

## Pacific National

Submission to the Economic Regulation Authority's Draft Report  
on the "Review of the Western Australian Railways  
(Access) Code (2000) 1 July 2005"

**August 2005**

## 1. **Executive Summary**

1.1 Pacific National welcomes this opportunity to respond to the Draft Report entitled "*Review of the Western Australian Railways (Access) Code 2000 1 July 2005*" (**Draft Report**) issued by the Economic Regulation Authority (**Authority**).

1.2 Pacific National agrees with and supports the Authority's recognition that the Code can be improved by addressing the problems of transparency and information asymmetry that are inherent in attempting to introduce above rail contestability.<sup>1</sup> Pacific National also agrees that requiring the railway owner to provide more information to access seekers and the Authority (especially access pricing for reference train services) will improve the problem of lack of transparency. Pacific National believes that in some cases the mechanisms proposed by the Authority can be further improved to provide even better outcomes.

1.3 Pacific National proposes that the following changes be made to the Code to further strengthen the rail access regime in Western Australia:

- **Standard Access Agreements** - The introduction of a standard access agreement or model terms and conditions for specific services such as intermodal and intrastate bulk haulage where there is a likely demand for competing above rail services. Section 2 of this submission discusses the benefits of this proposal.
- **Adjustment of GRV for Capital Subsidies** - The optimal way of precluding the railway owner from earning a return on assets funded by government subsidies is by way of a reduction in the regulated asset base which is used in the calculation of the ceiling costs under Schedule 4 of the Code, rather than as part of the Over-Payment Rules. Section 3 of this submission discusses the benefits of this approach.
- **Option to "Opt-In" to Part III of the Code** - A railway owner and access seeker negotiating an access agreement outside the Code should be able to "opt-in" to the negotiating process under Part III of the Code where an impasse had been reached without having to re-start the negotiations under section 8 of the Code. Section 4 of this submission discusses the benefits of this proposal.
- **Reference Tariffs** - Reference Tariffs should be established for those services where the Authority considers there is sufficient interest from access seekers. At its simplest level, a reference tariff could simply consist of the transfer price which a vertically integrated network owner such as WestNet charges its associated rail

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<sup>1</sup> p (ii), Draft Report.

operator for access to a specific service. Section 5 of this submission discusses the benefits of reference tariffs

- **Strengthen Authority's Ability to Monitor Pricing** - The Authority should have an obligation under the Code to verify that there has been no price discrimination or conduct by the railway owner amounting to a margin squeeze, and that access prices have been calculated in accordance with the Code and in a manner which is consistent for all access seekers. Railway owners should be obliged to provide the Authority with the information necessary for it to make this assessment. Section 6 of this submission discusses the benefits of this proposal.
- **Collaborative Regime for Investment in the Network** - The present regime in the Code for investment in the network should be extended to include a scheme which provides for a collaborative approach to network planning between access holders and the railway owner. The detail of Pacific National's proposal is set out in Section 9 of this submission.

1.4 The Regime has now been in place for four years, and, as far as Pacific National is aware, ARG remains the major provider of intrastate rail services to the biggest rail bulk freight customers in Western Australia. While Pacific National agrees with the Authority that the threat of competition will have provided some benefits to users, there is a real risk that given the inability of third party operators to win contracts, the costs involved in their unsuccessful attempts to do so and the experiences surrounding attempts to obtain competitive access prices in competitive bid scenarios, that the competitive constraint will not endure in the medium to long term. As a result, the benefits will dissipate if there is no actual third party entry within a reasonable period of time. The current code review provides a timely opportunity for the Authority to deliver real improvements in the regulatory regime.

## 2. **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.*

- 2.1 In Pacific National's experience as a railway operator, standard access agreements can play a valuable role in promoting access by providing access seekers with information about the minimum terms and conditions upon they could obtain access to a specific rail network. This is particularly so in a competitive tender bidding situation for bulk freight where a standard access agreement would provide potential rail operators with easily accessible information about the standard terms and conditions of access, including price, which it and other competitors will face in the tender.
- 2.2 The approval of a standard access agreement as a Part 5 Instrument under the Code has the advantage of providing a real opportunity for the Authority to ensure that the terms and conditions of access are consistent with Schedule 3 of the Code. It also provides stakeholders with an opportunity to provide input into the appropriate terms and conditions of access in an environment in which they are not directly involved in commercial negotiations with the railway owner. The appropriate terms and conditions of an access agreement will vary between access for the haulage of timetabled intermodal and cyclical bulk freight. Thus, Pacific National believes that there is merit in separate standard access agreements or model terms and conditions for services such as intermodal and intrastate bulk haulage where there is a likely demand for competing above rail services.
- 2.3 Pacific National does not support the inclusion of capacity management information in the standard access agreement as has been suggested in some submissions to the Authority.<sup>2</sup> This information varies depending on the nature of the access sought and is costly and time consuming to assemble. As an alternative, the railway owner should be required to provide access seekers with a copy of the working timetable which is already readily available.

