

***pacifc*national**



**REVIEW OF
WESTNET RAIL'S PART 5 INSTRUMENTS**

Submission To The Economic Regulation Authority

January 2006

1 EXECUTIVE SUMMARY

Pacific National welcomes this opportunity to respond to WestNet Rail's ("*WestNet*") proposed Part 5 Instruments ie Train Path Policy ("*TPP*"), Train Management Guidelines ("*TMG*"), Costing Principles and Over-payment Rules issued by the Economic Regulation Authority ("**Authority**") in December 2005.

Pacific National notes that WestNet do not appear to have substantially modified its Part 5 instruments from the previous versions. In reviewing these documents it is important to recognise their context, notably that Westnet as a vertically integrated operator has not granted any significant additional third party access to its network since its formation. In addition, it is useful to note that the ARTC will be submitting Access Undertakings to the ACCC in 2006. A timely further review of these Part 5 Instruments, say in the next two years, could facilitate helpful standardisation of policies across Australia.

Pacific National recommends a number of improvements to the Part 5 Instruments:

- It is inappropriate for WestNet to require an access seeker to demonstrate an underlying demand to justify seeking a train path. There is already protection in place to prevent hoarding of paths thus making this requirement redundant.
- Pacific National proposes a new category of train path. "Traffic Specific Capacity" for certain tasks that is similar to a Conditional Path but is allocated between specific operators closer to the day of deployment.
- It is inappropriate for Westnet to remove paths based on underlying demand, the use of traffic specific capacity should address WestNet's concerns.
- A more flexible approach to train management which moves away from the restrictive on time exit for on time train rules
- There is a need for greater transparency regarding access rates and that this can be achieved by posting existing average access rates
- Pacific National notes and endorses the Authority's recent recommendation to have its powers strengthened to guard against the vertically integrated incumbent price discrimination or price squeezing
- Over payments should be distributed across all operators including those with agreements negotiated outside the regime

Many of the concepts discussed are complex and Pacific National's would be extremely happy to discuss any of these ideas in more detail with the ERA and WestNet.

2 TRAIN PATH POLICY AND TRAIN MANAGEMENT GUIDELINES

Pacific National notes that WestNet does not appear to have substantially modified the Train Path Policy (“TPP”) or Train Management Guidelines (“TMG”) since the previous versions.

In reviewing these documents it is important to recognise their context, notably:

- WestNet is part of a vertically integrated above and below rail operator that has no incentive to voluntarily facilitate third party above rail operators on to the WestNet network.
- Since the formation of WestNet, Pacific National is unaware of any significant access granted to third party operators. The access agreements that currently allow competition on the Perth-Kalgoorlie standard gauge track have their origin prior to WestNet’s formation.
- A significant proportion of above rail movements on the WestNet network including all interstate traffic interact with at least one other and perhaps several other access providers. The largest of these providers is the Australian Rail Track Corporation (“ARTC”). ARTC will be submitting an Undertaking to the ACCC in the next few months which will apply on their network across Australia.
- Pacific National suggests that the Authority allow for another review of WestNet’s TPP and TMG in the medium term (say in two years time). By adopting this approach, WestNet and the Authority will have the opportunity of contributing to the standardisation of the approach to train management on a significant part of the Australian rail network.

Against this background Pacific National has reviewed the TPP and TPG and suggests below number of changes for the Authority’s consideration.

2.1 ALLOCATION OF TRAIN PATHS

It is inappropriate for WestNet to require an access seeker to demonstrate an underlying demand to justify seeking a train path as proposed in Section 2.2.1 of the TPP.

Pacific National knows from its own experience that new entrants are in a “Catch 22”:

- For an operator to contract a train path from WestNet it will need to demonstrate an underlying business;
- To demonstrate an underlying business may require a signed haulage agreement with a customer; and

- to sign a haulage contract with a customer requires demonstration of contracted train paths (and often this requires service in operation).

Therefore requiring an operator to demonstrate it has business to haul would often be sufficient to kill off an aspiring entrant.

If the purpose of WestNet's approach is to stop a party hoarding or otherwise unnecessarily accumulating train paths, there are already two protections in place to discourage this:

- take-or-pay charges; and
- The "use-it-or-lose-it" provisions in section 2.6 of the TPP

Combined, these are more than sufficient to protect WestNet from frivolous or non-genuine requests for train paths. This situation could also be mitigated against for certain traffics by the concept of Traffic Specific Capacity which we discuss below.

