Draft of the Determination of the Western Australian Independent Rail Access Regulator

Costing Principles to apply to WestNet Rail

Worsley Alumina's comments

Preamble

Worsley fully supports the view that the Costing Principles require an objective and a purpose. The Principles are inclusive of the calculation of WACC and Over Payment Rules. The Principles seek to define a framework for arriving at a suitable trade-off which recognises the railway owners legitimate business interests while protecting users against monopoly rents and preventing cross-subsidies between operators.

WACC

Worsley notes that in revising the WACC the Regulator has used the same assumptions and methodology as previously but has updated the parameter values where relevant. In calculating the WACC to be used the Regulator has used values at the 'High' end of the range, in particular, in the cases of the Market Risk Premium and β_e. That is, the return that WNR can earn is calculated to reflect that its revenue stream is at the 'risky' end of the general rail freight industry spectrum.

Calculation of floor & ceiling prices for access

Worsley broadly supports the Regulator's approach to the calculation of floor and ceiling prices. Worsley maintains its view that "railway infrastructure" does not include earthworks as it is the infrastructure, not the rail corridor, that WNR has leased and earthworks form part of the corridor formation. Inclusion of earthworks inflates the GRV. Worsley suggests that the inclusion of earthworks be reconsidered when the access regime, specifically the Costing principles, is reviewed.

Operator & government contributed assets

Worsley supports the Regulator's approach to how these are included in the calculation of floor and ceiling costs and requests that, where appropriate, the allocation be explicitly on a route section basis.

Interest cost during construction

With respect to the inclusion of interest costs during construction Worsley supports the Regulator's approach and suggests that the construction rate be reviewed regularly as the concept of 'MEA' includes advances in construction techniques.

Escalation
Worsley maintains its view that the case for escalation of ceiling costs is unproven as anecdotal evidence suggests that actual construction and capital costs are deescalating in real terms due to technological improvements.

KPIs
Worsley anticipates that individual access agreements will include a comprehensive KPI reporting system for the routes covered. Worsley believes that it is appropriate for the Regulator to take a comprehensive, global view of performance and that the KPI's should cover service level delivered under the access regime as well as the effectiveness of the Costing Principles. Specific areas Worsley suggests to be covered in such a system include:
- Track quality: duration & extent of speed restrictions
- Track availability: planned & unplanned maintenance duration

Over Payment rules

Basis of application
Worsley notes that the Code defines "route sections" as the sections into which the railway network is divided for management and costing purposes. A route then consists of a one or more route sections or parts of route sections. Although the Code only requires that WNR provide an access seeker with the floor and ceiling prices for a route the Regulator has required that "… WNR provide ceiling and floor costs with breakdowns into sections which then aggregate to the total costs for the route." (Costing Principles, Draft of the Determination, p35). Worsley is firmly of the view that Over Payment rules should apply on a route section, not a route, basis. Worsley notes that it is possible to apply for access on a route section basis and that, as such, an access seeker can arrange its affairs so that Over Payment rules apply on a route section basis.

Under recovery
Worsley does not believe that the Over Payment rules should include the concept of "under recovery". While the Code has specific reference to "Over Payment" there is no reference to "under recovery". The objective of the Costing Principles is to strike a balance that allows the railway owner to achieve a fair and reasonable return on its overall rail investment while protecting users against monopoly rent. That balance is struck at an access charge somewhere between the floor and ceiling prices. "Over Payment" is monopoly rent. "Under recovery" only occurs if the revenue falls below the floor cost; that is, revenue is less than the avoidable cost for the route section. Any revenue above the floor cost makes a contribution to the capital charge, which is a sunk cost.

Revenue may fall below the floor cost if there is no traffic or if traffic is less than projected. As the Costing Principles seek to avoid cross-subsidy between operators there is no case to make up this loss of revenue if there is no traffic. If the traffic is lost due to loss of upstream or downstream markets or lost due to competition from another transport provider then the Competition Principles preclude WNR from seeking to make up this revenue. Variations in traffic volume are a fact of life in business. Worsley notes that the Regulator has used high-end parameter values in determining WACC; that is, WNR's revenue stream is deemed to be "risky" when compared with its peers in the rail freight business. WNR is already compensated for volume variability through WACC and should not be compensated a second time through "under recovery".

If revenue exceeds the floor cost for a route section then there is no "under recovery". Revenue less than the ceiling cost does not constitute "under recovery" in any sense in the Code although it may fall below the railway owner's expectations. The 'fair and reasonable return' for the railway owner is determined in accordance with the Code, not the railway owner's expectations. There is nothing in the Code that guarantees the railway owner recovery of the ceiling cost for each route section. Quite the converse: revenue should be somewhere between the floor and ceiling costs. The return of and on capital is part of the calculation of the ceiling price but the Code does not guarantee full capital return any more than it requires the owner to rebuild the network every three years to MEA standard. If there was any sense of a 'guaranteed' return then WACC should have been set at the risk-free rate.

Breaches of the ceiling test

Worsley supports the Regulator's determination that breaches considered permanent should cause an immediate renegotiation of the access price with affected parties and that temporary breaches that could not have been reasonably avoided are subject to the Over Payment rules.

Consistent with the idea of inadvertent breaches of the ceiling test Worsley believes it is appropriate to consider revenue in aggregate over the three year period. Over Payments of more than 10% in any one-year will have been refunded. If the aggregate net revenue after any such refunds still breaches the ceiling then there is a further refund to users. If there are breaches of up to 10% in some years, but no breach in aggregate over the three years, then there is no refund. There is no "under recovery" and hence no carry-forward of "under recovery".

Allocation of revenue

Worsley does not believe that WNR should have any discretion in the allocation of revenues back to individual route sections and notes that, as access can be sought on a route section basis, this discretion, if any, can be rendered nugatory.