Western Australia

Economic Regulation Authority

DRAFT REPORT

REVIEW OF THE WESTERN AUSTRALIAN RAILWAYS (ACCESS) CODE (2000)

Economic Regulation Authority

1 JULY 2005

Level 6, Governor Stirling Tower, 197 St. Georges Terrace, Perth WA 6000
GPO Box 8469 Perth Business Centre WA 6849
Telephone: 61 8 9213 1900 Facsimile: 61 8 9213 1999
Email: enquiry@era.wa.gov.au Website: http://www.era.wa.gov.au/

HOW TO MAKE A SUBMISSION

Submissions on any matters raised in this Draft Report should be in written and electronic form and addressed to:

Mr Lyndon Rowe
Chairman
Economic Regulation Authority
GPO Box 8469
Perth Business Centre
PERTH WA 6849

Telephone: (08) 9213 1900
Facsimile: (08) 9213 1999

Submissions must be received by **5 August 2005**.

In general, submissions from interested parties will be treated as in the public domain and placed on the Economic Regulation Authority ("the Authority") website. Where an interested party wishes to make a confidential submission, it should clearly indicate the parts of the submission that are confidential. For more information about the Authority's submissions policy, see the Authority website.

The receipt and publication of a submission lodged by a person with the Authority and placed on the Authority's website shall not to be taken as indicating that the Authority has knowledge, either actual or constructive, of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority in these circumstances.

Further information regarding this Draft Report can be obtained from:

Mike Jansen
Manager, Projects
Economic Regulation Authority
Ph (08) 9213 1952
Email: Mike.Jansen@era.wa.gov.au

TABLE OF CONTENTS

EXECUTIVE SUMMARY

E.1 Scope of the review

The Western Australian Rail Access Regime ("the Regime") was established in order to facilitate third party access to monopoly infrastructure to promote competition in upstream and downstream markets by ensuring access on fair and reasonable terms. The Regime came into effect on 1st September 2001, and is comprised of the *Railways (Access) Act 1998* ("the Act"), and the *Railways (Access) Code 2000* ("the Code").

The provisions under Part 2 of the Act require the Minister to *"establish a Code in accordance with this Act to give effect to the Competition Principles Agreement…"*[1] Under section 12, the Act also requires the Authority to carry out a review of the Code on the third anniversary of its commencement, and every five years thereafter. This Draft Report is part of the initial third anniversary review of the Code, and aims to *"assess the suitability of the provisions of the Code to give effect to the Competition Principles Agreement in respect of railways to which the Code applies."*[2]

The Competition Principles Agreement (CPA) is part of the National Competition Policy (NCP) which was developed and signed by all Australian Governments. A key aim of the CPA is to establish a framework which will enable third party access to significant infrastructure facilities that exhibit natural monopoly characteristics and cannot be duplicated economically. Although, the NCP also includes two other documents,[3] the Act only refers to the CPA. Therefore, the scope of this review is limited to the suitability of the Code to give effect to the CPA.

The Issues Paper also sought comment on matters that relate to the Act in order for the Authority to ascertain a complete picture of the workings of the Regime. However, under the terms of reference for this review, any issues relating to the Act are outside the scope of the review.

E.2 Code review process

A requirement of section 12 of the Act, is that the review of the Code include the opportunity for public comment through written submissions to the Regulator. Accordingly, for the review of the Code, the Authority has developed a two stage public submission process and a workshop in order to ascertain public comment throughout the process.

On the 25th October 2004, the Authority published a public notice on its website,[4] noting that the review was underway. The first stage of the review was the Issues Paper, which was released on the Authority website on 23 February 2005.

---

[1] Section 4(1) of the Act.
[2] Section 12(2) of the Act.
[3] The Conduct Code Agreement, the Agreement to Implement the National Competition Policy and Related Reforms.
[4] Notice regarding the review of the Railways (Access) Code 2000 25 October 2004; see: http://www.railaccess.wa.gov.au/html/new00.php?id=69

The Issues Paper was prepared to assist parties making submissions on the review of the Code. This Paper outlined details on the regulatory background, the intentions of the CPA and the Regime, and the current operational and access issues that have arisen since the Code's introduction. Ten submissions to the Issues Paper were received.

This Draft Report provides a discussion of the submissions received. An initial assessment and some preliminary recommendations for amendments to the Code have been outlined in the Draft Report. The recommendations of this Draft Report will primarily focus on potential amendment options to the Code. Most of the Part 5 instruments established in accordance with the Code, contain a clause which specified that a separate review be completed two years after their approval. Consequently, issues relating to these documents are discussed at a strategic level separate from Code amendments in Section 5 of the Draft Report. The content of these Part 5 instruments are subject to a separate review following the Code review.

The release of this Draft Report on the Authority website will be followed by a 35 day submission period. Interested members of the public are encouraged to make submissions on the recommendations on potential Code amendments. During this public submission period it is proposed that a public workshop will be held to enable the issues to be discussed in an open forum.

The views raised from the submissions to the Draft Report and from the workshop will then be assessed in preparing the Final Report. The Final Report will be submitted by the Authority to the Treasurer for consideration by the Western Australian (WA) Government.

E.3 Extent to which Code gives effect to the CPA principles

The primary objective of this review is to assess how effectively the provisions of the Code give effect to the aims and provisions of the CPA. The intention of the CPA will be gleaned from evaluating the agreement in its entirety, with specific reference to clauses 6(2) – (4) that have been confirmed as the most relevant sections to this review.

The Authority has evaluated public views on the operation of the Code with respect to the relevant provisions of the CPA (primarily clauses 6(2) to 6(4)). The principal clauses of the CPA that may not be fully met by the Code in its present form, are:

- Appropriate terms and conditions of the Code (CPA clause 6(4)(a), (b), (c), (f), (i), (k), (n));
- Reasonable endeavours to accommodate the requirements of access seekers (CPA clause 6(4)(e))

In general, the Authority is of the view that the Code could be improved by addressing the problems of transparency and information asymmetry that are inherent in attempting to introduce a contestable market in a monopoly industry. By introducing amendments in these areas would improve the ability of the Code to give effect to the above listed CPA principles.

In evaluating potential areas of the Code that may require refinement, the Authority is mindful that all potential amendment options require full evaluation of the possible implications on investments in the network. Therefore, only options that are likely to provide significant improvements to the Code negotiation process without limiting the option of using commercially negotiating access arrangements outside the Code or putting at risk investment in the network or imposing excessive regulatory costs, have been developed as preliminary recommendations.

E.4 Application of the Code

The Code was originally designed to form an optional 'safety net' regulatory framework. That is a negotiating framework (see Parts 2-3 of the Code) of minimum rights that access seekers can elect to utilise for the purchase of rail access. Alternatively, consistent with the principles of commercial negotiations contained in the CPA, access seekers and railway owners are free to pursue different negotiation processes with pricing, terms and conditions which can be different to those defined in the Code.

There has been some discussion about which (if any) Code rights are retained by access seekers who negotiate outside of the Code (i.e. they did not utilise the negotiation processes contained in Parts 2-3 of the Code). The view of the Authority, confirmed by legal advice, is that agreements negotiated outside the Code are not subject to Part 5 instruments and do not have the ability to utilise other Code rights (eg. the ability to seek the Authority's view on whether prices are consistent with prices charged to associated entities or the right to use the Code's arbitration process (Part 3 Division 2)). Hence, unless access seekers formally utilise section 8 of the Code with a written proposal to the railway owner, they do not have the protection of the regime and the Regulator is not empowered to take certain actions. The view that the Code forms an optional 'safety net' stems from section 4(2)(d) of the Access Act which says that *"Provision is to be made in the Code"… "for the Regulator to have supervisory and other functions for the purposes of the Code, including a function of determining certain requirements in relation to access that are binding on the railway owner, a person making a proposal for access under the code and an arbitration."*

The Authority notes that access seekers could commence negotiations without using the Code and then at their discretion advise the railway owner in writing that they wish to restart negotiations under the Code commencing from section 8 of the Code.

To improve clarity on this issue, the Authority is proposing some changes to make it clearer for access seekers that they face an important choice at the start of negotiations. This choice is whether they will follow the Code's negotiation framework and hence retain a range of rights available to agreements negotiated under the Code or pursue alternative negotiation processes and forgo these protections provided by the Code.

E.5 Issues relating to Part 5 instruments

Part 5 of the Code requires that railway owners submit separate subsidiary instruments to be approved by the Authority. These "Part 5 instruments" are defined in the Code as the Train Management Guidelines, the Statements of Policy (Train Path Policy), the Costing Principles and the Over-payment Rules.

Many of the documents comprising the Part 5 instruments also require the development of Key Performance Indicators (KPI) that are also approved by the Authority.

The Authority has reviewed comments in submissions and potential refinement areas of each the Part 5 instruments (for further detail see Section 5). However, the actual detailed changes to the contents of the documents will be deferred to a future review of these documents.

Where access is negotiated outside the framework contained in Parts 2 and 3 of the Code, the Part 5 instruments do not apply. Segregation Arrangements are not defined in the Code as a Part 5 instrument.[5] The segregation requirements for railway owners are specified in the Act and these requirements need to be adhered to for all use of the network, including agreements negotiated outside the Code.

E.6 Issues relating to the Act

A number of the areas in the Code that have been identified as requiring amendment are linked to matters covered by the Act. Although outside the scope of this review, the Authority has needed to give consideration to these matters as stated earlier, in order to maintain consistency with the Code.

One of the main issues under the Act that has raised concern is the definition of 'railway infrastructure'. Many of the submissions commented that the Act should include yards, sidings, and terminals in the regulatory regime. The other matter that appears to have generated significant concern is the manner in which the Act currently deals with greenfield lines. The criteria for inclusion in the Code leaves a possible lengthy waiting period before the potential rail developer knows whether the line will be included in the Regime. This period of uncertainty could potentially cause a disincentive to invest in the network.

Any potential refinements that may be required to the Act involve a decision by the WA Government. A summary of comments contained in public submissions relating to the Act are contained in Attachment 1 of this Draft Report. The Final Report will focus only on amendments to the Code.

The Authority will not be including those matters relating to the Act, contained in Attachment 1, in the Final Report as they are outside the scope of the Code review. However, the Authority intends to separately forward a summary of comments made in submissions relating to the Act issues (both in response to the Issues Paper and the Draft Report) to the Treasurer for consideration by the WA Government.

[5] However, within section 42 of Part 5 of the Code, the Authority is required to seek public comment on these arrangements prior to Authority approval.

E.7 Summary of preliminary views and recommendations

The Authority seeks submissions from interest parties on any aspect of the Draft Report. In particular, the Authority is seeking comment on the preliminary views and proposed recommendations for Code amendments outlined in this Report, with a focus on whether the proposed changes improve consistency between the Code and the CPA. Moreover, the Authority is also keen to consider views on whether alternative amendments or other Code changes would achieve a better level of consistency with the CPA as well as improving the Regime by achieving a more efficient use of and investment in railway facilities.

Preliminary View 1

In relation to proposals to amend the Code to require the Authority to approve the Standard Access Agreement as a new Part 5 instrument, the preliminary view of the Authority is that it is unclear that such an approach would yield better outcomes nor is it required to improve consistency with the CPA. This initial view is based on the CPA stating that terms and conditions can be different; the absence of specific complaints relating to certain terms of the current standard agreement being unfair; the regulatory costs involved in establishing a Part 5 instrument; the risk that the Authority's involvement could stifle innovation; and a desire not to intervene where matters can be settled through commercial negotiation. The Authority seeks further views on this issue and remains open to considering other reforms such as amendments to Schedule 3 of the Code where this could become a set of principles.

Preliminary View 2

The preliminary view of the Authority is that the issue of precluding the railway owner from earning a return on assets funded by government subsidies is better addressed by changes to the Over-payment Rules. The Authority seeks further views on this issue and remains open to considering other reform approaches.

Recommendation 1

Part 2 of the Code needs to clarify that access negotiations completed without the use of the negotiation framework (Parts 2 and 3) of the Code are not entitled to any of the protections of rights under the Code. Part 2 also should be amended to require the railway owner to specifically agree with the access seeker whether negotiations are to proceed with or without using the processes within Code. If the Code is to be utilised the Authority should then be informed. Part 5 of the Code should also be amended to state that the Part 5 instruments apply only to access agreements negotiated under the Code. However, the railway owner and access seeker may agree to apply the same Part 5 instruments to access agreements negotiated outside the Code.

Recommendation 2

It is proposed that the Code be amended to require the public release of floor and ceiling prices in addition to floor and ceiling costs. These prices would be based on a standard reference train service assuming the most common train configuration for the route and would be calculated for routes requested by the Authority where the Authority believes there may be third party interest.

Recommendation 3

It is proposed that the railway owner be required to publicly release, on their website, detailed Information Packages including capacity information for routes requested by the Authority. The packages should be updated at least every two years or potentially more often where significant changes have occurred to the rail network.

Recommendation 4

Section 21 of the Code should be strengthened to allow the Authority to request from the railway owner the internal prices and related information by route section for relevant parts of the network with such information to be provided within 10 working days. This would improve the Authority's ability to quickly express an opinion as to whether the price sought by the access seeker in negotiations for access is consistent with prices charged to associates of the railway owner.

Recommendation 5

It is proposed that some additional principles be included within section 9(2)(b)(ii) of the Code to require that cost sharing arrangements for network expansions be set equitably between all users of the line based on a combination of relative current usage and economic benefits.

1 INTRODUCTION

1.1 Requirement for review

The Western Australian Rail Access Regime ("the Regime") came into effect on the 1st September 2001. The Regime is comprised of the Railways (Access) Act 1998 ("the Act"), and the Railways (Access) Code 2000 ("the Code"). The main objective of the Act, stated in section 2A, is to establish a rail access regime that encourages the efficient use of and investment in railway facilities within a contestable market. The Regime was established to provide a legislative option for access seekers, and not to force all access seekers under the umbrella of an access code.

Part 5 of the Code requires the establishment of four key regulatory instruments ("Part 5 instruments"), which consist of Costing Principles, the Train Path Policy (TPP) and Train Management Guidelines (TMG), and Over-payment Rules. These instruments provide a greater level of detail to enable implementation of specific principles contained within the Code.

Under Part 2 section 12, of the Act, the Authority is to undertake a review of the Code on the third anniversary of its commencement; and every five years thereafter. Section 12(2) of the Act stipulates that:

"The purpose of the review is to assess the suitability of the provisions of the Code to give effect to the Competition Principles Agreement (CPA) in respect of railways to which the Code applies".

The Authority must submit a report based on the review to the administering Minister (the Treasurer) for consideration.

Under the Act, a requirement of the review of the Code is to seek public comment on the effectiveness of the access regime. This condition is met through the public consultation periods following the Issues Paper and this Draft Report. A copy of the Act and the Code is available on the Authority's website www.era.wa.gov.au

A definition of the abbreviations used in this Draft Report is provided in Attachment 4.

1.2 Scope of review

1.2.1 Relevant Sections of the CPA

The primary purpose of this review of the Code is to assess how effectively the provisions of the Code meet the objectives of the CPA.

The CPA is part of the NCP which was formulated and signed by all Australian Governments.[6] The NCP is underpinned by three separate inter-governmental agreements:

(a) the CPA;

(b) the Conduct Code Agreement; and

(c) the Agreement to Implement the National Competition Policy and Related Reforms.

[6] Further information on the CPA, third party access and state based access regimes is available from the National Competition Council at http://www.ncc.gov.au/articleZone.asp?articleZoneID=64

Section 12 of the Act refers only to the CPA. Therefore, the scope of this review of the Code is limited to its suitability to give effect to the CPA, and does not include the other agreements which make up the NCP. All relevant clauses of the CPA will be taken into account, in addition to clause 6 which covers *'Access to Services Provided by Means of Significant Infrastructure Facilities.'*

A key aim of the CPA is to establish a framework which will enable third party access to significant infrastructure facilities that exhibit natural monopoly characteristics and cannot be duplicated economically.

The most relevant provisions of the CPA are clauses 6(2) to 6(4),[7] which inform the following key issues to be covered by the review;

- the Code's effectiveness in terms of its impact upon both the (below-rail) network service providers, and the (above-rail) network users (and potential users);
- the impact of the Code upon activities in downstream industries;
- the impact of the Code upon the efficiency of the operations of, and investment in, the rail network infrastructure; and
- comparative benchmarking of the effectiveness of the Code against rail access codes applying elsewhere in Australia to take into account developments in regulatory policy and practice.

The Issues Paper sought views on which parts of the CPA are most relevant to this review. The majority of submissions that address this matter concurred clauses 6(2) – (4) are the most relevant, and changes to the Code should be subject to the Public Interest Test (clause 1(3) of the CPA). WestNet Rail (WNR), the railway owner, stated that *"the effectiveness of the Code should not be measured against individual elements of the CPA in isolation, but against the CPA in its entirety"*.

1.2.2 Matters outside the scope of this Review

Although the scope of this review is limited to the Code, in order to ascertain a complete picture of the effects of the current provisions of the Code, the Issues Paper asked for comments on a variety of matters under the Regime including the Code and the Part 5 regulatory instruments under the Code and the Act. Whilst the Authority has received and considered issues relating to the Act, the Authority is limited by the Terms of Reference from recommending Act changes.

The manner in which the Authority will deal with the matters relating to the Act has been outlined in the Executive Summary section E6.

With respect to issues that relate to the Part 5 regulatory instruments, most of these instruments established within the Code contain a clause which specifies that a separate review be completed two years after their approval. Consequently, issues relating to the contents of these instruments are discussed at a strategic level separate from Code amendments in Section 5 of this Draft Report.

Where refinements to the contents of the Part 5 instruments are necessary, this will be conducted more thoroughly following this review of the Code in a separate process.

[7] See attachment 5 for a full list of the provisions under clause 6 of the CPA

1.2.3 Impact of amendments on existing access agreements

In conducting this review the Authority also notes section 38 of the Code which states that *"An access agreement is not affected by an amendment made to this Code after the agreement is made, unless this Code, or an instrument by which this Code is amended, provides otherwise."* Therefore, any amendments that are made to the Code following this review will not impact on existing access agreements, unless otherwise stipulated.

1.3 Objectives of third party access

The broad objective of third party access under the CPA is to encourage the efficient use of nationally significant network assets to promote competition in related markets.

The application of an efficiency objective in access regulation has the following three broad components:

- first, ensuring the efficient use of natural monopoly infrastructure, especially by limiting the opportunity of infrastructure owners to misuse market power (in either the market for these services or in related markets) by refusing or obstructing reasonable access to infrastructure services;
- second, facilitating efficient investment in natural monopoly infrastructure, especially by ensuring:
    - infrastructure services are maintained and developed appropriately;
    - infrastructure owners (and potential owners) earn sufficient returns to provide incentives for efficient investment;
    - incentives for inefficient development of competitive infrastructure and for inefficient investment in upstream and downstream activities are minimised; and
- third, promoting competition in activities that rely on the use of the infrastructure service where competitive infrastructure services are not economically feasible.

Clause 6 of the CPA establishes principles which a third party access framework should embody to achieve the above objectives.

Whilst this review is focussed on whether the Code meets the CPA objectives, the Authority is also mindful of transport industry perspectives on what makes an effective rail access regime. The Australian Logistics Council (ALC) has nominated the following five key principles that were identified to guide the design of an efficient framework:

- creating a level playing field engendering confidence in the regime certainty and transparency;
- delivering efficient prices;
- allocating risk and reward efficiently;
- ensuring proper integration of the transport chain; and

- avoiding excessive regulation.[8]

Overall, the principles developed by the ALC are broadly consistent and covered by the objectives of the CPA.

