ECONOMIC REGULATION AUTHORITY REVIEW OF WESTNET RAIL PROPOSED FLOOR AND CEILINGS FOR MAINLINE, WORSLEY LINE AND TERMINAL END BITS

ARTC SUBMISSION

Background

The Western Australian Economic Regulation Authority ('Authority') has sought submissions from interested parties on WestNet Rail's ('WNR') proposed floor and ceiling costs for the following rail lines as outlined in WNR's current submission.

- Kwinana to Bunbury Inner Harbour.
- Forrestfield to Kalgoorlie.
- Leonora to Kalgoorlie.
- Kalgoorlie to Esperance.
- Brunswick Junction to Collie rail line.
- Terminal ends of the Kwinana to Bunbury Inner Harbour rail line.

ARTC notes that in 2003 the Independent Rail Access Regulator ('Regulator') approved the floor and ceiling costs for the above rail lines on a route section basis under clause 9 (schedule 4) of the *Railways Access Code 2000* ('Code'). These costs applied for a 3-year period. The Authority is seeking submissions from interested parties to provide assistance to carry out a review of WNR's submission on the floor and ceiling costs to be applied to the above rail lines for the next 3-year period.

The Authority has sought general comment on WNR's submission and have also requested specific comment on WNR's assumptions in relation to Modern Equivalent Asset, Gross Replacement Value, Allocation of Common Costs, Maintenance Costs and Consistency of Future Review Dates.

Consistency in Regulatory Regimes

In previous submissions to the Authority, ARTC has expressed a need for a consistent approach to regulation across regimes. ARTC's views have typically been expressed strongly in relation to the interstate network, including that part of the interstate network in WA, however the philosophy of consistency should extend to all rail regulatory regimes.

ARTC notes the February 2006 COAG agreement to implement "...a simpler and consistent national system of rail access regulation for agreed nationally significant railways using the Australian Rail Track Corporation access undertaking as a model".[1] Hence, ARTC focuses in its review of WNR's current submission on the need for consistency with ARTC's access undertaking.

The key area of difference between ARTC's undertaking and WNR's approach relates to asset valuation methodology. ARTC adopts a DORC approach whereas WNR has adopted a Gross Replacement Value approach If COAG's February 2006 agreement is adopted it is likely that there will be a need to move to a consistent asset valuation methodology in rail regulatory regimes, with, as per COAG's communiqué, ARTC's approach as the model.

Modern Equivalent Asset (MEA) and Gross Replacement Value (GRV)

In its submission, WNR has noted that the MEA approach is the same as that approved in the 2003 determination with the exception of additional passing loops for the Kwinana to Bunbury line which have been included to allow for a reasonable increase in projected demand.

In the calculation of the Gross Replacement Value (GRV), WNR has used the same asset population as that approved by the Regulator in the 2003 determination with the exception of the additional passing loops for the Kwinana to Bunbury line and the inclusion of Communications Backbone infrastructure for the Kwinana to Bunbury and Forrestfield to Kalgoorlie routes which was previously excluded from the 2003 assessment.

ARTC notes that WNR has indicated that unit prices are based on the information outlined in its consultant's (Worley Parsons) report. Unit prices used are based on a combination of market tested prices for significant items and an escalation of 2003 unit prices, using appropriate indices, for less significant items.

As discussed above, ARTC notes the inconsistency of its use of a DORC methodology for valuation of assets against the GRV approach undertaken by WNR.

[1] Council of Australian Governments' Meeting 10 February 2006 Communiqué

Allocation of Common Costs

In its submission, WNR has indicated that common costs (operating and overhead costs) have been allocated on a combination of train numbers and gross tonne kilometres (GTK) with the exception of centralised train control costs which have been directly allocated to the rail lines where the costs occur.

