

## EXECUTIVE SUMMARY

This submission is made by AWB Limited and Grain Pool of WA (GPWA), the two rail customers for grain freight in WA. AWB is the marketer of the state's wheat crop, while GPWA deals with barley and other grains.

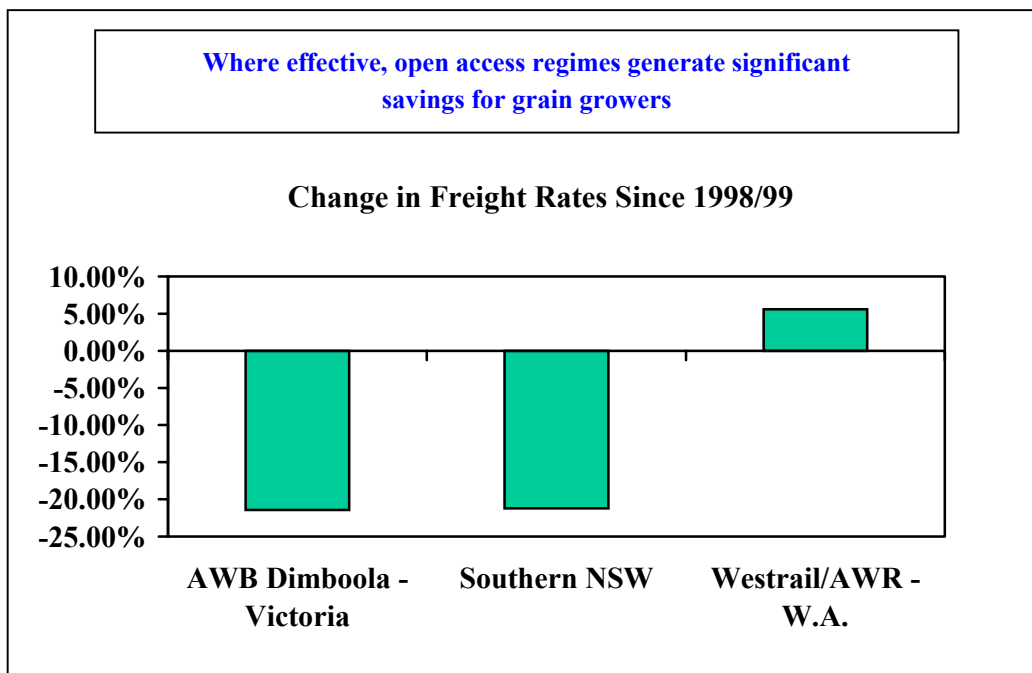
AWB Limited ("AWB") and The Grain Pool of Western Australia ("GPWA") are responsible for the marketing of Western Australia's export wheat, barley, lupins and canola on behalf of 7,500 grain growers. A principal objective of both organizations is to maximize net returns to growers through reducing supply chain costs.

Over the last decade there has always been a core annual production task of at least 6 million tonnes, reaching a record of 12 million tonnes in 1999/00. Industry is projecting future growth to 15+ million tonnes within the next 3-5 years. Approximately 95% of the State's grain production is destined for export markets, with the balance going to domestic consumption.

AWB is also actively involved in a number of other areas of the grain value chain including grain storage and distribution (Victoria & NSW), port operations (Victoria) and grain resource management (Victoria & NSW).

Grain has been transported through the State's rail network for over 75 years to ports at Geraldton, Kwinana, Albany and Esperance. Grain transport on rail represents nearly 30% of the total freight volume on the rail network and covers over 3,600kms of track, serviced both on the Standard and Narrow Gauge rail lines.

AWB and GPWA strongly support an effective regime for open access for rail operators in WA and for this reason AWB and GPWA have cooperated in the preparation of the following submission. AWB has succeeded in introducing above-rail competition in NSW and Victoria. The result has been reduced rail rates charged not only by the newcomers but also by the incumbents. In turn, this has led to additional tonnages moving by rail at the expense of road.



