

Pacific National

Submission to the Economic Regulation Authority
on the Review of the Western Australian Railways
(Access) Code (2000)

March 2005

1. Executive Summary and Outline

1.1 Executive summary

The purpose of the review is to assess how effectively the Code meets the objectives of the CPA. The objective of access regulation is to promote efficiency and the CPA seeks to do this, relevantly in the case of rail, by ensuring:

- the efficient use of natural monopoly infrastructure;
- the efficient investment in natural monopoly infrastructure; and
- promoting competition in activities that rely on the use of infrastructure services where it is uneconomic to develop alternative facilities.

Pacific National's experience as an access seeker or access provider in virtually all jurisdictions in Australia means it is well placed to provide information about whether the Code meets the objectives of the CPA.

Pacific National believes there are several key areas where the Code does not meet the objectives of the CPA as effectively as it could:-

(a) **Level and structure of access charges**

Inducing competition in dependent markets is one of the fundamental aims of the CPA. However, the approach taken to the calculation of ceiling prices in Western Australia permits very high access charges to be set by WNR. This ability presents the possible risk of an access provider setting access charges high enough to deter competitive entry in the haulage of freight on the intrastate network. No above rail competitor has been able to enter the Western Australian intrastate network where competing haulage services have been sought by customers for minerals haulage.

In addition, high ceiling prices for the use of the WNR network, which are well above the actual access price charged to Pacific National, with an ability for the railway owner to significantly increase below rail revenues can lead to:

- (i) significant uncertainty on the returns to above rail investments, increasing the cost of capital for the above rail sector and possibly deterring efficient investments;
- (ii) the provision of an opportunity for the vertically integrated rail operator to price the third party access seekers out of the market; and

- (iii) as freight volume grows, a misallocation of demand risk and additional revenue, which will damage the prospects for growth of rail freight volumes.

Because the current valuation of the asset base leads to very high ceiling prices, which in turn have deterred entry in dependent intrastate markets, created uncertainty on returns for above rail operators and thus failed to achieve the fundamental objectives of the CPA, Pacific National submits that consideration should be given to an adjustment to the legacy assets permitted to be included in the regulated asset base.

Furthermore, Pacific National submits that the Code should require a combinatorial segment based approach to ceiling prices (without which detection of monopoly pricing above full economic cost cannot be detected in portions of the network) as occurs in New South Wales.

(b) **Incentives for efficient investment**

One of the objectives of the CPA is for the terms of the access regime to induce efficient operation and investment in the regulated asset. An effective way to ensure efficient investment takes place is to provide for collaboration between above and below rail operators on investment decisions which affect both of their operations. Collaborative investment is in the public interest as it ensures efficient use of, and investment in, essential infrastructure and, accordingly, would meet the objectives of the CPA.

In Pacific National's experience WNR has demonstrated that it has been prepared to collaborate with above rail operators on investment decisions on the track from Kalgoorlie to Perth¹ and, as a vertically integrated railway operator, it has an incentive to do so.

However, should an access seeker wish to rely on the Code as a safety net in circumstances where there is a refusal by WNR to make investments which on an objective view would enhance efficiency, the Code provides no means for access seekers to seek regulator intervention. Accordingly, Pacific National submits that the Code should require the railway owner to collaborate with the access seekers with respect to network investments.

(c) **Term/certainty on prices**

Pacific National submits that the Code should ensure that either the duration of the access agreements is sufficient to encourage above rail operators to be able to recover their investment in above rail operations (say, 10 to 20 years at the option of the access seeker) or the Code provides some certainty in terms of the access charges. Whilst Pacific National has been able to negotiate an appropriate term with WNR to obtain the level of certainty on access charges required to encourage investment, there is no protection provided in the Code.

(d) **Access to information**

Pacific National submits that the Code should require the railway owner to provide details of available train paths and the access price for the train paths sought within 30 days from the date the access proposal. This would ensure that third party access seekers have the information required to respond to tenders for rail haulage services in Western Australia.

(e) **Consistency in pricing**

Pacific National submits that the Code should ensure that the access prices charged to third party access seekers are consistent with the access prices WNR charges to its related above rail operator and that those prices are calculated in accordance with an appropriate formula which is to be specified in the Code.

Section 16 of the Code prohibits unfair discrimination between an access seeker and the WNR related above rail operator, however the section 16 non-discrimination provisions only apply if an access seeker seeks access pursuant to the Code. This should be amended to apply to any access seeker regardless of whether the access seeker or holder sought access through the Code or through commercial negotiation.

Further, the Code should impose an obligation on the railway owner to disclose relevant price and costing information to the Authority so the Authority can verify that the railway owner is not discriminating between its own above rail operator and third party access seekers and that its prices have been calculated in the same manner for each access seeker and in accordance with the Code.

¹ such as in relation to the current proposal for longer crossing loops to be installed to allow 1800m trains to pass at 8 locations on the interstate line between Perth and Kalgoorlie.

The amendments in paragraphs (c) to (e) above are necessary to ensure effective, fair and transparent competition for haulage by rail in Western Australia, therefore effectively attaining the objectives of the CPA.

This review does not include a review of the 5 key regulatory instruments (Costing Principles, Segregation Arrangements, Train Path Policy, Train Management Guidelines and Overpayment Rules), which will be reviewed separately following this review of the Code. Pacific National looks forward to participating in that separate review process.

1.2 Structure of submission

Each of the key areas identified in section 1.1 are addressed in section 2 to 4 of this submission. The Attachment to this submission responds, where applicable, to each question raised by the Authority in the Issues Paper.

2. Key issue: Level and structure of access charges

2.1 Overview of pricing and costing principles

The approach taken to pricing in the Western Australia regime has deterred competitive entry in the Western Australian intrastate rail haulage. It has also created significant uncertainty on the returns for above rail operators. This section outlines the reasons the current level and structure of access charges in Western Australia has led to sub-optimal outcomes and a lack of entry into dependent markets in Western Australia and the principles which should be applied in calculating the ceiling in a way which effectively meets the objectives of the CPA.

Specifically,:

- sets out the impact of high ceiling on charges on the incentives for above and below rail operators;
- discusses the effectiveness of the non-combinatorial approach to calculating the ceiling in constraining monopoly pricing; and
- discusses the impact of the approach used in the Western Australian regime to recognise capital contributions.

