

WestNet Rail's Part 5 Instruments Review

Final Determination and Approval of the Proposed Over-payment Rules

28 August 2006

Economic Regulation Authority



WESTERN AUSTRALIA

Copies of this final determination and approval and WestNet Rail's approved revised Over-payment Rules are available from the Economic Regulation Authority website at www.era.wa.gov.au.

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EXECUTIVE SUMMARY

Final Determination

1. On 15 December 2005, WestNet Rail Pty Ltd (**WNR**) submitted its proposed Over-payment Rules to the Economic Regulation Authority (**Authority**) for approval. The submission of the proposed Over-payment Rules resulted from a requirement for WNR to review the existing Over-payment Rules two years after approval by the Independent Rail Access Regulator (**IRAR**) in May 2003.
2. The Authority has considered the proposed Over-payment Rules in conjunction with comments made in submissions to the Authority by interested persons.
3. The draft determination of the Authority was to not approve the proposed Over-payment Rules on the ground that it does not represent a fair balance of interests between the railway owner, operators (operators and customers) and access seekers as required under Section 20(4) of the *Railways (Access) Act 1998*. The detailed reasons for not accepting the proposed Over-payment Rules were outlined in the draft determination which was released for public consultation on 10 May 2006.
4. Following a period of further public consultation, the Authority considered issues raised in submissions and prepared its final determination. The five amendments to the proposed Over-payment Rules required by the Authority in its final determination are listed below.

Summary of Amendments

Required Amendment 1

Section 1 of the proposed Over-payment Rules should be amended so that the word 'section' is included after the word 'route' in the first line of the paragraph under the first bullet point.

Required Amendment 2

Section 2.7 of the proposed Over-payment Rules should provide for private and government contributions to be specified as an equivalent annual contribution for the purposes of the floor and ceiling calculations. The allocation process where contributed assets service more than one route section should also be specified in this section.

Required Amendment 3

Note (b) of rule 6, Section 3 of the proposed Over-payment Rules, should include the condition that refunds can be made to non-Regime operators if this provision is included in commercially negotiated access agreements to ensure consistency with rule 13.

Required Amendment 4

Section 2.8 of the proposed Over-payment Rules should be amended to delete items 1 and 2. Item 3 should be suitably amended such that the allocation process outlined under this item is used as the methodology for allocating all over-payments. Item 3 should also be amended to make it clear that the over-payment should only be reimbursed to the operators who have contributed to the over-payment on the route

section where the over-payment occurs. This section should also include contributed assets in calculating the refund to operators of any over-payment.

Required Amendment 5

Rule 6, in Section 3 of the proposed Over-payment Rules, should include non-access revenue in the numerator and denominator as reflected in the existing Over-payment Rules and should also include the provision of interest accrued in the formula as reflected in the existing Over-payment Rules.

Approval

5. WNR submitted a revised Over-payment Rules on 8 August 2006 which was in compliance with the Authority's final determination. The Authority has approved WNR's revised Over-payment Rules and this document has been placed on the Authority's website www.era.wa.gov.au.