1.4 Rail Access reviews in other jurisdictions

Following the NCP agreements, state based rail access arrangements were introduced in all mainland Australian States and the Northern Territory.[9] Similar to this Code review, there are concurrent reviews occurring in Victoria, and Queensland.[10] In undertaking the review of the Code, the Authority has the benefit of being able to review the options papers, submissions and reports that have been produced for reviews in other States. These documents confirm a range of common issues facing rail access regulatory arrangements. The Authority will closely monitor approaches utilised and likely reforms from other jurisdictions to ensure better inter-jurisdictional consistency as part of the likely and logical migration toward more uniform rail access regimes, or a national rail access regime.

1.5 Amendments to the Code in 2003

The Code was reviewed in 2003, which resulted in a number of mostly minor administrative and definitional amendments. These amendments were introduced after the Regime had been operating for two years, after which time a number of amendments were identified that could improve the efficiency and effectiveness of the Code. The most significant changes were the provisions to expand the breadth of negotiable access to include expansions/extensions to a route or railway infrastructure.

There were 15 areas of the Code which were amended following this review process, and the most significant amendments are summarised in **Text Box 1** below. Under section 49 of the Code, the Authority can initiate similar reviews in the future, however, this review should alleviate the need for further changes over the short to medium term.

---

[8] Australian Logistics Council, Principles of an Effective Access Regime, available at http://www.ozlogistics.org/sites/org/ozlogistics/media/PaperonAccessRegimes.pdf

[9] For further details on rail access regimes in other jurisdictions refer to section 5 of the Issues Paper.

[10] For information on the Victorian review of its rail access regime see: http://www.doi.vic.gov.au/DOI/Internet/Freight.nsf/AllDocs/6B33905E20D6D3AECA256E0500058650?OpenDocument
For information on the Queensland review of its rail access undertaking see: http://www.qca.org.au/www/welcome.cfm

Text Box 1 Summary of Code Amendments 2003

1. **Expansions and Extensions to Railway Infrastructure: Access Negotiations and Financial Requirements:** expand the breadth of negotiable access to include operations that are outside the existing capacity of the route or railway infrastructure. It requires railway owners negotiate expansions and extensions of a given route or associated railway infrastructure with an access seeker, as long as it is economic for the owner to do so.
   This amendment resulted in changes to a number of sections of the Code including: Part 1 s.3,5 & 8; Part 2 s.9; Part 3 s.14, 15 & 33; Part 4 s.36; and Schedule 4.
2. **Cost Liability upon settlement of Arbitration Disputes:** Section 34 of the Code was amended to ensure that the cost of arbitration is binding on both the railway owner and the access seeker.
3. **Definition of 'Railway Infrastructure':** The definition of 'railway infrastructure' in s. 3 was amended to ensure consistency with the definition of 'railway infrastructure' outlined in the Act.
4. **Identification of those Routes to which the Code Applies:** Schedule 1 of the Code was amended to include parts of the railway network that were not stated in the Schedule. Corresponding amendments were also made to Schedule 4 clause 3.
5. **Reimbursement of Over-Payments by the railway owners:** Requires railway owners to reimburse operators where over-payment has occurred, as determined by the Regulator. Amendment was made to s.47.
6. **Definition of Operating Costs:** The definition of 'operating cost' in Schedule 4 of the Code was amended to require assets to be, if appropriate, modern equivalent assets.
7. **Application of One Ceiling to Each Route Segment:** Clarifies that only one price ceiling applies to each route segment. Amendment was made to Schedule 4 clause 8.
8. **Time Limit for the Approval of the Determination of Ceiling Costs by the Regulator:** was amended because the previous time period was not considered sufficient to effectively assess the owner's application. Schedule 4 clause 10(2) and (3) were repealed and replaced.
9. **Calculation of Capital Costs where a Cutting or Embankment is Required:** This amendment to Schedule 4 clause 2 means that cuttings and embankments incurred after the commencement of the Code are to be included as railway infrastructure in the calculation of capital costs.
10. **Transitional Arrangements required until the Railway (Access) Amendment Code 2003 comes into effect:** This amendment outlined the process of adherence to the Code prior to the Railways (Access) Amendment Code 2003 coming into effect. This amendment altered a number of sections including s.9, 14, &15 and Schedule 4 clause 10(2) and (3).

Source Government of Western Australia (2003), *Amendments to the Railways (Access) Code 2000: Public Consultation Paper*, November 2003, pp. ii-iii.

1.6 Summary of Review Stages

Section 12 of the Act requires that a review be undertaken of the Code that includes the opportunity for public comment on the effectiveness of the Code. In accordance, with these requirements, the Authority has developed a two stage public submission process and workshop in order to ascertain public comment throughout the process. The Authority published a public notice on its website,[11] noting that the review was underway, on the 25th October 2004. The updated review schedule is as follows:

Activity	Date
Release Issues Paper	23 February 2005
Submissions close	12 April 2005
Release Draft Report	1 July 2005
Public workshop	21 July 2005
Submissions close	5 August 2005
Release Final Report	16 September 2005

[11] Notice regarding the review of the Railways (Access) Code 2000, 25 October 2004. See: http://www.railaccess.wa.gov.au/html/new00.php?id=69

1.6.1 Issues Paper and Submissions

The Issues Paper, released on the Authority website on the 23 February 2005, is the key initial component of the public review process. It discusses matters that relate to the operation of the Regime, including both Act and Code issues, and aims to stimulate comment from interested parties.

To provide interested parties with an adequate timeframe to respond to the matters raised in the Issues Paper, an initial 34 day period for submissions following its release was allowed. After granting an extension to the submission deadline, the closing date for submissions was the 12 April 2005. Ten public submissions were received containing comment in response to the matters raised by the Authority in the Issues Paper. The parties who made submissions are listed in Attachment 2, with their submissions available on the Authority's website at http://www.era.wa.gov.au/

The Authority considered all submissions in the course of preparing the Draft Report.

1.6.2 Draft Report

This Draft Report provides a discussion of public views, an initial assessment and some preliminary amendment recommendations. The preliminary recommendations of this Draft Report will primarily focus on potential amendment options to the Code. A summary of public views on issues relating to the Act is provided in Attachment 1.

This Draft Report will be released on the Authority's website followed by a second public submission period.

1.6.3 Public workshop

It is proposed that a workshop will be held after release of the Draft Report and prior to the conclusion of the second round of submissions. This public workshop will enable the issues to be discussed in an open forum. The proposed date for the public workshop is 21 July 2005.

The views raised from the submissions to the Draft Report and from the workshop will then be evaluated in developing the Final Report.

1.6.4 Final Report to Minister

The Final Report will be submitted to the Minister by the Authority. A copy of the Final Report will also be placed on the Authority's website.

2 CURRENT WA RAIL ACCESS REGIME

2.1 Development of the Current Regime

Following the national development of Part IIIA of the Trade Practices Act 1974 (TPA) in 1995, the WA Government developed a State based Rail Access Regime in 1998 by establishing the Act to apply to its Government owned rail businesses.[12] These reforms were introduced with the aim at encouraging effective, fair and transparent competition in WA's rail freight industry. However, the full Regime did not come into effect until its gazettal on the 1st of September 2001.

In December 2000, Westrail was privatised by the WA Government with the sale to Australian Railroad Group Pty Ltd (ARG). WNR, a subsidiary of ARG, which has been granted a 49 year lease of the rail freight network, is the network owner of the freight railway infrastructure for the purposes of access agreements under the Regime. Consequently, the organisational structure of the WA railway owner is vertically integrated. The Regime is administered by the Authority which monitors and enforces compliance by railway owners.

The Regime has not been certified as effective under the CPA. Regimes certified by the National Competition Council (NCC) (e.g. Australasia Railway Access Regime) preclude applications for declaration under Part III of the TPA. However, the Regime has been assessed by the NCC as being 'effective' for most criteria. It was not certified due to the WA Government's reluctance to make amendments to oblige the railway owner to have the Regime dissolved and become automatically covered in the event that a National Access Regime is established. The WA Government decided against this approach suggested by the NCC due to concerns about automatically committing to a Regime without first knowing the details.

2.2 Approach of the Regime

The objective of the Regime as specified in the Act is to encourage "*the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations.*"[13]

To achieve this objective, Western Australia (WA) has adopted a negotiate-arbitrate model for its rail access regime that enables negotiation of access agreements between railway owners and access seekers.

The Regime provides an optional 'safety net' framework in that negotiations are able to proceed either using the steps and timeframes specified in the Code (Parts 2 and 3) or alternatively negotiations may proceed using other commercial negotiation processes (ie outside the Code) in which case rights to a number of Code protections are foregone by access seekers.

Essentially, the negotiation provisions of the Regime form a 'safety net' of minimum rights that access seekers can elect to utilise to negotiate purchase of rail access. Disputes between the railway owner and the access seeker are to be resolved by arbitrators and mediators operating under the *Commercial Arbitration Act 1985*.

[12] For further details on the history and development of the current regulatory arrangements see Economic Regulatory Authority (2005), *Issues Paper: Review of the Western Australian Railways (Access) Code (2000)*; 23 February 2005; pp. 6-7.
[13] Section 2A of the Act.

The WA model is known as a hybrid model, in that it combines elements of both the ex-ante and ex-post models. The ex-ante elements of the Regime include the requirement to establish a Standard Access Agreement compliant with generic term and condition headings (as listed in Schedule 3 of the Code), as a starting point for negotiations. The Authority does not have any power to approve any elements of the Standard Access Agreement which are outside the areas of the Code noted above (i.e. Schedule 3 and the Part 5 instruments).

2.3 Coverage of the Regime

Part 3 of the Code obligates the railway owner to negotiate in good faith on receipt of an access proposal as defined in section 8 of the Code. The access seeker needs to be able to demonstrate it has the managerial and financial ability (section 14 of the Code) and its operations are within the current or expanded capacity of the route (section 15 of the Code). The railway owner and the access seeker are required to negotiate specific terms and conditions such as those matters listed in Schedule 3 of the Code.

The negotiation provisions have not yet been fully tested under the Regime due to the majority of parties agreeing that access negotiations be completed without following the processes specified in the Code. The Authority notes that following the Code steps but with faster response times does not in itself take negotiations outside the Regime. This has previously been described as negotiated "outside the Code". However, the Authority notes that access agreements which are negotiated outside the steps in Parts 2-3 of the Code forgo statutory rights to all other protections of the Code (e.g. Authority views on prices, the dispute resolution processes of the Code, Over-payment Rules, Costing Principles, Train Path Policy and Train Management Guidelines). Whilst railway owners may elect to apply some Part 5 instruments to all operations on the network, this is an internal policy rather than a statutory requirement. As part of this review, the Authority is keen to hear any views on whether the Code negotiation process could be improved by stipulating a more detailed and regular set of interactions.

The Code was originally designed to form an optional 'safety net' regulatory framework ie a negotiating framework (see Parts 2-3 of the Code) of minimum rights that access seekers can elect to utilise for the purchase of rail access. Alternatively, consistent with the principles of commercial negotiations contained in the CPA, access seekers and railway owners are free to pursue different negotiation processes with pricing, terms and conditions which can be different to those defined in the Code.

The view of the Authority is that agreements negotiated outside the Code are not subject to Part 5 instruments and do not have the ability to utilise other Code rights (e.g. the ability to seek the Authority view on whether prices are consistent with prices charged to associated entities or the right to use the Code's arbitration process (Part 3 Division 2)).

Hence, unless access seekers formally utilise section 8 of the Code with a written proposal to the railway owner, they do not have the protection of the Regime and the Authority is not empowered to take certain actions or roles.

The view that the Code forms an optional 'safety net' stems from section 4(2)(d) of the Act which says that *"Provision is to be made in the Code"… "for the Regulator to have supervisory and other functions for the purposes of the Code, including a function of determining certain requirements in relation to access that are binding on*

the railway owner, a person making a proposal for access under the code and an arbitration."

The 'person making a proposal for access' is defined by section 3 of the Code using the term "proponent" which is 'an entity that has made a proposal' with "proposal" being defined as a 'proposal under section 8' of the Code. Hence, section 8 of the Code is critical to defining whether the access seeker is under the Code.

In relation to Part 5 of the Code, the railway owner has certain binding requirements "in relation to access" (as defined by section 4(2)(d) of the Act) and the drafting of the Regime indicates that these are not intended to be statutory or mandatory requirements on the railway owner for access seekers that have elected to negotiate outside the regime. For example, in relation to TPP and TMG, WNR has proposed that both these instruments apply (as an internal policy or by specification within agreements) regardless of access applications that are made inside or outside of the Code, for safety and logistic reasons. Whilst this is acknowledged by the Authority as a reasonable and practical approach, the Authority still has no role in such 'outside the Code' agreements and the Authority is not convinced that there is a need to make such an approach mandatory.

Similarly, in the Over-payment rules, the Authority acknowledges that "payments in respect of non-regime operators will be retained by WNR, subject to the terms of any agreement to the contrary". Hence, the Authority recognises that it does not have the powers to force WNR to pay back over-payments made from agreements outside the regime. With respect to Costing Principles, these apply only to the access agreement established pursuant to the Code and agreements negotiated outside the Code are able to be established at higher or lower prices.

In relation to the Segregation Arrangements, as these are requirements on railway owners of Division 3 of the Act, the Authority is of the view that these requirements need to be fully adhered to and whether agreements are inside or outside the Code is not a relevant issue for segregation.

The Authority notes that access seekers could commence negotiations without using the Code and then at their discretion are free to advise the railway owner in writing that they will restart negotiations under the Code commencing from section 8 of the Code.

Several submissions to the Issues Paper sought some changes to the negotiation arrangements. By contrast WNR stated that there is little demonstrable evidence requiring material changes to the Code at this point in time, and furthermore "*other jurisdictions are using or moving to a hybrid model.*"[14] To improve clarity on this issue, the Authority is proposing some changes to make it clearer for access seekers that they face an important choice at the start of negotiations. This choice is whether they will follow the Code's negotiation framework and hence retain a range of rights available to agreements negotiated under the Code or pursue alternative negotiation processes and forgo these protections provided by the Code.

[14] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.18-19.

2.4 Key WA Rail Access Regime framework components

2.4.1 Railways (Access) Act 1998

Section 4 of the Act stipulates a requirement for a Code to be established, and provides the legal basis for enforcement of the Code. Together, the Act and the Code form the WA Rail Access Regime.

The primary matters that are governed by the Act include:[15]

- establishment of the powers and authority of the Independent Rail Access Regulator, which is the Authority (Part 3, section 13-23);
- segregation arrangements which require the railway owner to separate its access related, below rail (non-competitive) functions from other (competitive) functions. (section 28); (for further details see section 2.5.2 below); and
- enforcement mechanisms which include penalties or Supreme Court injunctions against the railway owner for non-compliance with key parts of the Regime (Part 5 sections 34-37).[16]

2.4.2 Railways (Access) Code 2000

The Code is subsidiary legislation, developed in accordance with Part 2 of the Act. The current Code was initially gazetted on 8 September 2000, with the 2004 Code amendment gazetted on 23 July 2004. The purpose of the Code is to provide a set of guidelines that dictate how the provisions of the Act are to be applied. Where the Act covers the broad policy principles of the Regime, the Code covers the practical implementation of the Regime.

The Code makes provision for railway infrastructure to be available for use by a third party through either a contract with the railway owner or a determination made through arbitration. It defines what is open to access by outlining which parts of the network are covered by the Regime. The other main provisions covered by the Code are:

- negotiation process;
- dispute resolution process;
- information to be made available to and by access seekers;
- Regulator functions including matters to be approved such as the Costing Principles, Over-payment Rules, TMG and TPP (or Part 5 instruments);
- contents of access agreements; and
- routes covered by the Code (Schedule 1)

2.4.3 Role of Regulator

Initially the administration of the Regime was the responsibility of the Office of the Rail Access Regulator (ORAR). However, this function was transferred to the Authority on 1 January 2004 as part of a reform to progressively merge the industry based regulators into a single WA Economic Regulator. Any reference to the

[15] For further details see section 4.2.1 of the Issues Paper.
[16] For more information on enforcement and the WA Regime see: http://www.railaccess.wa.gov.au/files/publications/Infosheet%238.pdf

Authority relates to the Independent Rail Access Regulator as the Regulator's functions have been subsumed into the Authority.

The governing body of the Authority is appointed by the Governor and, in regard to regulatory duties, is independent of direction or control by any Minister, public servant or industry.

The main responsibilities of the Authority include:

- review, approve and/or determine the Part 5 instruments under the Code (sections 43-47 of the Code - for further information see section 2.5 below);
- approve negotiation where capacity is likely to be reached (section 10 of the Code),
- provide an opinion on the consistency of prices provided to access seekers with prices paid by other operators including associated entities (section 21 of the Code),
- provide advice to the arbitrator when sought (section 30);
- determine floor and ceiling cost levels by route (clause 10 schedule 4).
- periodically review the Code (section 12 of the Act and section 49 of the Code);
- maintain a register of access agreements made under the Code (section 39);
- where needed to fulfil Code roles, the Authority has the power to obtain information and documents from the railway owners (sections 21, 22 and 22A of the Act);
- enforcement powers and responsibility for applying penalties for breaches of the Code or the Act (various sections of the Act).
- The ability to refer a dispute relating to an access agreement made under the Code to arbitration and appoint appropriate persons to conduct the arbitration under the Code (sections 26 and 27 of the Code). However, the Authority is not directly involved in the arbitration process.

Submissions in response to the Issues Paper have provided a variety of views on the merit of changing the role of the Regulator.

2.4.4 Rights and obligations of railway owner

Under the Act the "railway owner" is the person who has management and control of the railway infrastructure.[17] Under the Code, the railway owner has an obligation to negotiate in good faith with prospective access seekers who meet the necessary financial and managerial requirements. For agreements outside the Code, section 33 of the Act contains a broader 'duty of fairness' for the railway owner in that they are not to be "unfair to persons seeking access or to other rail operators." To give effect to good faith negotiations, the Code requires the railway owner to supply the access seeker with relevant information on capacity, price, and terms and conditions of the access agreement. The Code then requires the railway owner to prepare and make available track and capacity information, including a Standard Access Agreement for purchase (for further details see section 4.2.4 of the Issues Paper).

[17] The Government of WA retains technical legal ownership of the freight network via the 49 year lease to WNR.

As detailed in Section 2.3 of this Draft Report, where access seekers and the railway owners elect not to follow the negotiation processes of the Code, they are free to use alternative steps and rights and protections specified under the Code are foregone. However, the railway owner must fulfil obligations under the Act for such out-side the Code negotiations such as those pertaining to segregation.

When considering access proposals made under the Code the railway owner must endeavour to avoid unnecessary delays, and under the Act (section 33) they must not unfairly discriminate between proponents or rail operators.

When a third party has obtained access, the railway owner must not hinder or prevent that access, and must not discriminate between itself and other access seekers or operators (including associated entities) with respect to the allocation of train paths, management of train control and operating standards. This right to equitable treatment applies equally to all network users regardless of whether negotiations followed the steps specified in Part 3 of the Code or whether alternative negotiation processes were utilised.