Whilst the detailed aspects of pricing issues will be canvassed in the expected review of Costing Principles² and specific floor and ceiling “price” determinations, Pacific National believes that the furtherance of the CPA objectives expressed in paragraph 6(4), would be better achieved by a strategic review of the aspects of the Western Australian regime pricing rules identified in this Section 2.

2.2 Impact of a high ceiling

Section 6.7 of the Issues Paper states:

“The differences in the calculated revenues between DORC and GRV for defining upper price limits is less of an issue, because most customers prices are below the ceiling.”

This suggests that the issue of the ceiling is irrelevant.

However, it is undesirable to have a ceiling which is well above current charges, regardless of how that ceiling is calculated as a high ceiling together with an ability to significantly increase below rail revenues can lead to:

- significant uncertainty on the returns to above rail investments, increasing the cost of capital for the above rail sector and possible deterring efficient investments;
- the provision of an opportunity for the vertically integrated rail operator to price the third party access seekers out of the market; and
- as freight volume grows, a misallocation of demand risk, which will damage the prospects for growth of rail freight volumes.

Uncertainty on returns

Section 1.3 of the Issues Paper sets out the importance of facilitating efficient investment. This requires that risks are correctly allocated, and that investors are not subject to an expropriation risk due to the structure of the regulatory regime.

² Pacific National wishes to comment on the appropriate methodology to use in the valuation of the regulated asset base (such as GRV annuity or DORC or other) but will reserve its comments on the this issue for the review of the Costing Principles.

The Code currently provides a means by which the below rail operator can earn a higher return on its existing assets, simply due to a transfer from above rail operators. The lack of certainty over the level of charges acts as a disincentive for long term investment by above rail operators.

Opportunity for WNR to price third party access seekers out of the market

A ceiling well above actual levels of charges and the ability for the railway owner to increase the charges provides the vertically integrated rail operator, WNR, with an opportunity to price third party access seekers out of the market with high access charges.

The Code provides no protection to access seekers from this risk as it does not do anything to prevent WNR from building margin into the below rail access charges and squeezing the revenue the access seeker may generate from providing rail freight services in competition with the WNR related above rail operator. Whilst this conduct could be caught by the misuse of market power provisions of the TPA³, it is notoriously difficult to detect when this conduct is taking place and would be more effectively managed by ensuring that the regulatory regime provides appropriate incentives to discourage this type of conduct.

Misallocation of demand risk

The third risk is that a high ceiling and ability to increase below rail revenues as freight volumes grow will create a misallocation of demand risk.

Rail freight businesses face demand risk – that is, their earnings vary according to their success in growing demand. That risk needs to be allocated to the party best able to manage it.

Optimally, the party best placed to grow rail freight volumes should also be the party whose profits are most affected by change in rail freight volumes. The allocation of risk in this way will mean that:

- the efficiency of the rail sector will be enhanced, since parties who are well placed to chase rail freight volumes will also have the incentives to do so; and
- the cost of capital for the sector as a whole will be reduced, since parties bearing volume risk will also be the parties best placed to assess, manage and price the risks.

³ section 46 of the TPA.

Above rail operators play the main role in securing customers for rail freight, through the quality and price of their services, and are best placed to manage demand risk. This is not to say that below rail operators face no demand risk. Although below rail costs are predominantly fixed, some costs do vary with volume of demand. Ideally growth in volume should benefit the party responsible for causing that growth.

It would be a mistake to make the earnings of below rail operators highly sensitive to demand, through variable charges which are well above variable costs. This would expose them to a risk that they are not well placed to bear. It would also lead to windfall gains (or losses) dependent on the efforts of the above rail operators.

The existence of a ceiling well above current levels can encourage structures which are designed to move towards that ceiling. Typically this would entail a variable charge well above operating costs, allowing the below rail operator to "free ride" on volume growth dependent on the efforts of above rail operators.

2.3 Experience on the intrastate network

The lack of entry on the Western Australian intrastate network has been recognised by the Authority in the Issues Paper. In section 3.6, the Authority states:

"Following the implementation of the Regime, there has been no significant new entry into the intra-state freight rail market on the WNR network in competition to [AWR]. ... Although simplistically, it may appear 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."

However, in Western Australia there is no evidence that the potential for Pacific National and other rail freight operators to enter the Western Australian intrastate markets has been sufficient to give rise to competitive benefits to customers in Western Australia as has occurred in other jurisdictions.

To date no competing rail operator has been able to secure haulage agreements with customers on the intrastate network despite several competitive bids. Pacific National's experience in Western Australia indicates that the Code does not provide an effective means by which third party access seekers can obtain competitive access charges. Actual and potential competition is not occurring on a scale that would be expected, particularly given that grain and minerals traffic on the intrastate network is potentially attractive at current haulage prices and customers have shown a willingness to use an alternative rail operator provided they can secure competitive access charges from WNR.

2.4 Calculating the ceiling

The Western Australian rail access regime adopts a non-combinatorial approach to the calculation of the ceiling. The non-combinatorial approach does not prevent the railway owner from extracting monopoly rent and is, therefore, ineffective for the purpose of meeting the objectives of the CPA.

The NSW rail access regime specifies the ceiling test in the following terms. Revenue from each train movement or group of train movements must not exceed the stand alone cost of providing the infrastructure required by that train movement or group of train movements. The reference to any group of train movements gives this ceiling test its “combinatorial” character - any group, or “combination”, of train movements must pay no more than its own stand-alone cost.

A stand-alone ceiling test that is not applied on such a combinatorial basis would present opportunities for the infrastructure owner to over-recover its infrastructure costs and to cross-subsidise one group of access customers at the expense of another. The rationale for the combinatorial ceiling test is that it accomplishes a degree of pricing constraint that would apply if the infrastructure business were contestable. In a contestable infrastructure market, any group of access customers who were asked to pay more than their own stand-alone cost would bypass the incumbent infrastructure operator and either build their own infrastructure, or pay an entrant to do it on their behalf.

The ceiling revenues as specified under the Western Australian regime lack this combinatorial character. Ceiling calculations are simply done on the basis of individual corridors. By performing the ceiling tests in that way, the regime would not prevent WNR from earning monopoly rents on some parts of its network.