### 3. **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.*

- 3.1 Pacific National agrees with and supports the Authority's view that the railway owners should not be able to earn a return on assets funded by Government subsidies.
- 3.2 In the Draft Report, the Authority briefly discussed two potential approaches to this issue: amendments to the Over-Payment Rules or the exclusion of government subsidies from the calculation of ceiling costs under Schedule 4 of the Code. The Authority expresses the view that, given the light handed nature of the Regime, this issue could potentially better be

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<sup>2</sup> p34 of the Draft Report.

addressed through changes to the Over-Payment Rules so that subsidies and contributions are only allocated to the relevant upgraded route section.<sup>3</sup>

3.3 In reaching its view the Authority took into account that:<sup>4</sup>

- (a) some other industries have not adjusted the regulatory asset base to exclude capital contributions from other parties; and
- (b) the majority of Government contributions to WestNet's network fund the upgrades to level crossings, the purpose of which is to improve safety standards rather than act as a subsidy to enable lower freight rates.

3.4 However neither of these points is strictly correct. While the gas industry has not adjusted the regulatory asset base to exclude capital contribution from other parties<sup>5</sup>, both the water and electricity industries have used this approach.<sup>6</sup> The Independent Pricing and Regulatory Tribunal of New South Wales (**IPART**) excluded customer funded assets and assets paid for by the State Government from Sydney Water's regulatory asset base in determining prices for water supply, sewerage and drainage services.<sup>7</sup> The National Electricity Code specifically provides for the construction of funded augmentations to the electricity transmission networks and stipulates that transmission network service providers are not allowed to include the value of these assets in the regulatory asset base used to calculate transmission prices under the Electricity Code.<sup>8</sup>

3.5 In addition, Government contributions to the enhancement of the WA rail network becoming more common, including proposed Government funding to assist with upgrades on some branch lines and the interstate rail line.<sup>9</sup> In these circumstances, the Authority should not underestimate the significance of this issue by considering it to be confined to small government subsidies for level crossings.

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<sup>3</sup> p37, Draft Report.

<sup>4</sup> p37, Draft Report.

<sup>5</sup> pg 37 Draft Report.

<sup>6</sup> The gas industry has also adopted a different model to the GRV model where initial values are normally between DAC and DORC and the regulatory asset base is then adjusted for depreciation and new investment.

<sup>7</sup> *"Sydney Water Corporation Prices of Water Supply, Sewerage and Drainage Services Medium Term Price Path from 1 July 1996". IPART stated at pg 18 of the Report " It would be inappropriate to include customer funded assets and assets paid for by the State Government in the regulatory base. To earn a rate of return on assets provided free of charge to the water supplier would be double dipping."*

<sup>8</sup> See clause 5.6.6B of the Code and the definition of "Funded Augmentation" in Chapter 10 of the Code.

3.6 Pacific National submits that the preferred method of precluding the railway owner from earning a return on assets funded by government subsidies is by way of a reduction in the regulated asset base which is used in the calculation of the ceiling costs under Schedule 4 of the Code, rather than as part of the Over-Payment Rules, for the following reasons:

- the impact of the inclusion of Government subsidies in the calculation of Over-Payments will benefit only those rail operators active (and who have access negotiated under the code or included an over payment clause) at the time of the overpayment adjustment. For significant government subsidies it is likely that the benefits of the subsidy will be accrued by Westnet for many years (eg a subsidised loop). Thus to avoid temporal discrimination between rail operators, operators should receive the benefit of the subsidy through an adjustment to the capital base which reflects the lifetime of the subsidised asset.
- The exclusion of Government subsidies from the calculation of the ceiling helps to reduce uncertainty surrounding access charges due to the very large gap between floor and ceiling. The inclusion of Government subsidies (including lump sum payments) up to 3 years after the event in determining whether there has been a breach of the ceiling price test under the Over-Payment Rules does not have the same useful effect.