For above rail competition to occur, the access regime needs to be fair (neutral between operators, and with reasonable charges) and transparent (a clear framework needs to be instituted which provides certainty to new operators).

Recently AWB and GPWA (in line with the provisions of the Rail Access Code) sought from WestNet an indicative price that a rail operator may pay for access to the WestNet network to haul grain. The indicative rate provided by WestNet is three to four times higher than the rates on the east coast. At this level AWB and GPWA consider that it is highly unlikely that any rail operator other than AWR will be able to haul grain in WA. In addition the framework proposed in the four draft WestNet papers lacks transparency and appears to favour AWR.

This submission focuses on the role the Regulator can play pursuant to the Rail Access Regime to encourage above rail competition. Our main recommendations are:

1. That WestNet's proposed Costing Principles not be accepted, as they are inconsistent with the competition objectives of the regime and of National Competition Policy. Many of the principles should be heavily revised, including: the definition of infrastructure; the basis of cost allocation; the need for costs to be those of a prudent operator with modern equivalent assets; contractors' margins; financing charges; and price escalation.
2. Access charges for grain trains should be reduced so that they are nearer to the 'floor' benchmark as, unlike more heavily used lines elsewhere, the costs of constructing the grain lines are sunk costs. Charges should cover ongoing maintenance but not a capital return. Higher charges are inconsistent with the competition objectives of the legislation. The 'ceiling', based on Gross Replacement Value (of several billion dollars, whereas the whole railway was bought for just over half a billion) should not be relevant given the economics of the grain lines.
3. That WestNet's proposed Segregation arrangements not be accepted without substantial elaboration and tightening, as they fail to achieve the main objective of the Act. Specifically, the provisions on disclosure of confidential information need to be revised. Further, practical safeguards should be introduced to guarantee that no employee of the ARG Group, outside of WestNet, can become aware of WestNet's dealings with other rail operators and access seekers. Employees and contractors of WestNet should sign undertakings of confidentiality; compliance audits should be undertaken by a truly independent auditor; senior executives should not be placed in positions where they are conflicted; and AWR should not provide services to WestNet. So far as practical, WestNet's operations (particularly in dealings with rail operators and access seekers) should practically be separated from the wider operations of the ARG Group.
4. The draft Train Management Guidelines need substantial tightening as they could allow significant interference with a new operator's service. Problem areas include: operating instructions; track possessions for maintenance (including notice periods and a minimization of unplanned maintenance); the lack of KPIs; and the lack of penalties.

5. The draft Train Paths Policy, being based on a distinction between scheduled and unscheduled trains, should be changed to recognize the reality that grain trains are in an "in-between" category. Although there is a consistent pattern to many grain trains, with a regular core task, some fluctuations can occur due to weather and shipping schedule variations.

## Section 1: Introduction

This submission has been prepared by AWB Ltd ("**AWB**") and the Grain Pool of W.A. ("**GPWA**")<sup>1</sup>. It is made in response to an advertisement from the Office of the Rail Access Regulator ("**Regulator**") requesting comment on four draft papers ("**the Documents**") from WestNet Rail Pty Ltd ("**WestNet**") on the following aspects of the WA Rail Access Regime:

- Segregation Arrangements;
- Costing Principles;
- Train Management Guidelines; and
- Train Paths Policy.

The submission aims to assist the Regulator in assessing the Documents. The Documents will be important in determining how the WA Rail Access Regime is implemented by providing: guidance to parties seeking access; guidance to any arbitrator involved in determining disputes between parties; and guidance as to its effect and operation under the *Railways (Access) Western Australia Act 1998* ("Act") and the *Railways (Access) Code 2000* ("Code"). As major railway customers, AWB and GPWA and the growers they represent, have an interest in the substance of the Documents.

