

**SUBMISSION TO THE
OFFICE OF THE RAIL ACCESS
REGULATOR, WESTERN AUSTRALIA
IN RESPONSE TO
THE REQUEST FOR SUBMISSIONS RE:-**

**TRAIN MANAGEMENT GUIDELINES
STATEMENT OF TRAIN PATHS POLICY
COSTING PRINCIPLES
SEGREGATION**

DECEMBER, 2001

TABLE OF CONTENTS

ABBREVIATION USED IN THIS SUBMISSION	i
EXECUTIVE SUMMARY	ii
INTRODUCTION	1
.1 FreightCorp’s interest	1
.2 A brief description of FreightCorp	1
.3 The NSW experience	1
GENERAL COMMENTS	2
.1 Efficient and unbiased access	2
.2 Information parity	2
.3 Competition on above rail performance not on below rail assets.	2
TRAIN MANAGEMENT GUIDELINES	3
.1 Definitions	3
.2 Use of the Network in accordance with the Scheduled Train Paths	3
.3 Network Blockage	4
.4 Real time allocation of Train Paths	4
.5 Resolution of Prioritisation scheduled to Train Paths or to Trains and general Principles for Train Management	4
.6 Maintenance Provisions	4
.7 Management of daily issues related to Train Operations	5
.8 Disputes and Performance Monitoring	5
.9 Consultation and Review	5
.10 Network Access Provider’s Obligations	5
.11 Operator’s Warranty in Relation to Rolling Stock Standards	5
.12 Operator’s Warranty in Relation to Train Crew	6
.13 Operator’s Obligations	6
.14 Other	6
STATEMENT OF TRAIN PATHS POLICY	7
.1 Definitions	7
.2 Examples of Temporary Variations of Train Paths by the giving of instructions by WestNet	7
.3 Permanent Variations to Scheduled Train Paths by Agreement	7
.4 Repairs, Maintenance and Upgrading of the Network	7
.5 Removal of Train Path for Under Utilisation	8
.6 Cancellation of Services using Scheduled Train Paths	8
.7 Variation to Existing / Additional Train Paths	8
.8 Regulator’s Approval Required	9
.9 Competition for the Same Train Path	9
.10 Consultation and Review	9
COSTING PRINCIPLES PROPOSED GUIDELINES	10
.1 Gross Replacement Value	10
.2 Economic Life	11
.3 Allowable Return	11
.4 Annuity Calculation	11
.5 Definition and allocation of operating and maintenance costs	11
.6 Definition of Overhead Cost	12
.7 Ceiling Variation	12
SEGREGATION	14
1. General comments	14
2. WestNet’s access related functions and other functions	14

3.	Correspondence and Electronic Records	14
4.	Participation By Customers	14
5.	ARG Board	15
ATTACHMENT A		16
FREIGHTCORP MARK-UP OF WESTNET PROPOSED SEGREGATION ARRANGEMENTS		16
INTRODUCTION		2
	Background	2
	Preparation of Segregation Arrangements	2
BACKGROUND TO SEGREGATION ARRANGEMENTS		4
	Duty to segregate	4
	Section 31 Protection of confidential information	5
	Section 32 Avoidance of conflict of interest	5
	Section 33 Duty of fairness	5
	Section 34 Separate accounts and records	5
	Other segregation requirements	5
	WestNet's access related functions and other functions	5
CORPORATE STRUCTURE OF THE AUSTRALIAN RAILROAD GROUP		7
CONFIDENTIAL INFORMATION		8
	Correspondence and Electronic Records	8
	Costs and Revenue	10
	Information provided in the course of management reporting	11
CONFLICTS OF INTEREST		11
	Separation of Functions	11
	Role of the Boards of WestNet and ARG	12
DUTY OF FAIRNESS		13
SEPARATE ACCOUNTS AND RECORDS		13
OTHER MATTERS		14
	Measuring the effectiveness of segregation arrangements.	14
REVIEW AND CONSULTATION		14

ANNEXURES	14
Executive Committee Structure	14
Segregation of Information Systems	14
Segregation Arrangements to be adopted	16

Abbreviations Used In This Submission

ARG	Australian Railroad Group
AWR	Australia Western Railroad
FreightCorp	Freight Rail Corporation
IPART	Independent Pricing and Regulatory Tribunal
MPM	Major Periodic Maintenance
ORAR	Office of the Rail Access Regulator (WA)
QCA	Queensland Competition Authority
QR	Queensland Rail
RIC	Rail Infrastructure Corporation
RM	Routine Maintenance
TPO	Third Party Operator
WA	Western Australia

Executive Summary

This submission to the Office of the Rail Access Regulator (ORAR) is in response to the invitation to comment by 17 December 2001 on the draft Guidelines and Policies in relation to:-

TRAIN MANAGEMENT GUIDELINES
STATEMENT OF TRAIN PATHS POLICY
COSTING PRINCIPLES
SEGREGATION

Freight Rail Corporation (FreightCorp) has reviewed these Guidelines and Policies and provided detailed comments on issues based on FreightCorp's experience as an operator and access seeker in various regimes around Australia.

Introduction

.1 FreightCorp's interest

FreightCorp is a statutory State Owned Corporation owned by the NSW Government and constituted by the Transport Administration Act (NSW). We are required to operate commercially and provide a return to our shareholders. Our main business is the provision of rail based freight services as a train operator. FreightCorp does not own the infrastructure on which it runs trains, except for some terminals and marshalling yards. We depend on infrastructure owners such as Rail Infrastructure Corporation (RIC), Australian Rail Track Corporation (ARTC), Queensland Rail (QR) and Freight Australia to provide us with access to their track.

FreightCorp was created out of the formerly integrated State Rail Authority of NSW (SRA), in July 1996. Since its creation, FreightCorp has been a train operator in a vertically separated environment where the rail infrastructure owner does not have an interest in entrenching market incumbents and is required to provide access in an open, competitive and efficient manner. With this experience, FreightCorp believes that it is well placed to provide the Office of the Rail Access Regulator (ORAR) with an informed commentary on the positive and negative aspects of the proposed access policy and guidelines from the perspective of a train operator.

FreightCorp's vision is to be the premier provider of rail based customised freight transport solutions across Australia. That vision incorporates FreightCorp providing services across Australia including the Australian standard gauge network, Queensland's and Western Australia's narrow gauge network and Victoria's broad and standard gauge network. For this reason, FreightCorp has an interest as a rail access seeker on the WestNet Rail network. FreightCorp is committed to open competition in all market segments of the rail industry and welcomes the opportunity to provide this submission to the ORAR.

.2 A brief description of FreightCorp

Table 1 provides an overview of key elements of FreightCorp's business in the 2000/01 financial year.

Table 1: Overview of FreightCorp 2000/01

Employees		2,133
Traffic Task		89.0 m tonnes
Revenues		\$597.5 million
Profit After Tax		\$44.4million
Asset Base		
	Rollingstock	\$509.6 million
	Total Property, Plant & Equipment	\$764.4 million

Source: FreightCorp Annual Report 2000/01

FreightCorp currently engages in a number of different types of rail freight transport, ranging from intermodal containers to heavy haul bulk. Over the last two years, FreightCorp has expanded its geographic range of operations from our traditional NSW base to include services to Melbourne, and the haul of coal from Leigh Creek to Port Augusta in South Australia.

.3 The NSW experience

As mentioned above railway transport in NSW is a vertically separated environment where access is provided openly to a suitably accredited train operator. This separation occurred in 1996 and since that date the number of freight operators competing on the network has grown to approximately ten and approximately five operating on the vertically separated interstate network. This is in stark contrast to all market segments where there are vertically integrated incumbents responsible for managing access. In these instances, despite the effects of potential competition, there is only one operator (ie the incumbent). This situation will continue until mature and effective access arrangements have been developed.

General Comments

Our response to the ORAR Guidelines has been founded on a series of principles:

.1 Efficient and unbiased access

FreightCorp's fundamental concern regarding train scheduling and train control is that we would receive those services on an efficient and unbiased basis. Given WestNet/ARG's integrated structure, we believe that it is WestNet's responsibility to put in place a system of management of the network and its day to day operations that demonstrates overwhelmingly that WestNet will not disadvantage competitor train operators. FreightCorp believes this can be best achieved by following the example of Queensland where the provision of access and management of the network have been clearly separated and ring-fenced from the above-rail organisation.

In addition, the manner in which the access provider interacts with operators in the lead up to providing access and the administration of the access agreement must be consistent between the various operators. However, this should not mean that a third party must accept the standards dictated or unduly influenced by the related above rail operator.

.2 Information parity

With the history of a vertically integrated structure of WestNet/ARG, the physical proximity of the organisations, the shared information systems and the potential sharing of personnel, ring-fencing of information is likely to be breached. Where Third Party Operator (TPO) commercial information is known to AWR then commensurate information about AWR should be available to TPOs. This could include information about AWR's schedules and operating characteristics for its individual services.

.3 Competition on above rail performance not on below rail assets.

As services provided by the infrastructure asset owner have natural monopoly characteristics, there cannot, by definition, be competition for the provision of those services. It therefore follows that competition between operators should be based on the price and quality provided by the service that results from the organisation of above rail assets. Accordingly below-rail service should be equal for all parties and decisions made with regard to allocation of those services, service reliability and pricing should be transparent to all users.

Train Management Guidelines

.1 Definitions

The definition of “Instructions” is rather vague and ill defined. WestNet defines an “instruction” as meaning an instruction or direction which “ensure, facilitate or encourage...”. What legally is the test for “encourage?”

It goes on to say “..the proper, efficient, safe and lawful”. What does “proper” or “efficient” mean in this case? FreightCorp recommends that these terms be removed and that a phrase something along the lines of “with regard to the cost impact on operators...” be inserted in the Guidelines. The actions of train control are one of the major drivers of variable cost for an above rail operator and we recommend that this fact be recognised in the Guidelines.

In FreightCorp’s view Part (a) is vague to the point of meaninglessness and should be removed.

Part (b) of the definition should have the qualification of “Westnet considers upon the exercise of reasonable care are consistent..” removed and replaced with “Are consistent...”. To not make this change would mean that WestNet will have carte blanche to issue any direction or instruction they like as long as they consider it is consistent with the Guidelines. It would make the Guidelines almost irrelevant. The same issues apply to the definition of “Train Control Direction”.

Part (d) of the definition of “Instruction” states “does not include instructions and directions which: derogate from train paths”. The meaning and application of this test is unclear and ill defined.