#### 4. **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.*

4.1 Pacific National agrees with the Authority that it is important that access seekers understand the ramifications of any decision they make to negotiate an access agreement outside the Code at the beginning of the access application process.

4.2 The ability of access seekers to re-start the access negotiation procedure under section 8 of the Code may not provide access seekers with a sufficient safety net from unfair conduct by the railway owner. For example, in certain situations the negotiations between the access seeker

and the railway owner will be time critical, such as during a competitive customer tender process. There is the potential for the railway owner to take advantage of that fact to try and compel the access seeker to accept adverse terms and conditions knowing that the access seeker simply does not have time to re-start the access negotiations under section 8 of the Code. It would be inappropriate for the railway owner to be able to use the re-start requirement in order to unfairly extract concessions the access seeker. In order to avoid this type of disadvantage, Pacific National considers that there should be a mechanism whereby the access seeker can "opt in" to the negotiation procedures under the Code.

- 4.3 At the workshop held by the Authority on 21 July 2005 to discuss the Draft Report, representatives of both WestNet and the Authority agreed that it would be desirable for the railway owner and access seeker negotiating an access agreement outside the Code to be able to "opt in" to the negotiating process under Part III of the Code where an impasse had been reached without having to re-start the negotiations.
- 4.4 While ideally, the decision to "opt-in" to the negotiating process under the Code would be one made by the access seeker and the railway owner, a requirement for agreement before opt in would simply allow the railway owner to refuse its consent thereby maintaining its superior negotiating position. Accordingly, Pacific National submits that the access seeker should be able to elect to "opt-in" to the negotiating process under the Code.
- 4.5 It is envisaged that an access seeker and railway owner would only "opt-in" to the negotiating process rather than re-start under section 8 of the Code where the negotiations between the parties were well advanced and the parties had reached impasse in negotiations on specific issues such as access charges. In that situation the features of the Part III negotiating process which are going to be most relevant to the parties are the ability to seek an opinion from the Regulator on the price sought for access under section 21 of the Code and access to the arbitration procedure in Division 3 Part III of the Code.
- 4.6 Accordingly, Pacific National submits that the Code should be amended to provide the following procedure in parallel to those already in Part III of the Code:
- (a) An access seeker or railway owner who has been negotiating the terms and conditions of access by the access seeker to a specific route (or routes) or the extension or expansion of a route or the associated railway infrastructure can give the other party to the negotiation a notice under the Code (the "**Notice**") that it wants to commence negotiations for an access agreement under the Code either: as soon as reasonably practicable; or in any case not later than 14 days from the date of the notice.

- (b) Immediately before the negotiations begin, the railway owner and the access seeker must agree upon a day (the "**Termination Day**") after which the negotiations will cease if by the end of that day they have not entered into an access agreement or will continue later only if a later termination day is agreed to by the parties (the "**Negotiation Period**"). The Termination Day is not to be a day later than 30 days after the start of the negotiations.
- (c) The railway owner would be required to comply with sections 16 and 17 of the Code during the Negotiation Period.
- (d) During the Negotiation Period, the access seeker may apply to the Regulator for an opinion on price under section 21 of the Code.
- (e) The access seeker will be taken to be in dispute with the railway owner for the purposes of Division 3 of the Part III of the Code where:
  - (i) the railway owner refuses to negotiate with the access seeker during the negotiation period;
  - (ii) prior to the Termination Date the railway owner and the access seeker jointly agree in writing that the negotiations have broken down; or
  - (iii) the access seeker and the railway owner have not entered into an access agreement by the end of the day on the Termination Date.
- (f) The party which issues the Notice cannot decide to "opt out" of that process prior to an access agreement being entered into without the other party's consent.