The railway owner also needs to prepare and submit to the Authority information on Part 5 instruments as soon as practicable. The railway owner has a duty to produce documents and information requested by the Authority, and permit entry and inspection by the Authority. In all dealings with the Authority, the railway owner must not hinder, obstruct, or knowingly give false or misleading information.

Rights of the railway owner include the right to be consulted if the Code is to be amended or replaced.

2.4.5 Rights and obligations of access seekers

The majority of the rights and obligations of the access seeker under the Code relate to dealings with the railway owner. In order to enter into negotiations using the Code's minimum (or safety net) processes, the access seeker must establish that it has the financial and managerial capabilities to operate on the network. Where the train operator has well established credentials and accreditations, this demonstration should be relatively straightforward.

Where access seekers do not seek to utilise the Part 2-3 Code negotiation process, they may agree to use an alternative set of steps (e.g. with more regular interactions). A proposal under the Code to the railway owner must, as a minimum, specify the route, the required railway infrastructure, the times when the access is required, and the nature of the proposed rail operations. The access seeker is able to seek information from the railway owner as outlined above, and where under the Code they can also seek advice from the Authority on whether the price offered by the railway owner is consistent with the tariffs charged to other operators including associated entities. The access seeker must negotiate with the railway owner on matters listed in Schedule 3 of the Code, and the negotiation period must be jointly agreed with the railway owner no later than 90 days after the access seeker is ready to negotiate (unless varied by agreement).

Under the Code, the access seeker must not hinder or prevent access by other persons to any part of the network. Under section 25 (2)(a to c) there are three types of disputes where the access seeker may refer the dispute to arbitration which are:

- Where the railway owner has refused to negotiate an access agreement as required by section 13;
- the access seeker has notified the railway owner under section 18(3) that a dispute exists because the railway owner considers that the access seeker does not have the managerial and financial capability to undertake rail operations; and
- an agreement has not been reach prior to the agreed termination day or negotiations have broken down.

2.5 Subsidiary framework components

Part 5 of the Code requires the establishment of four key regulatory instruments which together with Segregation Arrangements (required by s28 of the Act) are summarised in the sections below. As previously stated, there will be a separate review with interested parties of some of these documents following this review of the Code. Preliminary views on the suggested refinements to these documents suggested by interested parties are summarised in Section 5, and will be further evaluated as part of the subsequent reviews.

The following section provides a brief summary of the objectives of each of the Part 5 instruments and Segregation Arrangements. For a more comprehensive description see section 4.3 of the Issues Paper.

2.5.1 Costing Principles

Section 46 of the Code requires the railway owner to obtain Authority approval of the Costing Principles it is proposing to implement. The Costing Principles for WNR were approved by the Regulator in December 2002, and in April 2003 for the Public Transport Authority (PTA).

The Costing Principles are a statement of principles, rules and practices that are to be applied and followed by the railway owner to:

- determine the floor and ceiling price tests; and
- keep and present the railway owner's accounts and financial records pertaining to the determination of costs for the floor and ceiling price tests.

The floor cost is the incremental cost[18] resulting from the access seekers operations on that route and use of that infrastructure. The ceiling cost is defined as a ceiling cost not more than the total costs[19] attributable to that route and that infrastructure utilised for an access seekers proposed operation. The floor and ceiling costs are then divided by the forecast route volumes to derive the floor and ceiling price boundaries. The actual prices of access to be paid to the railway owner are determined by negotiation under the provisions of Schedule 4 clause 6 and 13 of the Code.

The Code prescribes the use of the Gross Replacement Value (GRV) annuity approach to determine the revenue ceiling. GRV is the gross replacement value of the railway infrastructure. It is calculated as the lowest current cost to replace existing assets with assets that have the capacity to provide the level of service that meet the

[18] Incremental costs are defined as operating costs and capital costs and overheads (where applicable) that the Owner would be able to avoid in respect of the 12 months following the proposed access.
[19] Total costs = operating costs + capital costs + overheads

actual and reasonably projected demand and are, if appropriate, modern equivalent assets. The value of an asset is determined by the market based on expected returns. However, for infrastructure assets, market values are not readily estimated due to factors such as uniqueness and relatively infrequent asset sales.

If the railway owner receives government subsidies, and third party financial contributions, to support their operations, the Costing Principles do not require a reduction in ceiling costs to reflect this contribution. However, in evaluating whether revenues obtained by the railway owner exceed ceiling costs using the Over-payment Rules, these subsidies/contributions are recognised as a form of customer revenue.

2.5.2 Segregation Arrangements

The Act requires that the railway owner develops and submits to the Authority for approval, the Segregation Arrangements to apply and be followed by the railway owner. Unlike Part 5 instruments of the Code, the majority of the Segregation Arrangements are specified in the Act, reflecting the paramount importance of ensuring equitable treatment of access seekers. Section 28 of the Act requires the railway owner to make arrangements to segregate (or ring fence) its access-related functions from its other functions and to have appropriate controls and procedures to ensure an effective separation which protects the interests of the parties.

Under Section 29(1) of the Act these Segregation Arrangements must be approved by the Authority, subject to public consultation. Section 42 of the Code specifies the public consultation process to be undertaken prior to approval of Segregation Arrangements. The final WNR submission of the Segregation Arrangements was made in October 2002, with approval granted in April 2003. For PTA, the final submission on the Segregation Arrangements and Authority approval of these arrangements was provided in April 2003.

In the case of non-compliance with these segregation requirements, the Act establishes the penalties for the railway owner which could include fines of up to $100,000.[20]

While WNR and Australian Western Railroad (AWR) are separate subsidiaries of ARG, some submissions have commented on the potential inadequacy of the separation of WNR access-related functions from ARG and AWR, and the need to ensure effective arrangements are in place to separate contestable and non-contestable activities.

The Segregation Arrangements for both railway owners have been developed and approved following a period of public consultation. The Segregation Arrangements also form part of the annual compliance audit undertaken and reported to the Authority. There have been two compliance audits completed, with the results proven to be satisfactory and the audit reports have been made available on the Authority's website.

The PTA is also a vertically integrated entity. It has not established a separate below rail subsidiary but has rather placed its key railway owner functions into a separate

[20] Section 29 of the Act.

Network and Infrastructure Division. To date interested parties have not expressed any significant concerns to the Authority about the effectiveness of the PTA's segregation arrangements. The PTA has established 'outside the Code' access agreements with a number of third parties.

2.5.3 Train Management Guidelines

The Code requires that the railway owner develops and submits TMG to the Authority for approval (under section 43 of the Code). The TMG is a set of principles, rules and practices which apply to the management of train services. The general principle is to ensure operational safety is maintained through compliance with safe working rules, regulations and procedures. The Authority approved the TMG (along with TPP, discussed below) for WNR in February 2003, and in March 2003 for the PTA.

TMG (and TPP) are only mandatory for all usage of the network via access agreements negotiated under the Code. The Issues Paper raised the issue of whether TPP and TMG should apply to all access agreements regardless of the negotiation process. The WNR view is that this is already WNR company policy which was established in response to an Act requirement for a 'duty of fairness' (section 33 of the Act) as well as a Code requirement (section 16(2)) that "*the railway owner must not unfairly discriminate between the proposed rail operations of a proponent and the rail operations of the railway owner*". Subsequently, WNR has a current policy of applying TPP and TMG to all network usage with both approved documents attached as an appendix to all access or transport agreements. However, TPP and TMG provide a specific set of allocation procedures for train paths, management of train control and operating standards. Hence, it is conceivable that operators outside the Code could still have a different TPP and TMG arrangement and still comply with section 16(2) in the Code.

The Authority notes that there may potentially be some practical merit in a uniform application of TPP and TMG, however, this is a choice for the railway owner and the Authority does not seek to limit the commercial flexibility of access agreements established outside the Code.

Overall, there may be merit in making it clearer that TPP and TMG only automatically apply to agreements established under the Code and if access seekers wish them to apply to 'outside the Code' agreements then they should seek to make this a term of such an agreement.

2.5.4 Train Path Policy

Under clause 44(2) of the Code, the railway owner is required to make a statement of policy related to the allocation of train paths and the provision of access to train paths that have ceased to be used. As is the case for the other Part 5 instruments, the railway owner must submit the TPP to the Regulator for approval, who only makes amendment where it is inconsistent with the intentions of the CPA and the Regime.

The TPP is designed to ensure the allocation of train paths undertaken in a manner that ensures fairness of treatment between operators who have obtained access under the Code. It also acknowledges existing contractual rights and any new contractual rights created under access agreements entered into under the Code.

Similar to the TMG, the TPP needs to be approved by the Authority. This process was completed, concurrent with the TMG approval process, in February 2003 for WNR, and in March 2003 for the PTA. The TPP and the TMG establish policy and

guidelines respectively within which the specific details of train path and train management can be negotiated.

2.5.5 Over-payment Rules

Section 47(1) of the Code requires each railway owner to prepare and submit Over-payment Rules to the Authority for approval. Over-payment Rules apply where breaches of the ceiling revenue test occur on the part of that railway line that could not reasonably be avoided. The Over-payment Rules provide a mechanism in the Regime to:

- calculate the revenue that exceeds the total costs attributable to the route section and infrastructure; and
- reimburse operators who are provided with access under the Code to that route section and infrastructure in the event of an excess of revenue above the ceiling cost.

As discussed in Section 2.3, the Authority acknowledges over-payments in respect of outside the Code agreements are retained by WNR, subject to the terms of any agreement to the contrary. Hence, the Authority recognises that it does not have the powers to force WNR to pay back over-payments made from agreements outside the regime. Some interested parties also have expressed concerns to the Authority about the effectiveness of the Over-payment Rules. Most issues relate to the railway owners having the ability to allocate revenue in different sequences along the route sections across the route of a particular train service (see Section 5). In summary, the Over-payment Rules permit a revenue allocation sequence to route sections of:

- incremental costs to all applicable route sections; then
- allocation up to the ceiling cost for all applicable branch or feeder (dedicated) route sections; then
- allocation up to the ceiling on all applicable shared route sections; ie those route sections servicing more than one end customer or being used by more than one train operator.[21]

The justification of this revenue allocation sequence is that all sections must cover at least their incremental cost to avoid cross-subsidies. Then branch or feeder sections rank ahead of shared lines as there is no other traffic to fund the fixed costs of such lines. The outcome of this sequence is that for certain shared individual route sections with high volumes, the access revenue for such route section may exceed the individual ceiling. But when evaluated as a origin-destination route then the access revenue should be less than the sum of the ceiling costs for each route section.

[21] WNR Over payment-Rules, 29 April 2003, p 5.

3 CURRENT OPERATORS AND EXTENT OF COMPETITION

3.1 Summary of usage by current train operators

3.1.1 Australian Western Railroad

AWR is a subsidiary of ARG which is the primary (above rail) freight intrastate train operator in WA. AWR carries approximately 33 million tonnes of predominantly bulk intrastate rail freight, providing around 40,000 train services. These services are delivered by 60 narrow and 40 standard gauge locomotives.[22] AWR also moves approximately 1.5 million tonnes by road feeder services annually.

In WA, the main freight commodities include grain, alumina, bauxite, iron ore, nickel ore, mineral sands and woodchips. Almost 95% of the freight carried by AWR in WA is related to exports through the ports of Geraldton, Fremantle, Kwinana, Bunbury, Albany and Esperance. This characteristic is related to rails superior competitiveness for tasks with similar origin and destinations.

3.1.2 Pacific National

Pacific National (PN) is Australia's largest private rail freight operator, which recorded total revenues of $1.22bn in the twelve months to 31 December 2004.[23]

In WA, PN provides interstate freight train services connecting Perth to major Australian mainland capital cities and regional centres, including links to key ports. PN generally operates a daily return service from the east coast of Australia to Perth.

PN has an outside the Code access agreement with WNR (which was originally established with Westrail which was subsequently assigned to WNR at privatisation).

3.1.3 Public Transport Authority

The PTA brings together the management and delivery of public transport in WA, providing metropolitan and regional passenger rail services[24]. The rail service divisions of the PTA include:

- **Transperth**: is the metropolitan passenger train operating division, makes more than 750 trips each weekday between 56 stations; and
- **Transwa**: operates three regional passenger train services (the Australind, Prospector and AvonLink) which use both the PTA and WNR networks with subsequent road coach connections to over 275 regional locations in WA.

3.1.4 Specialised Container Transport

Specialised Container Transport (SCT) operates a range of freight train services including a twice weekly return interstate freight train service between Melbourne and Perth. SCT has an outside the Code access agreement with WNR (which was originally established with Westrail which was subsequently assigned to WNR at privatisation). SCT has elected to subcontract provision of rolling stock and crew to PN under a hook and pull agreement.[25]

---

[22] For further information see http://www.arg.net.au
[23] For further information see http://www.toll.com.au/news_corporate05.html
[24] For more information see http://www.pta.wa.gov.au
[25] http://www.sct.net.au/

3.1.5 Great Southern Railway

Great Southern Railway (GSR) operates a range of long distance tourist passenger trains across Australia, including the Indian Pacific passenger tourist service, which travels from Sydney to Perth. There are two return Indian Pacific services per week. GSR has an outside the Code access agreement with WNR.

3.1.6 Other

There are also some tourist train operations in WA. For example, the Hotham Valley Tourist Railway which operates steam and diesel passenger haul services. They offer a variety of specialist tourist services throughout the year, on the mainline and regional lines.

South Spur Rail and Midland RailCo also operate on the network, and are smaller private operators which have contracts to haul products mainly for WNR, such as ballast.

3.2 Extent of rail competition

Third party access is based on the notion that the economic welfare of society can be improved where there are voluntary negotiated exchanges of goods and services between willing parties.[26] The overarching aim of the Regime is to give effect to the NCP principles to remove constraints to access, promote flexibility and to ultimately increase competition within contestable markets. However, evaluation of the extent to which the Regime has given rise to increased competition is difficult due to the following factors that have prevented it from being fully tested:

- the Regime is relatively new, with implementation in September 2001 and the key determinations of the Regime (the floor and ceiling costs decisions) being made since September 2003. Additionally, as access seekers and railway owners have opted not to use the safety net framework by the Code in establishing agreements outside the Code, a range of Code rights and Authority functions have not been utilised;
- the majority of the end customers were subject to long term contracts prior to the sale of Westrail, and they have generally had to wait until these contracts expire, before they could market test using the Regime; and
- there has been no significant new entry into the intra-state freight rail market on the WNR network in competition to AWR. The other main operators are focused on interstate operations which have continued with minimal change pre and post the Regime.

The Authority is of the view that the Regime has provided some tangible benefits to users through allowing contestability and the threat of competition. However, at a simpler level, some interested parties hold the view that the absence of multiple train operators on the intra-state network means that the Regime has had limited success in boosting competition. This view would not fully consider the customer benefits obtained from market testing via the Regime providing a genuine competitive prospect of third parties being able to enter the market.

---

[26] Queensland Rail, "*Towards an Effective Access Regime*" Discussion Paper for Submission to the Australian Logistics Council, August 2003.
Available at http://www.networkaccess.qr.com.au/Images/Effective_Access_Regime_tcm10-2848.pdf

In their submission to the Issues Paper, WNR state that *"based on the number of access enquires from end customers and their operators (other than AWR) that the threat of competition has ensured that rail freight pricing has remained competitive."*[27] Some evidence of the competitive threat generating gains for end customers is the participation of AWR in the tender processes to procure or maintain contracted freight tasks for customers. ARG expressed the view that their average revenue per net tonne kilometres (NTK) has declined, due to *"competition from both road and other above rail operators, with both particularly manifest when major above rail (rail haulage) contracts have expired and gone to open tender."*[28]

However, a number of other submissions to the Issues Paper indicated that the "threat of competition" is not significantly genuine and that some refinements to the Code may be required to create a more effective Regime. ARTC contend that the above rail competition on the interstate network in WA had commenced and grown before the advent of the Regime, and the growth in rail market share has been driven by growth in the transport market generally. With respect to the above rail tender process, ARTC state that *"these processes are not transparent, so it is unclear as to whether the tender process was competitively neutral, the extent of frustration experienced by the third party entrant, and whether the tenders were eventually retained by AWR because of a superior above rail offering."*[29]

PN state that the charges for accessing the WA intrastate network have proven too high for competitors to ARG, such as PN, to enter and viably compete for business on that network.[30]

Alcoa stated that the lack of competitive above rail operators is a major impediment to achieving efficient freight rates, which is further exacerbated by the significant impediments to an interstate operator establishing a base in WA.[31] For AWB their experience in other jurisdictions of an increase in freight savings from the active presence of competing rail freight operators, has not been reflected in WA. In their submission on the Issues Paper, AWB stated that *"during the period from 1999-2005 rail freight rates in Western Australia have actually increased by approximately 4.3%."*[32] The Authority does not have information available to confirm or verify this estimate.

The Regime appears to have provided some significant improvements in price and quality outcomes for some customers. However, the extent to which these reflect the potential gains which could be achieved in a fully open and competitive market remains subject to some debate.

[27] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.3.
[28] ARG submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.3.
[29] ARTC submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.7.
[30] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 10.
[31] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.5.
[32] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.3.

3.3 Non-Code obstacles to entry and incumbent advantages

Due to the nature of rail infrastructure and train operations, the obstacles to entry which potential competitors face are often not limited to obtaining reasonable third party access terms and conditions. There are a number of other important factors which can be a competitive disadvantage for potential new rail operators.

A summary of examples of such obstacles to entry are listed below (for a more comprehensive description see section 3.7 of the Issues Paper):

- **Capital costs**: a new train can cost (for example 2 locomotives and 80 wagons) over $12 million, hence, prospective operators are likely to face a capital cost disadvantage versus the incumbent.
- **Rollingstock availability and gauge issues**: there is a current shortage of reliable and cost effective second hand rollingstock. This is exacerbated by inconsistencies in interstate gauges, which limits interchange of rollingstock between states.
- **Safety accreditation differences:** there are multiple different state based rail safety accreditation regimes in Australia. Whilst reforms are underway to harmonise or nationalise these safety regimes, rail operators which operator across multiple jurisdictions incur extra costs in adapting operations to comply with different jurisdictional requirements.
- **Terminal & siding access**: these assets are generally not covered by the Regime, therefore, potential rail operators need to negotiate with the above rail operator (AWR) or construct their own terminals and sidings. This can create challenges in built up areas or where the end customer has a significant sunk cost in the existing terminal assets.
- **Access to well sited Rollingstock Maintenance and stabling facilities**: can be limited in sites closer to major centres due to a shortage of contiguous available land adjacent to the rail line.
- **Prime train paths:** are determined by customer preferences on their ideal collection or delivery time, and a number of such paths are understandably currently held by the incumbent operator. However, if such paths are not utilised regularly they would be relinquished under the TPP.
- **Hiring skilled staff:** there is a generally acknowledged shortage of skilled commercial rail staff and train drivers.
- **Key freight flows locked into long term contracts:** around 90% of bulk freight volume originates from a few large customers who are largely subject to long term contracts.
- **Large freight volumes:** there are less than ten customers in WA with volumes of over 1m tonnes per annum which are more amenable for movement by rail. Road transport is often more competitive for smaller volumes or volumes with diverse origin-destination patters.
- **Customer confidence issues:** can be a problem for prospective train operator competitors as the incumbent is often a more ‘known quantity’ with ‘on the ground’ rollingstock and staff.