.2 Use of the Network in accordance with the Scheduled Train Paths

The qualifications in clause 3.1 are problematic. In 3.1(b) WestNet qualifies its commitment to run services according to Scheduled Train Paths subject to “matters outside the reasonable control of WestNet...”. FreightCorp recognises that there may be times when circumstances arise outside of WestNet’s control and trains will not be able to run to scheduled paths. This qualification is however not very well defined and FreightCorp is concerned that it is open to misuse and abuse as the explanation for WestNet not being able to fulfil its commitment. Therefore to ensure clarity and certainty FreightCorp recommends that the phrase “matters outside the reasonable control of WestNet” be exhaustively defined so all operators and the Regulator know what it does, and does not, cover.

Clause 3.1 uses the term “late “ but it is not defined. On NSW freight lines and on-time presentation is generally deemed to be presentation within 15 minutes of schedule.

In this clause WestNet makes commitments concerning early running and late running trains. These commitments are desirable but should be qualified and made subservient to clause 4 .2 Resolution of Prioritisation scheduled to Train Paths or Trains.

As stated above, the actions of train control are one of the major drivers of variable cost for an above rail operator. In FreightCorp’s view WestNet has two prime areas of responsibility; infrastructure management and train control. For WestNet to state that it “is not responsible for any delay suffered or cost incurred by the operator complying with a proper Instruction....” is an untenable proposition when the definition of “Instruction” is so broad.

.3 Network Blockage

FreightCorp accepts the need from time to time to accept directions from WestNet to clear incidents involving other operators. We would however recommend a modification to the Network Blockage clause 3.2. In FreightCorp's view to minimise disruption and ensure smooth running of the WestNet should not issue an instruction involving "Call Back"...ie no borrowing of loco's from a train which has already passed the point of blockage except in Emergencies, or by agreement with the Operator.

It is also important that WestNet take into account the relevant business criteria involved in making a decision to use the resources of one operator to clear the equipment of another operator from the network. For example, if two locomotives are equally suited to clear the network, but one train is more urgently required to deliver its cargo than the other, then such priorities should be considered. This necessarily means that there should be agreed processes for the management of such situations, including, where appropriate, reasonable consultation.

.4 Real time allocation of Train Paths

Clause 4.1 makes reference to the "Rail Access Management System" which records all train movements on the Network. It is FreightCorp's understanding that WestNet will give each operator access to information on its own train movements. The guidelines need to make this obligation clear.

To assist operators in running their operations as efficiently as possible and inline with the schedule, and to improve transparency of train management FreightCorp requests access to real-time data feeds from the train control system. It would certainly be inequitable if AWR had access to the output of this system and other operators could not. It is FreightCorp's view that all operators should have real-time read-only access to the system. Other access providers such as RIC and QR have offered to provide access to such real-time information.

.5 Resolution of Prioritisation scheduled to Train Paths or to Trains and general Principles for Train Management

FreightCorp endorses the use of a train priority decision matrix for train control. However the matrix presented in clause 4.3 is not sufficient for the task. While it resembles the matrix agreed upon for the Queensland regime by the QCA it has empty boxes representing various scenarios. Can WestNet do anything it wants in these situations? Furthermore there is "Rule 4" listed under the matrix but not referred to by the matrix. FreightCorp recommends that the train decision matrix endorsed by the QCA be approved for the Train Management Guidelines.

To bring to life the principles in the matrix FreightCorp's experience has demonstrated that it is imperative that all Train Control operators are properly trained in the use of the agreed matrix and are shown to be conforming to it, before commencement of operations for third party operators on WestNet network. **A statement to this effect should be included in the Principles.**

.6 Maintenance Provisions

As the infrastructure manager, WestNet must have in place a possessions management process which outlines what maintenance, upgrades etc and subsequent closedowns it intends to put in place. FreightCorp would expect that going forward, all operators in the network would be involved in its formulation and be aware well ahead of time what is planned.

There may however be times when due to some emergency WestNet must depart from this plan. It would appear that is why WestNet has included in clause 4.4 "WestNet may, without notice to the operator, perform repairs...". FreightCorp recommends that the use of this option be more tightly defined to specify that it is only invoked "for urgent safety reasons". To not have such a qualification in the clause allows WestNet to completely disregard its own possession plan at any time for any reason. Furthermore WestNet should give regard to the cost impact on operators of any such possession.

.7 Management of daily issues related to Train Operations

Clause 4.6 states that daily issues will be managed in accordance with the “WestNet Rules” and the relevant access agreement. “WestNet Rules” is an undefined term and is presumably what ever rules WestNet decides it will operate to and can be changed at their discretion. FreightCorp recommends that as a minimum these rules be disclosed for stakeholder’s scrutiny and that the process by which they can be modified be elaborated. As the clause is currently written it suggests that apart from what is specified in the relevant access agreement WestNet can manage daily issues in any way it wants.

.8 Disputes and Performance Monitoring

FreightCorp endorses the establishment of a Key Performance Indicator (KPI) regime .

.9 Consultation and Review

The proposal put forward by WestNet concerning review of the guidelines is inadequate. The Guidelines are in place to ensure equity between the incumbent vertically integrated operator and all third party operators. Any analysis of the effectiveness or otherwise of the Guidelines can only be performed in light of a third party operator’s experience on the Network. Therefore FreightCorp recommends that a review of the Guidelines be carried out one year after commencement of a third party’s operations on the Network. This review is to involve all operators on the Network, WestNet and the Regulator.

Furthermore FreightCorp recommends that any material changes to the policies and procedures must be subject to a review process similar to that undertaken in the development of National Codes and Australian Standards which includes dispute resolution involving expert determination.

.10 Network Access Provider’s Obligations

Clause 7.1.3 should in FreightCorp’s view have as an overarching principle that WestNet should warrant to maintain and operate the track infrastructure in a safe and cost-effective manner consistent with good practice. Furthermore it should remove restrictions placed on the network as soon as possible and, failing that, state to the Regulator and above-rail operators what date they will be removed. This is crucial because the accumulation of weight and speed restrictions over one or more network segments can have a serious detrimental impact of above-rail operators’ ability to perform their contracted freight task and can result in increases in many costs from crewing through to capital charges.

Operating incidents that affect train crew and rollingstock should also be considered in clause 7.1.3 (f) rather than just passengers and freight.

.11 Operator’s Warranty in Relation to Rolling Stock Standards

FreightCorp questions why the proposed Guidelines requires that the operator will “warrant” many actions but WestNet itself does not warrant its obligations. Furthermore Clauses 7.1.4 and 7.1.5 are largely redundant as it is mostly covered under an operator’s accreditation. FreightCorp however endorses the adoption of the Draft Codes of Practice as the standard to which all operators must adhere and it is the expectation of FreightCorp that it will be the standard which accreditation authorities will expect adherence.

.12 Operator's Warranty in Relation to Train Crew

The meaning of "instruction 141" is undefined. Undefined terms need to be defined in the Guidelines before they are approved. Furthermore these terms need to be defined before stakeholders can meaningfully comment on the Guidelines.

As a general principle, FreightCorp would not be able to accept any proposition based on documents to which we do not have access. If the Train Management Guidelines are to include a reference to other documents, then FreightCorp would recommend that the ORAR refuse to accept the guidelines unless:

- β The guidelines provide for the referenced documents to be available to access seekers, and
- β The guidelines provide a mechanism whereby the amendment of such documents provides for the ORAR to have the ability to approve or disapprove of such amendments.

.13 Operator's Obligations

Clause 7.1.6 (h) makes no mention or provision in regard to the potential cost impact of changes to communication equipment. These costs can be substantial and stakeholders should have involvement in a process of meaningful consultation in regards to any proposed changes that includes a consideration of the commercial effects of such changes. (see Consultation and Review section .9)

Clause 7.1.6(i) is an open ended requirement to provide information that FreightCorp would find onerous and objectionable. It is noted that WestNet has been reluctant to provide even standard infrastructure detail to operators up until present, and the requirement to provide "any information related to the operation of the Services (excluding commercial information) as WestNet reasonably require[d]" by WestNet merely increases the information asymmetry between the parties.

.14 Other

The process whereby scheduled train paths become paths available on the day for operators to use has not been adequately described and detailed.

Statement of Train Paths Policy

.1 Definitions

The definition of “Train Path” would appear to be confused with the definition of “Scheduled Train Path”. The Train Path definition refers to an “entitlement to operate” whereas it is a feasible path for a train, not necessarily utilised. Accordingly not every “Train Path” would be described in the Access Agreement. An alternative definition could be:-

Train Path means the series of Track segments over a particular time interval through which a Train can travel and may include stopping points and intervals and fuelling stations and other set down or changeover points

The meaning of the term “Conditional Train Paths” is obscure and the term would appear to be superfluous. In FreightCorp’s view there are two types of train paths, that is Scheduled or Unscheduled. Section 3.2 should be accordingly modified.

.2 Examples of Temporary Variations of Train Paths by the giving of instructions by WestNet

In clause 3.3 WestNet has too much freedom to vary train paths. As paths can be varied for any “potential” breaches of WestNet’s Network Rules, etc the operator has no certainty of operation and relies on the unbiased and equitable operation of Network Control. This is a concern for a Third Party Operator confronted with a vertically integrated access provider.

Clause 3.3 goes on to say “the instructions may comprise, but need not be confined to...” . The qualification of “need not be confined to” means that WestNet can issue any instruction for the operator to do anything. This is far too broad and open-ended and should be removed. The instructions that WestNet can issue should be tightly defined and the principles outlining when they are issued need to be detailed.

.3 Permanent Variations to Scheduled Train Paths by Agreement

Clause 3.4 has, in FreightCorp’s view some deficiencies. In paragraph (v) it states that parties to the agreement will consent to variations with “such consent to be withheld only upon reasonable grounds”. The use of the term “reasonable grounds” is not defined and needs to be made more specific.

This clause states that “The requesting Party must give not less than 30 days notice of a variation request.” There should be no minimum length of time of notice for lodging a variation, only a maximum time by which the Notified Party must respond. It is incumbent on the Requesting Party to request any variation with enough allowance for the full response time limit to be reached.

Therefore, for example, if an operator wished to vary a path it intends to operate on 29 January it needs to make the request by 1 January to allow a 28 day response time. A request could be made at any time up to 29 January but the access provider would then be under no compunction to respond before 29 January. However if it was a simple request it would allow the operator to make the request re a 29 January path on say 14 January and for WestNet to respond prior to 29 January.