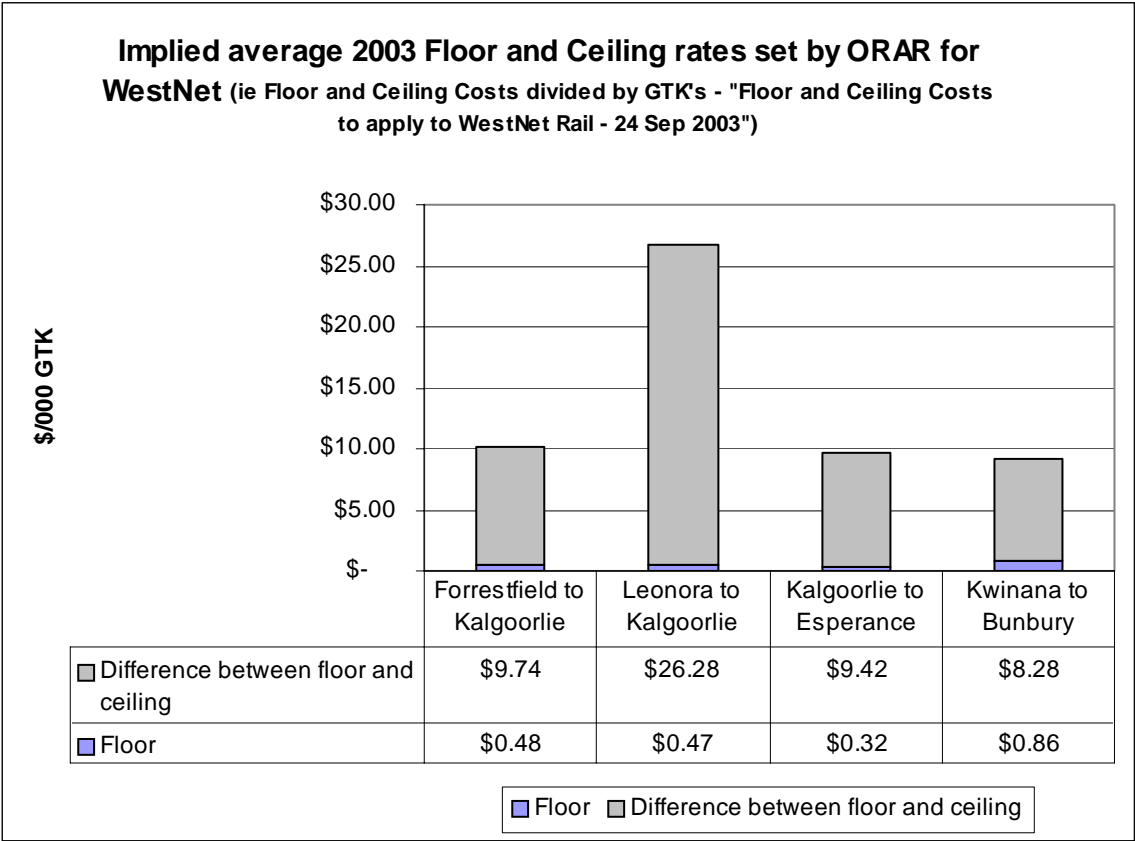
4.7 Pacific National submits that this proposal minimises the risk of either the railway owner or the access seeker gaming the parallel negotiating processes to the other party's disadvantage. The proposed process does not include the information requirements contained in sections 14 and 15 of the Code as it is more likely than not that these information issues will have been resolved by the parties in the earlier stages of the negotiations. Nevertheless, if the railway owner is concerned that such information has not been provided it can raise its concerns in any arbitration with the access seeker under Division 3.

## 5. **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 did Authority believes there may be third party interest.*



- 5.1 Pricing information is critical to enabling third party above-rail competition. Rail operators need reliable pricing information in order to properly prepare their offers to potential customers and design an appropriate service for them.
- 5.2 Unfortunately, the Authority's proposed public release of a floor and ceiling price is of little practical use to an above rail operator as neither represents the price that the access provider will charge the rail operator for providing the service. Further, there is such a large gap between the floor and ceiling on most routes that it provides rail operators with little guidance as to what the actual access prices might be as Figure 1 below demonstrates. As such, disclosing the floor and ceiling does not provide the rail operator with any certainty about the costs it may face in providing a particular service, or information which it can use to prepare an offer to a potential customer.