3.4 Tradeoffs between regulatory costs and third parties seeking greater rights

The goal of third party infrastructure access under NCP is to enable a contestable market to emerge that promotes genuine commercial negotiations between parties.

This is founded on the notion that operations will be more efficient with a minimum level of regulation and / or outside involvement from regulators or government. However, a sufficient regulatory framework is required to provide third parties with a set of minimum rights to attempt to achieve greater flexibility to reach more efficient outcomes. An overarching aim of access regulation is to promote, as far as possible, the allocative efficiency and overall economic welfare that would otherwise come from a competitive market.

Greater detail and prescription in a regime can give some clarity for the access seeker, but it can also potentially increase compliance and administration costs as well as possibly constraining the ability of the private sector to develop innovative or win-win outcomes. Consequently, there needs to be a balance between the amount of prescriptive detail in the regulatory framework and the flexibility to achieve commercially negotiated outcomes.

AWB's submission states a view that *"a vertically integrated operator… has an incentive to keep rivals off, whereas a vertically separated infrastructure provider has an incentive to get more operators on."*[33] This view suggest that the regulatory framework for a vertically integrated operator may need to be more detailed in order to prevent ambiguities arising that could provide an avenue for the infrastructure owner to delay third party entry to the network.

As outlined in section 2.2 of the Draft Report, the WA hybrid model has balanced the need for minimum entry rights with the need for commercially negotiated outcomes by instituting more of a principles based Regime. The Regime is comparatively less detailed and prescriptive than other regimes (e.g. Queensland). In response to the Issues Paper, WNR stated that there is little demonstrable evidence requiring material changes to the Code at this point in time, and furthermore *"other jurisdictions are using or moving to a hybrid model."*[34] However, the successful entry by PN into servicing the intra-state Brisbane to Cairns rail container market with the establishment of an access agreement with Queensland Rail (QR) may give some support to the case for a more prescriptive framework.

Other submissions also indicated the desire for a more prescriptive approach. Worsley point to the natural imbalance in relative bargaining power of the access provider and access seekers, and contend that *"when considering where this regime should sit on the regulatory spectrum between light-handedness and prescription, it needs to move more from the former towards the latter".*[35] The ARTC acknowledge that a greater *"degree of prescription is necessary to achieve market confidence where the access provider is vertically integrated"*[36] than is required when vertically separated. The Authority acknowledges that the effectiveness and customer confidence in the Regime needs to be assessed as part of this review and as part of this the Authority will assess if the Regime can be improved by addressing the issues of transparency and information asymmetry.

---

[33] ibid, p.5.
[34] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, pp.18-19.
[35] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.13.
[36] ARTC submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.7.

4 EVALUATION OF POTENTIAL CODE ISSUES

4.1 Evaluation of the Code

As at June 2005, the Code has been in operation for three years and eight months. Despite this time period, key parts of the Code remain untested. The time elapsed since the introduction of the Code is considered to be adequate to identify some areas of the Code that could be refined, but it is not sufficient to assess the effectiveness of all components. This was confirmed by a number of submissions that commented on the difficulty of testing the effectiveness of the Regime due to the lack of finalised access agreements. AWB stated that this lack of significant entry into the market makes it "*difficult to assess whether the lack of access is the result of a lack of profitable opportunities, or because of barriers to entry.*"[37]

The Issues Paper sought to stimulate discussion on key issues which may be inhibiting the Regime from providing a means to achieve effective access in accordance with the CPA principles. However, as stated in section 1.2 of this Draft Report, some of these issues relate to the Act and are therefore outside the scope of this review. All issues raised with respect to matters under the Act are summarised in Attachment 1.

This section of the Draft Report discusses views on the issues that have been raised with respect to the Code meeting CPA objectives, with proposed amendments to the Code summarised in Section 6. Section 5 details issues and potential refinements to the Part 5 instruments. These preliminary recommendations will be used for future reviews of the contents of the Part 5 instruments.

4.2 Coverage and Application of the Code

The Issues Paper and public submissions discussed whether the Code and the Part 5 instruments should only apply to all agreements negotiated under the Part 2-3 process of the Code (i.e. inside the Code) or whether there is merit is the Code or some Part 5 instruments applying to contracts negotiated outside the Code. Specifically, the Authority sought views on whether there is merit in refinements to the Code to ensure Part 5 Instruments are applied equitably to all users. Some submissions expressed a view that making all access subject to the Part 5 instruments was particularly desirable.

As discussed in Section 2.3, the Authority has given further consideration to this issue of operation "inside" or "outside" the Code. The Authority is of the view that the Code is best to remain consistent with its original intended design which is to provide an optional 'safety net' consistent with section 4(2)(d) of the Act. The Code remains an available option where access seekers are not comfortable of being able to conclude an outside the Code negotiation. However, commercial agreements negotiated outside the Code are not subject to Part 5 instruments and do not have the ability to access any other Code rights (e.g. the ability to seek the Authority's view on whether prices are consistent with prices charged to associated entities or the right to use the Code's arbitration process). Hence, unless access seekers formally utilise section 8 of the Code with a written proposal to the railway owner, they do not have the protection of the Regime and the Regulator is not empowered to exercise its

[37] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.5.

functions under the Code. The Authority will consider whether the Code requires refinement to make this position clearer within Section 6 of this Report.

4.3 Public Interest Test (clause 1(3))

Third party access regulation has been developed in order to promote the broader public interest. This is based on a key NCP principle that more competitive markets will be in the interest of the public as they lead to greater efficiency in resource use, lower costs and higher incomes. The Authority notes Worsley's comment in their submission that in *"considering the public interest, emphasis should be on promoting competition in rail where it is efficient from a social perspective."*[38]

Section 1(3) of the CPA contains a public interest test which requires the application of one of the following three approaches:

(a) the benefits and costs of a policy to be balanced against the costs; or

(b) the merit of the policy / action to be determined; or

(c) assessment of the most effective way to achieve the objectives.

The public interest test principles are applied when assessing the overall impact on society of a particular policy which may limit competition. The most relevant aspects of the public interest test for evaluating the performance of the Code appear to be economic and regional development, investment, the interest of consumers, the competitiveness of business and efficiency (CPA clauses1(3)(g)-(j)). The upgrade and expansion of rail networks can generate economic and regional development benefits. Hence, the Code should provide adequate incentives for efficient investment and avoid provisions that hinder efficient expansion proposals.

"Vertically integrated service providers may have an incentive to discriminate against upstream or downstream competitors." [39] Therefore, it is critical that the Code creates an environment that promotes the public interest, and avoids the potential efficiency losses.

In their submission to the Issues Paper, WNR comment that they *"believe the current Code is effective in ensuring the consideration of the public interest."*[40] Conversely, QR[41] and Worsley stated that the *"concept of 'public benefit' itself is too nebulous to be used as a benchmark"*.[42]

[38] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.5.
[39] ACCC (1999), *Access Undertakings: A guide to Part IIIA of the Trade Practices Act 1974*, p.59
[40] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.8.
[41] QR stated that *"the concept of 'public interest' as used in the Code and the CPA is too vague to use as a benchmark"*; QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.4.
[42] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.6.

Therefore, Worsley suggest that the Australian Logistics Council (ALC) core principles of an effective infrastructure access framework (as summarised in section 1.3 of this Draft Report) would provide a more effective assessment of whether public interest has been achieved.[43]

4.3.1 Investment in the network

In the period since the establishment of the Code, a substantial investment program has commenced on the PTA network which is funded by the WA Government.[44]

The WNR network does not receive significant capital subsidies from Government (aside from level crossings and other safety driven capital expenditure) and hence most investments need to produce a commercial return over the longer term. Consequently, the WNR capital program has been more targeted to upgrades and capacity increases on rail lines where higher volumes (eg the Kwinana to Bunbury rail line) enable an adequate return on such investments. However, Alcoa highlight that the railway owner has sought additional access payments for investment in capacity on this line.[45]

Submissions received by the Authority contained a range of perspectives on the extent to which the Code has had a positive, neutral or negative influence on the extent of investment on the network. WNR commented that parts of the Regime are currently untested, and "*investment in the network will only occur to the extent that satisfactory economic returns can be obtained and the legitimate business interests of the railway owner can be achieved.*"[46] ARG "*in principle supports positions taken by WNR in relation to the structure of the Code in relation to investment…The Code is presently neutral in it's impact on investment…*".[47]

The Chamber of Commerce and Industry of Western Australia (CCIWA) caution "*that investment in rail infrastructure is sustained and not put at risk by changes to the Code that are not supported by demonstrable evidence.*"[48]

However, the balance of the remaining submissions expressed concern about the ability of a vertically integrated railway owner to promote efficient and timely investment in the network.

FMG commented that "*there is a risk that incentives to invest and innovate will be undermined as any lowering of operating or capital costs will lower the revenue ceiling effectively transferring the full benefit to the end customer, thus preventing the owner of the assets appropriating any of the benefits of the investment and/or innovation.*"[49]

Some submissions suggested that a significant disincentive for investment in the network is present in the processes under the Code that address third party investment, which enable the railway owner to seek substantial or full contributions from proponents who request an expansion or extension of the network. This contribution can be either direct funding of the upgrade, or via higher access charges.

---

[43] Australian Logistics Council Discussion Paper (2003), *Principles of an Effective Access Regime*, March 2003, p.3.
[44] For information on the expansion of the PTA network see: http://www.newmetrorail.wa.gov.au/
[45] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, pp.4-5.
[46] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.9.
[47] ARG submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.2.
[48] CCI submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.2
[49] FMG submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.1

Alcoa raised this issue in their submission as they claim that the railway owner requested funding in response to their request to increase tonnage on the South-west mainline line. *"Were Alcoa to invest in the expansion, we consider that the current interpretation of the Code which increases the ceiling price and relies on overpayments to resolve third party contributions does not encourage third party investment."*[50] Therefore, Alcoa suggest that a more detailed process to negotiate the price for access is required, which takes into account the contributions and relative benefits obtained by each party. Moreover, Alcoa suggested that the Code could be revised in line with the approach used in other jurisdictions that only allow capital charges in the ceiling calculation for infrastructure funded by the access provider and exclude payments by other parties. Hence, Alcoa propose the Code should be redefined so "capital expenditure" includes only funding provided by the railway owner.[51]

Worsley were also concerned about the lack of investment in terms of the ensuing capacity constraints which can impose excessive costs on users. They suggested that compensation should be payable to users for certain disruptions to services under the Standard Access Agreement. The compensation costs could then be treated as part of the capital cost for WNR and hence, recovered under the regulatory cap.[52]

The view of the Authority is that the costs of the network expansions should be shared between all parties with Code access agreements who are beneficiaries of the new assets. Hence, there appears merit in examining whether section 9(2) of the Code should be amended to give effect to such a change. Additionally, amendments to Schedule 4 of the Code could be made to further encourage prudent investment in the network by ensuring the railway owner can generate fair, yet adequate, returns to fund such investments, see section 6.5 of this Draft Report.

PN suggested that 'the railway owner be required to collaborate with access seekers with respect to network investments'.[53] The Authority understands that a degree of consultation is undertaken and the extent of the benefits of making this a Code requirement are uncertain.

[50] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.2
[51] ibid,
[52] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, pp.9-11.
[53] PN submission to the 'Issues Paper: Review of the WA Railways Code', March 2005, p 16.

4.4 Coverage of services (clauses 6(3), 6(4)(d))

4.4.1 Coverage definition

The Act specifies the railway infrastructure to be covered, and not covered (e.g. terminals, sidings and ancillary services) by the Code. Any change to this coverage is essentially a policy decision for the WA Government. The comments in the submissions discussing potential changes to the definition of 'railway infrastructure' in the Act are summarised in Attachment 1.

4.4.2 Greenfield investments and expansions

A greenfield investment refers to the construction of a new rail line which is not connected to an existing network. A greenfield extension is a new line connected to an existing network.

The primary concern that has been raised in the review process is the potential length of time that it could take for processes that are required under the Act to include a new rail line into the Code. In summary, a new line needs to be commissioned and operational, following which the Minister can evaluate the merit of inclusion with this evaluation to include a public consultation process. Hence, proponents of new lines are uncertain if a potential line will be covered and this can impact on the bankability of the proposal. (For a more comprehensive discussion of the issues and public comments on this issue please see Attachment 1). In order to address this potential disincentive for investment, an amendment would need to be made to the Act as greenfield investments are predominately an Act issue.

PN suggested that the Code could adopt Division 2 of Part IIIA of the Trade Practices Act as criteria for deciding whether new lines should be covered.[54]

In their submission to the Issues Paper, WNR stated that the extension and expansion mechanisms under the Code *"are yet to be tested so it is premature to assess their effectiveness."*[55] However, they went on to suggest the following two options that should be included in the Code for the consideration of expansions and extensions:[56]

- *"The railway owner will always consider the credit risk of any access seeker in considering the commercial terms for extending or expanding the network. In many instances the railway owner will require security from the access seeker for this credit risk;*
- *The railway owner must be able to recover the investment and a return on that investment over the period in which the additional business will be generated, which in many cases which will be shorter than the useful life of the expansion/extensions of assets."*

The Authority does not see a need for the initial requirement, as section 14(b) of the Code already requires that the proponent shows that it has the necessary financial resources to carry on the proposed rail operations. In terms of the second suggestion, this is an issue relating to the definition of useful life as contained in the Costing Principles, and hence this is a matter that needs to be considered in the review of the Costing Principles.

[54] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 18.
[55] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, pp.9-10
[56] ibid.

The Authority is of the view that there are some potential changes that can be made to either the Costing Principles and/or to Schedule 4 clause 6(2), in relation to the negotiation of access prices. The current provisions could be amended to require that access price negotiations, under the Code, with respect to extensions or expansions of the network take into account the relative usage and economic benefit of other train operators or end customers with Code access agreements. This would be in addition to the current requirement to take into account the costs and economic benefit of the railway owner and proponent.

Whilst coverage of greenfields investments (or new lines) is mainly an Act issue beyond the scope of this review, some submissions (see Attachment 1) suggested the investment process could possibly be improved to provide some more guidance for railway developers, either in the Act or some other policy document, as to whether the greenfields line is likely to be eventually included under Schedule 1 of the Code.

4.5 Treatment of interstate issues (clauses 6(2), 6(4)(p))

Clause 6(4)(p) of the CPA states that there should be consistency of access arrangements, where more than one set of regulatory frameworks applies to a service eg an interstate passenger or container train. An effective access regime should be able to facilitate cohesion with other regimes to enable train operators to obtain connecting train paths between different railway owners or jurisdictions. This requires the access seeker to be able to effectively coordinate the timing of their usage between different railway owners.

The Australian Rail Association (ARA) has made the following comments about the need for nationally consistent regimes in order to contain administrative costs to the industry and ensure that the competition principles are maintained:[57]

"There is a concern about the continuing divergence of access regimes and the tendency for each jurisdiction to review their regimes independently. Over time the divergences may lead to such differences that the administrative costs to industry will continue to increase. There is often limited rationale for regulators to adopt different practices. The ARA would support a more national approach to the development, management and review of access regime to ensure that competition principles are achievable and administrative costs contained."

However, for WA to change regulatory regimes to utilise a national regime for all or part (e.g. the interstate line) of the routes specified in Schedule 1 of the Code is a significant policy decision for the WA Government.

The Issues Paper asked whether the Code and the wholesale agreement are an appropriate framework for interstate access seekers.[58] Given the terms of reference for this review, for this issue, the Authority is able to consider amendments to the Code which relate to inconsistencies with other jurisdictional frameworks which create problems for interstate operators.

[57] ARA Response to the Productivity Commission's Discussion Draft on the "Review of National Competition Policy Reforms", 17 December 2004; http://www.pc.gov.au/inquiry/ncp/subs/subdr214.rtf

[58] The ARTC has a wholesale agreement with WNR giving ARTC the ability to purchase interstate paths within WA on behalf of access seekers to provide them with a one-stop shop. The wholesale agreement has not yet been utilised and interstate operators to date such as PN (via predecessor entity National Rail) and SCT have had separate access agreements with WNR.

As the current wholesale agreement sees ARTC offer the same prices, terms and conditions as WNR, PN prefers direct negotiations with WNR. PN suggests that the wholesale agreement could be reformed to stimulate some competition between ARTC and WNR and the provision of a lower wholesale price to ARTC.[59] PN also stated that it is not aware of any material inconsistencies between the WA and ARTC Regimes which would make obtaining third party access more difficult.[60]

The ARTC stated in their submission to the Issues Paper that, with respect to the Regime, *"there are still a number of different treatments that can cause some uncertainty in access to the operator of an interstate service including, for example, provision for capacity transfer, resolution of capacity demand conflicts, open-ness in pricing, and treatment of costs in floor/ceiling limits."*[61] The Authority has attempted to address these issues in other amendments to the Code.

As stated by the ARTC, *"the WA Regime is in many areas, broadly consistent with similar provisions incorporated in ARTC's Access Undertaking."*[62] However, some key differences such as the use of reference tariffs and the ceiling price calculation would need to be resolved.

Despite some differences, the Authority considers that the Regime is broadly consistent with the ARTC Undertaking which may form the basis of any potential future National Regime. Amendments that result from this review of the Code are likely to further improve this consistency. Consequently, the Code is broadly consistent with the CPA requirements regarding national uniformity.

4.6 Negotiation framework (clause 6(4)(a)-(c), (e), (f), (g)-(i),(m)-(o))

The NCC have stated that a *"negotiation framework should provide a solid environment in which negotiations are encouraged and are likely to produce outcomes similar to those expected in a competitive market."* [63] The following conditions are considered to be necessary in order to give rise to a robust negotiation framework:

- timely and effective (CPA 6(4)(d), (e));
- establish minimum rights to negotiate access (CPA 6(4)(a), (b));
- enforcement process to support right to negotiate access (CPA 6(4)(c)); and
- segregation arrangements to support negotiation (CPA 6(4)(n)).

A number of submissions from interested parties have found it difficult to assess whether the negotiation framework is generally effective. Although some submissions commented on specific elements which were seen as shortcomings in the negotiation framework, the framework broadly addresses the four key NCC negotiating framework conditions with respect to timeliness, minimum negotiating rights, enforcement and segregation.

---

[59] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 19.
[60] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 20.
[61] ARTC submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, pp.4-5.
[62] ibid, p.4.
[63] National Competition Council, *"Australasia Railway Access Regime – Application for Certification under Section 44M(2) of the Trade Practices Act 1974"*, Final Recommendation, February 2000.

Alcoa have suggested that a regulatory review and approval of the Standard Access Agreement would *"provide a more meaningful starting point for negotiation of access terms"* and may more effectively meet the CPA objectives.[64] Worsley similarly suggest that the negotiation framework could be assisted by replacing the upper and lower bound for tariff negotiations with reference tariffs, and a Standard Access Agreement approved by the Regulator.[65] (see section 6.2 for further discussion).

The Regime was designed as a light-handed regulatory model without a specific requirement to establish reference tariffs. Railway owners remain free to establish such reference tariffs or to otherwise publish a set of standard prices on their own volition. In evaluating the merit of reference tariffs, the Authority has considered the need to ensure the principle of discriminatory pricing (as permitted within floor and ceiling limits under the Code subject to consistency guidelines of Schedule 4 Clause 13) is maintained as well as probable outcomes if a requirement to establish reference tariffs was created. A requirement to introduce reference tariffs for assets of vertically integrated (and commercially focused) ownership structures may constrain the negotiation process as there is some prospect of the reference tariffs being set at levels closer to the ceiling prices. Such an outcome would be against the intent of the Regime and it would also not be in the interests of access seekers.