INTRODUCTION

Background

6. WestNet Rail (**WNR**) is the principal provider of “below” rail freight infrastructure, covering approximately 5,000 kilometres of track, in the south-west of Western Australia. WNR is a subsidiary company owned by Babcock and Brown Ltd, a publicly listed Australian company.
7. Section 3 of the Western Australian *Railways (Access) Act 1998* (**Act**) defines a “railway owner” to mean the person having the management and control of the use of the railway infrastructure. Within this context, WNR is considered to be the railway owner for the freight rail infrastructure.
8. The Over-payment Rules is one of the four Part 5 Instruments set out in Section 40(3) of the *Railways (Access) Code 2000* (**Code**). Each of the Part 5 Instruments is currently being reviewed by the Authority.
9. The scope of the Part 5 Instrument reviews is limited to those matters specifically set out under Part 5 of the Code.
10. In the case of the Over-payment Rules, sections 47(1) and 47(2) of the Code set out the extent of the issues considered in this review, as follows:
 - (1) As soon as is practicable after the commencement of this Code each railway owner is to prepare and submit to the Regulator a statement of the rules (“the over-payment rules”) that are to apply where breaches of clause 8 of Schedule 4 occur on the part of that owner that could not be reasonably be avoided.
 - (2) The rules referred to in subsection (1) must give effect to the following basic requirements-
 - (a) The excess revenue referred to in clause 8(4) of Schedule 4 in respect of an operator or group of operators must be at all times be within a limit, being a percentage of the relevant costs, from time to time notified in writing to the railway owner by the Regulator;
 - (b) At the expiry of each successive period of three years from the commencement of access by an operator or group of operators there must be no such excess in respect of that operator or group of operators.
11. In May 2003, the Independent Rail Access Regulator (**IRAR**) approved the Over-payment Rules submitted by WNR following the introduction of the Code. The IRAR carried out a public consultation process during the course of its assessment in 2002. In its determination, the IRAR stipulated the requirement for a review at the end of two years of operation of the Over-payment Rules.
12. Following a request from WNR, the Authority approved an extension of time to 15 December 2005 for WNR to submit its proposed revisions to its Over-payment Rules (proposed Over-payment Rules) for the purpose of the review.
13. Under Part 5 of the Code, the Authority is required to undertake public consultation prior to making determinations on two of the Part 5 Instruments (Train Management Guidelines and Statements of Policy) but not in relation to the other two Part 5 Instruments (Costing Principles and Over-payment Rules). However, the Authority decided that a consistent approach to public consultation should be followed and

invited public submissions on all four Part 5 Instruments. This approach is also consistent with the approach taken by the IRAR in 2002.

14. On 15 December 2005, the Authority issued a notice calling for submissions from interested parties on WNR's proposed Over-payment Rules. Four public submissions were received from:

- Alcoa World Alumina Australia Pty Ltd.
- Australian Rail Track Corporation Ltd.
- Great Southern Railway Ltd.
- Pacific National Pty Ltd.

These submissions are available on the Authority's website (www.era.wa.gov.au).

15. In consideration of the Over-payment Rules, the Authority recognises the need to ensure that operators are protected from WNR's ability to attain monopoly rents balancing this against ensuring that WNR is not prevented from making a fair and reasonable return on its rail investments.

16. To assist the Authority in the review of the issues raised in the public submissions, the Authority engaged a consultant Strategic design and Development Pty Ltd (SdD) to review the submissions and provide independent comment to the Authority on the issues raised in these submissions. The SdD report is available on the Authority's website (www.era.wa.gov.au).

17. The draft determination was released for public consultation on 10 May 2006.

18. Subsequent to the Authority issuing a notice on 10 May 2006 calling for submissions from interested parties on the draft determination, seven submissions were received as listed below.

- Alcoa World Alumina Australia.
- Australian Rail Track Corporation Ltd (**ARTC**).
- Department for Planning and Infrastructure (**DPI**).
- Goldfields Esperance Development Commission.
- Great Southern Railway Ltd.
- WestNet Rail Pty Ltd.
- Worsley Alumina Pty Ltd (**Worsley**).

These submissions are available on the Authority's website (www.era.wa.gov.au).

19. It should be noted that some of the comments in the public submissions received during the course of this review fall outside the scope of the Over-payment Rules review. The Authority's determination is limited to the scope of this review and consequently, comments from the public submissions which have been determined

to fall outside this scope have not been considered by the Authority in making its determinations.

20. This final determination makes reference to a number of acronyms which are identified in the Glossary in Appendix 1.

Legislative Considerations

21. The key areas of the Code and the Act that have relevance to the formulation and application of the Over-payment Rules are as follows:

Section 47 of the Code states:

- (1) As soon as is practicable after the commencement of this Code each railway owner is to prepare and submit to the Regulator a statement of the rules (“the over-payment rules”) that are to apply where breaches of clause 8 of Schedule 4 occur on the part of that owner that could not be reasonably be avoided.
 - (2) The rules referred to in subsection (1) must give effect to the following basic requirements-
 - (a) the excess revenue referred to in clause 8(4) of Schedule 4 in respect of an operator or group of operators must at all times be within a limit, being a percentage of the relevant costs, from time to time notified in writing to the railway owner by the Regulator;
 - (b) at the expiry of each successive period of three years from the commencement of access by an operator or group of operators there must be no such excess in respect of that operator or group of operators.
 - (3) The Regulator may-
 - (a) approve the statement submitted by the railway owner either with or without amendments; or
 - (b) if he or she is not willing to do so, determine what are to constitute the over-payment rules.
 - (4) The over-payment rules may be amended or replaced by the railway owner with the approval of the Regulator.
 - (5) The Regulator may, by written notice, direct the railway owner-
 - (a) to amend the over-payment rules; or
 - (b) to replace them with other over-payment rules determined by the Regulator, and the railway owner must comply with such a notice.
22. Clause 8 of Schedule 4 of the Code states:
- (1) An operator that is provided with access to a route and associated railway infrastructure must pay for the access not more than the total costs attributable to that route and that infrastructure.
 - (2) For the avoidance of doubt it is declared that the calculation of total costs under subclause (1)-
 - (a) is for the whole of the route and associated railway infrastructure; and
 - (b) is to be the same for all operators,
 regardless of the extent of the operations or use of the route and infrastructure by any particular operator.
 - (3) The total of-

- (a) The payments to the railway owner by-
 - (i) all operators; and
 - (ii) all other entities,that are provided with access to a route, or part of a route, and associated railway infrastructure (“the route”); and
- (b) the revenue that the railway owner’s accounts and financial statements show as being attributable to its own operations on the route, must not be a sum that is more than the total costs attributable to the route.
- (4) It is not a breach of this clause for-
 - (a) payments to the railway owner mentioned in subclause (1) to exceed the total costs referred to in that subclause; or
 - (b) the total sum mentioned in subclause (3) to exceed the total costs referred to in that subclause,if the over-payment rules approved or determined under section 47 are complied with.

23. The Act also provides a framework within which the Authority’s determination required under Section 47 of the Code is to be made. Section 20(4) states:

In performing functions under the Act or Code, the Regulator is to take into account-

- (a) the railway owner’s legitimate business interests and investment in the railway infrastructure;
- (b) the railway owner’s costs of providing access, including any costs of extending or expanding the railway infrastructure, but not including costs associated with losses arising from increased competition in upstream or downstream markets;
- (c) the economic value to the railway owner of any additional investment that a person seeking access or the railway owner has agreed to undertake;
- (d) the interests of all persons holding contracts for the use of the railway infrastructure;
- (e) firm and binding contractual obligations of the railway owner and any other person already using the railway infrastructure;
- (f) the operational and technical requirements necessary for the safe and reliable use of the railway infrastructure;
- (g) the economically efficient use of the railway infrastructure; and
- (h) the benefits to the public from having competitive markets.

The nature of the decision-making power given to the Authority under Section 47 of the Code is mandatory in that the Authority must take into account all the factors listed in Section 20(4) of the Act. However, the Authority has discretion to allocate such weight to each of the factors listed in Section 20(4) of the Act as it considers appropriate for each particular case.

Assessment Process

24. The process which has been followed for the review of WNR’s proposed Over-payment Rules is outlined below:
- January 2006 - Public submissions received on WNR’s proposed Over-payment Rules.
 - May 2006 - Authority’s draft determination published.
 - June 2006 - Public submissions received on draft determination.

- August 2006 - Authority's final determination and approval published.

REASONS FOR THE FINAL DETERMINATION

Discussion of Issues

25. Relevant issues raised in public submissions, during the second round of public consultation, on the Authority's draft determination are discussed below under the following headings:
- Defined terms.
 - Definition of revenue.
 - Over-payments apply to all access seekers.
 - Allocation of over-payment.
 - Over-payment rules.
26. The discussion of each of these items commences with the draft determination's required amendments followed by an outline of relevant comments received in the public consultation process on each amendment then the Authority's assessment and final determination.
27. The Authority has taken the view that those sections of WNR's proposed Over-payment Rules on which no comment has been made are acceptable to operators and access seekers. The proposed Over-payment Rules are largely the same as the Over-payment Rules approved by the IRAR in 2003 so operators and access seekers have had a considerable period to assess the effectiveness and suitability of these rules.
28. Some submissions contained comments which were within the scope of the review but which did not specifically address the amendments outlined in the draft determination. These comments are addressed at the end of this section under "Other Relevant Matters Raised in Submissions".
29. The Authority received seven submissions on the Authority's draft determination. However, there were only three submissions (from WNR, Alcoa and Worsley) that addressed the amendments in the draft determination. WNR¹ indicated that it accepted all five amendments.