**Figure 1**

- 5.3 Pacific National submits that information asymmetry between the incumbent train operator and potential new entrants is best addressed by the provision of reference tariffs. There has been a move towards the provision of reference tariffs in other jurisdictions. For example, reference tariffs are provided by the ARTC for its interstate network. Reference tariffs will also be

introduced as part of the new rail access regime in Victoria.<sup>10</sup> In a paper discussing pricing options for the Victorian intrastate network, the Victorian Department of Infrastructure commented that:

*"Regulator approved reference prices will provide access seekers with an "off-the-shelf" service and price without negotiation, accelerating access and reducing costs associated with negotiation and dispute resolution. This approach recognises that access seekers have relatively poor bargaining power and so minimal scope for negotiation".*<sup>11</sup>

5.4 Reference Tariffs have three main advantages:

- (a) **Speed** - they provide an easily accessible indicative price for rail operators in a competitive customer tender situation;
- (b) **Certainty** - rail operators know that they can obtain access to a specific service at a specific price. This is likely to reduce the potential for disputes between railway owners and rail operators regarding the price of access to those services; and
- (c) **Transparency** - the reference tariff provides a point of reference for the start of negotiations between the railway owner and the rail operator about access charges to the same or a similar service.

5.5 Pacific National notes WestNet's concern that reference tariffs would add little value to the negotiation process but introduce inflexibility and cost to the administration of the regime. Further, that different traffic conditions and the non-homogenous traffic mix in WA mean that an optimal access-pricing framework will need continual recalibration which it believes is a flexibility reference tariffs may not enable.<sup>12</sup>

5.6 WestNet's concerns are unfounded. First, the existence of a reference tariff does not preclude the access seeker and the railway owner from agreeing upon terms and conditions of access which include different from the reference tariff. Instead, the reference tariff, like the standard access agreement, acts as a safety net for access seekers as to the terms upon which they can obtain access to the network.

5.7 Second, the costs of establishing a reference tariff do not impose an unreasonable additional burden on railway owners to that already imposed by the formulating floor and ceiling

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<sup>10</sup> p 4 "*Victorian Intra-State Rail Access Pricing Options Paper*" Victorian Department of Infrastructure 28 April 2005.

<sup>11</sup> p 4 "*Victorian Intra-State Rail Access Pricing Options Paper*" Victorian Department of Infrastructure 28 April 2005.

<sup>12</sup> p41, Draft Report.

reference rates. At its simplest level, a reference tariff should simply consist of the transfer price which a vertically integrated network owner such as WestNet charges its associated rail operator for access to a specific service.

- 5.8 Third, provided that reference tariffs are only required for train services for which the Authority has a reasonable expectation that there is sufficient interest from access seekers, the introduction of reference tariffs should result in a decrease in negotiating costs between access seekers and railway owners.
- 5.9 Fourth, to the extent that a railway owner such as WestNet, has a legitimate commercial need to be able re-calibrate the calculation of its pricing, such a need can either be met through the inclusion of specific mechanisms in the method for determining a particular reference tariff or where necessary having a new reference tariff approved by the Authority. This would provide the railway owner with a similar or greater flexibility than it enjoys under its contractual arrangements with rail operators which are highly unlikely to give WestNet the ability to "recalibrate" access prices at will.
- 5.10 Pacific National submits that the advantages of reference tariffs significantly outweigh the disadvantages. From an access seeker's perspective, they provide invaluable information on the likely cost of one of the above rail operator's main cost components. It also enables the access seeker to enter into negotiations with the railway owner in the knowledge at least of the cost of the specific service which is the subject of the reference tariff. However, the existence of a reference tariff does not preclude the access seeker and the railway owner from agreeing upon terms and conditions of access which include different access charges from those represented in any applicable reference tariff.
- 5.11 At the workshop the Authority noted that that QR's reference tariffs are at or close to the ceiling, however this is a function of the train services for which there are reference tariffs, i.e. bulk coal freight and not the nature of reference tariffs themselves. For example, ARTC has a set of publicly available Indicative Access Charges for a standard service which serve the same function as a reference tariff and are closer to the floor price.<sup>13</sup>

## 6. **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.*

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<sup>13</sup> p40, Draft Report.

- 6.1 During the discussion of this issue at the Authority's workshop on 21 July 2005, WestNet expressed its concern about the utility of the working timetable for access seekers given that it regularly changes. Instead, WestNet suggested that the railway owner could provide access seekers with general information about the routes on which they are seeking access. For example, the number of trains per week which use a route.
- 6.2 Pacific National considers that summary type of information would not be as useful to access seekers as the working timetable for the route, as it does not provide the access seeker with any information about the dates and times of particular train paths on the route. While the working timetable may change periodically, it will give the access seeker very recent information about the availability of train paths and capacity on the route.
- 6.3 Pacific National remains of the view expressed in its earlier submission that it is appropriate that the network owner gives the access seeker a copy of the working timetable, and (given these documents already exist) the requirement does impose any undue burden on the railway owner, and should be easy to supply as the railway owner already has the requested information in the required format.