As a consequence:

- the charges for accessing the Western Australian network create significant uncertainty for above rail operators and act as a disincentive for investment in above rail infrastructure; and
- the charges for accessing the Western Australian intrastate network have proven to be too high for competitors to ARG, such as Pacific National, to enter and viably compete for business on that network.

The Western Australian regime's ceiling test should be reformulated along the combinatorial lines that are employed in the NSW regime.

2.5 Capital Contributions to Network Assets

Capital contributions have been said to be "...payments made toward the capital cost of an asset by a third party with the intention of reducing the capital outlay by the owner of the asset and with the expectation that the payment will be recognised for pricing purposes"⁴.

Capital contributions can be private or government funded. Approaches used to recognise capital contributions when valuing the asset are:

- exclude the contribution from the asset value for the purpose of regulating prices; and
- include the contribution in the asset value but offset it through pricing mechanisms (i.e. credits) that recognise the contribution.

Where the contribution is a private third party investment, then the optimised capital contribution should be included in the asset value and an offsetting pricing mechanism adopted to recognise the contribution of the third party.

Viable businesses have access to commercial funds. As a result, where the contribution is funded by government, this suggests that the investment is not fully commercial. In the case of rail, this is generally because the existence of inefficient and underpriced competition from road means that economically justified investments are not financially profitable. The response is to provide Government funds.

⁴ QCA's Draft Report on the Burdekin Haughton Water Supply Scheme, September 2002, p1.

Pacific National submits that when the Costing Principles are reviewed, consideration should be given to whether an adjustment should be made to require a reduction in the ceiling costs to reflect any Government contribution to the regulated asset base capital costs.

3. Key issue: Incentives for efficient investment

The Code does not provide sufficient incentives for efficient investment by the railway owner. In Western Australia, this has not necessarily resulted in inefficient investment decisions being made for two key reasons:

- (a) to date WNR has been prepared to collaborate with above rail operators, including Pacific National, on investment decisions; and
- (b) WNR, as a vertically integrated railway operator, has an incentive to invest in a way that benefits both above rail and below rail operators, to the extent that WNR operates as an above rail operator in the relevant market. WNR's related bodies corporate are involved in the rail transportation of minerals, grain and intermodal freight on the same network as used by third party above rail operators, such as Pacific National. The ARG grain and minerals traffic in particular is a profitable business. This provides WNR and its related bodies corporate with an incentive to invest in a way which takes account of the interests of above rail operators and increasing the quality of the network in a way which allows the above rail operators to increase the quality of the services they can offer customers.

However, the incentive and willingness to make efficient investment decisions depends upon the willingness of WNR to collaborate and its existing structure which provides the incentive for WNR to act in this way. For example, if a third party access seeker were to win business on a line from ARG and ARG then ceased hauling traffic on that line, WNR would no longer have a sufficient incentive to invest in an efficient way. There is no protection in the Code which would be available to above rail operators to ensure that efficient investment takes place were either of these factors to change.

An effective way to ensure efficient investment takes place is to provide for collaboration between above and below rail operators on investment decisions which affect them.

Collaborative investment is in the public interest as it ensures efficient use of, and investment in, natural monopoly infrastructure and, accordingly, such a condition would meet the objectives of the CPA.

4. Other non-price terms

4.1 Term of the access agreements

The term of the access agreements or pricing principles in the Code should be sufficient to encourage above rail operators to be able to recover their investment in above rail operations. Certainty in contract length or pricing under the Code is necessary to promoting competition in the provision of rail freight services.

Whilst Pacific National has been able to negotiate an appropriate term with WNR, there is no protection provided in the Code.

Pacific National suggests that a term of generally 10-20 years at the option of the access seeker would be sufficient to address this issue and meet the objectives of the CPA.

4.2 Adequacy of information disclosure

Sections 7(1) and 7(2) of the Code mandate the timely provision of certain information pertaining to line costs and gross tonnages carried on each track section. Such provisions are also features of the NSW regime, the QR and ARTC undertakings, and the current Victorian rail access regime.

However, from Pacific National's experience, there is nothing in the Code which ensures that it receives the access charges and other relevant information for the services sought in a timely way. For access seekers to compete with ARG in Western Australia, they will require the right to obtain this information from WNR within a reasonable time frame. Pacific National submits that the Code should require WNR to provide details of the availability of train paths and the access charges for the paths sought by the access seeker within 30 days from the date of the access proposal.

This amendment is necessary to promote effective, fair and transparent competition for haulage by rail in Western Australia.

4.3 Consistency in pricing

In order for access seekers to compete with ARG in Western Australia, the Code should provide certain assurances that there is some consistency between the prices offered to them and those available to ARG. Pacific National submits that the following provisions should be incorporated into the Code as they are necessary to promote effective, fair and transparent competition for haulage by rail in Western Australia:-

- (a) WNR should be required to publish the formulae by which it will price access on network segments so that access seeker can obtain predictive certainty in any bidding scenario and can respond quickly to bidding scenarios, consider rollingstock investment decisions and the regulator and access seekers can detect any evidence of price squeezing effectively. The formulae should detail how access charges will vary from those offered to ARG if there are differences in the characteristics of the service. For example the formula might allow third parties to calculate how much the access rate will vary if a proposed train service is 20% slower or faster than operated by another operator. This will provide important price signals to third parties and assist in the design of the service. The variation in access rates due to differences in the train service characteristics should reflect the actual cost impact on WNR. Pacific National expects that the detail of such formulae would be the subject of the Authority's review of the Costing Principles.
- (b) The Code should be revised to ensure that the prohibition on price discrimination applies regardless of whether an access seeker applies for access under the Code or through commercial negotiation.
- (c) The Code should impose an obligation on the railway owner to disclose relevant costing information to the Authority so the Authority can verify that the railway owner is not discriminating between its own above rail operator and third party access seekers and that its prices have been calculated in accordance with the Code.
- (d) WNR should be required to provide to the regulator the prices at which it has provided access to its related body corporate above rail operator as there is nothing inherently confidential about this information.

Attachment

A number of the questions raised in the Issues Paper were also raised in the Victorian Department of Infrastructure's paper on *Options for Reform of the Victorian Rail Access Regime*, July 2004. For example:

- Question 16 - the introduction of a capacity register;
- Questions 34 and 35 - involving a greater role for the Authority in access negotiations; and
- Question 36 - licensing requirements.