AWB, GPWA and grain growers have three principle interests under the Rail Access Regime:

- **Contestability.** It should be feasible and credible that a new railway operator could be contracted to provide part of the grain haulage service currently undertaken by Australia Western Rail Road Pty Ltd ("AWR"), despite AWR being part of the group of companies owned by Australia Rail Road Group Pty Ltd ("ARG") which includes WestNet. The possibility of competitive rail operation, whether or not actually implemented, provides a useful disciplined guidance on the rates charged by the incumbent operator, and on the level of service it provides. This has been shown by AWB's experience in NSW and Victoria, where the operation of ATN in the two States and of Freight Victoria in NSW has assisted in securing better arrangements with the incumbent railway operators.
- **Reasonable Access Charges.** Rail access charges should be non-discriminatory between operators providing a grain service and should not allow exploitation of WestNet's position to the potential advantage of ARG and AWR. As discussed below, the fact that a price is set so that it satisfies the "floor test" and "ceiling test" provisions of the Code does not necessarily mean an absence of monopoly rent in access prices. Customers also should not be expected to pay for inefficiencies in the provision of infrastructure.

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<sup>1</sup> AWB and GPWA retained ACIL Consulting and Blake Dawson Waldron to assist with parts of this submission.

- **Transparency.** Transparency of costs will assist in:
  - providing access seekers with greater pricing certainty;
  - ensuring that costs are not incorrectly allocated within the ARG group of companies, particularly between AWR and WestNet; and
  - ensuring that costs recovered from third party operators are fair and reasonable.

These objectives have implications for the Documents, especially those on segregation and costing. In this submission, AWB and GPWA make suggestions in relation to the Documents that will improve competitive neutrality and provide better pricing discipline.

A robust, transparent and more prescriptive access regime will provide confidence to potential new operators. AWB's experience in encouraging new operators on the East Coast to utilise third party rail access rights is that new operators had to devote considerable management time to investigate an opportunity and develop a proposal. An uncertain access regime discourages attempts to gain access, as shown by experience of rail operators seeking to haul grain on the South Australian branchline network.

The structure of this submission is:

**Section 2** provides background information on AWB and GPWA, with particular reference to its relationship with the WA rail industry. The section also deals with AWB's experience where an access regime has allowed effective above rail competition in New South Wales and parts of Victoria, including the impact on freight pricing and rail transport's market share. Based on this experience, the potential impact of an effective rail access regime in WA is briefly discussed.

**Section 3** discusses the principles in the Act and Code according to which the Regular must assess the Documents.

**Section 4** discusses the importance of ensuring effective segregation of WestNet from the rest of the ARG group to achieving the objectives of the Act and Code. AWB and GPWA conclude that WestNet's proposed segregation arrangements are incapable of effectively ring fencing WestNet's activities from AWR's activities. AWB and GPWA include some proposals that are designed to ensure that effective segregation does take place.

**Section 5** examines WestNet's proposed Costing Principles. Suggestions are offered that will improve transparency and the overall efficiency of the access regime.

**Section 6** provides an example of how, if not significantly amended to render them effective, WestNet's proposed Documents will significantly reduce any potential for above rail competition in Western Australia for grain haulage and highlights the need for effective segregation, transparency and efficient infrastructure expenditure.