An issue relating to the negotiation framework is the ability of the railway owner and access seeker to either use the Code negotiation process or to mutually agree to use a negotiation process different to that specified in the Code. The Authority intends to use this review to implement changes to clarify the implications of this decision and to ensure that access seekers understand that to obtain the rights and protections of all aspects of the Code that they need to advise the railway owner and complete the steps outlined in Parts 2-3 of the Code.

4.6.1 Timely and effective

The Regime needs to ensure that negotiations are not frustrated by unnecessary delays in relation to information requests, processing of proposals, the commencement of negotiations and also the length of the negotiations. The railway owner is required to use all reasonable endeavours to avoid unnecessary delays on its part.[66] The railway owner and the access seeker must agree on the day to begin negotiations as soon as practicable,[67] as well as a termination day after which negations will cease if they have not concluded an access agreement.[68]

As outlined in Section 4.2 of the Issues Paper, access seekers have the right to request information from the railway owner on the terms and conditions of proposed new business. Currently, the Code requires that within 14 days of initial contact and without a proposal from the access seeker, the railway owner must respond with technical track information, indicative pricing and conditions of access. When the railway owner receives requests for existing business, a large proportion of the information would have already been collected and calculated.

The Issues Paper sought views on whether there is any merit in introducing a quicker response time for information requests on existing business. However the majority of

[64] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.5.
[65] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.17.
[66] Section 16(1)(a)(i) of the Code.
[67] Section 19 of the Code.
[68] Section 20(2) of the Code.

submissions to the Issues Paper did not address the introduction of short time limits to be placed on the railway owner to respond to existing business access requests. The two submissions that did address this issue – WNR[69] and Worsley – did not support its introduction. As Worsley stated *"the current timeframes appear reasonable."*[70]

PN expressed the view that "there is nothing in the Code that ensures that it receives the access charges and other relevant information for the services sought in a timely fashion." PN seeks a Code change to require WNR *"to provide details on the availability of trains paths and the access prices for the paths sought by the access seeker within 30 days from the date of the access proposal"*.[71] However, section 7 (1)(a) of the Code requires the railway owner to provide within 14 days the 'price the entity might pay for access' and 'the available capacity of the route'. If the paths requested are not available, a separate Code process covers how to negotiate capacity additions.

The absence of other public comment over the time limits for the railway owner to respond to existing business access requests suggests that the current provision under the Code is likely to be adequate. Therefore, the Authority does not propose to amend the current information response time in the Code at this time. The Authority proposes to change the Code to require railway owners to establish (and keep reasonably current) an internet based Information Package which will improve the accessibility of information which is needed to develop an operations proposal. Such a package will also enable access seekers to improve their understanding of operating issues associated with developing a proposal prior to commencing negotiations.

4.6.2 Establish minimum rights to negotiate access

The negotiation processes are defined in Parts 2 and 3 of the Code. These place an obligation to negotiate in good faith on the railway owner in receipt of an access proposal. However, the access seeker needs to be able to demonstrate it has the managerial and financial ability (section 14 of the Code) and its operations are within the current or expanded capacity of the route (section 15 of the Code).

The Authority received no views from interested parties on sections 14 or 15. The NCC has previously assessed the negotiation process and did not identify any significant concerns. Therefore, the view of the Authority is that the Code is consistent with the CPA in establishing the minimum rights to negotiate access.

4.6.3 Enforcement process to support right to negotiate access

Enforcement procedures such as fines and penalties are primarily an issue detailed in the Act. The views of interested parties expressed to the Authority in submissions are summarised in Attachment 1.

4.6.4 Segregation Arrangements to support negotiation

The segregation arrangements in a regime are integral to the negotiation process, as they aim to ensure confidentiality of negotiations. The duty to segregate is under section 28 of the Act. This section also implies some endorsement of a vertically

[69] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.12.
[70] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.17.
[71] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.12

integrated structure in its requirement for railway owners to 'segregate access related functions from its other functions'. However, vertically integrated railway owners arguably have some greater incentives to frustrate access by competitors, for example, by potentially alerting its associated entity train operator to the receipt of a proposal for access pertaining to a customer of the associated entity. Therefore, the framework of the Regime needs to provide a series of segregation safeguards (e.g. it needs to ensure the railway owner protects confidential information so that it is precluded from unfairly discriminating against other railway operators).

The detailed segregation arrangements instrument is a requirement of section 28 of the Act. Comments expressed to the Authority in submissions in relation to the segregation arrangements are summarised in Attachment 1.

4.7 Dispute resolution (clauses 6(4)(a)-(c), (g)-(l), (o))

A regime must contain independent dispute resolution and enforcement processes. Independence from the parties is essential to guarantee that the regime will be affected without significant favour. Clause 6(4)(g) of the CPA is primarily concerned with the independence of the dispute resolution managers. It also covers dispute resolution funding by the parties.

Some submissions expressed the view that due to the fact that there has been, thus far, no use of the dispute resolution processes of the Code, the effectiveness of these processes has not yet been tested. In their submission, WNR shared this view and stated that refinements are not appropriate. However, the Code uses the WA Commercial Arbitration Act and this Act has been tested and heavily utilised since enacted in 1985, albeit not in the context of a rail access dispute.

It is useful to review the dispute resolution clauses of the Code against the Productivity Commission (PC) recommendations of conditions necessary to reflect Part XIC of the TPA: [72]

[72] Section 6 of the National Gas Code.

PC recommended dispute resolution conditions	Presence in the WA Code
Permit class arbitrations.	Class arbitrations are currently unavailable under the Code. The prospect of introducing class arbitrations raised in the Issues Paper was not supported by interested parties.
Impose time limits on both the negotiation and arbitration phase.	The existing time limits for negotiation and arbitration under Part 3 of the Code are considered to be adequate.
Permit the making of interim determinations by the Regulator.	Under section 24(4) of the Code the Regulator can not be included as the arbitrator. The Arbitrator can give directions to accelerate the arbitration process when an agreement is not likely to be reached within a reasonable time (Section 28(4)). Such directions are not considered to be interim determinations.
Permit dissemination of information submitted in one arbitration to contestants in another arbitration.	The Code enables the determination to deal with any matter relating to the use by the other party of railway infrastructure (section 33).
Appeals from the regulator's determinations be limited in scope and duration.	The Code is not specific on appeals from the regulator's determinations. Any decisions made by the Authority are appealable to the Supreme Court of WA.

The dispute resolution approach in the Regime is broadly similar to that used in the QR and ARTC Undertakings.

Submissions from Worsley[73] and QR[74] suggested that the dispute resolution could be improved by requiring an arbitrator who has an appropriate understanding of the industry rather than the current arrangements that rely upon parties with experience in conducting arbitration. The Authority acknowledges the benefits of requiring an arbitrator with significant experience and/or knowledge of the rail industry. However, under section 24 of the Code the Authority can appoint an arbitrator with such skills if deemed necessary. Therefore, the Code does not need to be amended in order to be able to utilise this suggestion.

Responses on dispute resolution provisions from interested parties were limited. Specifically, there was no support for the introduction of class arbitration or time limits for the settlement of access disputes. Therefore, it can be inferred that the dispute resolution clauses are currently not a significant concern to interested parties.

The Issues Paper asked for views on whether access seekers need the right to seek damages and other remedies in the case of a breach of agreement. However, as specified by WNR each party "*has a well established right to sue for damages for breach of that contract."*[75] Worsley stated that the quantum of any damages paid should relate to the actual value of the loss suffered as a result of the breach, as they

[73] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.18.
[74] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.15.
[75] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.13.

consider that the current penalties for breaches are inadequate.[76] However, any damages awarded will be a matter for the Court.

The primary issue that needs to be clarified in the Code with respect to dispute resolution is whether the Part 3 Division 3 arbitration clauses apply to access seekers who negotiated their access agreement outside the Part 3 negotiation clauses. As with the negotiation procedure, access seekers, who negotiate outside the Code, can by agreement with the railway owner include the dispute resolution provisions in the Code in their commercially negotiated access agreement.

The dispute resolution clauses in the Code, whilst not yet tested in a rail access dispute under the Code, appear likely to be consistent with the CPA.

4.8 Appropriate terms and conditions (clause 6(4)(a)-(c), (f), (i), (k), (n))

Access regimes should enable third parties *"to obtain access in a timely manner on terms and conditions which promote the efficient use of an investment in the infrastructure and do not distort the conditions for competition in related markets."*[77]

Some submissions to the Issues Paper have indicated that the lack of transparency of agreements has caused uncertainty about the consistency of agreements, and thus undermined the confidence in the Regime. Worsley have stated that the lack of transparency can be 'self-fulfilling', leading to the *"perception that the network owner will take advantage of the situation… even if this does not occur."*[78] This actual or perceived lack of transparency can prove to be a significant deterrent to new entrants. This is reflected by AWB's view that the *"railway owner is given considerable flexibility within the floor and ceiling price, this leads to uncertainty in assessing the attractiveness of entering the market…"*[79]

Submissions have indicated that measures should be implemented to increase the transparency of arrangements in order to reflect a level playing field and to promote the principle of non-discrimination between access seekers. Some of the measures suggested in submissions include the provision of greater pricing information and the introduction of network information packages including capacity information register (section 6).

4.8.1 Standard Access Agreement

Currently the Regime enables the railway owners and access seekers to negotiate and tailor their own terms and conditions. The primary objective of the Standard Access Agreement is to provide a benchmark of appropriate terms and conditions that can be expected by the access seeker. The Standard Access Agreement provides a starting point for negotiation of the terms and conditions that govern access to the network. Under the Code, the railway owner is obligated to prepare and make available a Standard Access Agreement for purchase. The agreement is to cover the matters listed in Schedule 3 of the Code. Both parties are free to suggest amendments to tailor the agreement to better suit the specific requirements of the proposed train service.

---

[76] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.18.
[77] Victorian Department of Infrastructure, 'Options for Reform of the Victorian Rail Access Regime', July 2004, pg. 5.
[78] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.15.
[79] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.1.

This agreement should provide access seekers with a fair and reasonable contract template which can be refined and expanded to reflect the individual requirements of each access seeker. However, some end users have indicated that some aspects of the current Standard Access Agreement do not give rise to these conditions.

Operators should always retain the commercial freedom to sign agreements with terms and conditions that can vary from those contained in the Standard Access Agreement. Clause (6)(4)(f) of the CPA is clear that terms and conditions can be different, and thus it would be contrary to the CPA to mandate the compulsory use of a prescriptive access agreement.

Currently, the railway owner determines the nature of the Standard Access Agreement covering the headings outlined in Schedule 3 of the Code. While both railway owners have in the past sought the Authority's review of their agreements, there is no requirement under the Code for the Authority to provide such approval. Hence, the railway owners are not currently obligated to accept any of the changes suggested by the Regulator. Additionally, there is no scope for public consultation on the reasonableness of the standard access agreements within the current Code processes and this has limited the ability of the Authority to provide well considered feedback to the railway owners.

It has been claimed that customer confidence in the Regime would be improved by the Authority completing a public review prior to approving the Standard Access Agreement. This could include comparison to the ARTC and QR Standard Access Agreement to try to establish more consistency between jurisdictions.

Alcoa *"do not consider that the Standard Access Agreement provided to Alcoa provided a reasonable starting point for negotiations."*[80] Their main concern is that the Standard Access Agreement fails to protect operators from disruptions resulting from upgrades to the track, with no incentive for the railway owner to minimise the costs upon users.[81] Consequently, Alcoa suggest that the Code should be amended to include a requirement on the railway owner to submit a Standard Access Agreement for approval by the Authority as a new Part 5 instrument with a public comment process being completed prior to release of the approved final access agreement.

The option of having an Authority Approved Standard Access Agreement is also endorsed in the Worsley[82] and QR submissions to the Issues Paper. QR contend that such an agreement would streamline or fast track the negotiation process, and also enable the Authority to impose more reasonable terms and conditions on the access provider, for example, the provision of information, development of KPI's and capacity entitlements.[83] Worsley also suggest that the railway owner could develop a Standard Access Agreement for different types of traffics.[84] They suggest that capacity information should also be included in the Standard Access Agreement.[85] To partly address this issue the Authority is recommending the development of capacity information to be provided as a component of an internet based Information Package (see section 6).

[80] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.6.
[81] ibid, p.3.
[82] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.17.
[83] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.14.
[84] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.23.
[85] ibid., p.20.

A different view was expressed by PN which stated that it is in the process of negotiating an access agreement for interstate movements with WNR and that negotiations are progressing well with no issues (to date) relating to the terms and conditions which PN believes should be raised in this review.[86]

Preliminary View 1

In relation to proposals to amend the Code to require the Authority to approve the Standard Access Agreement as a new Part 5 instrument, the preliminary view of the Authority is that it is unclear that such an approach would yield better outcomes nor is it required to improve consistency with the CPA. This initial view is based on the CPA stating that terms and conditions can be different; the absence of specific complaints relating to certain terms of the current standard agreement being unfair; the regulatory costs involved in establishing a Part 5 instrument; the risk that the Authority's involvement could stifle innovation; and a desire not to intervene where matters can be settled through commercial negotiation. The Authority seeks further views on this issue and remains open to considering other reforms such as amendments to Schedule 3 of the Code where this could become a set of principles.

4.8.2 Gross Replacement Value

Schedule 4 clause 2(4) of the Code prescribes the use of the Gross Replacement Value (GRV) annuity approach to determine the revenue ceiling. The Regime is unique in Australia its use of the GRV based annuity modern equivalent asset (MEA) model. GRV is the gross replacement value of the railway infrastructure, calculated as the lowest current cost to replace existing assets with assets that have the capacity to provide the level of service that meets the actual and reasonably projected demand and are, if appropriate, modern equivalent assets. Whilst railway owners are completing a range of upgrading projects, under the Codes simplified approach to the ceiling price calculation, the network is assumed to commence in a new condition and major periodic upgrading expenditure (eg re-sleepering) is not included in ceiling price calculations. As this GRV model is used for the calculation of the revenue ceiling, the development of appropriate terms and conditions is contingent on this methodology.

An alternate form of regulation used in other jurisdictions to calculate the ceiling tariff is the Depreciated Optimised Replacement Cost (DORC) valuation approach whereby the accumulated age and decline in condition is considered to produce a lower asset valuation offset by higher maintenance costs due to the inclusion of upgrading works. Hence, the DORC method produces initially lower ceiling tariffs that increase over time with upgrading expenditure costs and the GRV method initially produces marginally higher ceiling revenues, which remain constant over the life of the asset. It has been shown that, over 30 years, both methods return broadly equivalent revenue in net present value terms to the owner.[87] Whilst the ceiling revenues calculated under the DORC and GRV method have some differences depending on when calculated in the infrastructure life-cycle, for defining upper price limits, for most

[86] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 31.
[87] For more information see the ERA website
http://www.railaccess.wa.gov.au/files/publications/GRV%20VS%20DORC.pdf

train paths this difference is not a significant issue as most customer access prices are well below the ceiling. However, an exception to this is the high volume South West Mainline (SWM) route. The SWM is approximately 130 route kilometres out of the WNR network of over 5,000 kilometres and the Authority understands that access pricing on this route is generally close to the GRV calculated ceiling.

The Issues Paper sought views on whether the GRV annuity approach for setting the upper bound (ceiling) access revenue alters the prospects of access seekers entering an access agreement with the railway owner. The railway owner stated that there is no evidence of access seekers being unable to obtain access due to the GRV approach, as market conditions prevent the ceiling price being automatically charged.[88] Some submissions indicated that negotiated access from an essentially vertically integrated railway owner presented the larger challenge.

Other submissions were more critical of the GRV floor and ceiling approach. Alcoa stated that monopoly providers will attempt to either negotiate as close to the upper bound as possible or creep prices towards the upper bound over time, especially with customers who are 'captive' to rail.[89] AWB shared a similar view indicating that the mechanistic application of the ceiling price test could result in access charges which are many times higher for access seekers, as there are obvious incentives for the monopoly supplier to retain incumbent business by quoting access seekers higher price levels. They further state *"that in response to a 55% increase in net tonnes per full time equivalent, the claimed average rate reduction has been only 8.5%, this indicates that most of the benefits of increase productivity are not being passed on to consumers."*[90]

The Alcoa submission gave some support for the current approach stating that the *"longer term stability of the GRV calculation would be beneficial provided that the Code clarifies the definitions of contributed assets."*[91] Despite some issues associated with the use of the GRV calculation, the Authority considers that the differences between GRV and DORC over the longer term should not present a significant barrier to negotiating access. Therefore, the Authority does not seek to amend the use of the GRV approach for the ceiling calculation at this stage.

4.8.3 Adjustment of GRV for capital subsidies or customer contributions

If the railway owner receives government (operating and/or capital) subsidies to support their operations, neither the Code nor the Costing Principles require a reduction in ceiling costs to reflect this government contribution. Similarly, if the railway owner receives a contribution from a third party to the capital cost of an upgrade or expansion, there is no requirement for the ceiling cost to be adjusted to reflect such a contribution. However, in evaluating whether revenues obtained by the railway owner exceed ceiling costs using the Over-payment Rules, these subsidies or contributions are recognised as a form of customer revenue.

The consequence of this arrangement is that the railway owner is potentially able to earn a rate of return and depreciation on capital in which it did not invest provided over recoveries can be reallocated to a neighbouring route sector as permitted under

[88] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.15.
[89] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.6.
[90] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.6.
[91] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.6.

the Over-payment Rules. As a consequence, users do not receive any benefit from surplus revenues recovered from the Over-payment Rules.

Submissions have indicated that the current approach of the Code for dealing with subsidies or contributions has a negative impact upon the effectiveness of the Regime by inflating ceiling prices and making the difference between the floor and ceiling prices larger.

The main government subsidies that WNR receive are from Main Roads Western Australia (MRWA) which generally funds 50% of the upgrades to level crossings. Government contributions to the enhancement of the WA rail network appears to be becoming more common, with proposed Government grant funding to assist with upgrades on some branch lines and the interstate rail line.

While capital subsidies to WNR are currently relatively minor, the PTA network is substantially funded by capital and operating grants from the WA Government. Hence, if the PTA ceiling costs were adjusted to excluded subsidies the ceiling and floor price for the PTA would be similar and this may create some adverse economic signals.

The majority of the WA Government subsidy contributions to the WNR network are one-off, and not subject to contractual commitment each year. Consequently, WNR is concerned about adjusting the ceiling costs for capital contributions when the level of funding is not guaranteed. WNR argue that any amendment should only be limited to adjusting the ceiling for lump sum upfront subsidies for major capital, rather than minor contributions to maintenance or minor upgrading.

Excluding subsidies and contributed assets from the GRV would narrow the gap between the floor and the ceiling which most submissions view as beneficial. It would also prevent the railway owner from earning returns and depreciation on other parties investment in capital. However, the main issue is to increase the complexity of the Ceiling Test calculation including assessment of the extent of MRWA and other government subsidies on an asset by asset basis. Additionally, if this reform is imposed on the PTA then the ceiling test levels are likely to fall substantially which may create poor economic signals.

