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Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
PERTH WA 6000

Dear Sir/Madam

REVIEW OF THE RAILWAYS (ACCESS) CODE 2000

1. The Economic Regulation Authority (**ERA**) has invited responses to comments made in submissions received by the ERA in relation to its Review of the *Railways (Access) Code 2000* (**Code**).

2. In making a further Submission, we refer to our initial Submission dated 2 April 2015, incorporating the report prepared by Ernst & Young.

VALUATION METHODOLOGY

3. TPI maintains that Gross Replacement Value (**GRV**) should be retained as the basis to estimate the capital costs of railway infrastructure.

4. The Code defines GRV as:

> *"the gross replacement value of the railway infrastructure, calculated as the lowest current cost to replace existing assets with assets that –*
> *(i) have the capacity to provide the level of service that meets the actual and reasonably projected demand; and*
> *(ii) are, if appropriate, modern equivalent assets…"*[1]

5. Incorporating the 'modern equivalent assets' concept, GRV enables access negotiations to take place using the most current information available (including consideration of the latest understood improvements in efficiency and technology), allowing outcomes to occur that are economically efficient.

6. GRV is the most appropriate valuation methodology for calculating capital costs under the Code because of the long life and cost structure of below rail assets. Moreover, GRV will lead to more consistent prices over time than other valuation methodologies, including Depreciated Optimised Replacement Cost (**DORC**).

[1] *Railways (Access) Code 2000* (WA) Schedule 4, clause 2.

7. GRV is more likely than DORC to encourage new investment, given the higher upfront prices potentially incurred by access seekers under DORC. Access seekers that require access to below rail infrastructure will generally operate over periods that are shorter than the remaining lives of the rail infrastructure to which it seeks access. Using a DORC valuation methodology may lead to the access seeker incurring higher costs up front than when applying a GRV valuation methodology assuming a similar starting base. This will almost certainly lead to greater up front financing requirements for the access seeker, which may result in deferred investment decisions. This may also lead to railway owners facing greater hurdles in financing new below rail infrastructure.

8. Using GRV as the valuation methodology in the Code best reflects the intent of criterion (b) of clause 6 of the Competition Principles Agreement. Ceiling prices calculated using a GRV methodology will reflect the maximum revenue able to be earned by a railway owner, with lowest current costs to replace existing assets reflected in price signals. This revenue cap reflects the alternative costs available to an access seeker if they were to construct their own infrastructure.

9. A change in the valuation approach under the Code would require significant amendment to those sections of the Code that prescribe the negotiation and arbitration procedures. Further, such a change would be prejudicial to the legitimate business interests of railway owners currently covered by the Code, contrary to the Competition Principles Agreement. These factors, together with the material compliance costs associated with a change to the valuation methodology in the Code, outweigh any perceived benefits to changing the valuation approach under the Code. Certainly the adoption of a valuation methodology to enable national consistency is not, in our view, a valid basis upon which to materially alter the Code.

10. We disagree with the reasons provided by Co-operative Bulk Handling Limited (**CBH**) and Frontier Economics as to why DORC should be preferred to GRV.[2] Indeed, Frontier Economics acknowledges that GRV and DORC can produce identical outcomes, if applied consistently.[3] As stated in a paper by the Office of Rail Access Regulator in July 2002, both GRV and DORC "use a current cost approach which is usually justified on the basis that it results in prices which more closely reflect the cost of replacing capacity or providing additional capacity".[4]

11. Finally, the arguments relied on by CBH and Frontier Economics to assert that GRV is inappropriate as the valuation methodology for capital costs are largely based on an assessment of Brookfield's railway only, and many of the issues raised do not apply to other railway owners regulated by the Code. Such arguments cannot justify a significant amendment to the Code affecting all railway owners.

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[2] Frontier Economics Pty Ltd, "Review of the Railways Access Code: a report prepared for CBH" (April 2015) at page 3. CBH Group, "Submission to the Economic Regulation Authority: Review of Railways (Access) Code 2000" (2 April 2015) at page 19

[3] Frontier Economics Pty Ltd, "Review of the Railways Access Code: a report prepared for CBH" (April 2015) at section 3.3.4.

[4] Office of the Rail Access Regulator, "A Brief Comparison of the WA Rail Access Code approach to calculating ceiling cost with the conventional Depreciated Optimised Replacement Cost methodology" (18 July 2002).

PRESCRIPTIVENESS OF THE CODE

12. We do not support a move to a more prescriptive regime with a benchmark access tariff-setting approach. To do so would be contrary to the flexibility objectives contained in the Competition Principles Agreement.