2.2 CONDITIONAL PATHS

It is helpful that WestNet recognises the need for flexibility in pathing through Conditional Paths. However, it is Pacific National's view that the TPP fails to fully capitalise on the efficiency benefits available from flexibility in that it allocates these flexible paths to a particular operator.

Pacific National's therefore proposes the creation of a new category of path which has the characteristics of WestNet's Conditional Paths, but is allocated to a specific operator through a purpose built mechanism closer to the day of deployment. This recognises, for example, that there may be a single port or customer that is the destination (or origin) for a type of traffic (eg grain) being supplied by more than one operator; it allows for specific coordination of activity to enhance efficiency. It also expressly removes the complexity that arises with WestNet's solution ie to "reallocate" paths if the business moves to another operator (either temporarily or permanently).

The proposed concept of Traffic Specific Capacity is similar to that used by the Hunter Valley Coal Chain Logistics Team ("HVCCLT") to allocate capacity on a constrained network across different operators in a flexible manner. It ensures that capacity is available to move a specific traffic and is allocated to the operator (currently either Queensland Rail or Pacific National) that is contracted by the end customer.

The HVCCLT starts with an assessment of the ships entering port and their load requirements. Most ships require a blend of coals from different mines and there is limited storage at the port. Train paths are allocated so that a cargo is assembled to efficiently load ships entering the port. Taking an extreme example, if a cargo had to be assembled from mines served only by Queensland Rail, for that day Queensland Rail would be allocated all the train paths.

Traffic Specific Capacity is only applicable to trains whose task is overwhelmingly dominated (eg 80% or greater) by a single commodity (eg grain, alumina etc). Traffic Specific Capacity is not appropriate for train services that have several customers (eg Intermodal services).

2.3 PERMANENT VARIATION TO SCHEDULED TRAIN PATHS

The procedure for varying scheduled paths outlined in section 2.4 of the TPP appears to be repeated in section 2.9. The procedure laid out in Section 2.9 is more appropriate as it allows both WestNet and the operator to seek a permanent variation.

The main concern with the formulation of section 2.4 is that the grounds deemed to be reasonable for refusal of a variation are both related to the track provider. While this is framed on an “inclusive” basis (ie further grounds could be added) it is unhelpful to couch these so conclusively in one direction. Clearly an operator would have legitimate business requirements that ought to suffice as a reasonable refusal to an alternative train path.

2.4 REMOVAL OF A TRAIN PATH

It is not appropriate, as stated in section 2.6 of the TPP, that all types of paths carrying any type of traffic can be removed from an operator on the basis of an underlying form of business moving to another operator.

Pacific National recognises the need for a method to deal with specific traffics where it is appropriate for path allocation to be linked to end customer contracts (the traffic Specific Capacity concept discussed previously). However, it is not appropriate to apply such a rubric to all train paths and raises very difficult questions as to who would judge when the underlying business had been lost (eg if the train is servicing several customers and one customer decides to use road instead of rail is this lost contract a trigger for the above rail operator to lose the whole train path?)

Pacific National supports the right of an end-user to hold an access contract, but this right must also be accompanied by the commensurate obligations. Pacific National therefore rejects the concept proposed by WestNet and suggests that its concept of Traffic Specific Capacity provides a better solution.

2.5 PRIORITY OF DOCUMENTS

Section 7 of the TPP state the order of preference between the TPP, TMG and Access Agreements negotiated under the Code. Pacific National is concerned that it is WestNet's view that the documents overlap and potentially conflict with each other. Pacific National proposes that WestNet ensure that when these documents are drafted that the potential for conflict is removed and when Access Agreements refer to TPP or TMG issues that they reference these documents rather than including clauses that might conflict with them.

2.6 TRAIN MANAGEMENT

The Train Management Guidelines are based on the familiar matrix with "on time" exit from the network for "on time" trains as the objective. To the extent that this is an appropriate set of rules for the management of trains, the set proposed by WestNet is reasonable.

However, it may be the case that "on time" exit for "on time" trains is not the most appropriate overriding objective for the management of trains in all instances. Pacific National has observed that:

- few trains are truly "on time" consistently across their journey;
- many trains interact with other parties (either discharge points such as ports or other networks eg ARTC) which impact substantially on the ability of a train to be on time and which are often not within the control of the train operator;
- the consequences of incidents occurring on a network (which may not be WestNet's) reverberate throughout the entire network eg a major incident in Sydney (RailCorp's network – not even adjacent to WestNet's network) can disrupt the turnaround of a train set heading west and thus cause a train to enter WestNet's network late. This may even impact the return service from Perth, thus it too it "late" but how would one attribute a cause or in some way mitigate this lateness?