In assessing this issue, the Authority notes that in other industries such as gas the regulatory asset base has not been adjusted to exclude capital contributions from other parties. Furthermore, it would appear that the Government subsidies for level crossings are primarily to improve the safety standards by enabling the railway owner to install safer protections (eg boom gates as well as flashing lights) rather than being a subsidy intended to enable lower freight rates. Additionally, if rail users provide the railway owner with a contribution to an upgrade, the Authority would anticipate that the value of such a contribution would be reflected in commercially negotiated pricing outcomes between these parties. The Authority also notes that the ceiling test is simply the upper limit reference point for commercial negotiations. Overall, given the light handed nature of the Regime, this issue can potentially be better addressed through changes to the Over-payment Rules so that subsidies and contributions are only allocated to the relevant upgraded route section.

Preliminary View 2

The preliminary view of the Authority is that the issue of precluding the railway owner from earning a return on assets funded by government subsidies is better addressed by changes to the Over-payment Rules. The Authority seeks further views on this issue and remains open to considering other reform approaches.

4.9 Reasonable endeavours to accommodate the requirements of access seekers (clause 6(4)(e))

In addition to some public submissions which reported a perceived or actual lack of transparency, there were some requests in submissions to increase information flows in order to address the current information asymmetries between the railway owner and users of the network. In this review of the Code, the Authority will assess whether the Code can be refined to address these two issues. It is a requirement of clause 6(4)(e) of the CPA that *"the owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access,"* and information is a key requirement of potential access seekers.

4.9.1 Information Asymmetry

An example of information asymmetry cited by interested parties is a lack of detailed information on the remaining capacity of the network. Currently, only the railway owner has access to this information, and access seekers need to formally request information on the remaining capacity from the railway owner. The railway owner could potentially use this information asymmetry to overstate the extent of utilised capacity and require the proponent to fund an expansion.

The introduction of capacity information could address this current information asymmetry, and promote the principle of non-discrimination between access seekers. Capacity information would also assist access seekers to meet the section 15 requirement for proponents to show that its operations are within the capacity of the route or expanded route.

The format could be in the form of a map or a more detailed document. The railway owner would then be required to provide public notice when it intends to enter into an access agreement that would allocate a train path or substantial proportion of capacity on the network to an access seeker for a significant period.

The NSW Rail Access Undertaking has similar provisions requiring release of an Information Package with data on unutilised train paths (see Schedule 5 (vi)). The NSW Undertaking requires the network owner to provide indicative figures for unutilised train paths for representative trains of various configurations and characteristics (by sector, by time period and by day of the week) as well as a copy of relevant parts of the master timetable. RailCorp has responded to this requirement by establishing and maintaining a Track Capacity Map.

WNR have indicated that they do not believe that there is any merit in introducing a capacity register. In their submission to the Issues Paper WNR stated that capacity is difficult to measure as it is based on current operations remaining constant and measuring remaining capacity in a common unit of measure. *"Exactly what is required to increase capacity or meet a new access seekers requirements needs to be*

considered on a case by case basis and at a particular point in time."[92] Similarly, due to complexities involved in assessing capacity PN "*does not believe it is possible to introduce and maintain a capacity register."*[93] However, to enhance the negotiating ability of access seekers, PN does support a new requirement that the railway owner publish the working timetable. The working timetable is currently provided to access seekers as part of the preliminary information (required by section 7 of the Code), however it is not published.

Some end customers support the concept of the introduction of a capacity register. Alcoa have suggested that there would be particular benefits from a capacity register *"for parts of the network where the allocated train paths are likely to exceed 60-70% of the available capacity."*[94] In their view of greater benefit would be to oblige the railway owner to provide detailed information to support any proposed requirement for additional infrastructure to meet increasing demand.[95]

QR stated that the "*concept of a capacity register has merit, although for it to be effective, capacity will probably need to be defined according to a reference service because of the number of factors that determine the actual capacity of the rail network."*[96]

In addition to a capacity register, the negotiation arrangements and the transparency of the Regime could potentially be improved by introducing a statutory obligation on railway owners to periodically publish greater information about the access process under the Code as well as outside the Code. The release of information packs will allow potential access seekers to begin developing an operating proposal, as it has been stated that the current provision of information is considered inadequate to provide participants with an appropriate understanding of network issues prior to commencing negotiations.

QR already provide Information Packages in order to inform and assist access seekers. The information provided in QR's Information Packs include *"detailed descriptions of the system and tracks in question, operational information and constraints, information system and communication details, incident recovery information, running time data, interface details, and future infrastructure improvements."*[97] QR stated that the provision of information packages in WA would be of benefit to potential operators, particularly new operators, where practical first hand knowledge of the access process and operating parameters is unknown.

The Authority is of the view that there are benefits in establishing an internet based Information Package including information on capacity of rail routes and information about rights inside and outside the Code would be likely to reduce information asymmetry and improve transparency. This in turn will better meet the requirements of CPA 6(4)(e) to use all reasonable endeavours to accommodate the requirements of access seekers. For further details on the proposed amendment see section 6.

---

[92] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.12.
[93] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, pp 21-23.
[94] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.6
[95] ibid.
[96] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.12
[97] ibid., p.15.

4.9.2 Additional Pricing Information

The Regime only requires the determination and publication of ceiling and floor revenue limits and these are not converted into equivalent ceiling and floor unit prices. However, entities interested in making an access proposal can request preliminary information (provided by railway owners under section 7 of the Code) which includes the price they might pay for access and gross tonnage information. This could then be used (with floor and ceiling cost determination information) to estimate the likely floor and ceiling price levels. Alternatively, after making an access proposal to the railway owner, Section 9(1)(c) of the Code requires the railway owner to provide the access seeker to provide floor and ceiling prices for the proposed access.

Another potential means to address the perceived information asymmetry and ensure the railway owner makes all reasonable endeavours to accommodate the requirements of access seekers (CPA 6(4)(e)) would be to publicly release some of this pricing information. In the Issues Paper, the Authority asked interested parties whether they believed that there would be merit in introducing reference tariffs, and whether this would negate the effectiveness of the negotiate-arbitrate model. Some submissions had the view that reference tariffs would improve the "consistency, transparency, equity, certainty and market confidence"[98] of end users in the Regime.

The use of reference tariffs is consistent with pricing information used in a number of other jurisdictions, including the national and Queensland. These approaches are:

- ARTC's approved Access Undertaking establishes the Indicative Access Charges for a standard service (clause 4.6), in addition to floor and ceiling revenue limits[100]. Actual prices charged to ARTC customers are broadly consistent with their Indicative Access Charges and these are relatively closer to the floor price level.[101] This outcome results in a relatively modest network-wide rate of return on the DORC value of between 1-3%. The ARTC strategy is to attract higher volumes to rail with lower (road competitive) access prices to progressively increase the rate of return towards commercial levels.
- QR has voluntarily established reference tariffs for coal lines near the ceiling price only. The QCA has the power to require the establishment of reference tariffs for other parts of the network, but has not yet utilised this power. The QCA will continue to consider whether there is merit in establishing reference tariffs on other lines where third party interest is material.
- In NSW, the interstate lines are managed by ARTC and prices are understood to be broadly similar to those on other parts of the ARTC network. These prices have not yet been published on the ARTC website. However, this appears likely in the future as part of an expanded ARTC Access Undertaking. Access prices on the Hunter Valley Coal network, now also operated by ARTC, are understood to continue to remain at close to the ceiling price for the majority of central Hunter coal mines and similarly these prices have also not yet been published on the ARTC website. Whilst ARTC in NSW has not

[98] ARTC submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.9
[100] In 2002/03 network wide: $55m & $178m respectively on a DORC value of $1.47Bn.
[101] In 2002/03 ARTC generated $92.4m in access charges

> yet established publicly available reference tariffs, the NSW access prices for interstate, general and grain freight (as predominantly set by the former network owner) are generally broadly known to train operators. This is an internal management approach rather than a Regime requirement to issue reference prices.

The Authority is aware of the concern of the railway owner for the introduction of reference tariffs, who stated in their submission that they would *"add little additional value to the negotiation process but will certainly introduce inflexibility and cost to the administration of the regime."*[102] WNR further comment that the different traffic conditions and non-homogenous traffic mix in WA means that an optimal access-pricing framework will need continual recalibration, which they believe is a flexibility which reference prices may not enable. The railway owner is concerned that this process could be misleading, if an access seekers proposed service differs from the reference service.

Other submissions were generally in support of introducing reference tariffs, and increasing pricing information. ARTC asserted that reference pricing would encourage *"consistency, transparency, equity, certainty and market confidence"* in the Regime. Worsley further commented that they would increase the ability to differentiate between services, as well as the cost components underpinning each service and each participant's contribution to them.

Submissions in support of the introduction of the reference tariffs felt that the increase in information would improve the negotiate-arbitrate model, rather than limit its effectiveness. Worsley observed that reference tariffs would narrow the scope of the negotiate-arbitrate model, which would ensure that such processes were more focussed.[103] QR's submission stated that reference tariffs would *"provide increased pricing transparency and facilitate negotiation by providing a benchmark against which third party operators can assess the reasonableness of WNR proposed access charges."*[104] However, the Authority notes QR has contained its use of reference tariffs to lines at or close to the ceiling, which results in minimum impact on their negotiation position.

In light of these views from interested parties, the Authority considers that there is merit in introducing a requirement to supplement the publicly released floor and ceiling revenue limits information with the public release of floor and ceiling prices for reference trains. To provide such a floor or ceiling price requires assumptions on the key operating characteristics of the train (i.e. defining a reference train). Such characteristics would be based on current typical operating consists and include assumptions on the route, train length, operating speed, axle load etc. For further discussion on the proposed amendment see section 6.2 below.

4.10 Institutional Arrangements

There may be scope within the Code to refine Institutional Arrangements so that third parties have a greater ability to obtain access without imposing significant resource requirements on the railway owner and the Regulator. Possible refinements to the

[102] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.14.
[103] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.20.
[104] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.12.

roles and accountabilities of the railway owner and the Regulator may improve the effectiveness of the Regime.

4.10.1 Regulator

In other rail access regime reviews, submissions have put forward proposals for greater involvement by the regulator in different aspects of the negotiation process, including the resolution of contract management issues (eg track possession timing).

By way of example, the Victorian Regime Review Options Paper canvassed whether there was any merit in introducing reforms whereby the access seeker can deal with the regulator as an independent party for the purposes of making and processing an access application. This would prevent the railway owner from having access to confidential information which could be used to frustrate the access seekers' attempts to attain customers. Under this option, the regulator could process an access application, to which the railway owner would be expected to enter into.

In order for this option to succeed, the regulator would require sufficient information from the railway owner, on prices for all access services, and the availability of train paths in order to make preliminary assessments regarding capacity.

In considering this option, submissions to the Issues Paper took a similar view to the Victorian Regulator, the Essential Services Commission (ESC), which was not supportive of the option as it would require onerous exchanges and systems for capacity and pricing information and expertise not currently available within the ESC.

The majority of submissions were consistent with the railway owner's view that greater intervention by the Authority would run counter to the CPA principles of a reliance on commercial negotiations supported by a framework of light handed regulation. Both Worsley[105] and QR[106] state that it would be dangerous for the Authority to become involved in access negotiations. However, Worsley state that the Authority could potentially take on a mediation role subject to consultation with the parties as to whether there is merit in performing that role. The Authority also notes that the WNR Standard Access Agreement already contains a mediation type process.

As the Authority should be independent of commercial negotiations, it was viewed as inappropriate if it became involved in making and processing access applications. ARTC stated that direct Authority involvement in this process would add another layer of complexity and increase costs, whilst being unlikely to generate a sufficiently large benefit.

Another issue raised about the appropriate terms and conditions in the Issues Paper, is the involvement of the Authority in contracts which have been established outside the Code. Most feedback from submissions (eg WNR and Alcoa[107]) sought Code changes to ensure the Code applies to all Access Agreements and for all users of the network. However, as discussed in previous sections, the Authority sees more merit in retaining the safety net approach whereby access seekers are free to choose if they seek the protections of the Code and hence utilise its negotiation framework or whether they

[105] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.21.
[106] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.15.
[107] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.16; and Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.7.

are comfortable to negotiate alternative (non-Code) agreements and forego such protections.

The submission from PN suggested that the Code could be amended to ensure consistency in pricing by requiring:

- WNR to publish the formulae by which it will price access on network segments.
- Prohibit price discrimination regardless of whether access is negotiated inside or outside the Code.
- WNR to provide costing information to the Authority, so that the Authority can verify that the railway owner is not discriminating between associated entities and third parties and that prices are calculated in accordance with the Code.
- WNR provides the Authority with the access prices being charged to its associated entity.[108]

The Authority notes that the Code allows for price differentiation subject to Schedule 4 clauses 7, 9 and 13. The Authority also notes that the floor and ceiling test cost levels are not based on actual costs but instead they are based on the efficient costs of a modern equivalent network commencing in new condition. However, as part of the cost determination process, the Authority reviewed actual costs to ensure appropriate reductions were assumed.

Following consideration of all these issues the Authority does not recommend to increase the role of the Regulator in processing access applications. However, in an effort to address the perceived information asymmetry and requests from interested parties for greater transparency of access pricing the Authority proposes to strengthen the ability to give opinion on the price sought for access under the Code. It is proposed that the railway owner provide the Authority with all internal access prices for key routes. This data will be retained as confidential for the Authority's use only in section 21 roles. This would strengthen the ability of the Authority to provide a timely opinion to Code based access seekers on the fairness of the quoted access price under section 21 of the Code. The provision of internal access prices to the Authority would also ensure prices quoted to access seekers are at all times consistent with prices charged to associated entities.

This amendment would require the transfer of information to the Authority from the railway owner. This amendment would also help to engender greater consumer confidence in the Code framework and potentially deter railway owners from adjusting associated entity prices to match prices quoted to access seekers.

The Authority will consider changes to ensure it is clear that access agreements negotiated without the use of Parts 2-3 of the Code have none of the protections of the Code. There also appears to be merit in improving the Authority's ability to give opinion on quoted access prices under section 21 of the Code.

[108] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 13.

4.10.2 Railway Owner

The Issues Paper asked interested parties whether the railway owner should be subject to licensing, and how this may be implemented. This potential amendment was initially raised by the ESC as a licensing framework may complement the enforcement mechanisms under a proposed new Victorian Regime. It was hypothesised that the Authority would have specific powers of enforcement if the railway owner has contravened the conditions of the licence. The Authority would be able to apply penalties and enforcement via Supreme Court orders, which will often be more timely and less costly than activating the current provisions of civil enforcement.

This concept did not receive any support in submissions. WNR stated that any increased regulation or intervention increases the business risk for the railway owner, and would need to be reflected in an uplifted Weighted Average Cost of Capital.

At this stage the Authority does not see a need to introduce licensing requirements for the railway owner.

5 ISSUES RELATING TO PART 5 INSTRUMENTS

Part 5 of the Code requires that the railway owner submit four key regulatory instruments to be approved by the Authority. These include:

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

Many of the Part 5 subsidiary documents also require the development of key performance indicator (KPI) measurements. (For a description of the contents of these regulatory instruments see section 2.5 of this Draft Report). The Segregation Arrangements are an instrument of subsidiary legislation but these are required by section 28 of the Act.

The reason that the Code was drafted to require the development of these instruments was in order to keep the detailed prescription required in these instruments outside the actual Code document. Although these instruments are effectively part of the Regime, as they are separate subsidiary instruments, they are more effectively able to be reviewed during their planned review process two years after their final determination with the consideration of comments from interested parties.

With respect to this Code review process, the Authority will propose some potential refinements to these subsidiary documents. However, the actual detailed changes to the contents of the instruments will be deferred to the review of those documents following the completion of the review of the Code.

5.1 Costing Principles

5.1.1 Floor and Ceiling Approach

The primary importance of the Costing Principles is its determination of the floor and ceiling test (through the GRV method) as a means to calculate the costs of rail access. As stated by WNR, *"the Costing Principles are a statement of the principles, rules and practices that WestNet will apply to calculate Floor and Ceiling costs on a route section basis, as required to be established under the Code."*[109]

As transportation comprises a significantly large proportion of the cost structure for a range of different industries, it is essential that the floor and ceiling approach enables efficient rail transport costs. Transport prices that are above efficient costs (including reasonable return of and return on capital) or above the transport prices paid in the markets of competing exporters can adversely impact on competitiveness and can represent the difference between a business investment being viable or not.

In their submission to the Issues Paper, AWB state that the *"gap between floor and ceiling would be too great to provide sufficient guidance for price setting",* which is likely to hinder private negotiation by an access provider and an access seeker.[110] QR also suggested that the Code floor and ceiling approach required refinement stating that:

[109] WNR (2002), *"Costing Principles"* 19 December 2002, p.4.
[110] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.1.

"*The floor and ceiling approach established in the Code needs to be reconsidered. The requirement to negotiate within the upper and lower bounds does not necessarily work, especially for traffics which can be expected to operate at the ceiling or which are highly contestable such as with grain.*"[111]

As a solution to this issue, AWB suggest that as the grain lines have relatively low usage and would unlikely be replicated if they didn't already exist, the capital costs should be regarded as sunk and not justifying any return. Therefore, the access charge should only cover maintenance and overheads in order to maintain economic grain freight rates.[112] However, such an approach is likely to require an ongoing below rail government subsidy to fund periodic upgrading, because the railway owner would have no incentive to invest as the AWB proposed approach precludes a return on assets. Additionally, the Authority understands that the access charge for grain transport is relatively close to the floor price resulting in a minimal recovery of the capital costs of the grain lines.

QR also raised concerns about new infrastructure where it is priced at a higher rate than services operating in the same market which secured capacity before the capacity increase. The incumbent consequently derives a competitive advantage as they can secure the vast majority of available capacity at marginal cost, whereas subsequent entrants will need to pay a higher access charge due to the need for the rail infrastructure provider to recover the capital costs associated with expanding the facilities.[113]

QR suggests that access charges should include a component that explicitly addresses a capacity charge that all operators would face wherever capacity becomes constrained. QR also suggests that if all market participants face such a charge, it is more likely that the operation of the regime will prevent discriminatory pricing by the access provider between third party access seekers and its related freight business. However, such a capacity charge would arguably complicate and increase the prescriptive nature of the Regime based on commercial negotiation. It could also result in existing users paying higher prices for new capacity prior to its development without it necessarily being required. However, the Authority notes that the Regime allows for some differentiation in pricing (see Schedule 4 clauses 7, 8 and 13 of the Code).

The Authority also notes that the Costing Principles only apply to access agreements pursuant to the Code and that higher or lower prices can be established for non-Code agreements.

5.1.2 Cost allocation

Under the provisions of the Code and the Costing Principles, operating and overhead costs are distributed to all users. The Costing Principles states:

"Two proxies are used to allocate overheads. GTK's are used to allocate costs which vary more in quantum due to volumes moved, and train movements are used to allocate costs which vary more in quantum due to the number of train movements."[114]

---

[111] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.12.
[112] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.8.
[113] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.13.
[114] WNR (2002), *"Costing Principles"*, 19 December 2002, p.22.

This principle is used to allocate the operating costs of the railway owner which include a variety of roles, including access management; train control; train scheduling and operations planning; etc. In addition, overhead costs are allocated to the users of the network, which covers infrastructure management costs; WNR overheads; and corporate (ARG) overheads.

Some concern has been raised, particularly by users of the SWM, that have short track distances but a high number of train movements, who have a higher burden of the cost allocation relative to users of the grain lines, that have long track distances and low train movements.