.4 Repairs, Maintenance and Upgrading of the Network

The operator’s need to be consulted and involved in the possession planning process of WestNet. If this occurs then each operator will have sufficient time to plan for any possessions. The definition of “reasonable time” is not specific and

needs to be defined. The length and frequency of delays will influence an operator's stockpiling at both terminals.

Furthermore there is a need to develop a performance regime with rewards and penalties in regard to possessions management. This will drive WestNet to improve their infrastructure quality monitoring and planning.

Clause 3.5 needs to be rewritten so that it is only for reasons of "urgent safety" that WestNet may without notice take possession of the network at any time. For any other reason WestNet will be able to provide the operators with weeks of notice of proposed possessions.

.5 Removal of Train Path for Under Utilisation

Clause 3.6 defines a service as not being operated if the operator has failed to operate its train "in conformance with.....times set out in the Scheduled Train Paths". As it is written this could be interpreted to mean that trains that are late (or early) in presenting or arriving by even just a few minutes are not in conformance and therefore deemed to have failed to operate. In FreightCorp's view the definition of "failed to operate" has to be objectively defined so as to avoid this potential interpretation. The QCA have the concept of "allowable variation" around times which may be useful for the ORAR to employ in defining this concept. We also note that the QCA saw fit in Queensland to impose an obligation on the access provider to demonstrate that there existed a genuine alternative use for a path before it was allowed to remove it from an operator. It is FreightCorp's view that the requirement to demonstrate this alternative use is an important safeguard to avoid "game-playing" by the access provider in a situation where common ownership cannot help but raise the prospect of a conflict of interest.

The trigger for the resumption of a path is significantly more stringent than that proposed in Queensland and has the nature of a "hair-trigger" once the initial three services are missed. FreightCorp would recommend the adoption of the resumption process articulated by the QCA.

Furthermore this clause should have a "resumption right" of train paths for WestNet. These resumption rights would differ from removal for non-use as they would apply to situations when an operator loses the contract to move freight for a customer.

To allow another operator to compete for above-rail business the paths that are required to move freight for existing customers should be able to be resumed by WestNet if the above-rail operator performing the task loses the contract. The paths can then be re-assigned to the operator that wins the business. This resumption right differs from a non-use provision as the trigger for non-use requires a passage of a number of months before it can be invoked whereas resumption rights will give potential operators the access certainty required to bid for business.

FreightCorp commends the QCA final draft decision in regard to resumption rights to the ORAR.

.6 Cancellation of Services using Scheduled Train Paths

The clause 3.8 gives five reasons why an operator may cancel a Service. Subsection (b) allows cancellations of up to 5 times a year. This is a very low level of cancellation in particular when compared to say a daily service in which it would equate to 1.4% of services. FreightCorp recommends that similar to the proposed ARTC regime and agreements in other jurisdictions that up to 10% of scheduled paths can be cancelled with no penalty.

.7 Variation to Existing / Additional Train Paths

The first line in clause 4.2 refers to "variation" should be amended to read "variation or addition" in line with the last paragraph of this clause.

.8 Regulator's Approval Required

The intention of this clause is unclear to FreightCorp. What does "preclude other entities from gaining access to that infrastructure" mean? Any allocation of train paths will preclude another operator from using the same train paths. Is the intention that the allocation of the last paths available on a section of track requires approval?

The intention and operation of this clause requires clarification.

.9 Competition for the Same Train Path

The awarding of train paths to the first operator to request a path may be contradictory to an open access regime which promotes above rail competition. This may be the case when new business is being put out to contract by a customer. If one operator becomes aware of the likelihood of this occurring they will rush to claim paths for this business prior to it being awarded and therefore potentially deny another operator access to the network. This scenario is another example of why a strong resumption right needs to be imbedded in the policy.

In a scenario such as this one it is FreightCorp's view that ideally WestNet would provide letters of intent to each operator confirming the paths being allocated conditional on the awarding of the business to that operator. FreightCorp also commends Schedule G of the Queensland Draft Undertaking (October 2001) as an approach to Network Management Principles.

.10 Consultation and Review

The proposal put forward by WestNet concerning review of the Policy is inadequate. The Policy is the right place to ensure equity between the incumbent vertically integrated operator and a third party operator. Any analysis of the effectiveness or otherwise of the Policy can only be performed in light of a third party operator's experience on the Network. Therefore FreightCorp recommends that a review of the Policy be carried out one year after commencement of a third party's operations on the Network. This review is to involve all operators on the Network, WestNet and the Regulator.

Costing Principles Proposed Guidelines

.1 Gross Replacement Value

As highlighted in our submission to the National Competition Council (NCC)¹ ("**NCC Submission #1**") the NSW Independent Pricing and Regulatory Tribunal recommended the use of Depreciated Optimised Replacement Cost (DORC) approach for valuing assets. Since the time of that recommendation "there is a general trend amongst regulatory bodies in Australia to adopt the" DORC methodology.² The DORC approach has also been adopted by Queensland, by the NCC for the Australasia regime and will soon be adopted by the Australian Consumer and Competition Commission (ACCC) for use in valuing Australian Rail Track Corporation's infrastructure.

In FreightCorp's view the criteria for adoption of a valuation methodology is that it provides a balance between low access prices which still provide an appropriate economic return for the asset owner on their initial investment and incentive to maintain and upgrade the track as required. If access prices are too low there is the potential that an infrastructure owner will close lines. If access prices are too high some freight will be moved by road, vertically integrated access providers can deny above-rail competition and economic growth in a State will be reduced with a subsequent reduction in job growth. It is FreightCorp's view that the Gross Replacement Value (GRV) methodology provides a significantly higher return to WestNet than is required to achieve the objectives defined above. This is especially so when WestNet's proposed application of the GRV approach is examined.

WestNet's proposed Costing Principles states "...it is assumed that the infrastructure is new."³ This is a nonsense as the infrastructure is not new and it is contrary to the Railways (Access) Code 2000 ("Access Code"). It suggests that no piece of track will have to be replaced in the next 20 years as all the track is "as new" and the economic life (which would have to be shorter than the technical life) is defined by WestNet as 20 years.⁴

It also raises the question of how depreciation is to be treated. The Access Code includes depreciation as a component of "capital cost". However it would be double counting for WestNet to be charging to Routine Maintenance and Major Periodic Maintenance (RM and MPM) which they claim is being performed at a level that keeps the track equivalent to brand new while also charging for depreciation and valuing the network at gross replacement value. It would be instructive for WestNet to disclose the depreciation rates they have been applying in their internal accounting on the book value of their infrastructure.

FreightCorp recommends that the ORAR recognise that the use of GRV also requires the recognition that there are no maintenance or depreciation costs to be taken into account (as the assets are all brand new) and disallow the use of such costs in determining the ceiling.

WestNet claims that it knows what market costs are for capital work and therefore has the information to determine what the unit rates are for calculating capital costs. In the interests of transparency FreightCorp recommends that WestNet presents these rates for public scrutiny. To not do so is the equivalent of stakeholders agreeing to WestNet's exhortation, "We know how much things cost. Trust us!"

¹ Submission to the National Competition Council in Response to the Application for Certification of a Rail Access Regime by the Western Australian Government ("NCC Submission #1") May 1999, p14

² Report on Review of ARTC's Access Undertaking Submission to ACCC, Currie & Brown, November 2001, p3

³ Costing Principles, WestNet Rail, 15 November 2001, p 5

⁴ Costing Principles, WestNet Rail, 15 November 2001, p 12

It appears that WestNet wishes to include a profit and risk margin for construction of its own assets and then claim a Weighted Average Capital Cost (WACC) return on that margin. It is FreightCorp's view that the WACC already includes a profit and risk component and that WestNet's proposed approach is a doubling up of returns.

WestNet has proposed a WACC of 11% for construction cashflows. WestNet have provided no basis for its departure from the Regulator's determined 8.2% allowable return. The Regulator's determined WACC has been calculated with regard to WestNet's capital structure and risk profile and its cost of equity and debt. There is no valid reason for WestNet to impose an 11% WACC to construction cashflows.

.2 Economic Life

As suggested above it is incongruous for WestNet on the one hand to assume its infrastructure is new due to its maintenance policies and then suggest that the infrastructure has a finite life. Perhaps it suggests that WestNet will be substantially reducing its RM and MPM going forward and therefore access seekers should expect a substantially lower cost for these items being incurred by WestNet than in previous years.

Furthermore FreightCorp would suggest that WestNet's table⁵ included is a list of the technical life for various asset classes not economic life. An economic life table would require an analysis of how long the network will be economically viable and in use, in particular sections of the network servicing mines, which in turn would require an analysis of mine life.

.3 Allowable Return

The WACC of 8.2% is in FreightCorp's view a reasonable rate of return and is reasonably consistent with the rates allowed in other jurisdictions around Australia.

It is worth noting that the price paid by ARG for the combined AWR and WestNet assets is well below the gross replacement value attributable to the WestNet network. It is therefore a fact that the allowable rate of return under the GRV valuation will return a hugely inflated return on the investment actually undertaken by WestNet. With this in mind, it provides WestNet with a significant level of freedom to differentially price those routes that it believes might be subject to competition compared to other routes. This, coupled with the ability of its sister company AWR to marginally price has the potential to significantly distort the market for the provision of above rail services.

While it is understood that the ORAR has limited discretion in nominating the valuation methodology, it is FreightCorp's view that the ORAR does have the power to nominate an appropriate rate of return. It is FreightCorp's view that such a rate of return should be determined to ensure that the use of the ceiling rate should not allow for the distortion of the market for the supply of above rail services.

.4 Annuity Calculation

The Costing Principles are vague on the definition and calculation of the "annuity". Some worked examples are required to ascertain WestNet's proposal.

.5 Definition and allocation of operating and maintenance costs

In the interests of transparency FreightCorp recommends that WestNet presents these costs for an independent audit.

⁵ Costing Principles, WestNet Rail, 15 November 2001, p 12

.6 Definition of Overhead Cost

WestNet claims it has “an efficient overhead structure”⁶ but then goes on to state that it is provided with certain corporate overhead functions by Australian RailRoad Group (ARG)⁷. FreightCorp questions if these functions are being provided on an efficient cost basis and would call upon the Regulator to review how ARG assesses and allocates its costs to WestNet. There also needs to be more information about how these costs are translated into access charges.

