Public Submission by
Alcoa World Alumina Australia
on Review of WestNet Rail's
Part 5 Instruments

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1. INTRODUCTION

The Economic Regulation Authority (ERA) released a notice on 15 December 2005 inviting submissions on each of WestNet Rail's (WNR) proposed amendments to its Part 5 Instrument documents (all dated December 2005) including:

- Costing Principles;
- Overpayment Rules;
- Train Path Policy; and
- Train Management Guidelines.

Alcoa World Alumina Australia (Alcoa) has reviewed these proposed Part 5 Instruments and provides the attached comments in response to the request for public submissions issued by the ERA. Minor comments have been provided on the Train Management Guidelines and the Train Path Policy documents however the main issues in this submission relate to changes to the Costing Principles and the Overpayment Rules.

References in this submission in italics or section numbers in italics are references to the relevant text or heading numbers in the documents submitted by WestNet Rail.

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2. COSTING PRINCIPLES

The following comments are provided on two topics within the proposed Costing Principles dated December 2005.

(i) Allocation Proxy

In the Regulator's Determination dated 24 September 2003, of "Floor and Ceiling Costs to Apply to WestNet Rail", the last paragraph of Section 4.3 "Operating Costs and Working Capital" states that:

"The Regulator believes that the number of trains managed on a line (as a percent of total train movements) provides a fair indication of the intensity of management resources applied to the line. On the basis of the above arguments, the Regulator has accepted WNR's proposed methodology of using 100% train movements in the allocation of operating costs between route sections."

Whilst we understand the Regulator's statement above, we do not believe that the current methodology used to calculate the allocation to route section is an acceptable proxy for the allocation of costs.

From discussions at the time with the ERA[1], we understood that the methodology used is such that for each end-to-end train movement, every route section within that route is assigned the value of one train movement. The following example illustrates the issue:

CASE 1: Take for example the simple case of a train traversing a route A to E which consists of four route sections AB-BC-CD-DE. Using the current methodology adopted, each route section is given a "train movement value" of 1. Now, the route AE has a "train movement value" of 4. Using this allocation proxy, each of the four route sections would be allocated equal amounts equal to ¼ of the operating costs.

CASE 2: Now consider the case where the same route AE is broken up into only three route sections, namely AB-BC-CE (where CE equals CD plus DE in the previous Case 1). In this case, using the current methodology, as each route section is assigned a "train movement value" of 1, the route AE now has a "train movement value" of 3 and using this allocation proxy, each

[1] Note that details of the methodology are not included within the proposed Costing Principles document being reviewed.

of the three route sections AB, BC and CE would be allocated equal amounts equal to ⅓ of the operating costs. This is in comparison to the ¼ of costs previously allocated to AB and BC respectively and the ½ of costs which were allocated to the equivalent route section combination of CD plus DE in the previous Case 1. This is summarised in the table below.

Case 1 Route Section	Case 1 allocation of operating costs	Case 2 Route Section	Case 2 allocation of operating costs	Difference (Case 2 - Case 1)
AB	0.25	AB	0.33	0.08
BC	0.25	BC	0.33	0.08
CD	0.25	CE	0.33	- 0.17
DE	0.25			

Table: Summary of Case 1 and Case 2

The above example incorporating Case 1 and Case 2 shows that this allocation proxy changes as the number of route sections on the route change. Each route section within a route which is broken up into fewer route sections (e.g. Case 2 AB and BC) will each be allocated a higher percentage of the costs. Also if two route sections are combined (Case 1 CD and DE to CE), they can benefit from a lower total operating cost allocation.

Also, this method of allocation does not give any consideration to the length of the route sections within a route. Irrespective of route section length, each is given an equal operating cost allocation, resulting in short sections of line being allocated disproportionately high operating cost allocations compared to their other costs.

The issues with this allocation proxy are:

- As short route sections receive disproportionately high allocations, the ceiling prices on short route sections are artificially inflated. Operators requiring access to these route sections are unfairly treated.
- As branch or feeder (dedicated) route sections are generally short route sections and WestNet is to allocate access revenue to these route sections before allocating access revenue to shared route sections (refer to Overpayment Rules), this initial allocation which results in a higher ceiling price, allows excess revenue to be allocated to branch or feeder (dedicated) route sections and potentially allows WestNet to receive excessive revenue without triggering any overpayment.