The reform of the Victorian rail access regime involved a comprehensive de novo review of the regime and considered all possible avenues for regulation of rail access in Victoria. The matters identified above were considered but not pursued by the Victorian Department of Infrastructure after it received extensive submissions on, and consulted very widely among all stakeholders concerning, the options. The Department then issued a paper on the *Reform of the Victorian rail access regime, Proposed Legislative Framework Reforms*, in December 2004. The framework for reform proposed in that paper did not include any of the above proposals as options.

Having regard to the experience of the current review in Victoria, Pacific National believes that the December 2004 Framework Paper is the most appropriate starting point for the consideration of any reforms in Western Australia as that paper distilled the considerable amount of work and evaluation performed during the comprehensive review.

A1. Competition Principles Agreement

A1.1 Relevant sections

Question 1: Are there any sections of the CPA other than clauses 1(3) and 6 which need to be considered for the purposes of the review of the effectiveness of the Western Australian rail access regime?

Pacific National does not believe that there are any other sections of the CPA which need to be considered for the purposes of this review.

A1.2 Adequate time

Question 2: Has adequate time elapsed to fully assess the effectiveness of the Regime?

Whilst the Code has only been in operation for 3 years, adequate time has elapsed to assess the effectiveness of the Code generally and it is appropriate to assess its effectiveness particularly given the fact that no rail operator has been successful in seeking access to the Western Australian intrastate network. It is also timely given the reviews and other changes taking place in, other Australian rail jurisdictions. However, Pacific National has limited actual experience of the Regime and such experience may reveal further issues.

A2. Public Interest Test

A2.1 Effectiveness of the Code

Question 3: Is the Code effective in ensuring the consideration of the public interest?

Pacific National believes that the fundamental reason no rail operator has been successful in seeking access is that the pricing structure does not effectively allow competition in dependent markets as required by clauses 6(3)(a)(ii) and 6(4)(i)(viii) of the CPA.

As currently drafted, the Code is not effective in ensuring the consideration of the public interest in the following key respects:

- the level and structure of access charges does not promote competitive entry into the Western Australian intrastate rail haulage and does not promote efficient use of, and investment in, monopoly infrastructure;
- the Code does not contain mechanisms to ensure that efficient investment takes place;
- the Code does not ensure either certainty as to access prices or that the duration of access agreements are for a sufficient period of time to encourage rail operators to enter and invest;
- the Code does not ensure that access seekers may within a reasonable time frame obtain access to the information required to determine the viability of competing on the Western Australian network, including the availability of train paths and access prices;

- the Code does not provide any certainty to third party access seekers that they will be able to obtain access charges which will enable them to compete with the WNR related above rail operators.

However, subject to addressing these concerns (see response to Question 4 below), Pacific National generally agrees that the Code will be effective in ensuring the consideration of the public interest in:

- the efficient use of natural monopoly infrastructure;
- the efficient investment in natural monopoly infrastructure; and
- the promotion of competition in activities that rely on the use of the infrastructure service where it is uneconomic to develop alternative facilities.

Question 4: What changes could be made to the Code, if any, to improve the operation of the public interest test as defined in clause 1(3) of the CPA?

To ensure that the Code effectively meets the objectives of the CPA, in particular by promoting efficiency by ensuring the efficient use of, an investment in, natural monopoly infrastructure and promoting competition in dependent markets, the Code should be amended in the following ways:-

- consideration should be given to the legacy assets permitted to be included in the regulated asset base;
- the Code should adopt a combinatorial segment based approach to the calculation of ceiling prices;
- the Code should require the railway owner to collaborate with access seekers with respect to network investment;
- the Code should ensure that either the term of an access agreement may, at the access seeker's option, be for a period of 10 to 20 years or the Code provides some certainty in terms of access charges for that period;
- the Code should require the railway owner to provide access charges to train path availability within 30 days from the date of an access proposal; and

- the Code should require the railway owner to:
 - publish the formula (including details of the way in which access charges may vary) by which access charges for related and non-related access seekers and holders must be calculated;
 - provide that the non-discrimination principles apply regardless of whether the access seeker or holder applies for access under the Code; and
 - impose an obligation on the Authority to verify that there has been no discrimination and that the access prices have been calculated in accordance with the Code and in a manner which is consistent for all access seekers.

A2.2 Efficient allocation of resources and adequate investment

Question 5: Is the Code resulting in the efficient allocation of resources and adequate investment in the network? What changes to the Code, including to the public interest test, might be considered to [ensure there is] an efficient allocation of resources and adequate investment in the network?

An effective way to ensure efficient investment takes place is to provide for collaboration between above and below rail operators on investment decisions which affect them.

Collaborative investment is in the public interest as it ensures efficient use of, and investment in, essential infrastructure and, accordingly, such a condition would meet the objectives of the CPA. The Code does not provide sufficient incentives for efficient investment by the railway owner.

A3. Coverage of Services

A3.1 Access to terminals, sidings and ancillary services

Question 6: Whilst coverage is mainly defined in the Act rather than the Code, the Authority seeks views on the adequacy of the coverage of the Regime and views of potential refinement of merit. Is the coverage of service adequate?

and

Question 7: What if any additional infrastructure could be included in the coverage to improve effectiveness of the Regime?

From Pacific National's perspective, it is critical that there be clarity and certainty as to the assets subject to regulation. If specific infrastructure is to be covered by the Code, then each facility must be identified and the appropriateness of its inclusion considered. In that assessment, consideration will need to be given as to whether it is economic to develop another facility.⁵

Pacific National believes that the criteria for coverage in section 5 of the Act which is largely based on the criteria for declaration in section 44G(2) of the TPA is adequate to meet the objectives of the CPA.

For these reasons it is important that the assessment of whether to extend the regime to incorporate other facilities is done on a case-by-case basis with independent expert input to assess the specific characteristics of each facility.

If this approach is not adopted, then the nature of the regulatory regime fundamentally changes in a way which is not consistent with the nature of access regulation generally or the objectives of the CPA.

A3.2 Greenfields investments and expansions

Question 8: Is there a need to change the Act and/or the Code to provide greater certainty on the processes for obtaining coverage by the Regime of new routes and/or for extensions to existing routes?