.7 Ceiling Variation

This proposed CPI-linked price escalation formula will act as a deterrent to rail transport and does not reflect the efficiencies that WestNet will achieve over time. Applicants and the public generally are sensitive to the fact that freight prices are not keeping pace with inflation, and that CPI-linked increases to input prices, such as the rail access price, will work against rail’s viability as a transport mode.

Every organisation is now expected to experience a rising level of productivity over time. This is often the result of improved work practices and the introduction of new technology. It is unrealistic that WestNet should be immune from the expectation that these efficiencies should be provided however WestNet is released from this expectation if the ceiling price varies due to CPI.

Furthermore this ignores the efficiencies that WestNet will experience with the increase of traffic over time. Infrastructure related businesses are by their nature high-fixed cost businesses which experience disproportionately large increases in profit margins for small increases in utilisation. Increases in utilisation occur, to a large degree, due to no action by WestNet itself. It is unreasonable that as WestNet experiences this efficiency improvement through little or no effort of its own that it can continue to increase the ceiling charges by CPI.

The automatic CPI-linkage of the ceiling charges should be replaced with either a commitment to maintain constant nominal prices or, if an index must be used, that index should be related to bulk haulage pricing. The CPI, which incorporates price movements in things such as clothing and vegetables, is not a relevant index to be applying to below-rail access charges.

.8 Calculation of Regulatory Ceiling

There appears to be a major anomaly between the Access Code and the Costing Principles proposed by WestNet. In its application of a ceiling pricing approach “WestNet will adopt one Regulatory Ceiling”.⁸ However the Access Code states :-

*An operator that is provided with access to a route and associated railway infrastructure must pay for the access not more [sic] than the total costs attributable to that route and that infrastructure.*⁹

All other rail access regimes in Australia have ceiling tests that are calculated by route or segment. WestNet appears to be suggesting that it will have one regulatory ceiling for the whole network. This appears to be anomalous and contradictory to the Access Code and needs to be clarified.

.9 General

In the interest of transparency it is FreightCorp’s view that all of WestNet’s cost allocations and resulting access charge schedule for all operations on the whole

⁶ Costing Principles, WestNet Rail, 15 November 2001, p 9

⁷ Costing Principles, WestNet Rail, 15 November 2001, p 9

⁸ Costing Principles, WestNet Rail, 15 November 2001, p 10

⁹ Railways (Access) Act 1998, Railways (Access) Code 2000, Schedule 4 Clause 8 (1)

Network be reconciled with its financial accounts to the satisfaction of the Regulator. This will limit any potential mis-allocation of costs or loading of costs on to a particular access seeker.

Segregation

1. General comments

FreightCorp has reviewed the Segregation Arrangements proposed by WestNet and found them, at their best, to be aimed at providing a minimum level of compliance with its legal obligations under the Act. At worst the Arrangements will be ineffective and not meet WestNet's obligations under the Act.

FreightCorp details its concerns about the Arrangements in the comments that follow and in Attachment A which is a mark-up by FreightCorp of WestNet's proposed Segregation Arrangements.

2. WestNet's access related functions and other functions

WestNet claims to have "no other function than provision of access...". While this statement is clarified later in the clause, it is misleading and should be changed to read something like:- "WestNet is responsible for the management of the infrastructure, network control and access to the Network."

In regard to the provision by Australia Western Railroad (AWR) of train scheduling services questions arise concerning whether any of AWR's narrow gauge scheduling services can assume priority over potential freight operations of a third party operator, and if so what are the interface guidelines, delay penalties, etc.?

We note that clause 2.3 of the Segregation Arrangements (page 4) suggests that "all of the functions in 1 and 2 above are performed directly by WestNet (or using contractors or agents under its direct control)" and that "the test of separation of functions has been adequately met". However, in the preceding paragraph, WestNet identifies that key functions are in fact carried out by AWR. If this is the way in which WestNet regards its obligations towards separation, then FreightCorp predicts that no third party operator will seriously consider competing on the WestNet network.

3. Correspondence and Electronic Records

Having WestNet and AWR in the same building and separated by only one floor does not in any way lend itself to either a perception or reality of true independence. One is again drawn to a comparison with Queensland where Queensland Rail Network Access Group's office is in a different building to Queensland Rail's offices.

Furthermore the password protection proposed by WestNet would need to be supported by a high integrity security system that was easily and regularly auditable by the Regulator.

4. Participation By Customers

FreightCorp has had much experience in seeking to gain above rail business in a vertically integrated rail system. One of the key issues that affect the willingness of customers to offer business to potential new operators is their concerns regarding the reaction from the incumbent service provider.

It is almost inevitable (except where an operator has existing equipment of the right specification to operate on the WestNet infrastructure) that it will take up to two years, for a new operator to be able to commence services. It is most unlikely that any new operator would invest in equipment without having secured firm haulage contracts. This leads to the situation where the customer must commit to a new operator for a long time in advance of when that operator can provide the services. FreightCorp's experience has shown that customers are fearful of retaliation from the incumbent through either poor service, or even the potential withdrawal of

services during the intervening period. Such fears are sufficiently powerful to deter many potential customers from making the transition to a new operator.

Even if a potential customer is willing to consider the transition to a new operator, the potential for information regarding such a move to become available to the current service provider is a significant barrier to be overcome. Such things as chance comments in **the building foyer or lifts** between two former colleagues are sufficient for the confidential aspirations of a customer to become known to the current operator. It is therefore extraordinary that WestNet should consider mere separation of floors as sufficient separation to safeguard confidentiality. It does not even provide the appearance of separation.

5. ARG Board

We note with concern the fact that the ARG Board will have members of both the AWR and WestNet Boards. It is inevitable that confidential information provided to the ARG Board will affect the decisions made by the AWR director when considering issues affecting AWR. We find the statement in clause 5.2 that the proposed arrangement means that “[t]here can be no conflict of interest that arises in this situation” is disingenuous at best. The fact that two members of the same Board (ARG) share confidential information regarding each others’ businesses which happen to be separated in order to enhance the chance of competition must be seen as a conflict of interest and at the very least leads to the suspicion that information will be exchanged that is detrimental to third parties.

The claim by WestNet in clause 5.1 that “there is therefore no conflict of interest” is at best a naïve understanding about the manner in which competition must be managed in such an environment. The very perception by customers of the common ownership of AWR and WestNet inevitably leads to the expectation that there is a conflict of interest between those two parties.

It is FreightCorp’s view that there is a requirement on the part of ARG to demonstrate a clear and unambiguous commitment towards the genuine separation of the two organisations through:

- β Imposition of a comprehensive ring-fencing policy,
- β An undertaking by the ARG directors who are on the AWR or WestNet Boards to absent themselves from (AWR or WestNet) Board discussions where issues regarding the other organisation are discussed, and
- β Physical separation of the two entities such that there is unlikely to be regular casual interaction between the employees (eg similar to QR Network Access Group, moving one organisation to a different part of Perth).

Attachment A

FreightCorp Mark-up of WestNet Proposed Segregation Arrangements

Segregation Arrangements

[WestNet Rail Logo]

November 2001

	Contents		10.2	Segregation of Information Systems	14
1	INTRODUCTION	2	10.3	Segregation Arrangements to be adopted	16
1.1	Background	2			
1.2	Preparation of Segregation Arrangements	2			
2	BACKGROUND TO SEGREGATION ARRANGEMENTS	4			
2.1	Duty to segregate	4			
2.2	Other segregation requirements	5			
2.3	WestNet's access related functions and other functions	5			
3	CORPORATE STRUCTURE OF THE AUSTRALIAN RAILROAD GROUP	7			
4	CONFIDENTIAL INFORMATION	8			
4.1	Correspondence and Electronic Records	8			
4.2	Costs and Revenue	10			
4.3	Information provided in the course of management reporting	11			
5	CONFLICTS OF INTEREST	11			
5.1	Separation of Functions	11			
5.2	Role of the Boards of WestNet and ARG	12			
6	DUTY OF FAIRNESS	13			
7	SEPARATE ACCOUNTS AND RECORDS	13			
8	OTHER MATTERS	14			
8.1	Measuring the effectiveness of segregation arrangements.	14			
9	REVIEW AND CONSULTATION	14			
10	ANNEXURES	14			
10.1	Executive Committee Structure	14			

Introduction

Background

WestNet Rail Pty Limited ("WestNet"), a wholly owned subsidiary of the Australian Railroad Group Pty Limited ("ARG"), is the manager of the leases of the freight rail infrastructure network in Western Australia, previously operated by the State Government owned Westrail.

The Railways (Access) Code 2000 ("the Code") requires certain parts of the rail network managed by WestNet to be made available for access by third party rail operators. Schedule 1 of the Code lists the sections of the WestNet rail network covered by the Code.

With the appointment of an Acting Rail Access Regulator with effect from 1 September 2001 and the proclamation of the Code, the Code is now effective in all respects.

Preparation of Segregation Arrangements

The Railways (Access) Act 1998 ("Act") requires that WestNet prepares and submits to the Regulator the Segregation Arrangements it proposes to adopt. The Arrangements will be subject to a period of public consultation, after which the Regulator will approve or determine the Arrangements.

FRC Comment: Minimum Requirements for Segregation

It is apparent from WestNet's proposed segregation arrangements that it intends to introduce a segregation regime which is aimed at minimum compliance with its legal obligations under the Act. FreightCorp believes that this is, not only disappointing, but a possess a serious threat to third party operators having the confidence to seek to break in to the WA above rail market. In that regard, FreightCorp endorses the comments of the Queensland Competition Authority (QCA) report on the QR Access Undertaking where the QCA states:

"As a vertically integrated operator, QR could potentially use its monopoly power in the below rail market to gain an unfair competitive advantage in the above rail market...The QCA believes that third party operator's perception of this potential problem could seriously undermine confidence in the above rail-market which would distort the evolution of this market. In the QCA's view, the perception problem underlines the importance of QR having credible ring-fencing arrangements in the eyes of third party operators such that these operator's have confidence that QR's capacity to exploit an unfair competitive advantage is appropriately constrained".

FreightCorp is concerned to ensure that WestNet puts in place appropriate segregation requirements that effectively manage this issue. In this regard, it is disappointing to note that WestNet's Segregation requirements do not meaningfully reflect the entirety of WestNet's obligations under clause 28 of the Act; that clause requires that WestNet "must make arrangements to segregate its access-related functions from its other functions" and in doing so it must "ensure that the measures in place [to do so] operative effectively and are complied with". WestNet's Segregation Arrangements do not comply in any way with this obligation. As a result, FreightCorp believes that the Arrangements should not be approved by the Regulator in their current form.