We suggest that, whilst the number of trains managed on a line may provide a fair indication of the intensity of management resources applied to the line, it does not translate to a fair allocation at the next level down i.e. for a route section as it does not take into consideration the number and length of route sections.

(ii) Floor and Ceiling variation

Section 5.1 of WNR's Costing Principles states that:

"WestNet will index the Floor and Ceiling costs based on CPI less the "X" factor. CPI-X will not apply in the year that the GRV and operating costs are reset. The "X" factor will be set at one quarter of CPI for the second and third years. The Floor and Ceiling will be reset at the end of the third year based on a review of assumptions and movements in costs. The Regulator will monitor and access the movement in costs to determine an appropriate "X" factor for the years after the reset."

Alcoa maintains its view that the indexation of the ceiling should be based on CPI-X where X is a productivity improvement factor for the following two years and is not a defined percentage of CPI. The value of X should be set to reflect the ability of WestNet to achieve substantial productivity gains over the three years following a price reset.

On this basis, we suggest that the Costing Principles should be silent on the actual figure and refer to the ERA's determination therefore allowing a new "X" factor to be applied prior to any further review of the Costing Principles.

3. OVERPAYMENT RULES

The following comments are provided on the proposed Overpayment Rules dated December 2005:

1 Introduction

Correct typographical error on numbering 1 to 4

Explain the change to Bullet Point 1 at the end of *Section 1 Introduction* where Total Revenue is now defined over a route and not a route section (see extract below). This bullet point does not appear to make sense with the deletion of "section":

"Calculate the amount by which Total Revenue earned on a particular route [~~section~~] exceeds the Total Costs attributable to the route section and infrastructure;…"

2.7 Allocation of Non-Access Revenue

This section should be reworded to say that Non-Access Revenue will be calculated based on the definitions in the Costing Principles (Section 2.3 Gross Replacement Values sub heading *Contributed Assets*) as the revenue is an annualised equivalent of a lump sum payment. The allocation to a route section should be based on the proportion of the contribution utilised in that route section where it is spread over more that one route section.

Also *"Non-Access revenue"* should be capitalised as Non-Access Revenue as it is a defined term.

2.8 Allocation of an over-payment

Whilst the overpayment rules have yet to be tested, Alcoa is concerned with the wording of Section 2.8 Allocation of an over-payment. We have noted that the ERA will permit WNR and an Operator to reach agreement on a unique allocation arrangement provided this is contained within an Access Agreement and that under these circumstances, the Access Agreement terms would override the allocation required under the Overpayment Rules however we are still unclear as to how the process works.

Alcoa has previously expressed the view that using revenue over the entire route (or worse, multiple routes) does not provide an equitable allocation percentage for over-payments and that

the revenue apportioned to the route section should be used to calculate the over-payment on that route section. In other words, the particular route section that causes the over-payment should be the only route section used in calculating both the quantum of the over-payment and the allocation of that overpayment to the Operators using that route section.

Our continuing concerns are expressed in the following points:

(i) Section 2.8 Item 1

Item 1 suggests that:

"If an Operator can be identified as being responsible for triggering the overpayment, then the excess revenue will be allocated back to all operators on the entire route of that Operator."

It is unclear from this definition how a "trigger" event is identified and which Operator is considered to have caused the trigger. For example, if three Operators are using the SW Mainline and the revenue on a particular section is at 98% of the ceiling and a fourth Operator commences operations on a route that incorporates that route section and as a result the ceiling is exceeded – is the fourth Operator the cause of the trigger or was it the fact that the revenue from the other three was already high?

If the fourth Operator was the cause then *"the excess revenue will be allocated back to all operators on the entire route of that Operator"* implying that irrespective of the individual routes used by each of other Operators, it will be the fourth Operator's route which will be used for the revenue calculation. Does this mean that the other Operators must also be users of the fourth Operator's *"entire route"* in order to qualify or do they only have to be users of the route section that triggered the overpayment?