Section 5 of the Act sets out the criteria for coverage of the Code but does not provide for the process for obtaining coverage. The Authority should consider including criteria and a process consistent with the process for declaring a service in Division 2 of Part IIIA of the TPA.

Incorporating such a process would more effectively achieve the objectives of the CPA because it provides an effective and certain process by which coverage may be obtained. The Division 2 process includes:

- a right for the Minister or any person to ask the NCC to recommend a particular service be declared;
- an obligation on the NCC to recommend to the Minister whether or not to declare the service;

⁵ Consistent with the Tribunal's interpretation of this criterion and the relevant economic principles, it is necessary to determine whether developing another facility would confer net benefits on society. This requires an assessment of all social benefits and costs of development and taking into account all three dimensions of efficiency, ie. allocative, productive and dynamic.

- the matters the NCC is to take into account, and be satisfied of, prior to making a recommendation to declare should be specified in the Code;
- the matters to be taken into account to determine whether an existing regime is an effective regime should be specified in the Code;
- the process for the Minister declaring a service, including the matters to be taken into account, and which the Minister must be satisfied of, prior to making the recommendation to declare;
- an obligation on the Minister to publish his or her decisions and the reasons for that decision;
- the duration and effect of a declaration; and
- the review and revocation of a declaration.

Pacific National submits that for the Code to effectively meet the objectives of the CPA it should adopt the same process within Division 2 of Part IIIA of the TPA as outlined above.

A4. Interstate Issues

A4.1 Effectiveness for interstate access seekers

Question 9: Is the Code and the wholesale agreement an effective framework for interstate access seekers? How could it be improved?

Pacific National has obtained access directly from WNR for the past 3 years and believes that all current interstate rail operators do so. Accordingly, in practice, no rail operator has sought access via the ARTC wholesale agreement.

In principle, the existence of a wholesale agreement may provide an effective framework for interstate access seekers if there is some ability on the part of ARTC to distinguish the terms and conditions of access, including the price it may offer access seekers. This would provide some competitive tension between WNR and ARTC as competing suppliers which would benefit access seekers.

However, no competitive tension exists between WNR and ARTC as suppliers of access services as ARTC is only able to offer the same terms as offered by WNR to access seekers. In other network industries, wholesale services are supplied on terms which permit retail competition between competing service providers to the ultimate benefit of end customers and in furtherance of the objectives of the CPA. In Western Australian rail access, this competition is absent.

Pacific National believes that such an arrangement would provide an effective framework for interstate access seekers only where ARTC had the opportunity to compete on price and add value to the terms and conditions of access to attract access seekers.

With respect to an assertion that the wholesale agreement means that ARTC is a "one stop shop" for access on the interstate standard gauge network, Pacific National submits that any serious rail operator wishing to conduct commercial rail haulage operations for reward would not view the requirement to negotiate for Perth/Kalgoorlie access with WNR as a barrier. Rather the competitive tension engendered by genuinely differentiated access offers from WNR and ARTC on that network segment would be of much greater potential value. Accordingly, there are good arguments for the Code to require WNR to supply services at wholesale rates to ARTC to allow that competitive tension to ensue.

A4.2 Inconsistencies between Regimes

Question 10: Are there any inconsistencies between the ARTC Undertaking and the Regime which result in a loss of efficiency or make obtaining third party access more difficult?

Pacific National is not aware of any such inconsistencies, but has not had cause to use the Code to obtain terms of access.

A5. Negotiation Framework

A5.1 Timely and effective

Question 11: Is the maximum penalty for breaches of the regulatory framework (\$100,000) adequate for providing railway owners with an incentive to ensure full compliance?

Pacific National believes that the existing maximum penalty for breach of the Code is adequate.

Question 12: Whilst there are not multiple intra-state operators visibly competing and operating in Western Australia, is the threat of competition realistic enough to ensure that freight rates are efficient?

Pacific National does not believe that the threat of competition is realistic enough to ensure that freight rates are efficient. This is primarily because the level and structure of the charges for access to the Western Australian intrastate network has deterred competitive entry in Western Australia.

Question 13: Is the negotiation framework effective?

and

Question 14: What, if any, reforms to the negotiation framework would enhance the ability to meet the CPA objectives?

Pacific National believes that a properly structured and enforced access regime based on a negotiate-arbitrate model will be effective to meet the objectives of the CPA. There are the following 3 key stages in a properly structured negotiate-arbitrate model:

- provision of information to access seekers;
- negotiation of the terms and conditions of access; and
- resolution of any dispute by an independent expert or arbitrator.

The Code requires the following amendments in order for the framework to be effective for the purposes of meeting the objectives of the Code:

- (a) a requirement that the railway owner must provide the access seeker with the availability of train paths and the access prices for the paths sought within 30 days from the date of the access proposal;
- (b) a requirement that the railway owner periodically publish the working timetables for the routes;
- (c) the Code should give access seekers a right to refer a dispute over the provision of information to the access seeker; and
- (d) the Code should include either a reasonable time limit for resolving a dispute or an obligation on the arbitrator to resolve a dispute as quickly as possible.

A5.2 Establish minimum rights to negotiate access

Question 15: What options are there to try to ensure railway owners use all reasonable endeavours to accommodate the requirements of access seekers?

General principle

For a rail access regime to effectively meet the objectives of the CPA, it should ensure that access providers use all reasonable endeavours to accommodate the requirements of access seekers subject to capacity being available to accommodate the access seekers' requirements. Such an obligation would generally include the requirement to:

- provide access seekers with a clear and transparent guide for seeking access to declared services;
- ensure that access seekers and access holders have fair and reasonable access to declared services;
- provide a fair and reasonable basis on which conflicts between access requests are resolved; and
- require access requests to be managed within appropriate time frames.

Code

Pacific National believes the issues in the above points are generally covered by the Code.

The Code contains the following provisions which appear to be aimed at ensuring that WNR uses reasonable endeavours to accommodate the requirements of access seekers and to a certain extent address point 2 above:

- (a) an obligation on WNR to use reasonable endeavours to meet the requirements of an access seeker which has complied with the Code;
- (b) a prohibition on discriminating between access seekers and between access seekers and WNR related access seekers generally and specifically in respect of the allocation of train paths; and
- (c) provisions dealing with extensions or expansion of the network to accommodate the access seeker's request, which include provision for the access seeker to pay a component of the costs of such extension or expansion.