The Costing Principles will be reviewed in order to improve the efficient operation of the floor and ceiling test and the cost allocation issues.

5.1.3 Useful life of assets

A further issue that has come to the attention of the Authority is some different interpretations of the life of assets by the railway owner and by some interested parties. For agreements established outside the Code, pricing can be based on any asset lives the parties agree as reasonable which could include the expected plant life of the end customer being serviced. For Code based access agreements, the useful life of the railway infrastructure is generally based on the weighted cost asset life of the individual lives of the various infrastructure components (as listed in Annexure 7.1 of the approved Costing Principles). As discussed in section 4.4.2, the WNR submission seeks a Code change to enable recovery of investment cost and a return on that investment over the period in which the additional business will be generated, which in many cases which will be shorter than the useful life of assets. However, the approved Costing Principles (section 2.4) already contains a mechanism to enable WNR to approach the Authority to seek endorsement of the use of a shorter asset life in circumstances where the economic life of an asset is dependent on the life of a specific business such as a mine.

The view of the Authority is that no change to the Code is required as:

- WNR has the commercial flexibility to utilise different asset lives within agreements outside of the Code; and
- the Costing Principles also allow WNR to seek regulator endorsement of the use of shorter asset lives where the assets economic life is linked to the life of an end customers business.

5.2 Over-payment Rules

The Over-payment Rules provide the mechanism to calculate whether revenue from Code access agreements exceeds the total ceiling costs attributable to route sections, in order to reimburse operators who access that route section. This mechanism is crucial to the equitable and efficient operation of the costing and pricing principles of the Code. However, the primary area of concern is that the Over-payment Rules enables any excess revenue in one section to be reallocated to the next and subsequent route sections provided it is traversed by the same train service. Through this device the railway owner has the ability to reallocate excess revenue from a service, on a route section, to neighbouring route sections used by the same service that are under the ceiling cost.

As noted in Section 4.8.3, a further issue raised by submissions on the Over-payment Rules is the categorisation of government subsidies, and third party capital contributions, as access revenue instead of an adjustment to the ceiling costs. If the railway owner receives government subsidies to support their operations (e.g. for upgraded level crossings), the Costing Principles do not require a reduction in ceiling costs to reflect this government contribution.[115] However, in evaluating whether revenues obtained by the railway owner exceed ceiling costs using the Over-payment Rules, these government subsidies are recognised as a form of customer revenue. But like other access revenue, the Over-payment Rules for subsidies (even if for assets in specific route sections) are evaluated along the full origin-destination route of a train operators service. Hence, the subsidies can initially be allocated to cover incremental costs along the full route and then allocated to cover the ceiling costs of branch or feeder route sections and finally allocated to cover up to the ceiling costs on shared route sections.

Due to these concerns, the Issues Paper asked interested parties whether the Over-payment Rules provide a fair and equitable approach to address any breaches of ceiling costs/revenues. With the exception of WNR's submission,[116] submissions that addressed this issue expressed the view that Over-payment Rules require reform.

Worsley commented that *"these rules are also seen to be ineffective and need to be tightened considerably. For example, to make them 'work', it must go down to a route section by route section basis and this is sub-optimal."*[117] It is their view that reference tariffs would be a better method for regulating access charges, particularly for traffics which are expected to be at or near the ceiling. However, where a reference tariff is set at or close to the ceiling then tonnage forecast can still result in an over recovery.

FMG stated that the Over-payment Rules do not allow for carry forward in the case of underpayment. *"This has a distorting effect on the effective ceiling rate in that since cyclical fluctuations in demand may result in variations around that ceiling rate the absence of any carry forward provisions means that the average rate actually achieved will always be lower than that theoretically allowed…"*[118] However, this view may not appreciate that in calculating potential refunds, the Over-payment Rules permit under recoveries along a train service route to offset over recoveries within a successive three year period. Similarly other regimes, such as NSW, have an "unders and overs" approach to enable the railway owner to offset over recoveries with revenues below the ceiling. PN suggested that the Code include "a combinatorial segment based approach to ceiling prices" as used in NSW. This approach would focus on whether groups of segments exceed the ceiling test which differs from WA which is more focused on whether train operators pay access in excess of the ceiling test revenue across the origin-destination of their route. [119]

QR also observed that the main problem with the Over-payment Rules is that they operate ex-post whereas the problem for third party operators is to secure customers

[115] For further detail see section 6.9.
[116] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.15.
[117] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.19.
[118] FMG submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.2.
[119] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 3.

on the basis of negotiated tariffs. The current system further complicates customer contracts with regard to reimbursements.[120]

The Authority acknowledges that revenues above ceiling limits in respect of non-Code operators can be retained by WNR, subject to the terms of any agreement to the contrary, and that the Authority does not have the powers to force railway owners to repay over-payments made from agreements outside the Code. Hence, access seekers who are pursuing negotiations outside the Code who seek to be entitled to some form of repayment where access charges rise to levels above agreed rates of return would need to develop their own rebate type arrangements within their access agreements.

Overall, the Authority suggests that the future review of the Over-payment Rules evaluate the need for changes to the over-payment rules in relation to reallocation of over recovery to other sections, the inclusion of subsidies and the potential to recognise under recoveries.

5.3 Train Management Guidelines and Train Path Policy

The TPP and TMG are complementary Part 5 instruments under the Code, which together establish the policy and guidelines respectively within which the specific details of train paths and train management can be negotiated.

TPP and TMG both apply in a non-discriminatory way to operators who negotiate access agreements under the Code. Under Section 16(2) of the Code, the railway owner must not unfairly discriminate between their associate operator and other rail operators with respect to TPP, TMG and operating standards. This requirement is in place in order to ensure equitable treatment of such operators (e.g. maintain the order of priority of the scheduled train paths). Most submissions to the Issues Paper indicated that customer confidence in the allocation of train paths would be improved if the universal application of the TPP and TMG to all users of the network was required by the Code.

As discussed in Section 2.5.3, the Authority notes that the current choice by WNR to apply TPP and TMG to all Code and non-Code agreements is a commercial decision and the Authority does not seek to limit the commercial flexibility of access agreements established outside the Code. TPP and TMG only automatically apply to agreements established under the Code and if access seekers wish them to apply to 'outside the Code' agreements then they should seek to make this a term of such an agreement. The Authority sees merit in making this situation clearer under the Code.

Some submissions to the Issues Paper raised concerns that due to the vertical integration of the railway owner, the *"affiliate will secure preferential access to paths."*[121] Whilst there is some potential for giving some preferential treatment within access agreements made outside the Code, section 33 of the Act imposes a 'duty of fairness' and the Standard Access Agreement (which is generally used for both Code and outside the Code agreements) train paths are relinquished by operators (including associated entities) where reasonable regular utilisation is not achieved.

The provision of information on capacity for various routes may also be effective in improving customer confidence in the equity of the allocation of prime train paths. The availability of capacity information of primary routes of interest will enable all

[120] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.6.
[121] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.11.

access seekers, existing operators and end customers determine whether there is some spare capacity on a route or whether the section is fully utilised.

The review of the TPP and TMG will evaluate the merit of any changes to the TPP and TMG documents in order to improve customer confidence that train management and allocation of train paths are applied in a non-discriminatory way to all users.

5.4 Key Performance Indicators

The majority of the documents comprising the Part 5 instruments identify the need to establish KPI's. These are calculated based on Authority approved methodologies and formulas. KPI results are available on the Authority's website. The aim of most of the KPI's is to monitor the quality of service being provided by the railway owner, and to promote ongoing investment in the infrastructure to maintain or improve quality standards.

The KPI's will also be subject to review after a specified period following their initial establishment. This review process will be important in ensuring that KPI's and their results are meaningful.

In their submission to the Issues Paper, WNR state that the current KPI's will continue to become more useful and relevant after they have been in place long enough to use the data to develop trends. It is their view, that at this stage it would be premature to revisit the KPI's.[122]

However, some end users and operators have questioned whether some of the KPI's are meaningful, ARTC and QR both suggested alternate KPI measurements. As WNR is vertically integrated, the ARTC is of the view that the KPI reporting should be separated to associated party and third party use of the network respectively. The ARTC considers that reporting on a quarterly basis would be more timely and meaningful than the current annual reporting.[123] They further identified that the following elements of the KPI's are not adequately sufficient or meaningful:

- service reliability: measures do not recognise that a train can become unhealthy en-route, even though on time entry may have been achieved;
- no transit time indicators are reported;
- Track Quality Index (TQI) is not reported;
- speed restriction reporting of only the change in the number of restrictions is not particularly meaningful, at a minimum the length of the track under restriction should be publicly reported. The length of the restriction and the restricted speed are also imported to train operations; and
- actual unit cost outcomes are not provided.

The Authority has previously agreed two sets of requirements for KPI's with the railway owners. The first set of KPI's is an annual requirement which is made public through the Authority's website. The second set of KPI's, consisting of a more comprehensive and confidential set of measures (including service reliability and track quality index), is reported to the Authority on a quarterly basis.

[122] WNR submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.15.
[123] ARTC submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.10.

Worsley's submission stated that the current KPI framework is too high level for individual access agreements. They state that the key issue should be to develop an appropriate set of KPI's for individual contracts, noting that they could differ with different traffic types. Consequently, they suggest that the Authority should introduce a two-pronged approach, including:[124]

"(i) at a whole of regime level - the introduction of a 'scorecard' to assess the regime's overall effectiveness could be developed; and

(ii) The key performance indicators that are included in the access agreement form an important component of that agreement. While these are subject to negotiation, most of these should be able to be standardised (and hence consistent), other than say, where different levels of service quality have been agreed. A standard suite of indicators and service quality requirements could be developed as part of the standard access agreement and reference service respectively."

The Regime recognises the need to define performance standards and has included this requirement in Schedule 3 (item 11) of the Code which outlines a set of basic minimum items to be addressed in Standard Access Agreements. The Authority considers it inappropriate to establish a fixed set of KPI's in the Standard Access Agreement, as the KPI's should be negotiated between the railway owner and access seeker to reflect different operational, financial and other priorities of the access seeker.

Although there may be some reservations about the effectiveness of the current KPI's, the Authority is of the view that more time may be required to better evaluate if the current provisions are broadly effective. In addition, some of the KPI's may be better placed in an information package, such as is being recommended for introduction in section 6. The implementation of this information package may create a need to review whether some of the KPI's still need to be included in a separate report.

Any future review of the KPI's will evaluate the need to make any changes to KPI's in order to improve their relevance and usefulness taking into consideration the ongoing need for some of the KPI's, particularly if an Information Package is introduced.

[124] Worsley submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.23.

6 PROPOSED AMENDMENTS TO THE CODE

This section of the Draft Report further evaluates the potential amendment options that have been assessed to have some merit. The Authority is seeking views from interested parties on these proposed amendments.

6.1 Code coverage

As discussed previously in section 4.2, the Authority has further considered the application of the Code where access is negotiated using Parts 2 and 3 provisions vis-à-vis negotiations completed outside the Code. The Authority is of the view that the Code should remain an optional safety net and any negotiations completed without following the Code processes are not able to seek the rights and protections of the Code. However, there is merit in making this situation clearer for access seekers so they better understand that they face a key decision early in the negotiation process in that if they do not adhere to the negotiation processes within the Code commencing with Section 8, they lose all entitlement to the rights of the Code including the automatic application of the Part 5 instruments.

Therefore, the Authority recommends amendment to the introduction sections of Part 2 of the Code to make clearer that if these negotiation provisions are not followed that all rights to the Codes protection are foregone. The Authority is of the view that at the commencement of the negotiation of an access agreement, the access seeker and the railway owner must formally agree on whether negotiations will be undertaken according to the Parts 2 and 3 of the Code or whether a non-Code agreement will be negotiated. Similarly, a further clarification could be added to the introduction of Part 5 to reinforce the fact that the Part 5 instruments apply only to agreements negotiated under the Code unless the railway owner and access seeker agree to apply the same Part 5 instruments to access agreements negotiated outside the Code. To further clarify this situation, the Authority is recommending (Recommendation 4) that a process flow chart for negotiating access agreements (including detailed descriptions of rights under agreements negotiated using the Code and those negotiated outside the Code) is provided in the Information Package.

The proposed amendment would improve consistency and clarity vis-à-vis CPA clause 6(4)(a) which encourages access to be established on ‘terms and conditions agreed between the owner of the facility and the person seeking access’. Similarly the proposed amendment clarifies the requirement of CPA 6(4)(b) that where such a commercially negotiated agreement cannot be reached, that a right for persons to negotiate access to a service is available.

Recommendation 1

Part 2 of the Code needs to clarify that access negotiations completed without the use of the negotiation framework (Parts 2 and 3) of the Code are not entitled to any of the protections of rights under the Code. Part 2 also should be amended to require the railway owner to specifically agree with the access seeker whether negotiations are to proceed with or without using the processes within Code. If the Code is to be utilised the Authority should then be informed.

Part 5 of the Code should also be amended to state that the Part 5 instruments apply only to access agreements negotiated under the Code. However, the railway owner and access seeker may agree to apply the same Part 5 instruments to access agreements negotiated outside the Code.

6.2 Additional Pricing Information

The Authority is of the view that the operation of the Regime will benefit from introducing a requirement to publicly release floor and ceiling pricing information for key routes based on an assumed reference train (defined via assumptions on axle load, operating speed, train length) with these being set with reference to currently used train configurations for a particular routes. This information would be developed for all routes the Authority believes may have some interest from third parties. Such information would complement the floor and ceiling revenue information that is already publicly available through the various floor and ceiling cost determinations so as to improve transparency and market confidence.

Whilst the current process sees an access seeker provided with a likely access price as part of initial information provided upon written request under section 7 of the Code, the floor and ceiling prices are not provided until after provision of a formal access proposal (under section 9(1)(c)(i)). Hence, to estimate the likely floor and ceiling prices access seekers would need to convert floor and ceiling revenues using tonnage information formally requested from the railway owner under section 7 of the Code. Therefore, there appears merit in enabling third parties to view the floor and ceiling pricing limit information without the need to making any formal requests.

The provision of additional pricing information aims to alleviate information asymmetry, and improve the ability of potential access seekers to consider the likely financial and operational feasibility of their proposed access. Whatever the form of this additional pricing information, it is intended only as a benchmark for a reference train service and actual access charges are likely to differ, whilst being consistent with internal access prices charged to associated entities. While a number of submissions sought the establishment of reference tariffs based on access prices paid by associated entities, the Authority intends to maintain the existing negotiate–arbitrate model and retain better consistency clauses 6(4)(a) and (f) of the CPA, and at this time the Authority does not seek to undermine this by requiring the publication of such prescriptive pricing information.

Whilst floor and ceiling price limits are arguably less useful vis-à-vis reference tariffs, they largely preserve current negotiating positions and provide some reduction to information asymmetry without a significant additional administrative cost.

The Authority is of the view that the most appropriate sections to amend to give effect to this requirement for additional pricing limit information is in Schedule 4, clauses 9 and 10.

Recommendation 2

It is proposed that the Code be amended to require the public release of floor and ceiling prices in addition to floor and ceiling costs. These prices would be based on a standard reference train service assuming the most common train configuration for the route and would be calculated for routes requested by the Authority where the Authority believes there may be third party interest.

6.3 Information package including capacity information

One of the issues associated with the railway owner being vertically integrated is the information asymmetry which can potentially be used to frustrate access by competitors of the associated entity, for example not providing all key infrastructure details and constraints in a timely fashion. In order to promote the principle of taking all reasonable endeavours to accommodate access seekers, the railway owner could be obligated to publish and regularly update information about the capacity of the network and other data required to develop an operational proposal.

The Authority believes that a benefit of requiring the railway owner to provide capacity information would be to contain the ability of the railway owner to understate the extent of spare capacity which may then in turn require a contribution from the access seeker towards expenditure (e.g. on passing loops) to increase capacity.

It is the view of the Authority that the best approach would be to progressively develop useful capacity information (within a timeframe to be agreed with the railway owner) through information added to the WNR website for each key route that has been of interest to third parties. The information would include a combination of both the axle load and the current paths, listing the spare train path capacity on any line.

The Authority is also of the view that information on capacity would be part of a broader requirement that the railway owner release in an information package separated into data for key routes. This amendment would mandate a more proactive approach to the provision of additional information, replacing the current practice whereby the railway owner provides information following receipt of an access proposal. The contents of the information package would consider inclusions for information packages generated in other jurisdictions (e.g. QR and ARTC) as well as that included in section 6-7 and schedule 2 of the Code. Examples of information that could be published on the internet include:

- a map providing a geographical description of the network;
- detailed track diagrams;
- existing train running times by section;
- communication systems;
- curves and gradients;
- safeworking system requirements;

- the working timetable;
- a summary of the future upgrading and capital works planned over the next five years;
- passing loop locations and loop lengths;
- track type, condition, quality and standard by route section;
- rollingstock envelop (i.e. train profile maximum limits) and clearance information;
- permanent speed restrictions;
- net and gross tonnages by route section for past three years; and
- a process flow chart and explanation of rights for negotiating access both within the Code and outside the Code.

In practice, WNR has already prepared much of this information in response to requests from access seekers and the conversion of this information into more detailed packages for key lines is not likely to involve significant new resources.

This increase in available information will help access seekers understand the potential operational feasibility of their proposal prior to making formal inquiries to the railway owner. It will also assist the access seeker to fulfil the section 15 requirement to show that its operations are within the capacity of the route or expanded route.

This amendment to the Code aims to address the transparency issues identified by public submissions, and may encourage more effective negotiations by allowing access seekers to better develop initial proposals prior to starting negotiations with the railway owner. The Information Package may also reduce the opportunities for the railway owner to engage in practices which hinder or deter proposal development by access seekers. If effective in addressing these issues, the benefits of this amendment will outweigh the additional administrative and management costs incurred by the railway owner to assemble and periodically update information.

It is proposed that sections 6 and 7, and schedule 2 of the Code, will be amended to require the internet publication of information packages to aid the initial development of proposals by potential access seekers. This information will partly mitigate information asymmetry issues and improve consistency of the Code with the CPA clause 6(4)(e) which requires infrastructure owners to use reasonable endeavours to facilitate access.

Recommendation 3

It is proposed that the railway owner be required to publicly release, on their website, detailed Information Packages including capacity information for routes requested by the Authority. The packages should be updated at least every two years or potentially more often where significant changes have occurred to the rail network.

6.4 Changes to Regulator ability to give opinion on price sought for access

This review process has identified that operators and end customers have some reservations over the manner in which the railway owners treat associated entities in comparison to other railway operators. To date there has been no use of section 21 of the Code. The Authority sees this as a critical function and in this review proposes to improve it's ability to efficiently respond to requests without the need to call on the railway owner for prices.

In an effort to strengthen market confidence in the Segregation Arrangements, changes are proposed to allow the Authority to request from the railway owner a full set of internal prices and related information for relevant parts of the network. This information would be required to be provided within 10 working days. The provision of this information (which the Authority would keep confidential) would allow the Authority to carry out a better assessment of prices when required to do so under the provisions of Section 21 of the Code.

The flow of internal pricing information from the railway owner to the Authority, will marginally increase the administrative burden and costs resulting from the Regime. However, as the railway owner already has this information, and does not need to collate additional information, it is expected that the additional costs would be minimal. Further, this amendment is seen as improving the consistency of the Code with CPA clauses:

- 6(4)(e): the requirement that the railway owner use all reasonable endeavours to accommodate the requirements of persons seeking access.
- 6(4)(m): the requirement that the owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.
- 6(4)(n): the requirement that separate accounting arrangements be established for the elements of a business which are covered by the access regime.