The utility of "on time" exit for on time trains may or may not be important for individual trains, and such importance varies from day to day, dependent on the particular circumstance of

its markets. For example, it may be the case that an “on time” train will not be required at its ultimate destination until some time after its scheduled arrival. In such a case it would be inappropriate to delay other trains to ensure this one remained “on time”. However, it is unlikely that WestNet will be in a position to know such facts for all the trains on its network.

It is for this reason that, Pacific National suggests that there should be the opportunity for each operator to inform WestNet of its priorities on a “real time” basis so that the dynamics of the operator’s business can be taken into account “on the day”. To some extent this is supported by the communications required under TMG section 2.4, however the ability for the operator to provide more input into decisions regarding train movements would be an improvement.

The concept of “on time” running being *the* fixed criteria for path allocation is of concern to Pacific National. The practicalities of operating trains on complex networks dictates the use of a more flexible approach. An appropriate approach will take into account the impacts of operations across several networks and focus on minimising transit time.

3 COSTING PRINCIPLES AND OVERPAYMENT RULES

As stated in the Costing Principles:-

“The purpose of the Railways (Access) Act 1998 (“the Act”) and the Railways (Access) Code 2000 (“the Code”) is to establish a rail access regime that encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations.”

Pacific National understands that the majority of access charges are below the ceiling, being constrained by competition from other modes and affordability for the customer. Thus, Pacific National believes that a focus on non discrimination and avoiding price squeezes can bring the most benefit to end users by improving the competitive process. Pacific National notes that the *Final Report – Review of the WA Railways (Access) Code 2000* Recommendation 4 proposes to strengthen the Authority’s powers to review access rates to guard against these events occurring. The actual level of the ceiling is less important¹ in achieving competition and thus Pacific National’s comments on the costing methodology and over payment rules are reasonably brief.

3.1 THERE IS A NEED FOR GREATER TRANSPARENCY

Pacific National notes that the proposed Costing Principles are almost identical to the current principles. It is Pacific National’s view that there is a need for greater transparency in the application of the ceiling rate of return test.

Pacific National supports the recommendation by the Authority to the public release of floor and ceiling prices in addition to floor and ceiling costs². In addition, to address the issue of information asymmetry Pacific National recommends that the average access rate (stated in \$ / ‘000 GTKs) for all heavily trafficked routes also be released. This will provide a meaningful guide to a third party access seeker as to whether it should expect to be charged at the ceiling or somewhere significantly below the ceiling.

¹ However, it is not costless to have a high ceiling as noted in previous Pacific National Submissions, see for example “Submission to the ERA on the Review of the Western Australian Railways Access Code (2000)” March 2005.

² Final Report – A Review of the WA Railways (access) Code 2000; ERA – 23 September 2005, p58

3.2 RISK AND DISCRIMINATION

Pacific National still has some concern regarding the latitude WestNet has to offer different access rates to third party access seekers due to different “risk profiles”. The dimension of “risk” does not appear to be defined and the method of calculating how rates vary due to risk profiles is either not disclosed or non-existent. This provides little comfort to third party access seekers in regard to certainty or transparency. Pacific National requests that the definition of risk and the method by which it will be measured be stated publicly and that the percentage impact of differing levels of risk on access prices be disclosed by WestNet. If this request cannot be easily fulfilled it highlights the highly subjective nature of this condition and the fact that it is wide open to abuse by a vertically integrated incumbent.

3.3 CARRY FORWARD OF UNDER RECOVERY

As noted above, Pacific National is of the view that for a large number of the traffics on the WestNet network ceiling rates are set at unsustainable levels for vertically separated above-rail operators. This issue is compounded by using a GRV methodology which likely leads to a higher ceiling than an appropriate DORC estimate. The use of the under-recovery concept allows for rates to be established at even a higher level than the ceiling.

3.4 ELIGIBILITY OF OVERPAYMENT REBATES

It is Pacific National’s view that the overpayment reimbursements should be distributed to all operators not just those that operate under an access agreement negotiated under the Code. WestNet’s approach would diminish the incentives for an operator to negotiate outside the Code, thereby undermining the flexibility inherent in the design of the WA regime facilitating negotiation in and out of the Code. It is noted that under the current arrangements any payments in respect to non-regime Operators will be retained by WestNet. This significantly increases the incentive for WestNet to charge a rate above the ceiling (possibly by underestimating volumes) knowing that WestNet will keep all overpayments apportioned to third party operators who did not negotiate access under the Code.