FreightCorp urges the Regulator to have regard to the findings of the QCA in relation to the QR ring-fencing arrangements. FreightCorp considers that the principles for effective ring-fencing arrangements are an appropriate and useful guide for the Regulator to have regard to when forming its position on the Segregation Arrangements. The key principles endorsed by the QCA are as follows:

- Ring-fencing arrangements must deal with perceived and actual conflicts of interest arising as a result of vertical integration of above and below rail functions;
- Those arrangements should be subject to external audit and the arrangements themselves should establish enforceable rights and obligations under the Access Undertaking (with penalties applicable for a breach of those arrangements);
- The ring-fencing arrangements should include mechanisms to ensure that (I) Train control functions remain within WestNet; (ii) Any organisation change that may affect the efficacy or operation of the segregation arrangements should be submitted to the Regulator for approval prior to implementation; (iii) Confidential Information is adequately defined and there are clear obligations on staff to keep information confidential between the above and below rail groups; (iv) There is adequate training (and monitoring of compliance) of staff in relation to the ring-fencing arrangements; and (v) External advisors used by the above and below rail groups should wherever possible be separate.

FreightCorp endorses the QCA approach in relation to the QR ring fencing guidelines and believes that they form an appropriate base for the Regulator to consider in forming its view on the WestNet segregation arrangements.

This paper is structured to provide the background and context for the segregation requirements to apply to WestNet and how WestNet proposes to manage the segregation issues. This will provide useful information to access seekers and other stakeholders.

In relation to the Arrangements themselves, WestNet considers that these should be specific and concise and therefore proposes that the Arrangements set out in Section 10.3 will be submitted for the Regulator to approve or determine under the Act. Should amendments be required subsequent to approval or determination, the matters set out in Section 10.3 would be the mechanism to achieve the changes.

FRC Comment: FreightCorp believes that all of the information included in the Segregation Arrangements (as amended following the Regulator’s review) should be included as part of the formal arrangements approved by the Regulator. FreightCorp believes that the Arrangements set out in Section 10.3 of the Segregation Arrangements are, as standalone principles, woefully inadequate to constitute a meaningful segregation regime. FreightCorp sees no reason why the information included in all sections other than 10.3 of the Segregation Arrangements (as amended following the Regulator’s review) should not be included in the approved Segregation Arrangements.

Furthermore, FreightCorp considers that the Segregation Arrangements (once finalised) should create enforceable rights and obligations on and of WestNet and access seekers. This is particularly important in the areas of protection of confidential information; the investigating and reporting of alleged breaches of the Segregation Arrangements and compliance auditing. In this regard, FreightCorp endorses the position adopted by the QCA in relation to the QR access undertaking, where the QCA states:

“Enforceability of ring-fencing arrangements

QR has maintained its view that the Undertaking should focus on outcomes and as such it should only contain ring-fencing principles and not be prescriptive regarding QR’s internal procedures for achieving those outcomes. However, in recognition of stakeholders concerns, QR has proposed to extend its statement of ring-fencing

obligations to include an obligation to establish and maintain appropriate internal procedures to ensure QR complies with its ring-fencing obligations in the Undertaking. QR would also accept an obligation:-

1. to advise the QCA what its internal procedures are and
2. to report annually on its compliance with those procedures.

The QCA maintains its position in the Draft Decision that, given the importance of ring-fencing to the integrity of the above-rail market, and the intensity of the interface inherent in rail operations as comprehended by the Draft Undertaking, it is appropriate for detailed procedures to be set out in the Undertaking to establish enforceable ring-fencing obligations. Moreover, a key role of the Undertaking is to provide confidence to the market and to reduce the prospects of disputes occurring. QR has been given an opportunity to detail its ring-fencing arrangements and has not done so during the course of the two-year process of the assessment of the Undertaking, or indeed in response to the Draft Decision. Further, the Undertaking defines conduct which will be deemed not to hinder access and, it is in this context of defining 'safe harbour' conduct for QR that it is appropriate to outline ring-fencing arrangements with some prescription"

In relation to the above, FreightCorp also notes that WestNet's obligation under section 28 of the Act is to establish appropriate "controls and procedures". The Segregation Arrangements as currently drafted contain high level principles and not "controls and procedures".

Background to Segregation Arrangements

Duty to segregate

The privatisation of Westrail Freight required it be sold as a vertically integrated business. The Act was structured to accommodate this requirement and it is WestNet's view that its group corporate structure specifically recognises segregation of access related functions.

FRC Comment: While the corporate structure of ARG may in some shape or form anticipate the segregation of access related functions, it does not follow that the corporate structure of ARG is enough to give access seekers comfort that attempts to seek access to the WA below rail network will not be frustrated.

Section 28 of the Act provides that the owner or entity granting access to the railway should separate its access related (below rail) functions from its other functions. Segregation of access related functions are often referred to as "ring-fencing". Section 30 of the Act requires the owner must ensure compliance with the provisions of Sections 31 to 34.

FRC Comment: Section 28 of the Act provides that the railway owner "must" make arrangements to segregate its access related functions from its other functions. It further provides that the railway owner must have "appropriate controls and procedures to ensure that the measures in place to segregate access related functions operate "effectively" and are complied with. FreightCorp notes that WestNet's interpretation is that section 30 of the Act requires WestNet (in order to comply with section 28) to ensure that the provisions of sections 31-34 are satisfied. WestNet further notes that in its view it's only obligation in relation to segregation is to comply with sections 31-34. FreightCorp notes that the introductory wording to section 28 clearly states "Without limiting section 28, in carrying out its obligations under that section a railway owner must ensure that the provisions of section 31, 32, 33 and 34 are satisfied". FreightCorp believes that it is clear from that wording, that WestNet's obligations under section 28 are not fulfilled simply by compliance with clauses 31-34 only. FreightCorp believes that it is important that the Regulator is mindful of this when reviewing the Segregation Arrangements.

Each of these sections is summarised below.

Section 31 Protection of confidential information

This section provides for protection of confidential information relating to access seekers from improper use and disclosure to others including the railway owners employees except for a proper purpose.

FRC Comment: FreightCorp notes that the obligation under section 31 of the Act is to have an “effective regime designed for the protection of confidential information relating to the affairs of persons seeking access or rail operators from (a) improper use and (b) disclosure by relevant officers, or other persons, to other officers or employees of the railway owner of other persons, except for proper purposes.

The confidentiality arrangements proposed by WestNet are not an “effective regime” as required under clause 31 of the Act.

Section 32 Avoidance of conflict of interest

Arrangements must be made to ensure that a relevant officer does not have a conflict between the performance of access related functions and any other business of the railway owner.

FRC Comment: For the reasons set out in this paper, FreightCorp does not consider that the Segregation Arrangements meet the requirement of section 32 of the Act.

Section 33 Duty of fairness

This section provides relevant officers must not have regard to the interests of the railway owner which is unfair to access seekers.

Section 34 Separate accounts and records

This section requires that accounts and records must separate the access related functions from other functions of the railway owner and, where necessary, costs are to be apportioned in a fair and reasonable manner.

FRC Comment: For the reasons set out in this paper, FreightCorp does not consider that the Segregation Arrangements meet the requirement of section 34 of the Act.

Other segregation requirements

It is WestNet's view that there are no other requirements for segregation other than those included in the Act. This is considered fundamental in the consideration of the guidelines to be adopted by WestNet.

FRC Comment: As noted above, FreightCorp does not believe that the above conclusion is correct as a matter of law. It is clear from the introductory wording to section 30 of the Act, that the legislature did not intend that compliance with sections 31-34 alone would (necessarily) constitute an effective segregation regime as required under section 28 of the Act. Accordingly, FreightCorp believes that it is open to the Regulator (in addition to making amendments to the processes proposed for sections 31-34) to find that additional measures outside the scope of sections 31-34 must be included in the Segregation Arrangements in order to ensure compliance with section 28 of the Act. FreightCorp believes that the Regulator needs to do so, in order for an effective Segregation Arrangement to be put in place.

WestNet's access related functions and other functions

WestNet is the manager of the Standard and Narrow gauge leases granted by the Corridor Minister. Accordingly it has no other function than the provision of access to the railway infrastructure. This is critical to the assessment of the segregation

arrangements as there are no above rail operations carried out by WestNet (other than for infrastructure maintenance). Thus, the issues relating to segregation within WestNet simply do not arise.

FRC Comment: We note that clause 2.3 above suggests that “all of the functions in 1 and 2 below are performed directly by WestNet (or using contractors or agents under its direct control)” and that “the test of separation of functions has been adequately met”. However, in the following paragraphs, WestNet identifies that key functions are in fact carried out by AWR. If this is the way in which WestNet regards its obligations towards separation, then FreightCorp predicts that no third party operator will seriously consider competing on the WestNet network. The issue of segregation within WestNet is therefore very much a live one which needs to be explored.

WestNet defines the following functions as access related functions;

- (i) **negotiation of Access Agreements (either under the regime or on a commercial basis) and granting of access rights**
 - (ii) **management of Access Agreements including performance monitoring and day to day operation issues**
 - (iii) **the collection; use, and dissemination of train running data including manifest details; and access usage**
 - (iv) **train scheduling including train path allocation, publication of working timetables, control planning; and the granting of ad-hoc train path entitlements**
 - (v) **train control which includes provision of appropriate authorities for trains to use scheduled train paths (train orders or signals); real-time management of trains**
 - (vi) **emergency management on the network including co-ordination of emergency service responses**
 - (vii) **development, maintenance and monitoring compliance with appropriate safety standards for WestNet staff its contractors and operators on the Network**
 - (viii) **development and authorisation of the WestNet's Rules (including the General Appendix and Working Timetables) and the issue of special notices, instructions and warnings related to the rules**
 - (ix) **the development of train operating standards (to the extent they relate to the infrastructure) such as maximum braking distances, maximum train lengths etc., and also the maintenance standards for the infrastructure itself**
 - (x) **the maintenance of the track and infrastructure including signalling and communications maintenance**
1. Where WestNet engages the services of contractors for the provision of services it retains ultimate control.

FRC Comment: FreightCorp questions what “retains ultimate control” in this context means. In order to comply with WestNet’s obligations under the Act, WestNet is required to put in place “controls and procedures” to ensure that the Segregation Arrangements are effective and complied with. Statements to the effect that WestNet “retains ultimate control” do not of themselves demonstrate that any “controls and procedures” are being effected to ensure that, in this case, contractors do not breach the spirit of the Segregation Arrangements.