Defined Terms

Draft Determination Amendment

30. One amendment was outlined in the draft determination relating to defined terms in the proposed Over-payment Rules, as listed below.
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¹ WNR, Part 5 Instruments- Submission on the draft determination of Over-payment Rules, page 1.

Amendment 1

Section 1 of the proposed Over-payment Rules should be amended so that the word 'section' is included after the word 'route' in the first line of the paragraph under the first bullet point.

Interested Party Submissions

31. Two submissions were received (from Alcoa and WNR) on the amendment.
32. Alcoa² has indicated its support for the amendment and has also suggested that there are other references in the proposed Over-payment Rules where there appears to be some confusion between the terms "route" and "route section" which should be clarified.
33. WNR³ indicated that it accepted the above amendment and would comply with the amendment by revising the proposed Over-payment Rules.

Authority's View on Comments in Submissions

34. The Authority notes Alcoa's support for the amendment and its comment that all references to the term "route" should be reviewed to ensure there is no confusion with the term "route section" in the text. The Authority has made WNR aware of Alcoa's comment and WNR has undertaken to increase the clarity between the terms by making the appropriate changes to the proposed Over-payment Rules.
35. The Authority notes that WNR has accepted Amendment 1.
36. Based on the above discussion of comments raised in submissions on Amendment 1, the Authority does not consider that any change is necessary to the amendment in the final determination.

Final Determination Amendment

Required Amendment 1

Section 1 of the proposed Over-payment Rules should be amended so that the word 'section' is included after the word 'route' in the first line of the paragraph under the first bullet point.

Definition of Revenue

Draft Determination Amendment

37. One amendment was outlined in the draft determination relating to the definition of revenue in the proposed Over-payment Rules, as listed below.

² Alcoa, Submission on the draft determination on WNR's Part 5 Instruments, page 1.

³ WNR page 1.

Amendment 2

Section 2.7 of the proposed Over-payment Rules should provide for private and government contributions to be specified as an equivalent annual contribution for the purposes of the floor and ceiling calculations. The allocation process where contributed assets service more than one route section should also be specified in this section.

Interested Party Submissions

38. Three submissions were received (from Alcoa, Worsley and WNR) on the amendment.
39. Alcoa⁴ has indicated its support for the amendment and has also suggested that WNR should be required to calculate the equivalent annual value of contributed assets on the same basis as WNR funded assets as defined in the Costing Principles.
40. Worsley⁵ has also supported the amendment and indicated that the method of determining the time period or term to be used in the equivalent annual contribution calculation should be specified.
41. WNR⁶ indicated that it accepted the above amendment and would comply with the amendment by revising the proposed Over-payment Rules.

Authority's View on Comments in Submissions

42. The Authority notes Alcoa's support for the amendment and its comment outlined in paragraph 39. The Authority also notes that the equivalent annual value calculation for the total gross replacement value of the asset base is performed in accordance with section 2.6 (the annuity calculation) of the Costing Principles irrespective of how the assets are financed. Consequently, the methodology for calculating the equivalent annual value, as outlined in section 2.6 of the Costing Principles, will be the same for both WNR financed and contributed assets.
43. In regard to the comment by Worsley on the time period to be used in the equivalent annual value calculation, section 2.6 of the Costing Principles indicates that the time period in the equivalent annual value calculation is based on the relevant economic life of the asset class. This recognises that there are different economic lives for different asset classes which will be factored into the equivalent annual value calculation. Consequently, the Authority does not consider that any further clarification of the time period is necessary in the Over-payment Rules, as this issue is covered in the Costing Principles.
44. The Authority notes that WNR has accepted Amendment 2.
45. Based on the above discussion of comments raised in submissions on Amendment 2, the Authority does not consider that any change is necessary to the amendment in the final determination.

⁴ Alcoa page 1.

⁵ Worsley, Draft Determinations on WestNet Rail's Part 5 Instruments- Submission by Worsley Alumina Pty Ltd, page 5.

⁶ WNR page 1.