Role of an independent person

A suggestion raised in the context of the reform of the Victorian rail access regime was that an independent person, such as the regulator, could take responsibility for managing train paths on behalf of the access provider.⁶ The aim of this suggestion appeared to be to ensure access seekers not related to the access provider would have fair and reasonable access to declared services.

Unfortunately, this “honest broker” role is likely to create more problems than it solves. Unless the independent person were to become the train planning and timetabling authority, it would necessarily have to disclose some information about the train path request in order to ascertain the availability of the desired paths. The independent person would need to be well versed in the difficult science of track capacity estimation and train scheduling. Any regulatory agency that took on such a mission is likely to find itself compromised by the confusion of regulatory and retailing roles, and potentially unable to function credibly in either capacity.

In Pacific National's view, the existing provisions of the Code together with the Western Australian segregation arrangements appear adequate to ensure access seekers not related to the access provider would have fair and reasonable access to declared services.

Question 16: Is there merit in introducing a capacity register?

Pacific National does not believe it would be possible to introduce and maintain a capacity register.

From Pacific National's experience as an access provider in Victoria, it is not a simple matter to provide and keep up to date the capacity available given the complexity involved in assessing available capacity. The availability of capacity depends on a number of factors, including:

- the nature of the access sought;
- the operational characteristics of existing services; and
- the operational characteristics of infrastructure used to provide the relevant services, including signalling.

⁶ This issue is also relevant to Question 34.

Consistent with the practice in other jurisdictions and the existing provisions of the Code, Pacific National proposes that the standard working timetable be published.

Capacity allocation is perhaps best addressed in the Train Path Policy and other related documents. Effective train path planning policies which ensure that the allocation is fair and reasonable and in the public interest include the following key features:

- they provide access seekers with a clear and transparent guide for seeking access to declared services;
- they ensure that access seekers and access holders have fair and reasonable access to declared services;
- they provide a fair and reasonable basis on which conflicts between access requests are resolved in a way that is consistent with other rail access regimes in Australia; and
- they provide for access requests to be managed within appropriate timeframes.

Path types, permanent, day-to-day and ad hoc would be dealt with in the access agreement.

Pacific National would be interested in making further submissions about the train path planning process when the Train Path Policy is reviewed by the Authority.

A5.3 Enforcement process to support right to negotiate access

Question 17: Should a shorter time limit be placed on the railway owner to respond to existing business access requests?

Pacific National understands by this question that the Authority is seeking views on whether a shorter time should be imposed on WNR when considering access requests by *access holders* than applies to requests by *access seekers*.

On the basis of this understanding, Pacific National sees no reason why a shorter time would be required for access holders given that the access provider will require time to determine whether capacity is available regardless of whether access is being sought by an access holder or an access seeker.

A5.4 Segregation arrangements to support negotiation

Question 18: Are the segregation arrangements adequate and what changes might improve confidence of access seekers, whilst avoiding significant administrative costs?

Pacific National considers that the segregation arrangements are adequate.

A6. Dispute Resolution

Question 19: Are the dispute resolution provisions in the Code appropriate and effective?

and

Question 20: Are any refinements required?

In Pacific National's view, the dispute resolution provisions are not appropriate and effective to meet the objectives of the CPA as they currently do not provide for timely and effective resolution of disputes.

For the dispute resolution provisions of the Code to be effective, the Code should address the following issues:

- the Code provides for limited circumstances for access seekers to refer a dispute for arbitration (see section 25 of the Code). In Pacific National's experience, disputes often arise at any early stage. The Code should give access seekers a right to refer a dispute over the provision of information, including preliminary information to access seekers in accordance with the Code; and
- the Code should include either a reasonable time limit for resolving a dispute, or an obligation on the arbitrator to resolve a dispute as quickly as possible.

Most rail access regimes do not impose specific timeframes on the regulator to make its determinations, but do emphasise that the regulator should act as quickly as possible:

- clause 3.12.5(b) of the ARTC rail access undertaking provides that the arbitrator will proceed as quickly as is possible and consistent with a fair and proper assessment of the matter;
- in Queensland, section 117(5) of the QCA Act provides that the QCA must give a draft determination of an access arbitration before making a final access determination. Section 196(1)(e) provides that in an arbitration, the QCA must act as speedily as a proper consideration of the dispute allows. Sub-section (2) provides

that the QCA must have regard to the need to carefully and quickly enquire into and investigate the dispute and all matters affecting the merits and fair settlement of the dispute; and

- the *Australasia Railway (Third Party Access) Act 1999* does not contain any provisions requiring determination of an access dispute in any particular period. However, under section 27, the arbitrator must act as speedily as a proper consideration of the dispute allows, having regard to the need to carefully and quickly enquire into and investigate the dispute and all matters affecting the merits, and fair settlement, of the dispute.

Generally, and from the experience in other network industries, it has taken longer than 30 days for the regulator to determine an access dispute. For example, the Gas Code requires the arbitrator to provide a final decision within three months from the date that the regulator requires the parties to make submissions. However, the arbitrator has the right to increase this time by up to one month on one or more occasions by providing notice.⁷ Similarly, under the Gas Code, the NCC is required to make a final recommendation on whether a pipeline should be covered within 77 days.

Pacific National would suggest that the regulator should be required to determine a dispute within a particular timeframe (3 months may be an appropriate period), with limited rights to extend this period. If the regulator extends the period, it should be required to provide reasons for the extension. This would require greater accountability of the regulator in making its determination in a prompt manner.

Question 21: Should the settlement of access disputes be subject to time limits, which would be subject to interim determinations by the Regulator?

Settlement of access disputes

Pacific National understands by this question that the Authority would like views on whether the resolution of access disputes should be subject to time limits. If this understanding is correct, see Pacific National's response to Question 19.

⁷ Section 6.11 and 6.12 of the Gas Code.

Interim determinations

It is not clear from the Issues Paper what the role of interim determinations would be.

Pacific National supports giving the regulator the power to issue directions and determinations about the conduct of access arbitrations.

