THE PILBARA INFRASTRUCTURE'S PROPOSED COSTING PRINCIPLES – ERA DRAFT DETERMINATION

ARTC SUBMISSION JANUARY 2010

Background

The Economic Regulation Authority ("Authority"), Western Australia, has sought submissions from interested parties with respect to its Draft Determination on The Pilbara Infrastructure's ("TPI") Costing Principles.

In August 2008, TPI submitted its proposed Costing Principles to the Authority for approval, in accordance with Part 5, section 46(1) of the Code. This followed the TPI Railway becoming included in the State's rail access regime through the proclamation of Part 3 of the *Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004*.

The WA Regime: ARTC's Previous Submissions

In line with its previous submissions to the Authority, and its previous involvement in the consultation processes conducted by the Authority (or its predecessor) and the NCC in relation to the WA Rail Access Regime, ARTC's positions and comments have largely been based around two broad themes, being,

- ARTC has consistently indicated that it considered it important that access regimes within each jurisdiction in Australia are consistent to the maximum extent possible, whilst recognizing structural differences between providers in each jurisdiction.
- The need for the WA Access Regime and regulatory supervision to ensure that adequate measures are put in place to provide the market with confidence that access to the WA network can be gained in a timely, fair and equitable way when the access provider is vertically integrated. One outcome of this is that ARTC has consistently argued that access regimes for vertically integrated operators need to be much more prescriptive in nature than regimes considered appropriate in a vertically separated environment.

ARTC's interest in the Part 5 Instruments, including Costing Principles, is that they are consistent with these needs.

ARTC's Comments on the Draft Determination

<u>Comments Relating to ARTC's Previous Submission</u>

ARTC has previously made submissions to the Authority in relation to Costing Principles for WestnetRail (WNR) which, in a general sense, would also apply in the case of TPI. Therefore, ARTC in principle, supports the Authority where consistency has been sought between TPI's and WNR's Costing Principles.

In relation to ARTC's previous submission on TPI's Costing Principles (September 2008), ARTC is mostly satisfied that its comments were considered and dealt with in the Draft Determination.

The area where ARTC would like to follow up on relates to its comments on Section 4.2, Efficient Cost Test. ARTC stated:

> "Where actual costs are used, TPI states that a "…robust tendering process will provide the regulator with some comfort that the resulting price reflects an efficient market price." In line with transparency, such a process should be clearly outlined and agreed with the ERA.
>
> It is ARTC's view that TPI should be required to report against agreed efficiency KPI's to the ERA."

To reiterate, ARTC agrees with the TPI in that a robust tendering process will provide some comfort that the resulting price reflects an efficient market price. In ARTC's view this tendering process should, however, be outlined in conjunction with, and approved by the Authority in order to ensure that it provides a competitive outcome. In line with transparency and increasing market confidence, ARTC considers this to be an important requirement.

ARTC's feels also that TPI should be required to report against agreed efficiency KPI's to the Authority. This is a requirement of WNR's Costing Principles and should also apply to TPI. In a vertically integrated environment the track owner can discriminate against third parties through the standards it chooses to maintain the network. This will impact the efficient cost of maintaining the network. ARTC has made previous comment on the need for and importance of KPI reporting.

<u>Comments on the Authority's Key Issues</u>

The Authority has asked for comment on a number of key issues. ARTC's comments are as follows:

Timetable for submission of TPI's costing model and floor and ceiling costs

Rather than stipulating a period of within 18 months of the approval of the costing principles to submit TPI's costing model, ARTC's view is that the requirement for submission should be related to TPI's compliance timeframe requirements. In Section 7 of TPI's Costing Principles, TPI's compliance will be subject to an annual independent external audit.

Costs associated with land on which the railway infrastructure is located

ARTC agrees *in principle* that only costs consistent with the Code should be included. The Code makes it clear that no costs associated with the value of the land on which the railway infrastructure is located can be taken into account. However, ARTC believes that if a party has a legitimate cost relating to land, for example, a land purchase in order to build infrastructure, a return on this should be considered as a reasonable inclusion in the regulated cost base. The current wording of the Code perhaps reflects the circumstances at the time of Code development which perhaps did not contemplate future land purchase requirements, and other necessary land related costs.

ARTC suggests that the Draft Determination and TPI's Costing Principles at this point in time adhere to the Code, but also that the Authority considers possible changes to the Code to reflect cases where there are legitimate land costs on which a return should in principle be allowed.

Economic lives for some asset classes

ARTC agrees with the Authority that where TPI has suggested shorter proposed economic lives for some asset classes, TPI should be required to provide full justification for these shorter lives.

Adoption of cost allocators for indirect costs

ARTC agrees with the Draft Determination that TPI's overhead costs should be allocated based on a combination of GTK's and train numbers, consistent with the approach for WNR's Costing Principles. ARTC has proposed similar cost allocators for indirect costs in its Access Undertaking.

GTKs should be used to allocate overhead costs which vary more in quantum due to volumes moved such as indirect and overhead expenditure relating to maintenance of the infrastructure. On the other hand, train numbers (or train kilometres) could be considered as a reasonable basis for allocation of non-maintenance related expenditure such as network control and system related overheads.

Use of an efficiency 'X' factor

It is ARTC's view that the decision to apply any X factor needs to recognise the situation at hand. Where some doubt may exist about the level of efficiency, ARTC believes that the application of an X factor is probably valid. If it is evident that efficiency of service provision has been achieved or is close to being achieved, a lower X factor, or even no X factor is appropriate. This is because it becomes more difficult to achieve productivity gains, the closer to efficient an organisation is. ARTC is suggesting that the decision to apply a factor is not a simple 'one size fits all' decision and in each case, should reflect the circumstances involved, including the extent of efficiency gains that may already have been achieved.