- 2 Australia Western Railroad Pty Limited ("AWR") provides extremely limited services as follows;
- (a) emergency response services in the event of a derailment by a skilled and equipped recovery team (but the derailment site remains under WestNet's control).
 - (b) the operation of signal cabins at West Kalgoorlie and Kwinana, which in part control mainline network operations. The signal cabins operate under the instructions of WestNet's Train Controllers and in the case of Kwinana the cabin will be closed and come back to train control in early 2002.
 - (c) train scheduling services on parts of the narrow gauge network.

As all of the functions in 1 and 2 above are performed directly by WestNet (or using contractors or agents under its direct control), the test of separation of functions has been adequately met.

FRC Comment: As per our comment immediately above, FreightCorp does not believe that statements to the effect that contractors or agents are under WestNet's "direct control" comply with WestNet's obligations under the Act.

The focal point of this paper and the Segregation Arrangements is therefore related to the issues of the interaction between WestNet and its related entities which conduct above rail operations.

Corporate Structure of the Australian Railroad Group

The Corporate structure of the Australian Railroad Group is as follows:

[corporate diagram not reproduced]

Important features of the structure are:-

The Australian Railroad Group Pty Limited ("ARG") is owned as to 50% each by Wesfarmers Limited and Genesee & Wyoming Inc., and is incorporated in South Australia.

AWR conducts the above rail operations in Western Australia and may expand its operations to other states.

WestNet is owned by AWR Holdings WA Pty Limited and thus by ARG. AWR Holdings WA Pty Limited is a holding company only and does not conduct operations of any kind.

WestNet StandardGauge Pty Limited and WestNet NarrowGauge Pty Limited are two subsidiary companies of WestNet and are the lessee's of the railway infrastructure subject to the Act and Code. WestNet has an agreement with these companies to allow WestNet to manage the railway infrastructure and therefore comply with the requirements of the access regime.

For the purposes of the Act, WestNet should be considered as the railway owner as defined in that legislation.

There are no directors of WestNet that are also directors of AWR.

FreightCorp Comment: A provision should be included in the Segregation Arrangement that clearly states that no director of WestNet will be appointed as a director of AWR or any other above rail related entity. Furthermore, a provision should be included in the Segregation Arrangements to the effect that WestNet (and ARG) must not make any changes to the current organisation structure of the ARG group of companies which may likely be considered to result in any reallocation of above and below rail functions between WestNet and the above rail group companies without the consent of the Regulator (by way of amended Segregation Arrangements). Of particular concern in this regard would be any reassignment of functions along the following lines:

- the abolition of WestNet;
- any current WestNet functions including scheduling and train control, be reassigned to any other ARG group company; and
- any construction, maintenance or associated functions performed by WestNet being assigned to an above rail ARG company.

Furthermore, FreightCorp considers that a contractual provision underpinning compliance with the Segregation Arrangements should be included in the WestNet standard access agreement.

Confidential Information

WestNet proposes a regime for the protection of confidential information.

Confidential Information is defined in the Code to mean "information" that has not been made public and that;

- a) by its nature is confidential;
- b) was specified to be confidential by the person who supplied it; or
- c) is however deemed by a person using it or disclosing it to be "confidential".

There will be a limited amount of confidential information as defined. This will relate to specific access applications, negotiations and on-going contract management including billing. In practice, there are two key areas that need to be dealt with;

FRC Comment: A major concern for FreightCorp regarding confidential information is the premature disclosure to our potential competitor (ie AWR) of an access request. If this disclosure occurs at a preliminary stage of negotiations between FreightCorp and a potential customer then this information can be used by AWR to disrupt these negotiations. Furthermore some potential customers will be hesitant to commence any negotiations with FreightCorp if they believe these negotiations will be made known to AWR. The reason for this is that they may fear retribution from their existing above-rail rail supplier (ie AWR) if they become aware of these negotiations. Accordingly it is imperative that any segregation / ringfencing arrangements adopted by WestNet do not allow the potential release of information alerting AWR of FreightCorp seeking access and that these arrangements are audited by ORAR or an external auditor. The Segregation Arrangements as proposed do not achieve this objective and are therefore insufficient. This is further demonstrated when these Arrangements are compared to the ringfencing arrangements as proposed by the QCA for QR.

It is also of major concern to FreightCorp that WestNet notes that there will be "a limited amount of confidential information as defined". In addition to the types of information that WestNet considers will meet the test of "Confidential Information" FreightCorp notes that Confidential Information will include all details included in an access application (including the existence of the application itself), including the identity of the customer, tonnage, product and mix, access charges etc.

Correspondence and Electronic Records

All correspondence between WestNet and Access Seekers/Operators is maintained on WestNet files within WestNet and the files and correspondence are not available to any other party.

As noted in Section 5.1, WestNet is located on a separate floor from AWR. As an additional measure to protect confidentiality all records relating directly to access will be maintained in a separate area with restricted entry to WestNet staff.

FRC Comment: Having WestNet and AWR in the same building and separated by only one floor cannot in any way lead to true independence. One is again drawn to a comparison with Queensland where Queensland Rail Network Access Group's (QRNAG's) office is in a different building to QR's offices.

FreightCorp has had much experience in seeking to gain above rail business in a vertically integrated rail system. One of the key issues that affect the willingness of customers to offer business to potential new operators is their concerns regarding the reaction from the incumbent service provider.

It is almost inevitable (except where an operator has existing equipment, of the right specification, ready to operate on the WestNet infrastructure) that it will take up to two years, for a new operator to be able to obtain the appropriate equipment and commence services. It is most unlikely that any new operator would invest in equipment without having secured firm haulage contracts. This leads to the situation

where the customer must commit to a new operator for a long time in advance of when that operator can provide the services. FreightCorp's experience has shown that customers are fearful of retaliation from the incumbent through either poor service, or even the potential withdrawal of services during the intervening period. Such fears, whether groundless or not are sufficiently powerful to deter many potential customers from making the transition to a new operator.

Even if a potential customer is willing to consider the transition to a new operator, the potential for information regarding such a move to become available to the current service provider is a significant barrier to be overcome. Such things as chance comments in a building foyer between two former colleagues are sufficient for the confidential aspirations of a customer to become known to the current operator. It is therefore extraordinary that WestNet should consider mere separation of floors as sufficient separation to safeguard confidentiality. It does not even provide the appearance of separation.

As a matter of detail, the password protection proposed by WestNet would need to be supported by a high integrity security system that is regularly audited for compliance and security integrity.

The principle data that WestNet collects in the course of operation of an access agreement relates to the number and size of trains, and the tonnages of products transported. In some, but not all cases, that data will include details of specific products.

This information is recorded in RAM's (The Rail Access Management System) and access, whilst provided to a large number of users, is password protected in order to ensure an operator or access seeker only accesses their own data.

FRC Comment: FreightCorp believes that the Regulator should require WestNet to maintain a separate information server for access related information. FreightCorp is concerned that some measures be included in the Segregation Arrangements to ensure that WestNet regularly monitors RAMs to ensure that no above rail operator staff have access to any access related information and that if there is a suspected breach of this requirement that WestNet be obliged to inform the Regulator within 5 business days. FreightCorp also proposes that the Regulator should be able to make details of any such report from WestNet publicly available.

WestNet may be required to disclose data in relation to the following matters;

- a) the requirements of 7(i) (b) (i) of the Code.
- b) requirements of other legislation such as the Rail Safety Act.
- c) for public processes for example, to support public policy reviews.

FRC Comment: While FreightCorp supports WestNet being able to release confidential information in relation to (a) and (b) above, it does not support a general right to release information for "public processes" including "public policy reviews". FreightCorp believes that unless WestNet is under a legal compulsion to release confidential information it must not do so without obtaining the consent of the party who owns that confidential information. Additionally, FreightCorp considers that access seekers should be able to require WestNet to enter into a confidentiality deed to protect the access seeker's confidential information. FreightCorp would support that deed being reciprocal. Given the importance of the protection of confidential information of access seekers, FreightCorp considers that the Regulator should reserve the right to establish a confidentiality deed that the parties would be required to enter into if they were unable to agree on the terms of a confidentiality deed.

That information is only ever presented in a way which protects the confidential basis of the source data.

FRC Comment: The above statement should be rephrased into an obligation to ensure (except as required by law) that this is the case and should be included in the Segregation Arrangements.

FRC Comment: FreightCorp is also concerned that “**appropriate controls and procedures**” are implemented to ensure that the confidentiality of information is protected. In that regard, specific controls and procedures need to be included in the Segregation Arrangements in relation to the disclosure of information to, and protection of confidentiality by both advisers and employees. FreightCorp considers that the Segregation Arrangements must clearly:

- include an undertaking that WestNet and the access seeker will at all times keep confidential and not disclose to any other person, any confidential information exchanged in the course of an access application or access agreement without the approval of the other party (not to be unreasonably withheld);
- define any segment of the ARG group where confidential information needs to be disclosed without the access seeker’s consent;
- define the managers in those segments to whom confidential information can be provided;
- require that those managers enter into a binding confidentiality undertaking to WestNet to keep that information confidential and only use it for a proper purpose;
- limit the ability of WestNet to provide confidential information to any external adviser or consultant, until such time as that adviser or consultant has entered into a confidentiality undertaking for the benefit of the access seeker;
- undertake to ensure that no employee, or internal or external adviser will have any indirect or direct involvement in ARG’s above rail business; and
- undertake that no confidential information will be provided to an external advisor engaged by the above rail companies within the ARG group.

FreightCorp considers that a clause should be included in the Standard Access Agreement to the effect that WestNet will comply with the Segregation Arrangements.

Costs and Revenue

The process of accounting requires acceptance of confidential information related to both price and volume.

ARG has a centralised accounting group which will provide services to WestNet. We detail that process in Section 7. Within that group there will be a specialist accountant who will deal with WestNet's revenue and operating budgets.

FRC Comment: Absent stringent controls and procedures being established, it is untenable for WestNet to receive accounting services from AWR. FreightCorp believes that the Regulator should require that WestNet employ its own financial accountant (noting that the revenue from access charges from third party operators should easily be sufficient to justify this). WestNet can achieve synergies in this area by using the same accounting system as AWR but it does not need to share staff. If AWR staff are privy to WestNet cost and revenue data they will be in an untenable situation with their loyalty (and remuneration) tied to AWR but having obligations to not inform their employer (AWR) of information they may be aware of regarding WestNet’s costs and revenues. Such pressures cannot be overcome simply via a confidentiality undertaking from those employees to AWR. In the absence of the segregation arrangements creating a binding and enforceable obligation for and against WestNet, AWR and access seekers, (such that access seekers could sue for a breach of the segregation arrangements) FreightCorp does not support WestNet’s proposed shared staffing arrangement.