(ii) Section 2.8 Item 2

Item 2 suggests that if more than one Operator can be identified as triggering the over-payment , then the revenue will be calculated based on *"all of the routes of those Operators"* – presumably meaning the "triggering" Operators. Again it is unclear on what basis an Operator becomes a trigger or how more than one Operator can be a trigger.

The text here suggests that revenue from more than one route must now be included in the allocation formula but it is not clear what revenues are included. Do all routes of each of the "triggering" Operators which traverse the route section causing the overpayment become revenue for the purposes of the calculation of the allocation of the overpayment and which routes of the "non-triggering" Operators are included? How does this result in a fair allocation of the overpayment to any of the Operators who are not, in this case, "triggering" Operators?

(iii) Section 2.8 Item 3

Item 3 seems to be the more logical assumption of the three alternatives in that it assumes that it is not possible to identify the 'triggering' Operator and so the over-payment is allocated to all Operators using that route section. However, it seems unlikely that the use of all the routes of all Operators gives a fair outcome as the length of each of the routes of each Operator will determine in part the quantum of the revenue which in turn determines the percentage allocation of the overpayment. This provides an advantage to the longer haul Operator whose revenue contribution along the route may be much higher. It is our stated preference that only revenue on the route section which caused the overpayment should be used as the measure of the allocation.

(iv) Section 2.8 Last paragraph

On the basis that Section 2.8 Item 3 is the most likely scenario, the next paragraph is ambiguous – it states in part that *"the repayment will be apportioned based on the total annual Access Revenue received above the Floor for access by each Operator on the route as a proportion of the Total Access Revenue above the Floor for the route section."* There appears to be a mix of terms here – with route referred to first then route section referred to afterwards. Is this a typographical error or should it read that the Access Revenue of each Operator over the triggered route is divided by the Total Access Revenue over the same route – i.e. not route section.

(v) Last paragraph Section 2.8 typographical error:

"Floor Price test" should read Floor Price Test.

3 Overpayment Rules

The formula now being used to calculate the allocation percentage for return of overpayments has been simplified to include only Access Revenue and exclude contributions by private operators, government or third parties. Excluding Non-Access Revenue would be acceptable if the contributed asset leading to the Non-Access Revenue does not result in a change to the Access Revenue. Alcoa considers that in most cases there will be a resulting change to the Access Revenue and therefore the new formula will give an incorrect allocation. For example, If Alcoa were to contribute to an increase in line capacity by part funding a new passing loop and this resulted in an increase in Alcoa's access rate for that section of line, then Alcoa would seek to negotiate a discount on the new access rate equivalent to its contribution. As a result the numerator in the equation in Section 3 item 6 would be lower and the allocation % to Alcoa would be unfairly reduced.

The formula should not be changed and Non Access Revenue should be included as before.

Also Note (b) to Item 6 needs to be expanded to say that whilst only Operators operating inside are directly entitled to a share of the payments, Operators outside the Code may be entitled to payments through WNR under Item 13. The implication in Note (b) is that 100% of the overpayment goes to Operators inside the Code and this is not the case.

6 Definitions

The Economic Regulation Authority definition should be moved to be in alphabetical order again (being an update to Regulator).

4. TRAIN PATH POLICY

The following comments are provided on the proposed Train Path Policy dated December 2005:

(i) The definition of "Flexible Scheduled Train Path (Freight)" has now been included in the TPP and reflected in Access Agreements. However, the definition of "Train Path" in the TPP does not include "Flexible Scheduled Train Path (Freight)".

(ii) The TPP text in section 2.8(ii) uses the term "Fixed Scheduled Train Path" but this term is not defined and we believe is now obsolete.

(iii) In the definition of "Instructions", the term "Train Control Directions" is used but the definition is omitted.

5. TRAIN MANAGEMENT GUIDELINES

The following comment is provided on the proposed Train Management Guidelines dated December 2005:

(i) The definition of "Flexible Scheduled Train Path (Freight)" has now been defined in the TMG but the definition of "Train Path" in the TMG does not include "Flexible Scheduled Train Path (Freight)".