million noted above and are budgeted to cost \$59,000 for the year ended 30 June 2005.

The allocation of 20% of corporate overhead costs to non-DBCT assets and activities is considered reasonable by Prime Infrastructure as DBCT consumes the vast majority of Prime Infrastructure's corporate resources given, for example, its regulatory nature, the complex relationships with the DBCT Users, the DBCT operator and various Government entities (mainly via the Port Services Agreement) and expansion related issues;

By comparison, the other assets in Prime Infrastructure's portfolio consume very little of the corporate resources as they each have their own experienced management teams in place, are unregulated with long term revenue streams from off-take contracts and are not actively investigating any expansion possibilities. The following table illustrates why the DBCT assets consume the vast majority of Prime Infrastructure's corporate resources:-

DBCT	Non-DBCT Assets
<ul style="list-style-type: none"> <li>• Regulated asset;</li> <li>• Existence of multiple capacity off-takers, hence a greater amount of management effort is required for contract management and negotiation;</li> <li>• Relationship with the DBCT operator has to be managed;</li> <li>• Relationship with various Government entities has to be managed</li> <li>• Expansion issues; and</li> <li>• New customers may seek access to the facility.</li> </ul>	<ul style="list-style-type: none"> <li>• Non-regulated assets;</li> <li>• Long term PPA contract for the bulk of the capacity;</li> <li>• Single credit worthy counterparty; and</li> <li>• No expansion currently being pursued.</li> </ul>

Despite the fact that the DBCT assets consume the vast majority of corporate resources, the allocation proposed by Prime Infrastructure (ie 80/20) is also in line with an allocation based on the underlying enterprise value of the respective assets as disclosed at page 11 of our 2003 annual report. This is summarised in the table below:-

	\$m	%
Enterprise value DBCT	945	78
Enterprise value non-DBCT assets (Prime Infrastructure's share)	273.5	22
Total Enterprise value	1218.5	100

#### 14. Babcock and Brown Fee

Prime Infrastructure has proposed that should an actual tax approach be adopted and should the QCA determine that "tax benefits" are derived from the stapled structure then the fees payable to Babcock and Brown Investor Services (BBIS) as Responsible Entity of the Trust should be included in calculating the regulatory Corporate Overhead costs allowance. As is noted below and as was discussed earlier today in our meeting with the QCA, we do not believe that any "tax benefits" are derived from this structure. For completeness however, we have summarised below the role of BBIS. As responsible entity for the Prime Infrastructure Trust (PIT), BBIS's primary duties and obligations include:-

- Exercising its powers and performing its functions under PIT's constitution and the Corporations Act in the best interests of Prime Infrastructure security holders; and
- Ensuring that PIT is carried on and conducted in a proper and efficient manner.

As part of this BBIS is responsible for:

- Monitoring the financial performance of PIT, including approving PIT's financial statements; and
- ensuring the existence of, and compliance with, adequate internal controls and procedures.

BBIS fulfills these responsibilities through the operation of its Board, professional executive management and an internal control framework.

A subsidiary of BBIS fulfills a similar role in relation to the DBCT Trust.

A summarized description of the BBIS Corporate Governance, BBIS Board, BBIS compliance plan and how the fees paid to BBIS are calculated is provided at Appendix 1. The fees paid to BBIS compare favourably (ie are less than) fees paid under similar arrangements with regard to other infrastructure trusts traded in the market.

If you have any questions in relation to any of the above or require any further information or additional clarification, please do not hesitate to contact me on 07 3229 0600.

Yours Sincerely

A handwritten signature in black ink that reads "Jeff Pollock". The signature is written in a cursive, slightly slanted style.

Jeff Pollock  
Chief Financial Officer

CC: Paul Bilyk

## BBIS Board

Responsibility for the corporate governance and the internal workings of BBIS rests with its Board.

The BBIS Board of directors is comprised in accordance with BBIS's constitution. The BBIS Board is currently comprised of senior executives of Babcock & Brown as follows:

Mr Phillip Green (Chair)
Mr Peter Hofbauer
Mr Michael Maxwell
Mr Shahen Mekertichian
Mr Andrew Tyndale

Meetings of the BBIS Board are held as required.

## Compliance Plan and Compliance Committee

In accordance with the Corporations Act, BBIS has registered a Compliance Plan for PIT with ASIC. The Compliance Plan outlines the measures undertaken to ensure compliance with the Corporations Act and PIT's constitution.

BBIS has a Compliance Committee whose duty is to monitor BBIS's compliance with the Compliance Plan, regularly assess the adequacy of the Compliance Plan and report its findings to BBIS and, in appropriate circumstances, to ASIC.

In the absence of BBIS having a Board with a majority of external members, BBIS has appointed a Compliance Committee consisting of three members, the majority of which are independent from BBIS. The Compliance Committee is currently comprised as follows:

Mr Peter Read (Chair)	Independent committee member
Mr Bledwyn Gambold	Independent committee member
Mr Paul Ferguson	Internal member - BBIS Legal Counsel and Company Secretary of BBIS

The Compliance Committee has written terms of reference, and unless more frequent meetings are required, meets on a quarterly basis.

## Remuneration of BBIS

Under the terms of PIT's constitution, BBIS is entitled to receive out of the assets of PIT a fee for its services calculated at the rate of 2% per annum of the gross asset value of PIT. However, BBIS is currently paid a fee which is less than the amount that would be paid under the above-mentioned rate. The current fee is determined in accordance with the formula set out in Prime Infrastructure's Prospectus dated 10 May 2002. By way of summary, the fee comprises:

- a Base Fee component, calculated as:
  - 0.1% per annum of a set base market capitalisation; and
  - an additional 1% per annum of the amount that Prime Infrastructure's market capitalisation exceeds the base market capitalisation; and
- an Incentive Fee component, which is equal to 15% of any excess return of the accumulation index for Prime Infrastructure's securities over the return of the S&P/ASX 200 Accumulation Index.

## BBIS as responsible entity

BBIS, as responsible entity of PIT, is responsible for the corporate governance of PIT and the protection of PIT unitholders' interests.

BBIS has an established framework for the management of PIT including a system of internal control, risk management processes and a compliance plan.

The Corporations Act, ASX Listing Rules, Constitution of PIT and the general law regulate the workings of PIT and the essential practices, responsibilities and duties of BBIS (as PIT's responsible entity) and its officers.