The accountant dealing with AWR issues will not be involved in WestNet accounting service provision. It should be noted that WestNet accounting staff would not be involved in dealing with access applications or negotiations with access seekers.

Controls associated with separation of information within the financial systems are detailed in Section 10.2.

Where an employee of WestNet has prescribed duties which are managing or conducting access related functions, the following procedure will apply. WestNet will at the time of their permanent or temporary appointment, require the employee to sign a statement that they are aware of their responsibilities and obligations under the Code and specifically as it relates to confidential information as defined in the Code and in these Arrangements. This process will be conducted on an annual basis in conjunction with a compliance audit.

Information provided in the course of management reporting

The management executive of ARG meets in a pattern so that any confidential WestNet matters are only reported to WestNet Managers and the following staff of ARG:

Chief Executive Officer
Deputy Chief Executive Officer
Chief Financial Officer
General Manager Human Resources
General Manager Compliance

Accordingly, appropriate details of access contracts or negotiations will be provided to the staff noted above. Specifically, details of access contracts or negotiations will not, however, be provided to the management of AWR. In addition, the financial and operating results of a specific company will not be disclosed to other relevant entities in the ARG Group.

FRC Comment: FreightCorp does not support the proposal outlined immediately above. The proposed Arrangements allow “appropriate details” [which in itself requires much greater definition and control] of confidential WestNet matters to be reported to ARG’s senior management. The application for and the subsequent provision of access to a third party operator by WestNet will most likely be to the detriment of AWR as it indicates some likely loss of business by AWR. AWR’s senior management will become aware of such access requests by a third party operator. This is untenable. The basis upon which limited numbers of executives within ARG can receive such information and the basis upon which they can do so must be addressed with a much greater level of precision and particularity. These issues need to be addressed so that information regarding the seeking of access by a third party operator is not conveyed to AWR.

Certain functions such as Human Resources and ARG related safety matters will be dealt with at the ARG Executive. This is to ensure that the ARG Executive (as noted above) is appropriately informed in relation to the business affairs of ARG. There is no other practical way to manage ARG and the process clearly segregates confidential information in relation to access related functions from AWR.

Details of the management meeting structure are detailed in 10.1.

Conflicts of Interest

Separation of Functions

The principal concern is where train control and scheduling is located. Under the WestNet structure train control and scheduling are WestNet functions and there is therefore no conflict of interest.

WestNet's access related functions are separately staffed by either WestNet employees or by direct contract.

In any event, where such contractual arrangements exist there will be a requirement imposed by WestNet that the contractor be familiar with and comply with the provisions of the Code.

WestNet does not propose to relocate staff between the train operator (AWR) and itself. In the event such a rotation occurred (due to exception circumstances such as widespread illness) WestNet would ensure the personnel;

- a) did not have access to confidential information
- b) were familiar with the requirements of the Code and
- c) were appropriately supervised in the event a conflict of interest were to arise

WestNet operates on a separate floor from AWR and thus there are no common areas.

Role of the Boards of WestNet and ARG

As indicated in Section 3, WestNet has a separate Board of Directors one of whom is also a director of ARG.

FRC Comment: We note with concern the fact that the ARG Board will have members of both the AWR and WestNet Boards. It is inevitable that confidential information provided to the ARG Board will affect the decisions made by the AWR director when considering issues affecting AWR. We find the statement in clause 5.2 that the proposed arrangement means that “[t]here can be no conflict of interest that arises in this situation” is disingenuous at best. The fact that two members of the same Board (ARG) share confidential information regarding each others’ businesses which happen to be separated in order to enhance the chance of competition must be seen as a conflict of interest and at the very least leads to the suspicion that information will be exchanged that is detrimental to third parties. The claim by WestNet in clause 5.1 that “there is therefore no conflict of interest” is at best a naive understanding about the manner in which competition must be managed in such an environment. The very perception by customers of the common ownership of AWR and WestNet inevitably leads to the expectation that there is a conflict of interest between those two parties. There is a requirement on the part of ARG to demonstrate a clear and unambiguous commitment towards the genuine separation of the two organisations through:

- Imposition of a comprehensive ring-fencing policy;
- An undertaking by the ARG directors who are on the AWR or WestNet Boards to absent themselves from (AWR or WestNet) Board discussions where issues regarding the other organisation are discussed, and
- Physical separation of the two entities such that there is unlikely to be regular casual interaction between the employees (eg moving one organisation to a different part of Perth).

All reports provided to the WestNet Board are confidential to that Board.

It was a requirement of the Government sale process that the business of Westrail Freight be sold to one purchaser, that is, it was sold as a vertically integrated business.

Therefore, in the context of the Act and Code which require that the railway owners access related function be separated from its other functions, WestNet again notes that it has no other function than the provision of access. The company structure of ARG is specifically designed to recognise that in a vertically integrated business there are areas where potential conflicts of interest may arise.

The process that will be adopted is that the WestNet Board will review and recommend to the ARG Board for final approval proposals which involve access related matters. The ARG Board will receive information it considers appropriate to discharge its obligations under the Corporations Act.

It should be noted that there is and will be no directors of AWR who will also be directors of WestNet. There can be no conflict of interest that arises in this situation because the WestNet Board will assess and recommend access related matters in accordance with the Act and Code and as noted, WestNet has no other function than the provision of access. Accordingly, only proposals which comply with all aspects of the Act and Code will be recommended to the ARG Board for approval.

It should be noted that existing or prospective users of the Network can refer matters to the Regulator should they be of the opinion that they have been dealt with other than in accordance with the Act or Code.

Duty of Fairness

Where WestNet provides access to a related entity, such as AWR, or another operator under commercial access arrangements outside of the Code there is a duty of fairness requirement under the Code.

The Act requires a general duty of fairness.

The Code identifies specifically the issue of price and through Section 21(i) of the Act a proponent may ask the Regulator to form a view on whether the conditions of Section 13(a) of Schedule 4 to the Code has been applied correctly.

This provides for access seekers to be able to determine whether price discrimination occurs. This is likely to be the most contentious issue.

With respect to discrimination in the provision of services the WestNet Standard Access Agreement calls for specific consultation and provision of information between the parties and a dispute resolution mechanism which would allow Operators to deal with issues where they feel they have been discriminated against.

The Costing Principles set out how WestNet will allocate overhead costs to all users in a fair manner.

Section 7 of the Act provides that the provisions of the Code or Act will not affect contracts entered into by WestNet before the commencement of the Code. The practical effect of this is that all pre-existing access agreements prior to proclamation of the Code are “grandfathered”.

Separate accounts and records

It has been noted previously that WestNet has no other functions which are not access related and therefore much of the provisions of Section 34 of the Act have, by definition, already been complied with. Set out below is the process that will be adopted by ARG with respect to certain corporate functions relating to accounting and financial matters.

As noted in Section 3, ARG is the parent company for AWR and WestNet. As part of its corporate structure ARG has a Finance group responsible for the groups' accounting and information systems. The Accounting Services is headed by the Chief Accounting Officer and reports to the Chief Financial Officer, as does the Information Systems Manager.

The role of the finance group is to fundamentally provide information systems support and accounting services to all ARG companies. In particular, at the accounting services level, the consolidation of each business units results for presentation at both ARG executive and board of directors. The Accounting Services employees have been well briefed on the process of segregation and accordingly are not permitted to provide group information back to the business units.

Segregation of computer information systems and the generation of reports between AWR and WestNet is provided through the use of individual computer user IDs and passwords that are allocated to employees (and non-employees). These identify the

company and section the computer user belongs to. Further details are set out in Section 10.2.

Other matters

Measuring the effectiveness of segregation arrangements.

WestNet will instruct its internal auditors (currently outsourced to Ernst & Young) to conduct a compliance audit in relation to the Segregation Arrangements on an annual basis. This report will be submitted to the Regulator.

WestNet will report any breach of the Segregation Arrangements of which it becomes aware to the Regulator in writing within 5 business days.

Access seekers or existing users can approach the Regulator at any time they consider a breach may have occurred. The Act and Code provide wide powers for the Regulator to investigate any alleged breaches of the Segregation Arrangements.

Review and consultation

WestNet will formally consult with the Regulator at the end of the initial two years of operation of the Segregation Arrangements to determine whether any amendments are required.

Annexures

Executive Committee Structure

[drawing not reproduced]

Segregation of Information Systems

When a user logs on to the ARG computer network their access to shared files, information systems, e-mail, and the ability to generate reports etc is automatically restricted to their company and section.

AWR and WestNet have physically separate computer file servers.

User IDs and passwords are set up and managed by the Computer Services Section within the Finance Group. Authority to allocate passwords within an entity resides with the General Manager of that entity.

There are further restrictions applying to the following primary stand alone systems;-Financial and Maintenance Management System (MIMS)

Concept Payroll/Personnel Management

Revenue Accounting System (RAS)

Rail Access Management System (RAMS)

When a user logs on to a specific information system the functions they have and the company related information they can access and report on is restricted according to their user ID.

These restrictions are setup and managed by the information system's administrator.

Details of the restrictions for each stand alone system are as follows.

Financial and Maintenance Management System (MIMS)

Our key financial and maintenance management system is the MIMS system. MIMS allows for separate account structures, calendars and security controls by assigning "district codes" to organisations. Assigning a district Code to an organisation is the equivalent to assigning a different set of accounts to that organisation.

AWR and WestNet have different district codes within MIMS.

Detailed management reports are produced by each company accountant and access for the extraction of this detailed information from various modules within the Mincom system is restricted by the MIMS Security Officer in Accounting Services.

Accounting Services within the Finance Group performs all system security. Security on all financial modules is restricted by firstly the company and then secondly by modules within the same company.

Accounting Services personnel only have total access across all companies.

Each company has their own module:-

General Ledger

Supply

Accounts Payable

Accounts Receivable

Fixed Assets

Maintenance

Details of each module are as follows-

1.1 General Ledger Module

The processing of company journals and the loading of the interface files to Mincom from external subsidiary systems are performed centrally by the Accounting Services.