Final Determination Amendment

Required Amendment 2

Section 2.7 of the proposed Over-payment Rules should provide for private and government contributions to be specified as an equivalent annual contribution for the purposes of the floor and ceiling calculations. The allocation process where contributed assets service more than one route section should also be specified in this section.

Over-payments Apply to all Access Seekers

Draft Determination Amendment

46. One amendment was outlined in the draft determination relating to the issue of over-payments applying to all access seekers, as listed below.

Amendment 3

Note (b) of rule 6, Section 3 of the proposed Over-payment Rules, should include the condition that refunds can be made to non-Regime operators if this provision is included in commercially negotiated access agreements to ensure consistency with rule 13.

Interested Party Submissions

47. Two submissions were received (from Alcoa and WNR) on the amendment.
48. Alcoa⁷ has indicated its support for the amendment without any further comment.
49. WNR⁸ indicated that it accepted the above amendment and would comply with the amendment by revising the proposed Over-payment Rules.

Authority's View on Comments in Submissions

50. The Authority notes that both Alcoa and WNR have accepted Amendment 3. Consequently, the Authority does not consider that any change to the amendment is necessary in the final determination.

⁷ Alcoa page 1.

⁸ WNR page 1.

Final Determination Amendment

Required Amendment 3

Note (b) of rule 6, Section 3 of the proposed Over-payment Rules, should include the condition that refunds can be made to non-Regime operators if this provision is included in commercially negotiated access agreements to ensure consistency with rule 13.

Allocation of Over-payment

Draft Determination Amendment

51. One amendment was outlined in the draft determination relating to the issue of allocation of over-payment, as listed below.

Amendment 4

Section 2.8 of the proposed Over-payment Rules should be amended to delete items 1 and 2. Item 3 should be suitably amended such that the allocation process outlined under this item is used as the methodology for allocating all over-payments. Item 3 should also be amended to make it clear that the over-payment should only be reimbursed to the operators who have contributed to the over-payment on the route section where the over-payment occurs.

Interested Party Submissions

52. Two submissions were received (from Alcoa and WNR) on the amendment.
53. Alcoa⁹ has indicated its support for the amendment and also indicated that section 2.8 of the proposed Over-payment Rules should include the provision of contributed assets in the methodology outlined in order to refund any over-payments and ensure consistency with the formula outlined in rule 6 of section 3 of the proposed Over-payment Rules (which outlines how refunds for over-payments will be made to eligible operators).
54. WNR¹⁰ indicated that it accepted the above amendment and would comply with the amendment by revising the proposed Over-payment Rules.

Authority's View on Comments in Submissions

55. The Authority notes Alcoa's support for the amendment and its comment outlined in paragraph 53. In regard to the inclusion of contributed assets, the Authority agrees that section 2.8 of the proposed Over-payment Rules omits the provision of contributed assets in the methodology for the refund of over-payments and considers that the methodology should be consistent with the formula in rule 6.

⁹ Alcoa page 2.

¹⁰ WNR page 1.

56. The Authority notes that WNR has accepted Amendment 2.
57. Based on the above discussion of comments raised in submissions on Amendment 4, the Authority considers that an additional requirement needs to be added to Amendment 4 to include a further change to section 2.8 of the proposed Over-payment Rules.

Final Determination Amendment

Required Amendment 4

Section 2.8 of the proposed Over-payment Rules should be amended to delete items 1 and 2. Item 3 should be suitably amended such that the allocation process outlined under this item is used as the methodology for allocating all over-payments. Item 3 should also be amended to make it clear that the over-payment should only be reimbursed to the operators who have contributed to the over-payment on the route section where the over-payment occurs. This section should also include contributed assets in calculating the refund to operators of any over-payment.

The Over-payment Rules

Draft Determination Amendment

58. One amendment was outlined in the draft determination relating to the issue of the over-payment rules, as listed below.

Amendment 5

Rule 6, in Section 3 of the proposed Over-payment Rules, should include non-access revenue in the numerator and denominator as reflected in the existing Over-payment Rules.