7. **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.*

- 7.1 Pacific National agrees that this proposal will strengthen the Authority's ability to ensure that railway owners are not engaging in discrimination in the access prices they offer an affiliated rail operator to those they offer third party rail operators.
- 7.2 Of equal importance to effective anti-discrimination mechanisms in facilitating third party rail competition is providing the Authority with a means of evaluating whether the railway owner is engaged in margin squeeze conduct. While the issue of margin squeeze can currently be dealt with a dispute between an access seeker and a railway owner during negotiations under Part III of the Code, it is important that these concerns can be dealt with by the Authority swiftly as they arise rather than requiring the parties to participate in an arbitration with its attendant delays and costs.
- 7.3 The operator has scope in a high ceiling regime to offer access prices high enough to deter competition in the haulage of freight on the intrastate network. The lack of transparency about the actual access prices being charged means that there is nothing to prevent the incumbent

operator from offering customers a bundled price inflating the below rail access charges and so squeezing the revenue that above rail operators may generate from providing rail freight services in competition with ARG.

7.4 Information about transfer pricing alone it is not sufficient to enable the Authority to undertake an analysis of whether the railway owner is engaging in conduct which results in a margin squeeze. In order for the Authority to be able to do this effectively it also needs to understand the price to charged to major customers (of which there are around ten in WA) and estimate efficient above rail costs.

7.5 The Code should be amended to impose an obligation on the Authority to verify that there has been no price discrimination or conduct by the railway owner amounting to margin squeeze and that access prices have been calculated in accordance with the Code and in a manner which is consistent for all access seekers.

7.6 Given that the information to be provided is all accounting information that the railway owner already has to assemble, the obligation to provide it to the Authority does not place a significant additional burden on the railway owner. It also provides access seekers and the Authority with a real opportunity to ensure that margin squeeze is not occurring which makes access pricing more transparent thereby promoting confidence in the access regime.

## 8. **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.*

8.1 Pacific National agrees in principle to the sharing of the cost of network expansions between rail operators. It considers that careful consideration would have to be given to the most equitable and pragmatic way such arrangements could be implemented.

## 9. **Additional Issues**

### *Investment in the Network*

9.1 Pacific National welcomes the Authority's suggestion that details on investment be included in the information pack.<sup>14</sup> However, Pacific National believes adding to this requirement with the introduction of regime for collaborative investment outlined in paragraph 9.3 below can deliver the following significant benefits:

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<sup>14</sup> p55 of the Draft Report.

- (a) It would provide a structured means by which access holders can propose investment options for the network;
- (b) The provision of investment criteria would provide certainty for access holders and network owners as to the basis on which proposed investments in the network will be evaluated; and
- (c) The development of an annual investment plan by the network owner encourages access holders and the network owner to take a more strategic long term approach to network planning and investment.

9.2 Pacific National's proposal seeks to replicate the collaborative network planning that would occur between a rail operator and railway owner which were part of a vertically integrated business. Such a scheme is in the interests of both the railway owner and rail operators especially in the absence of any real possibility of bypass of the railway owner's existing network by the rail operator.

9.3 The scheme Pacific National is advocating has the following main features and would be subject to satisfaction of the investment criteria set out in Attachment 1:

- (a) The railway owner developing and publishing an investment plan by a certain time each year for the following year and forecast investment for the following say 3-5 years. The plan would contain the proposed projects, timing, estimated cost and the likely benefits and outcomes.
- (b) Access holders would have an opportunity to put forward investment options for railway owner to consider based on the criteria in Attachment 1. The criteria ensure any investment is efficient, and also take into account the railway owner's legitimate business interests.
- (c) The railway owner would be required to consider the alternative investment options in good faith and consult with persons who would be affected by the railway owner's investment plan and/or the alternative investment options.
- (d) The railway owner would be required to publish a response to any alternative investment options within a certain period of time by either:
  - (i) accepting the alternative and publishing a revised investment plan; or
  - (ii) rejecting the alternative and publishing an explanation of the basis for the decision.