The external interfaces are from:-

Payroll/Timekeeping

John Holland (contractor for narrow gauge WestNet)

Civil and Mechanical Maintenance (contractor for standard gauge WestNet)

Clyde Engineering (contractor Australia Western Railroad)

Individual financial statements and reports for each company are produced centrally by the Accounting Services and these reports are distributed to the respective company.

Corporate reports can only be produced by the Finance Group and are issued only to the Chief Executive Officer and the Chief Financial Officer of ARG, who ultimately are responsible to the ARG Board of Directors.

Supply Module

The supply and procurement processes are decentralised within AWR and WestNet. Access to system information is controlled by the MIMS Security Officer. Inventory for both AWR and WestNet is separately located and managed.

Accounts Receivable Module

The Accounts Receivable processes are centralised within Accounting Services. The MIMS Security Officer controls access to system information.

Accounts Payable Module

Accounts Payable is centralised with the exception of data input of invoices by WestNet. MIMS Security Officer controls access to system information.

There are still some shared order numbers used by AWR and WestNet for purchasing a few general products (eg stationary, electricity). Order numbers are used to track and report on particular item purchases from a supplier.

These shared order numbers enable MIMS users with purchasing authority to view both AWR and WestNet Rail purchases. These orders are to closed off and new orders for each district to be issued.

Fixed Assets Module

The asset register is maintained separately for each company by the Accounting Services. The MIMS Security Officer controls access to the system.

Maintenance Module

The maintenance system has financial and non financial information. Data processing of maintenance information is decentralised and segregated between AWR and WestNet. The MIMS Security Officer controls access to this system.

Concept Payroll/Personnel Management

This information is restricted to HR staff within each company or by the Payroll and Personnel section within the Finance Group.

Revenue Accounting System (RAS)

The revenue accounting system is a single stand alone system that accepts and raises freight consignment notes for AWR and rail access charges for WestNet. This system is only accessible to personnel within Accounting Services. Various proposals to replace this system are being considered. Ring fencing of information is an essential element of the terms of reference and accordingly will be an important deliverable in the final system.

Rail Access Management System (RAMS)

WestNet's Access Management System (RAMS) is used by WestNet, AWR and other rail operators to record and view train timetables, consist information and driver information.

RAMS provides good security of information through the use of user IDs. However passwords are not mandatory and users could logon as someone else if they know their user ID. Modifications are currently being carried out on RAMS to automatically log users on and remove the option of using someone else's user ID.

Segregation Arrangements to be adopted

As noted in Section 1.2, set out below are the Segregation Arrangements proposed by WestNet. These will be submitted to the Regulator for approval or determination.

FRC Comment: As noted at the beginning of FreightCorp's comments, FreightCorp sees no reason for not including the entire text of the Segregation Arrangements in the form to be approved by the Regulator. It is FreightCorp's view that the current outline of what are in effect high level principles in section 10.3 do not comply with WestNet's obligations under section 28 of the Act.

10.3.1 *Legislative context*

WestNet Rail Pty Ltd ("WestNet") is the "owner" as defined in the Railways (Access) Act 1998 ("Act") of a rail network in Western Australia which is subject to the provisions of the Act to the extent that the network is defined in Schedule 1 of the Railways (Access) Code2000 ("Code") which is established under the Act. WestNet Rail recognises its obligation to comply the Act and the Code and specifically Sections 28 and Sections 31 to 34 of the Act.

10.3.2 *Segregation of Access Functions*

WestNet defines Access Related Functions as;

- (i) negotiation of Access Agreements (either under the regime or on a commercial basis) and granting of access rights;
- (ii) management of Access Agreements including performance monitoring and day to day operation issues;
- (iii) the collection; use, and dissemination of train running data including manifest details; and access usage.

- (iv) train scheduling train path allocation, publication of working timetables, control planning; and the granting of ad-hoc train path entitlements.
- (v) train control which includes provision of appropriate authorities for trains to use scheduled train paths (train orders or signals); real-time management of trains.
- (vi) emergency management of the network including co-ordination of emergency service responses
- (vii) development, maintenance and monitoring compliance with appropriate safety standards for WestNet staff, its contractors and operators on the Network
- (viii) development and authorisation of the WestNet's Rules (including the General Appendix and Working Timetables) and the issue of special notices, instructions and warnings related to the rules.
- (ix) the development of train operating standards (to the extent they relate to the infrastructure) such as maximum braking distances, maximum train lengths etc., and also the maintenance standards for the infrastructure itself.
- (xi) the maintenance of the track and infrastructure including signalling and communications maintenance.

Where WestNet engages contractors or other parties to provide any part of the access related functions it will;

- (a) retain ultimate control of the function by establishing contractual arrangements; and

FRC Comment: What constitutes “ultimate control” and how that will be achieved is at large and requires clarification.

- (b) ensure that any contractor is aware and complies with any obligations imposed by the Act or the Code.

10.3.3 Confidential Information

WestNet Rail has established a regime of Confidential Information as defined in the Code including;

- (a) a system of written record keeping that only allows appropriate WestNet staff to access the records;

FRC Comment: Who determines which people are “appropriate” to access the records. Criteria for making that determination should be included in the Segregation Arrangements.

- (b) a security system on electronic records that only allows appropriate WestNet staff to access the records;

FRC Comment: Who determines which people are “appropriate” to access the records. Criteria for making that determination should be included in the Segregation Arrangements.

- (c) appropriate controls on data, including information in the Rail Access Management System (RAMS) and costing and pricing information to protect confidential information.

FRC Comment: Who determines which controls are “appropriate”. Criteria for making that determination should be included in the Segregation Arrangements.

- (d) specific provisions in each access agreement providing contractual obligations on WestNet to protect confidential information.

FRC Comment: As noted throughout these comments, FreightCorp believes that the Regulator should require that the access agreement contain a clause that both parties will comply with the ring-fencing guidelines.

WestNet Rail is required to provide management reports to both its own Board of Directors and to officers and members of the Board of its parent company, the Australian Railroad Group (ARG).

FRC Comment: This statement leaves the protection of confidential information wide open and is totally unacceptable to FreightCorp.

With respect to such management information;

- (i) reports to management of ARG are dealt with only in meetings where WestNet and ARG management are present and no representatives of related entities operating train services, such as AWR, are present.
- (ii) Members of the WestNet Board are not members of the AWR Board;
- (iii) Where confidential information is provided from the WestNet Board to either ARG Management or the ARG Board it will be clearly identified.

WestNet confirms it will keep information it receives in relation to access related matters confidential in accordance with the Arrangements as set out herein.

Where an employee of WestNet has prescribed duties which are managing or conducting access related functions, the following procedure will apply. WestNet will at the time of their permanent or temporary appointment, require the employee to sign a statement that they are aware of their responsibilities and obligations under the Code and specifically as it relates to confidential information as defined in the Code and in these Arrangements. This process will be conducted on an annual basis in conjunction with a compliance audit.

10.3.4 *Conflicts of Interest*

Because of the separation of access related functions WestNet Rail believes that there are no existing conflicts of interest.

In the event that any staff are rotated within ARG, especially the related entity AWR, to perform Access Related Functions within WestNet, WestNet would ensure the personnel;

- a) did not have access to confidential information;
- b) were familiarised with the requirements of the Code; and
- c) were appropriately supervised in the event a conflict of interest were to arise

10.3.5 *Duty of Fairness*

WestNet acknowledges and accepts it has a duty of fairness to access seekers relative to its treatment of other access seekers under the Code; and others granted access under other arrangements.

The mechanism for ensuring the duty of fairness is two-fold;

- 1. access seekers can determine the fairness of prices negotiated under provisions of Clause 21(I) of the Act; and
- 2. provisions of WestNet's standard access agreement provides for specific consultation mechanisms; the provision of information; and dispute resolution mechanisms which would allow access seekers to test the duty of fairness related to other than price issues in the provision of access.

10.3.6 *Separation of Accounts and Records*

WestNet will maintain separate accounts and records with the accounting service to be provided by the accounting group within ARG.

The protection of the confidentiality of that information is established by:

1. WestNet having a designated Accountant within ARG who performs no other accounting functions;
2. The provisions of section 4 of these Guidelines.

10.3.7 *Compliance with these principles*

Compliance with these guidelines will be achieved by;

WestNet will instruct its internal auditors (currently outsourced to Ernst & Young) to conduct a compliance audit in relation to the Segregation Arrangements on an annual basis. This report will be submitted to the Regulator.

FRC Comment: Again, consistent with the approach adopted by the QCA in Qld, FreightCorp supports the notion that on-going and regular auditing of compliance with the Segregation Arrangements is required. Doing so, is an important way for WestNet to demonstrate its commitment to the arrangements. FreightCorp does not believe that WestNet's proposed audit process provides sufficient detail to establish enforceable obligations on WestNet. To address this issue, FreightCorp believes that the processes should be fleshed out to require:

- the appointment of an external audit to audit compliance with the arrangements;
- audits should be carried out at intervals of 6 months or when an alleged or actual breach of the arrangements occurs;
- WestNet should undertake to co-operate with the audit and the auditor, and provide all information required; and
- details of the audit should be made public as soon as the audit process is completed.

WestNet will report any breach of the Segregation Arrangements of which it becomes aware to the Regulator in writing within 5 business days.

Access seekers or existing users can approach the Regulator at any time they consider a breach may have occurred. The Act and Code provide wide powers for the Regulator to investigate any alleged breaches of the Segregation Arrangements.

FRC Comment: Similar to the approach adopted by the QCA in relation to the QR Access Undertaking, FreightCorp considers that (in order to engender confidence in the Segregation Arrangements - and thereby promote 3rd party access):

- compliance reviews should be carried out by a party external to WestNet (and certainly not an internal auditor if the function was ever brought back in house);
- any alleged or actual breaches should be notified to the Regulator within 5 business days and details of the matter able to be made public by the Regulator;
- third parties should be able to refer a suspected breach of the arrangements to the Regulator for action;
- particularly in relation to the protection of confidential information, breaches of the arrangements should incur a pecuniary penalty (this would be in addition to a contractual commitment to the access seeker to comply with the arrangements);

In relation to the last bullet point, FreightCorp notes that the QCA recommended the inclusion in the confidentiality obligations established in the Undertaking of a liquidated damages clause. The QCA proposed that a reasonable pre-estimate of damages for a relatively minor ring-fencing breach was \$10,000. For serious ring-fencing breaches, the QCA proposed an access seeker/third party operator should have recourse to courts, with a reasonable threshold for such recourse being potential damages in excess of \$100,000. FreightCorp supports this approach.