Interested Party Submissions

59. Two submissions were received (from Alcoa and WNR) on the amendment.
60. Alcoa¹¹ has indicated its support for the amendment and also suggests that some of the terminology used in the formula (i.e. “*an operator’s annual access revenue*”) appears to be incorrect as it should be either an operator’s annual payment or revenue received by WNR. Alcoa also considers that accrued interest should be included in the formula outlined under rule 6 of section 3.
61. WNR¹² indicated that it accepted the above amendment and would comply with the amendment by revising the proposed Over-payment Rules.

¹¹ Alcoa page 2.

¹² WNR page 1.

Authority's View on Comments in Submissions

62. The Authority notes Alcoa's support for the amendment and its comment outlined in paragraph 60. In regard to the different terminology used by WNR in the proposed Over-payment Rules, WNR has defined "access revenue" in section 2.3 of the proposed Over-payment Rules as "*all income received by WNR for the provision of track access to the network*". The Authority considers that the definition of access revenue is consistent with Alcoa's requirement that the equation be defined in terms of revenue received by WNR. The Authority agrees with Alcoa's view that the formula used in rule 6 should include interest accrued.
63. The Authority notes that WNR has accepted Amendment 5.
64. Based on the above discussion of comments raised in submissions on Amendment 5, the Authority considers that an additional requirement needs to be added to Amendment 5 to include accrued interest under the formula in rule 6 of section 3 of the proposed Over-payment Rules.

Final Determination Amendment

Required Amendment 5

Rule 6, in Section 3 of the proposed Over-payment Rules, should include non-access revenue in the numerator and denominator as reflected in the existing Over-payment Rules and should also include the provision of interest accrued in the formula as reflected in the existing Over-payment Rules.

Other Relevant Matters Raised in Submissions

65. In regard to the issue of the allocation methodology for access revenue as outlined in the proposed Over-payment Rules, ARTC¹³ suggests that this allocation process could lead to uneconomic branch lines being kept open and believes that it should be dealt with in more transparent ways rather than through cross-subsidisation.
66. The Authority notes that the comment by ARTC outlined in paragraph 65 is similar to its comment in its first submission on the proposed Over-payment Rules. The Authority in its draft determination addressed the concerns expressed by ARTC in its first submission in some detail and decided not to seek a change to the proposed allocation process on the basis of allowing WNR to have some degree of discretion to allocate revenues for a route back to the individual route section to ensure the efficient and economic use of the railway infrastructure.
67. It should be noted that the Authority recognises the validity of ARTC's comment in relation to the grain network where there may be uneconomic branch lines. However, in the grain network there is unlikely to be a situation where access revenue exceeds the ceiling cap due to road competition. Therefore there is unlikely to be any over-payment occur within the grain network. The Authority,

¹³ ARTC, Submission on the draft determination on WestNet Rail's Part 5 Instruments, page 4.

therefore, considers that there is no change required to its position on this issue outlined in the draft determination.

APPROVAL OF WNR'S REVISED OVER-PAYMENT RULES

68. Subsequent to release of the draft determination and receipt of WNR's submission on this determination, representatives of the Authority held discussions with WNR in relation to the amendments required by the Authority. On 8 August 2006, WNR submitted a further submission containing revised Over-payment Rules.
69. The Authority has reviewed the revised Over-payment Rules and is satisfied that the changes made by WNR meet the requirements of this final determination.
70. Consequently, the Authority, approves the revised Over-payment Rules as submitted by WNR on 8 August 2006.
71. WNR's approved revised Over-payment Rules has been placed on the Authority's website www.era.wa.gov.au.

APPENDICES

Appendix 1 Glossary

Act	Railways (Access) Act 1998
Alcoa	Alcoa World Alumina Australia Pty Ltd
ARTC	Australian Rail Track Corporation Ltd
Authority	Economic Regulation Authority
ARG	Australian Railroad Group Pty Ltd
Code	Railways (Access) Code 2000
CPI	Consumer Price Index
DORC	Depreciated Optimised Replacement Cost
GRV	Gross Replacement Value
GSR	Great Southern Railway Ltd
GTK	Gross Tonne Kilometres
KPI	Key Performance Indicator
MEA	Modern Equivalent Asset
Operator	Train Operators and end user customer
PN	Pacific National Pty Ltd
SdD	Strategic design and Development Pty Ltd
WACC	Weighted Average Cost of Capital
Worsley	Worsley Alumina Pty Ltd
WNR	WestNet Rail Pty Ltd