- (e) If the railway owner rejects the alternatives, the access holder would have the right to make the investment itself. In this case, the access holder would receive a holiday on access charges or other rebate to reflect the cost of the investment.
- (f) This option would limit the access holder's choice to making the investment itself or going without the investment. It would not allow the access holder to force the railway owner or any other person to make the investment.
- (g) Access Holders would have the right to refer the matter to an expert to determine whether the investment should be made on the basis of pre-determined criteria. The railway owner would only be entitled to add the efficient cost of any investment to the regulated asset base if the access holders all agree to the investment or the expert decides that the investment should be made on the basis of the relevant criteria.

9.4 Pacific National's proposed scheme has the following advantages in addition to those identified in paragraph 9.1 above:

- (a) It does not limit the type of investments access holders can request the railway owner to make to those which fall within the present definitions of an "extension" or an "expansion" under the Code. A number of investments which rail operators may want the railway owner to make arguably fall outside the definitions of "extension" and "expansion" under the Code. In particular the term "expansion" is defined in section 3 of the Code to mean:

*"in relation to a route, means an increase in the capacity of the route by an enhancement or improvement of the railway infrastructure associated with the route."*

The term "capacity" is defined in section 3 of the Code to refer to:

*"...the number of rail operations that can be accommodated on the route during a particular time..."*

For example, the upgrade of existing rail track to meet the specific train characteristics of a service for a bulk freight customer such as increased axle load will not necessarily increase the "capacity" of the route, and accordingly would not fall within the definition of an "expansion" under the Code; and

- (b) It provides a means for the access holder to undertake the investment if the network owner refuses to undertake the investment without the parties having to engage in a dispute resolution process.

### *Greenfield Investments*

- 9.5 Pacific National agrees with the Authority that WestNet's proposed amendments to the Code for the consideration of expansions and extensions<sup>15</sup> are unnecessary because section 14(b) of the Code already requires the access seeker to demonstrate that it has the necessary financial resources to carry out the proposed rail operations. Further, that the issue of the railway owner's return on investment is a matter that should be dealt with as part of the review of the Costing Principles.

### *Obstacles to Access*

- 9.6 Pacific National considers that the Non-Code obstacles to entry listed on pg 20 of the Draft Report could be overcome by any serious rail operator provided that the rail operator is able to obtain an access price for a specific route which was comparable to that offered to the incumbent train operator.

### *Class Arbitrations*

- 9.7 Pacific National remains of the view expressed in its original submission that it supports the introduction of class arbitrations on the basis outlined in the submission<sup>16</sup>

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<sup>15</sup> pg 26, Draft Report.

<sup>16</sup> pg 21 of Pacific National's Submission March 2005.



## **Attachment 1 Investment Criteria**

- (a) (Safety and technical requirements) – In the opinion of the Railway Owner (acting reasonably) the investment:
  - (i) is technically feasible;
  - (ii) is consistent with the safe and reliable operation of the Rail Network;  
and
  - (iii) meets the Railway Owner's relevant engineering and operational standards.
  
- (b) (Demand) – There is an identified demand for the investment that:
  - (i) is forecast on a reasonable basis by the Railway Owner; and
  - (ii) it can reasonably be expected that demand for the investment is likely to be sustained for a reasonable period after its completion; or
  - (iii) where the predicted demand is not expected to be sustained for at least a reasonable period after the completion of the investment, then the demand is expected to be maintained for the period over which the Railway Owner intends reasonable to depreciate the investment.
  
- (c) (Capacity created) – The investment will meet the additional demand for which it is designed.
  
- (d) (Efficiency) – The investment is the most efficient method of meeting the demand, taking into account:
  - (i) time required to undertake the investment;
  - (ii) cost of the investment;
  - (iii) appropriateness of the investment for facilitating future investments in, extensions to or expansions of Capacity of the Rail Network; and
  - (iv) impact on other service providers to rail haulage customers using the Rail Network,

or, if the investment is not the most efficient, it is otherwise the most desirable method taking into account the criteria in paragraphs (i) to (iv) above.
  
- (e) (Return on investment) – the Railway Owner reasonably expect to earn a return on the investment over the life of the asset created taking into account:
  - (i) the efficient incremental costs and revenues forecast to be generated by the investment; and
  - (ii) any capital contributions made by other parties to the investment.