13. As stated in our initial Submission, the object of regulating infrastructure under the Code is to promote competition while ensuring economic efficiency in dependant markets. Where third party access is to be made available to privately owned infrastructure, any constraints imposed on the infrastructure owner should be limited so as to encourage maintenance, investment and technical innovation, and enhance economic efficiency. Negotiated agreements with prices and terms that are appropriate to the specific access that is sought reduce the risk of regulatory error in setting prices and allow for more efficient access prices to be set.

14. Submissions made favouring the introduction of benchmarked tariffs fail to consider critical factors other than price which underlie access arrangements. The terms and conditions of access agreements will necessarily be influenced by the price payable under that agreement. A more prescriptive access regime with benchmarked tariffs would lessen the railway owner's ability to take into account the particular requirements of a proponent in developing an access agreement. This would invariably hinder negotiation of the terms and conditions of access and the adoption of innovative approaches to access agreements so as to meet the specific needs of the proponent.

15. Comments were made in various submissions to the effect that the Code allows for limited regulatory oversight of the price-setting process and that more regulation is required. However, these comments fail to take account of the fact that the Code is not designed around consumer protection. Proponents under the Code are not consumers but are companies with various professional advisers and advocates who actively participate in negotiating the price and terms of access. There is not the imbalance in negotiating power that exists, for example, in the context of gas regulation. Further, railway owners have far more onerous statutory obligations and responsibilities than proponents, which act as constraints in the negotiation of price and terms.

16. The "build or buy" signals referred to in the submissions of CBH and Frontier Economics[5] are precisely the objectives that should be taken into account when interpreting the Competition Principles Agreement and applying the Code, and determining whether infrastructure is economic to duplicate. As Frontier Economics notes in its submission, "an access regime that exposes access seekers to build or buy signals can be appropriate if there is a realistic prospect that infrastructure-based competition will emerge".[6] Historical precedence, namely the construction and extension of a number of railways in the Pilbara, has demonstrated that TPI's railway is, in fact, economic to duplicate. As noted in our initial Submission, the

[5] Frontier Economics Pty Ltd, "Review of the Railways Access Code: a report prepared for CBH" (April 2015) at page 23. CBH Group, "Submission to the Economic Regulation Authority: Review of Railways (Access) Code 2000" (2 April 2015) at page 19.
[6] Frontier Economics Pty Ltd, "Review of the Railways Access Code: a report prepared for CBH" (April 2015) at page 23.

recent Harper Review provides that where it is commercially feasible to develop another facility:

> *the facility owner and access seeker have commercial incentives to reach an access agreement where it is efficient to do so. Where the facility can be bypassed, the facility owner has no incentive to refuse access and has an incentive to allow access if its overall costs will thereby be reduced. If the facility owner and access seeker are unable to reach agreement, it is a strong indication that substantial inefficiencies will result from access.*[7]

17. Increasing the prescriptiveness of the Rail Access Regime would increase compliance costs for both the ERA and railway owners. It would likely require the design of a sophisticated framework that limits regulatory discretion and ensures the rigorous review and correction of regulatory error. The cost of introducing such a framework will outweigh any perceived benefits relating to economic efficiency. Further, given the limited number of railway owners in Western Australia and the historical contractual and commercial basis underlying access, increasing the prescriptiveness of the regime would impose a significant burden on railway owners without materially increasing the net economic benefits to stakeholders.

REQUIRED INFORMATION

18. The 'required information' that a railway owner is required to provide to an entity under section 7 (including Schedule 2) of the Code is not necessarily information that is in the public domain and may be commercially sensitive. As such, a railway owner should not be required to publish this information on the Internet or in any other public forum and should only be required to provide the information to entities genuinely considering making a valid proposal for access under the Code.

19. We agree with Brookfield's suggestion that an entity seeking information under section 7 of the Code should be required to provide preliminary information about the operations the entity is contemplating having accommodated on the railway infrastructure.[8]

20. Further, the railway owner should only be required to provide any confidential information to an entity that has provided a confidentiality undertaking in respect of that information.

SECTIONS 14 AND 15

21. For the reasons stated in our initial Submission, the matters in sections 14 and 15 of the Code should be treated as threshold issues that must be satisfied by a proponent before consideration of its proposal by the railway owner. The Code should also prescribe the date by which a proponent must satisfy sections 14 and 15.

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[7] The Australian Government Competition Policy Review, March 2015 at page 433.

