



11<sup>th</sup> January 2002

Dr Ken Michael  
Acting Rail Access Regulator  
PO Box 7459  
Cloister Square WA 6850

(by email)

Dear Dr Michael,

**Ref: Request for Public Submissions :**

- 1) Train Management Guidelines**
- 2) Statement of Train Paths Policy**
- 3) Segregation Arrangements**
- 4) Costing Principles**

WMC Resources Limited ("WMC") is a significant user of the standard gauge rail network between Leonora and Esperance, and between Kalgoorlie and Fremantle/ Kwinana.

Rail transport of WMC's products from one WMC site to another for further processing, and then from the final processing point to Fremantle or Esperance for export, represents a major cost to WMC. This cost must be kept at a level which matches best practice rail operations in other parts of the world.

A large percentage of WMC's rail cost can be attributed to "below rail activities" which are controlled by Westnet Rail under the WA Rail Access Regime. Given that Westnet is in control of almost all the standard gauge freight network, it is very important that the Rail Access Regime allows no more than a fair commercial return to Westnet for owning and operating the rail infrastructure.

As a general comment, our view is that the documents submitted by Westnet to the Regulator's office do not include sufficient detail to provide users of the rail infrastructure with the required level of confidence that the access system will :

- Operate equitably,
- Deliver real above rail competition,
- Prevent monopoly behaviour by the track owner, and
- Provide best practice access rates

Our comments on each Westnet submission are as follows :

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## **Train Management Guidelines**

The overriding point in this paper is that the guidelines must apply in a non-discriminatory way between all users of the Network. Westnet has stated this and must be able to clearly demonstrate that it does occur.

Section 3.2 (Network Blockages) should be closely monitored so as to establish Key Performance Indicators showing which Operator causes the blockages.

Section 6 (Consultation and Review) should require Westnet to formally consult with the Regulator at the end of the initial two years or any earlier time that the Regulator may deem appropriate (for example, this may apply if the Regulator is made aware of possible problems with the Train Management Guidelines).

## **Statement of Train Paths Policy**

Section 3 (Management of Train Paths) does not appear to adequately cover longer term issues that could be relevant to WMC. For example, future mine planning may identify the need for a train path several years in advance – a mechanism must exist to cater for this type of scenario.

Section 9 (Consultation and Review) should require Westnet to formally consult with the Regulator at the end of the initial two years or any earlier time that the Regulator may deem appropriate (for example, this may apply if the Regulator is made aware of possible problems with the Train Paths Policy).

## **Segregation Arrangements**

Despite the Segregation Arrangements paper saying all the right things, segregation will be difficult to manage day to day. We note that effective segregation of the Revenue Accounting System and the Rail Access Management System is yet to occur, although it is planned.

Possible rotation of staff between AWR and Westnet is also of some concern, as in our view it is not entirely practical to limit access to all confidential information.

It is important that regular checks are made by independent third parties as to the effectiveness of the segregation arrangements. Any audit performed must be more frequent than the annual audit as suggested by the paper, and must cover in detail all compliance requirements under the Code.

## **Costing Principles**

WMC has a number of concerns with the principles and assumptions contained within the Westnet document. The Costing Principles will ultimately set the floor and ceiling prices for access, and so it is of critical importance that the principles are fully explained and can be demonstrated to have delivered best practice rail access rates, not simply

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maximised the return to the track owner. The information available needs to be in far more detail.

Specific concerns relate to :

### Infrastructure

We query whether Formations should be included in infrastructure.

### Gross Replacement Value & Maintenance

The GRV model, whilst undoubtedly maximising the sale price received for Westrail, nevertheless should not have been used, with the Depreciated Optimised Replacement Cost (“DORC”) model, as more commonly used, being preferred. We accept that the GRV model is fixed within the Code, however there is a real risk that Westnet will earn excessive returns if the GRV model is combined with a maintenance regime based on the existing track condition.

Westnet is permitted under the Code to use the GRV in its capital cost calculation. As far as we can determine from the limited information supplied by Westnet, the maintenance costs used in the capital calculation are predominantly based on the existing track – this is clearly incorrect, as the maintenance cost should be based upon new track, otherwise there is a doubling up of costs.

In brief, if the GRV is used then maintenance cost should be based on new track. If the DORC is used then the maintenance cost should be based on best practice maintenance for the existing track. We mention “best practice maintenance” as our view is that Westnet should not simply use the maintenance cost structure inherited from Westrail, but rather should be striving to operate more efficiently.

### Design, Construction, Project Management and Financing Charges

We are not convinced that these type of charges are valid as part of the GRV calculation, and would recommend that the Regulator seek independent expert advice on the subject. Again, the lack of detail from Westnet causes some difficulty. The suggested WACC of 11% is excessive.

### Economic Life & Operating Costs

Westnet has assumed the assets are totally expired at the end of the period, with no salvage value. We seriously question this logic, as in reality most assets will never be replaced in total but will be maintained in a fit for purpose condition as long as the railway is in existence. A more realistic set of assumptions must be adopted.

### Allowable Return

The original WACC of 8.2% was calculated during the Westrail sale process, and even at that time was at the upper end of the range of WACC’s determined by economic modelling.

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Current reality is that many of the underlying fundamental assumptions have altered, with the result being that our own modelling suggests an upper WACC limit of around 7.3 % would be more appropriate.

### Overhead Cost

WMC has some concern that overheads can easily exceed original estimates. As Westnet state, they have no other function than the provision of access to the railway infrastructure. Regular and detailed audits of overhead charges, and their relevance to the business of access to the WA rail infrastructure, need to occur. Corporate overheads in particular must be closely monitored to ensure they are relevant.

### Review and Consultation

Westnet should be required to formally consult with the Regulator at the end of the initial two years or any earlier time that the Regulator may deem appropriate (for example, this may apply if the Regulator is made aware of possible problems with the Costing Principles).

### Closing Comments

The Costing Principles contain a range of variables, which together will form the “basket” of inputs to the overall access fee calculation. Given that the Code is very generous to Westnet in terms of the GRV, the Regulator is urged to critically review other variables such as the WACC, to ultimately arrive at a fair and reasonable middle ground which does not impose a financial burden on users, and thus result in a less competitive WA with the rest of Australia and the world. WA already suffers in many instances because of our geographical isolation – a further inflated cost base is not needed or warranted.

If any point in our submission is unclear, please do not hesitate to contact the undersigned on 08 94422845 or email [john.oliver@wmc.com](mailto:john.oliver@wmc.com).

Yours faithfully

**WMC RESOURCES LTD**



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