ARTC's notes that there have been significant increases in the common costs, as per the following:

- Overhead Costs (WNR submission section 3.2.2) increase from $13,188,808 in 2003 to $16,193,526 in 2006, a nominal increase of 23%.
- Operating Costs (WNR submission section 3.2.4) increase from $5,377,660 in 2003 to $6,477,000 in 2006, a nominal increase of 20%.

There is insufficient detail in WNR's submission section 3.2 for ARTC to analyse the detail of these increases. Hence the Authority will need to be satisfied that these increase in costs are valid and reasonable.

In relation to the re-allocation of train control costs, analysis by ARTC suggests that the re-allocation of these costs appears to be proportionally less on WNR only segments (e.g. Kwinana to Bunbury) and places proportionally increased cost on lines where there currently is competition. On the surface, this could be seen as an anti-competitive outcome and the Authority will need to ensure that the approach taken by WNR in relation to re-allocation of train control costs is reasonable.

Maintenance Costs

In its calculation of maintenance costs, WNR has used a 'dollars per kilometre approach' rather than an activity based costing approach. In the 2003 determination, the Regulator required WNR to utilise the former approach.

ARTC notes that over a 3-year cycle, a dollars per kilometre approach may over or under estimate the level of expenditure on specific segments of track. For example, a specific rail line may have the average allocation of maintenance assigned to its floor and ceiling calculation when in fact a minimal level of maintenance actually occurs during the 3-year period.

ARTC's approach is to identify maintenance costs as per its Board approved budgeted maintenance programs for each section of track. ARTC smooths maintenance expenses over the term of its 5 year undertaking in order to remove some of the lumpiness that is inherent in rail maintenance expenditure at a segment level. Hence ARTC would recommend the Authority review WNR's planned maintenance expenditure for each of the rail lines under review and analyse that expenditure against the outcomes of the dollar per kilometre approach that is proposed. This analysis will help determine the reasonableness of WNR's approach against the planned maintenance expenditure.

ARTC notes a significant increase in maintenance costs in WNR's submission (refer section 3.2.6). There is an increase from $10,000 in 2003 to 11,740 in 2006, a nominal increase of 17% (which is well above inflation). There is insufficient detail in section 3.2.6 of WNR's submission to analyse the detail of the increase in costs and hence the Authority will need to be satisfied that these increases are valid and reasonable.

Consistency of Future Review Dates

The Authority sees merit in ensuring that future timelines for the application of floor and ceiling cost determinations, for those WNR rail lines subject to this review, be made consistent in order to improve the efficiency of the regulatory review process. It is proposed that the end date for all of the rail lines subject to this review be 1 July 2009 with subsequent determinations applying over the same three year periods. The implication of this proposal is that there would be a reduced period over which the determination for the rail lines consisting of terminal ends of the Kwinana to Bunbury Inner Harbour line and the four grain lines would apply for the next determination period (beyond 31 December 2006). The relevant period for these lines would reduce from three years to 2 years and six months. Thereafter, a three year time period would apply to all the lines as mentioned above. The Authority has asked for comment on this proposal.

ARTC agrees with the approach of ensuring future timelines for the application of floor and ceiling limits for WNR rail lines be consistently applied.

ARTC notes that its floor and ceiling costs are reviewed every 5 years as part of it access undertaking application to the ACCC.

Further general comments on WNR's submission

In its submission in Section 2.2 (Annual Costs), WNR advises that it has used its actual Board approved 2006/07 budget as the basis for cost determinations and that the budget has been compiled reflecting the assumed costs of WNR as a stand alone organisation. There is insufficient detail in the submission for ARTC to analyse the basis for the cost determinations and hence the Authority will need to be satisfied as to the reasonable of the cost assumptions, specifically the level of overheads allocated.

In relation to WNR's submission section 3 (Key Assumptions), sub section 3.1.5 (Remoteness Factors), WNR advise that the same remoteness factors approved by the Authority in 2003 have been used in calculation of the ceiling and floors in this current submission. There is insufficient detail on the actual value and application of remoteness factors in the submission. The application of remoteness factor values should be more transparent in WNR's submission.