[8] Brookfield Rail Pty Ltd, "Public submission: 2015 Railways (Access) Code 200 review issues paper" (2 April 2015) at page 32.

22. Brockman's proposal for access to TPI's railway was made in May 2013. Over two years later, Brockman is yet to satisfy TPI of the matters in sections 14 and 15 of the Code. This delay by Brockman, which cannot be credited to the legal proceedings commenced by TPI, has created significant uncertainty for TPI. If Brockman is ultimately unable to satisfy TPI (or an arbitrator) of the matters in sections 14 and/or 15, TPI will have wasted considerable time and money in reviewing and responding to Brockman's proposal. This is not consistent with the economic objectives of the Code or the Competition Principles Agreement, and the Code should be amended to ensure that this eventuation is avoided in future.

23. We do not agree with the submission made by Brockman that the Code should include formulaic and objective tests which clarify the extent of 'necessary financial resources' in section 14. What is 'necessary' will inevitably depend on, among other things, the risk profile of the proposal, the solvency, credit worthiness and experience of the proponent and the other customers utilising the railway owner's infrastructure. To reduce the flexibility and subjectivity of this requirement would also be contrary to the Competition Principles Agreement.

24. Further, any suggestion that the threshold for 'necessary financial resources' should be low demonstrates a complete lack of understanding of the potential risks to the railway owner and the infrastructure from third party access, which, as stated above, will vary depending on the nature of the proposal and the identity and experience of the proponent or third party operator.

25. We do not support a blanket review by the ERA of the capacity test contained in section 15 of the Code as proposed by Brockman. The assessment of capacity of a railway will depend on many factors, including the operating philosophy of the railway owner and the terms set out in the railway owner's published Train Path Policy and the Train Management Guidelines. Additionally, further prescription of concepts contained in the Code, such as capacity, is not consistent with the Competition Principles Agreement.

26. Finally, the railway owner should be able to challenge the validity of an access proposal at any time if the information provided by the proponent relating to sections 14 or 15, or indeed any other matter under the Code, is not satisfactory. This will ensure that proponents are accountable for ensuring the legitimacy, genuineness and accuracy of their proposals. Due to the significant resources expended by a railway owner (and the ERA) in reviewing and assessing access proposals, any proposals found not to be genuine or accurate should be deemed invalid and immediately withdrawn by the proponent.

SEGREGATION OBLIGATIONS

27. Part 4, Division 3 of the *Railways (Access) Act* (**Act**) sets out the railway owner's duty to segregate. Segregation is not directly covered by the Code (other than in a very limited way in section 42) and may therefore be outside the parameters of the ERA's review. Nevertheless, we consider it necessary to respond to some of the comments made regarding the adequacy or otherwise of the segregation obligations in the Code.

28. We agree with Roy Hill's Submission[9] that the segregation obligations under the Act go well beyond the principles contained in the Competition Principles Agreement. The functional separation of vertically integrated supply chains results in unnecessary expense for railway owners and significant operational inefficiencies. The objects of protecting a proponent's confidential information and avoiding conflicts of interests by a railway owner can be achieved without the need for full functional separation.

29. The additional requirements suggested by Brockman in its submission on the Code Review, particularly the manner in which a railway owner schedules trains, are not matters that should properly be dealt with in a railway owner's segregation arrangement. Indeed, these matters are largely covered in a railway owner's Train Path Policy and Train Management Guidelines.

30. Further, the obligation of confidentiality contained in section 31 of the Act should apply equally to both railway owner and proponent. In other words, the proponent should also be under an obligation not to disclose the confidential information of a railway owner.

CONCLUSION

31. In making this further Submission, we reiterate our earlier comments made in our initial Submission dated 2 April 2015, which includes the comments contained in the paper prepared by Ernst & Young.

32. We have not addressed every comment made in the various submissions received by the ERA in relation to the Code Review. Our failure to address each specific comment should not be construed as agreement with the relevant comment.

33. Finally, we note that the Supreme Court decision in *The Pilbara Infrastructure Pty Ltd v Brockman Iron Pty Ltd [No. 2]* is currently the subject of an appeal, which will be heard later this year. Accordingly, it is not appropriate to rely on the findings of Justice Edelman, in the event that these are subsequently overturned by the Court of Appeal.

Yours sincerely

[redacted]

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[9] Roy Hill Infrastructure Pty Ltd, "Submission to Economic Regulation Authority: 2015 Review of Railways (Access) Code 2000" (23 March 2015) at page 4.