However, Pacific National does not believe that there are net benefits in permitting interim determinations if such determinations actually determine the terms and condition of access until such time as a final determination is made. If an interim determination actually creates access rights until the publication of the final determination, this would introduce significant risks and uncertainty into the process. Before it can commence operating its trains, an access seeker needs to obtain accreditation and determine its timetables and train configuration to service its customers' requirements, as well as undertake significant other planning and preparation, often at significant expense. If the interim determination is changed by the regulator (for example, if access rights are reduced or the cost of access is increased under the final determination), this could create significant problems for the access seeker and its customers.

Alternatively, an "interim determination" that is non-binding - effectively a discussion paper for further comment (such as a draft decision by the ACCC) - could only serve to increase the length and cost of the process, but on the other hand, could lead to a more robust decision following a further round of submissions and lower risk of appellable error.

Generally, Pacific National favours a simple process in which the regulator issues one final determination. The regulator should be encouraged to move towards a final determination as quickly as possible. Requiring the regulator to, effectively, make two determinations, and encouraging two separate rounds of submissions and argument, would ultimately lengthen the process and not provide certainty or reduce costs for any party and result in less benefit overall owing to the damage delay can do to the business of the parties. A single determination with adequate opportunity for consideration and input from the parties would be preferred.

Question 22: Should "class" arbitrations (involving more than one access seeker) be introduced, where the Regulator could, if appropriate, disseminate information in one dispute to the parties in another?

Pacific National would support a proposal under which the arbitrator could determine particular common principles that would then apply to subsequent arbitrations for relevant access seekers. This would assist greatly in expediting the process and providing certainty to all parties.

The Federal Court has developed a representative proceedings scheme in Part IVA of the *Federal Court of Australia Act 1976* (Cth).

Without going into a detailed summary of those procedures, Pacific National suggests that the principles that have been developed by the Federal Court in determining when to hear class actions could be usefully applied in the Western Australian rail access context. This would provide some safeguards to ensure that any right of class or joint arbitrations is not abused by access seekers. For example:

- the Federal Courts scheme provides that the parties must have a claims "*in respect of, or arise out of, the same, similar or related circumstances*" with at least one substantial issue of law or fact that is common to the claims; and
- the Federal Court has a wide discretion to order that a representative proceeding not continue as a representative proceeding - eg. where it considers the costs of conducting the action as a representative proceeding are likely to exceed the costs of separate proceedings. Further, where there are issues common to some, but not all group members, the Federal Court has the power to establish sub-groups.

The benefits of class or joint arbitrations of reducing cost and improving consistency of decisions only prevail to the extent that the issues are common to all the parties to the arbitration. The benefits should also be weighed carefully against the costs of delays associated with joining parties to the arbitrations and the complexities that class or joint arbitrations raise, such as issues relating to the protection of confidential information.

Pacific National supports the introduction of some form of representative or class arbitration, provided the rights to join any class or group are permissive and only in circumstances where "class arbitrations" and the dissemination of particular information to and among members of the class are considered appropriate.

Given the divergence of interests of access seekers, however, Pacific National considers that it is unlikely that any "class arbitration" option would be widely used by access seekers.

Question 23: Should access seekers be given the right to seek damages and other remedies in the case of a breach of an access agreement by the railway owner which causes significant damage or loss?

The only circumstances in which such a right would be required would be where the access provider sought to preclude the access holder from recovering damages and other remedies in the event of breach of the agreement by the access provider. However, the railway owner should not be permitted to preclude an access holder from recovering damages and other remedies.

A7. Appropriate Terms and Conditions

A7.1 Non-price terms and conditions

Question 24: Is the hybrid model the most appropriate model for use in the Regime?

and

Question 25: In this hybrid model, is there merit in introducing reference tariffs, which are firm prices for defined services and route that the railway owners would offer access seekers? Would reference tariffs negate the effectiveness of the negotiate-arbitrate model?

Pacific National believes that a published formula for the calculation of access prices demonstrating all variables that will affect the access price is the most appropriate method of estimating a price prior to the actual price offer. This approach is suited to the hybrid model.

Appropriately set mechanisms for determining the access price would not negate the effectiveness of the negotiate-arbitrate model. They would instead improve the efficiency of negotiation.

Question 26: Is there merit in introducing a statutory obligation on railway owners to periodically publish greater information about access (Access Information) to allow potential access seekers to develop business cases for freight operations?

Subject to one issue, the information to be provided under the Code is sufficient to allow potential access seekers to develop business cases for freight operations.

The Western Australian regime is relatively broad and requires WNR to make available for purchase the following information:

- the form of the standard access agreement;
- a map of the routes in Schedule 1 of the Code showing the configuration of the tracks on each route;
- for each route, details of the length, ruling grades, operating gauge, track design characteristics, indicative running times for various types of standard trains, maximum axle loads and speed restrictions that apply and the indicative maximum train lengths; and
- the permissible gauge outlines that enable the required dimensions of rolling stock to be determined.⁸

In addition, an access seeker who is proposing to make a proposal in respect of a particular route may ask WNR to provide the following information:

- an initial indication of the available capacity of that route, the price the entity might pay for access and the terms and conditions WNR would want to include in any access agreement;
- for each relevant route section, particulars of the gross tonnes carried on that section in each of the 3 complete financial years of WNR preceding the day on which the request is received and the curve and gradient diagrams;
- the working timetable for the route; and
- the origin and destination of any train paths proposed by WNR for the route.⁹

The only amendment required to allow potential access seekers to develop business cases for freight operations is that the working timetable for the relevant routes should be periodically published by WNR.

⁸ Section 6 and Schedule 2 of the Code.

⁹ Section 7(1) of the Code.

Question 27: Does the railway owner's standard access agreements provide a fair and reasonable contract template?

Pacific National is in the process of renegotiating an access agreement for interstate movements with WNR and the negotiations are progressing well. Pacific National has not yet come across any issues which it believes should be raised in the context of this review.

A7.2 Pricing and Costing Principles

Question 28: Does Western Australian's GRV annuity approach for setting the upper band (ceiling) access revenue alter the prospect of access seekers entering an access agreement with the railway owner?

The current ceiling prices have precluded new entry on the Western Australian intrastate network.

Question 29: Do the railway owner's Overpayment Rules provide a fair and equitable approach to address any breaches of ceiling costs/revenues?