The Authority will be able to give an opinion as to whether the quoted access price is broadly consistent with the internal price and the Costing Principles. The proposed amendment should also improve customer confidence in the Regime.

Recommendation 4

Section 21 of the Code should be strengthened to allow the Authority to request from the railway owner the internal prices and related information by route section for relevant parts of the network with such information to be provided within 10 working days. This would improve the Authority's ability to quickly express an opinion as to whether the price sought by the access seeker in negotiations for access is consistent with prices charged to associates of the railway owner.[125]

6.5 Pricing of Network Expansions

Submissions to the Issues Paper indicated a concern about the current pricing process for network expansions where an access proposal needs to increase capacity in order to be accommodated on the network. Under section 9(2)(b) of the Code the railway owner must provide the access seeker with a preliminary estimate of the costs relating to the extension or expansion, and the likely share of these costs to be borne by the proponent. Therefore the railway owner can seek full contributions to fund the network expansion from the requesting party via upfront funding or progressively via higher access prices. Hence, whilst the new capacity and the assets which facilitate it (eg a new passing loop) may be used by a variety of train operators or end customers, the railway owner is free to request that the cost of the new capacity be fully funded upfront by the requesting party.

This has raised concerns from users with respect to new infrastructure that is priced at a higher rate than services in the same market which secured capacity before the capacity increase. This arrangement can be seen to provide a competitive advantage to the incumbent operator.

However, the CPA requires that the decision to extend the facility should take into account the relative benefits and usages to the railway owner, the proponent and other users. Clause 6(4)(j) the CPA sets out the following conditions to be observed:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

Therefore, the Code requires that the costs of the network expansion should be shared in accordance with economic benefits to all users. By increasing the detail and the steps in the pricing of the network expansion, the funding requirement could be made more equitable by sharing the costs based on the relative usage and the relative economic benefits to the parties from the expansion.

It is anticipated that the introduction of this amendment will not involve a significant increase in costs for the railway owner, as it involves a minor adjustment to the existing process.

[125] Schedule 4 clause 13(a) of the Code.

The introduction of this amendment should improve the clarity of any new capacity capital costs, which would be then shared based on a combination of relative usage and economic benefits. However, there is a potential risk that smaller users of the network may not have the capacity to pay an upfront contribution or higher ongoing prices, and consequently could be negatively impacted.

Recommendation 5

It is proposed that some additional principles be included within section 9(2)(b)(ii) of the Code to require that cost sharing arrangements for network expansions be set equitably between all users of the line based on a combination of relative current usage and economic benefits.

ATTACHMENT 1: SUMMARY OF SUBMISSIONS ON POTENTIAL REFORMS TO THE ACT

This attachment to the Draft Report of the review of the Code summarises the comments from interested parties regarding issues raised in relation to the Act. As these issues are outside of the scope of this review, the discussion of these Act issues has been placed in this Attachment to the Draft Report. Submissions on the information contained in this Attachment are sought from interested parties.

The Final Report will deal only with matters relating to the Code as required under the scope of this review.

The manner in which the Authority will deal with the matters relating to the Act has been outlined in the Executive Summary section E6.

(i) Change of definition of Rail Infrastructure in the Act

The definition of what is covered by the Regime is found in the section 3(1) of the Act which defines "rail infrastructure" as:

"the facilities necessary for the operation of a railway including –

(a) railway track, associated track structures, over or under track structures, supports (including supports for equipment or items associated with the use of a railway);

(b) tunnels and bridges;

(c) stations and platforms;

(d) train control systems, signalling systems and communication systems;

(e) electric traction infrastructure;

(f) buildings and workshops; and

(g) associated plant machinery and equipment,

but not including –

(h) sidings or spur lines that are excluded by subsection (3) or (4) from being railway infrastructure associated with the railway concerned;

(i) rolling stock, rolling stock maintenance facilities, office buildings, housing, freight centres, or terminal yards and depots."

Under this definition, access to yards, sidings and terminals is not included because it has been deemed they do not exhibit nationally significant infrastructure characteristics and use by multiple parties may not be practical. This means that under the current arrangements, access seekers who need access to these facilities need to negotiate additional contracts outside their access agreement with the railway owner or railway operator. The definition of railway infrastructure does however include 'stations and platforms' which could arguably be excluded due to the reasoning applied to terminals and sidings.

The TPA allows interested parties to seek declaration of these facilities, if it can be shown that they are not economically or practicably duplicable. The ARTC stated in their response to the Issues Paper that "*the access regime should cover infrastructure that would reasonably be required by an access seeker in order to utilize the network where it is considered that the duplication of that infrastructure is uneconomic.*"[126] ARTC would like to see an amendment so that approval for access is assumed unless the Minister formally rejects declaration, as opposed to the current practice whereby rejection to access is assumed.

This viewpoint reflected the general consensus of the majority of users, that the Act should cover all necessary infrastructure required to deliver a declared service, which could possibly include sidings and terminals. In their submission, QR suggested that there is merit in adopting an approach similar to the one in Queensland which assesses each rail terminal and associated facility on a case by case basis to determine whether it should be subject to third party access.

Alcoa argued that AWR has a competitive advantage in bidding for the above rail operations due to the fact that existing facilities are not available to new entrants and there is only limited availability of land suitable for these activities.[127] Alcoa further commented that *"given disputes in other jurisdictions, and the competitive advantage afforded to the incumbent above rail operator, the Authority should consider including additional facilities under the control of the railway owner in future amendments to the Act."*[128]

The Authority understands that the railway infrastructure inclusions and exclusions as listed in the Act were influenced by a series of NCC decisions in 1997 in relation to five applications by SCT for declaration of rail and freight support services provided by Westrail. The first application covered use of the Kalgoorlie to Perth railway line (EGR). The other applications covered rail freight support services such as arriving/departing services, marshalling/shunting services and access and fuelling services. The NCC recommended that the EGR be declared but not the rail freight support services. The NCC found that the latter services were economic to duplicate.[129] The NCC findings were influential in the WA Government's decision as to what could be assessed under the current Regime.

(ii) Enforcement mechanisms to support the right to negotiate access

To be an effective access regime, there must be enforcement mechanisms that apply if a party fails to comply with particular obligations. The current enforcement provisions (Division 2, section 21 and 22 of the Act) include fines initiated by the Regulator and then enforced by a Supreme Court ruling. Additionally the Authority can also apply to the Supreme Court to grant an injunction if it is satisfied that the railway owner has engaged or is proposing to engage in conduct that amounts to a breach of the Code. These measures impose financial penalties to deter non-compliance with the regime, and are supported by the railway owner. ARG have stated that they support *"enforcement being based on the power of the regulator to issue direction supported by appropriate civil penalties."* [130]

---

[126] ARG submission to *'Options for Reform of the Victorian Rail Access Regime'*, August 2004, pg. 1.
[127] Alcoa submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p.3.
[128] ibid., p.5.
[129] NCC Submission to the Productivity Commission Inquiry, Progress in Rail Reform, 10 November 1998, p 7.
[130] ARG submission *'Options for Reform of the Victorian Rail Access Regime'*, August 2004, p.4.

There could be some grounds to introduce the ability for access seekers to be awarded damages if it can demonstrate a loss or damage from breach of an access agreement with the railway owner. This concept is supported by Worsley, who maintain that $100,000 is an insufficient disincentive, and losses incurred from railway owner should be recoverable as damages by the party that suffers damage. Worsley propose that any penalties should reflect the full economic value of the loss suffered by the party. However, fines are generally set at a level broadly commensurate with the significance of the offence, and it would be impractical to fine based on an individual economic loss. This approach is arguably more suitable for civil suit compensation claims.

(iii) Greenfields Lines

As described in section 4.4.2 of this Report, a greenfield investment typically refers to the construction of a new rail line which is not connected to an existing network. A greenfield extension is generally viewed as a new line connected to an existing network.

Greenfields investments and expansions of the railway infrastructure need to generate a considerable level of demand if operations are to be profitable, and to compensate for the high level of risk. Thus, regulation of greenfields projects needs to deal appropriately with the ex ante risks facing the investor, otherwise incentives to invest may be lower. Consequently, access arrangements should not deter investment, however it must also promote access and competition in related markets.[131]

Greenfield expansions are covered by section 3(2) of the Act, which states that if any new railways are constructed which connect to the railway, the Minister may declare the new railway to be part of the railway network. Any new lines also need to pass the test for inclusion which is covered in section 5(3) of the Act, whereby the proposed route needs to satisfy the following criteria:

(a) *whether access to the route will promote competition in at least one market, other than the market for railway services;*

(b) *whether it would be uneconomical for anyone to establish another railway on the route;*

(c) *whether the route is of significance having regard to:*

i. *its length;*

ii. *its importance to trade or commerce; or*

iii. *its importance to the economy;*

(d) *whether access to the route can be provided without undue risk to human health or safety;*

(e) *whether there is not already effective access to the route; and*

(f) *whether access or increased access to the route would not be contrary to public interest.*

[131] National Competition Council, *"Australasia Railway Access Regime: Final Determination"*, February 2000, p.1.

Any new and extended route needs to pass this test for inclusion in order to be added to Schedule 1 of the Code which lists all the routes to which the Code applies. If railway infrastructure, covered by the Code, is extended or expanded (e.g. a new passing loop or a rail line duplication) the Code will also apply to that route or infrastructure.

Currently under the Code, the Authority has no formal involvement in regulating new rail lines until they are operational and formally added to Schedule 1 of the Code. Under this process the railway developer could be subject to a lengthy waiting period between line commissioning and Ministerial approval for formal inclusion of the line in Schedule 1 of the Code. Therefore proponents of new lines are uncertain if a potential line will be covered by the Regime and this can impact on the bankability of the proposal.

This process is yet to be tested, as no expansions or extensions of the network have been included into the Code. Proponents building new rail lines are likely to seek to contract a base load of volume prior to construction in order to reduce the high level of risk associated with investment in long-lived assets.

This uncertainty related to the regulation of new lines is viewed by some interested parties as a disincentive to invest in the network. Therefore, there is a desire to be able to obtain a view at the proposal stage on whether coverage is likely as well as reforms to minimise this waiting period prior to inclusion into the Regime by speeding up the testing process.

QR have stated that there is an information asymmetry between the rail developer and potential users. They suggest that the *"rail developer should have the capacity to gain an understanding of the status of its proposed rail infrastructure and the nature of the regulation that would be applied to it, before the proposed rail infrastructure is developed."*[132] QR also recommended that changes be made to the Act (and Code) to identify the nature of the Service to be covered, in addition to the infrastructure required to deliver it.

Some submissions suggested that the confidence of railway developers could potentially be improved if it was possible to obtain a preliminary view from the Authority on whether the proposed line would be covered, and the likely ceiling and floor costs.

(iv) Segregation Arrangements

The segregation arrangements in a regime are integral to the negotiation process, as they aim to ensure confidentiality of negotiations and fairness. The crucial importance of segregation sees the duty to separate (or ring fence) the access related (below rail) functions from the other functions outlined in Part 4 Division 3 (section 28 to 34) of the Act. The duty to segregate under section 28 of the Act requires the development of the Segregation Arrangement instrument which details the specific separation control procedures which need to be approved by the Authority. Consequently, reference to the Segregation Arrangements in the Code is limited (section 42), which refers to the approval process of the arrangements. There were no submissions suggesting changes to section 42 of the Code. However, a number of other views on segregation were expressed.

[132] QR submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.9.

In earlier reviews which established the Segregation Arrangements, the Authority considered the merit of requiring separate buildings for WNR and AWR. This requirement was not imposed due to a view that it would not preclude the illegal exchange of confidential information and it also created extra costs whilst reducing communication effectiveness in relation to permissible exchanges, e.g. maintenance and operating strategy.

The Authority is proposing to strengthen the segregation arrangements by providing the Regulator ability to audit consistency between prices provided to associated entities and access seekers, as discussed earlier in section 4.10.1. This should strengthen customer confidence in the segregation arrangements.

The statutory segregation requirements are contained in Part 4 Division 3 of the Act. The duty to segregate under section 28 of the Act requires the development of the Segregation Arrangement instrument which details the specific separation control procedures which need to be approved by the Authority (submissions on issues relating to the Segregation Arrangement instrument are summarised in Section 5.3 of this report).

A number of submissions indicated concern about the effectiveness of the Regime in maintaining these segregation arrangements with some suggesting more structural separation is required. For instance *"AWB feels that the Code needs to be revised to end vertical integration in the Western Australian rail infrastructure, or to reinforce the virtual separation of the entities, which it feels has not been achieved with any degree of success"*[133] Some submissions also suggested that as vertically integrated railway owners have greater incentive to frustrate access by competitors, it is critical that the Regime provides adequate safeguards against the railway owner favouring its associated entities.

PN expressed the view that it considered that the segregation arrangements are adequate.[134]

Overall, the use of a vertically integrated structure was a WA Government policy decision which is reinforced by a number of clauses of the Act and the sale agreement with ARG.

(v) Consistency with National Regime

Clause 6(4)(p) of the CPA states that there should be consistency of access arrangements, where more than one set of arrangements applies to a service. An effective access regime should be able to facilitate cohesion with other regimes to ensure smooth running over the interstate jurisdictions. This should enable the access seeker to coordinate usage of the rail infrastructure between states.

The ARTC has negotiated a wholesale agreement with the WA Government that gives the ARTC exclusive rights with respect to new agreements on the interstate part of the network. As yet, no operations are being conducted on this part of the network pursuant to an access agreement developed under the wholesale agreement.[135]

---

[133] AWB submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.3.
[134] PN submission to the *'Issues Paper: Review of the WA Railways Code'*, March 2005, p 25.
[135] ARTC submission to the *'Issues Paper: Review of the WA Railways Code'*, April 2005, p.3.

Under section 27(1) of the Code, if there is arbitration of an issue which is relevant to arbitration under another access regime, then arbitration is to take place both under the Code and the other relevant regime.

Despite these arrangements to enable some consistency between jurisdictions, the practical effectiveness is yet to be tested. Currently, the ARTC Undertaking appears to be the most likely regulatory framework to emerge as a National Rail Access Regime.

ARTC stated in their submission to the Issues Paper that the Regime has a number of different treatments that can cause some uncertainty in access for the operator of an interstate service, e.g. provision for capacity transfer, resolution of capacity demand conflicts, open-ness in pricing, and treatment of costs in floor/ceiling limits. The incumbent interstate operators (SCT and PN) preferring to deal directly with the party controlling maintenance and operations on the network, rather than indirectly through the ARTC suggests the one-stop-shop concept has less merit to operators than a direct communication line with the actual network owner and controller. Overall, *" ARTC does not consider the arrangement as being particularly effective, however it does provide a base for an effective ceiling on access pricing and terms for interstate operators with WNR."*[136]

[136] ibid, p.5.

ATTACHMENT 2: SUBMISSIONS RECEIVED

1. Alcoa World Alumina Australia
2. Australian Railroad Group
3. Australian Rail Track Corporation
4. AWB Ltd
5. Chamber of Commerce and Industry of Western Australia
6. Fortescue Metals Group Ltd
7. Pacific National
8. Queensland Rail
9. WestNet Rail
10. Worsley Alumina

ATTACHMENT 3: TERMS OF REFERENCE

REVIEW OF RAIL (ACCESS) CODE 2000

Section 12 of the Railways (Access) Act 1998 provides the Terms of Reference of Review of the Railways (Access) Code 2000 as detailed below:

12. Review of the Code

(1) The Regulator must carry out a review of the Code as soon as is practicable after –

(a) the third anniversary of its commencement; and

(b) the expiry of each 5 yearly interval after that anniversary.

(2) The purpose of a review is to assess the suitability of the provisions of the Code to give effect to the Competition Principles Agreement in respect of railways to which the Code applies.

(3) Before carrying out a review of the Code, the Regulator must call for public comment in accordance with subsection (4).

(4) The Regulator must –

(a) cause notice of the review to be published, in one issue of –

(i) a daily newspaper circulating throughout the Commonwealth; and

(ii) a daily newspaper circulating throughout the State;

and

(b) include in the notice –

(i) a statement that written submissions on the Code may be made to the Regulator by any person within a specified period; and

(ii) the address to which the submissions may be delivered for posted.

(5) The period specified under subsection (4)(b)(i) is not to be less than 30 days after both of the notices under subsection (3)(a) have been published.

(6) The Regulator must prepare a report based on the review and give it to the Minister.

ATTACHMENT 4: ABBREVIATIONS

Abbreviation	Meaning.
ACCC	Australian Competition and Consumer Commission.
APT	Asia Pacific Transport
ARA	Australasian Railway Association
ARG	Australian Railroad Group
ARTC	Australian Rail Track Corporation
ATC	Australian Transport Council
Authority	Economic Regulation Authority of Western Australia
ASR	Australian Southern Railroad
AWR	Australian Western Railroad
CAPM	Capital Asset Pricing Model.
CoAG	Council of Australian Governments.
CPA	Competition Principles Agreement
CSO	Community Services Obligation
DORC	Depreciated Optimised Replacement Cost
ESC	Essential Services Commission (Victoria).
ESCOSA	Essential Services Commission of South Australia
EU	European Union
FMG	Fortescue Metals Group
GRV	Gross Replacement Value
GSR	Great Southern Railway
IPART	Independent Pricing and Regulatory Tribunal of New South Wales.
KPI	Key Performance Indicators
MEA	Modern Equivalent Asset
NCC	National Competition Council
NCP	National Competition Policy
ORAR	Office of Rail Access Regulation, now part of the Authority
PN	Pacific National
PTA	Public Transport Authority
QCA	Queensland Competition Authority
QR	Queensland Rail
SCT	Specialised Container Transport
SWM	South west mainline (a high volume route on the WNR network)
TPP	Train Path Policy
TPA	Trade Practices Act 1974
TMG	Train Management Guidelines
TQI	Track Quality Index

Abbreviation	Meaning.
WACC	Weighted average cost of capital.
WNR	WestNet Rail
WAGR	Western Australian Government Railways

ATTACHMENT 5: CLAUSE 6 OF COMPETITION PRINCIPLES AGREEMENT

Access to Services Provided by Means of Significant Infrastructure Facilities

6. (1) Subject to subclause (2), the Commonwealth will put forward legislation to establish a regime for third party access to services provided by means of significant infrastructure facilities where:

   (a) it would not be economically feasible to duplicate the facility;

   (b) access to the service is necessary in order to permit effective competition in a downstream or upstream market;

   (c) the facility is of national significance having regard to the size of the facility, its importance to constitutional trade or commerce or its importance to the national economy; and

   (d) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

   (2) The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

   (a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

   (b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

   (3) For a State or Territory access regime to conform to the principles set out in this clause, it should:

   (a) apply to services provided by means of significant infrastructure facilities where:

   (i) it would not be economically feasible to duplicate the facility;

   (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

   (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

   (b) incorporate the principles referred to in subclause (4).

   (4) A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

(d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

(f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

(h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

(i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:

  (i) the owner's legitimate business interests and investment in the facility;

  (ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

  (iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

  (iv) the interests of all persons holding contracts for use of the facility;

  (v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

  (vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

(j) The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

(k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

(l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

(m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

(n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

(o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

(p) Where more than one State or Territory regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other cooperative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.