The overpayment rules are substantially similar to those that apply under the NSW rail access regime for ceiling violations in respect of the Hunter Valley coal system. Whenever a revenue cap applies (as it does in New South Wales and Western Australia) a mechanism of this type is needed. Experience to date with the NSW rail access regime suggests that the Unders and Overs Account mechanism established by IPART in 1999 is working satisfactorily and Pacific National supports the use of this mechanism in Western Australia.

However, since:

- (a) the ceiling calculation means the Overpayment Rules are unlikely to be used in practice; and
- (b) there is no competing rail operator to ARG on intrastate routes,

their efficacy is moot for so long as the method of ceiling calculation remains as is.

A7.3 Key Performance Indicators

Question 30: Are the KPIs sufficiently meaningful? Can these be made more useful and relevant?

Pacific National has no issues to raise with respect to KPIs applying on the WNR network in the context of a CPA compliance review.

A7.4 Contracting 'outside the Code'

Question 31: Should users have some right to seek Authority involvement in contracts which have been established 'outside the Code'? How might this be achieved, what risks might this create and what are the implications of these risks?

Somewhat unusually, the Western Australian Code permits contracts to be reached outside the Code framework. It is not entirely clear what is meant by contracting 'outside the Code' but Pacific National understands that it could mean that the parties to such a contract waive their rights to have any disputes resolved within the Code's dispute resolution framework or according to the regime's principles. The ability to contract outside the Code is of concern if 'outside Code' access contracts have the ability to impact on other access seekers. For example, if an 'outside Code' contract consumed scarce train paths then the other provisions of the Code may be unable to ensure fairness of path allocation among access seekers.

It would be an acute concern if ARG were to contract with its own subsidiary WNR outside the Code. That eventuality would render nugatory the obligation to ensure that access seekers pay no more than the incumbent for an equivalent train path. Competitive neutrality could not be assured in such a situation and the objectives of the CPA would potentially be defeated. Accordingly, Pacific National submits that the access provider should not be permitted to oust the Code with respect to arrangements with access seekers which are related bodies corporate.

A8. Institutional Arrangements

A8.1 Regulator involvement in investment decisions

Question 32: Does the Regime encourage investment and are the information flows, that provide the signals for where investment in the system is required, efficient?

The Code does not encourage investment and the information flows that provide the signals for where investment in the system is required are not efficient.

Question 33: What reforms to the Code could improve investment incentive efficiency?

An effective way to ensure efficient investment takes place is to provide for collaboration between above and below rail operators on investment decisions which affect them.

Collaborative investment is in the public interest as it ensures efficient use of, and investment in, essential infrastructure and, accordingly, such a condition would meet the objectives of the CPA.

Question 34: Is there merit in introducing a greater role for the Authority? (for example as the conciliator in train path issues, review fairness of track downtime schedules and evaluating progress towards MEA).

This suggestion raises questions of whether the Authority would have all relevant information to undertake tasks of this nature, and of the efficient level of regulatory engagement in access issues.

From the perspective of an access seeker in Western Australia, a higher level of intrusion in the access provider's business does not appear warranted, on the basis of experience to date.

Question 35: Would the benefits of having the Authority making and processing access applications, outweigh the costs of such a system?

Whilst it is not clear what is proposed by the Authority, it appears that the Authority is contemplating that it would receive, process, and ultimately mandate the awarding of access contracts on particular terms and conditions. This would mean that the Authority would essentially stand in the shoes of the access provider and grant contracts on its behalf without bearing any of the business consequences itself.

Pacific National questions whether it would be appropriate, or even possible, for the Authority to attempt to deploy the relevant expertise and resources to undertake an important commercial function such as the awarding of access contracts, which depends ultimately upon a detailed knowledge of the operations of above and below rail commercial enterprises. Pacific National also queries why this level of intrusion into commercial negotiations between access providers and access seekers is required.

More fundamentally, though, by assuming a commercial role, the regulator would impugn its own independence and become unable to provide neutral guidance on access disputes or the formulation of access rules. The proposal necessarily involves an inappropriate mingling of regulatory and commercial functions. Finally, by involving itself in the awarding of access contracts on behalf of the infrastructure owner, the Authority could well expose itself to the risk of litigation from disaffected access seekers or access providers who might question its commercial judgments. One also imagines that if they had such a process, the mechanisms would need to be consistent with due process and hence involve an element of consultation – which would then become a chance for WNR to object to access being granted. In other words, this could risk adding to the hurdles rather than helping to make them more manageable.

A8.2 Railway Owner

Question 36: Should the railway owner be subject to licensing and what benefits would this bring? If licensing was to be established how might it best be implemented?

The proposal to make the railway owner subject to ad hoc licensing requirements reflects an apparent desire to strengthen the regulator's ability to direct the access provider to do certain things. Pacific National opposes this option based on the uncertain nature of this method of regulation. It is far preferable for the regulatory regime to be specified completely and in detail in advance. Unlike the Code, which is enshrined in legislation, the licensing approach would permit the regulator to make new regulations and impose new license conditions at its discretion and with extremely limited rights of appeal or review. Were there a demonstrated need to do so in the experience of the past 3 years, such intrusive regulation might be considered appropriate. However, with the improvements suggested elsewhere in this submission, Pacific National does not believe that a broad power to impose licence conditions is warranted under the circumstances.

Glossary

ACCC	Australian Competition and Consumer Commission
Act	<i>Railways (Access) Act 1998 (WA)</i>
ARG	Australian Railroad Group Pty Ltd
ARTC	Australian Rail Track Corporation
Authority	Economic Regulation Authority
Code	<i>Railways (Access) Code 2000 (WA)</i>
CPA	Competition Principles Agreement
DORC	Depreciated optimised replacement cost
GRV	Gross replacement value
IPART	Independent Pricing and Regulatory Tribunal of New South Wales
Issues Paper	Issues Paper for the Review of the Western Australian Railways (Access) Code (2000) issued by the Authority, 25 February 2005
NCC	National Competition Council
QCA	Queensland Competition Authority
QCA Act	<i>Queensland Competition Authority Act 1997 (Qld)</i>
QR	Queensland Rail
TPA	<i>Trade Practices Act 1974 (Cth)</i>
WNR	WestNet Rail Pty Ltd