**Section 7** discusses WestNet's proposed Train Management Guidelines.

**Section 8** discusses WestNet's proposed Train Path Policy.

## **Section 2: Background**

### **2.1 AWB and GPWA**

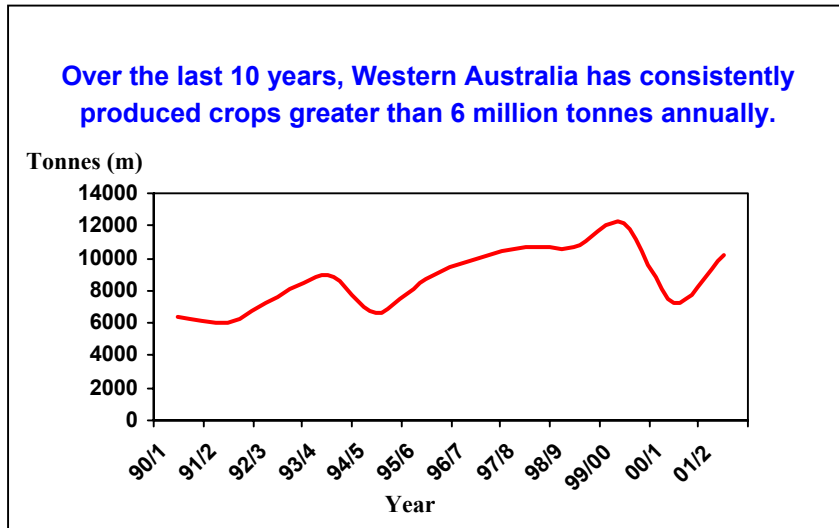
AWB is Australia's statutory export wheat marketer making it this country's major national grain marketing organisation and one of the world's largest wheat management and marketing companies. AWB regularly exports over 5 million tonnes of grain from Western Australia each year. In addition to grain trading, which includes trading in barley, sorghum, oilseeds and pulses on the eastern seaboard, AWB provides finance and risk management services to growers and manages Australia's national wheat pools, which account for around 3% of the total value of Australia's exports and approximately 12% of Australia's total farm exports. AWB is also actively involved in a number of other areas of the grain value chain including grain storage and distribution (Victoria & NSW), port operations (Victoria) and train resource management (Victoria & NSW).

GPWA is Western Australia's largest state-based grain marketing organisation and single desk exporter of barley, lupins and canola. GPWA, through its trading company AgraCorp, also markets pulses and cereals worldwide with total annual throughput in the region of 3 million tonnes.

There are over 7,500 grain growers throughout the State of Western Australia. Approximately 95% of the State's grain production is destined for export markets, with the balance going to domestic consumption. The State's rail network has transported grain for over 75 years and continues to be an integral part of the grain supply chain of Western Australia.

Western Australia is made up of four export zones: Geraldton; Kwinana; Albany; and Esperance. All are serviced, at least in part, by the rail network. Grain comprises nearly 30% of the total freight volume on the rail network. The rail services required by grain covers over 3,600kms of track and utilise both Standard and Narrow Gauge rail lines.

Continued efficiencies in farming practices, agronomic improvements and the increased percentage of cropping on available farmland has seen annual grain harvest production sharply increase over the past 25 years. Harvest production, which greatly depends upon the seasonal weather patterns, ranges from 6 million to 12 million tonnes. Industry projections indicate future growth to 15+ million tonnes within the next 3-5 years.



The export rail task represents over 65% of the total harvest production. The size of the task in any one year depends on grain production distribution patterns between port zones. The export rail task is a daily transport operation, with a core task that consistently moves throughout the year, together with some seasonal peaks.

Co-operative Bulk Handling Ltd (“CBH”) is the storage and handling service provider for AWB and GPWA. The CBH grain storage network comprises 197 receival points (including the four export terminals), of which 158 sites are serviced under an existing rail contract. Of the 158 sites, 127 are direct rail serviced receival points and 31 are road-serviced points, which feed into rail. The rail system regularly delivers grain tonnages of over 200,000 tonnes per week to meet AWB and GPWA's export commitments. Significant investment in infrastructure directly related to the rail network in Western Australia throughout the grain growing zones and export terminals has been undertaken by AWB, GPWA, CBH and ARG with the aim to further improve performance of the rail network.

## **2.2 AWB’s East Coast Experience: Impact of Effective Rail Access on Freight Rates**

AWB’s prior experience of the introduction of open access to rail networks supports the proposition that open access results in enhanced contestability in rail freight markets and significant freight cost savings for growers.

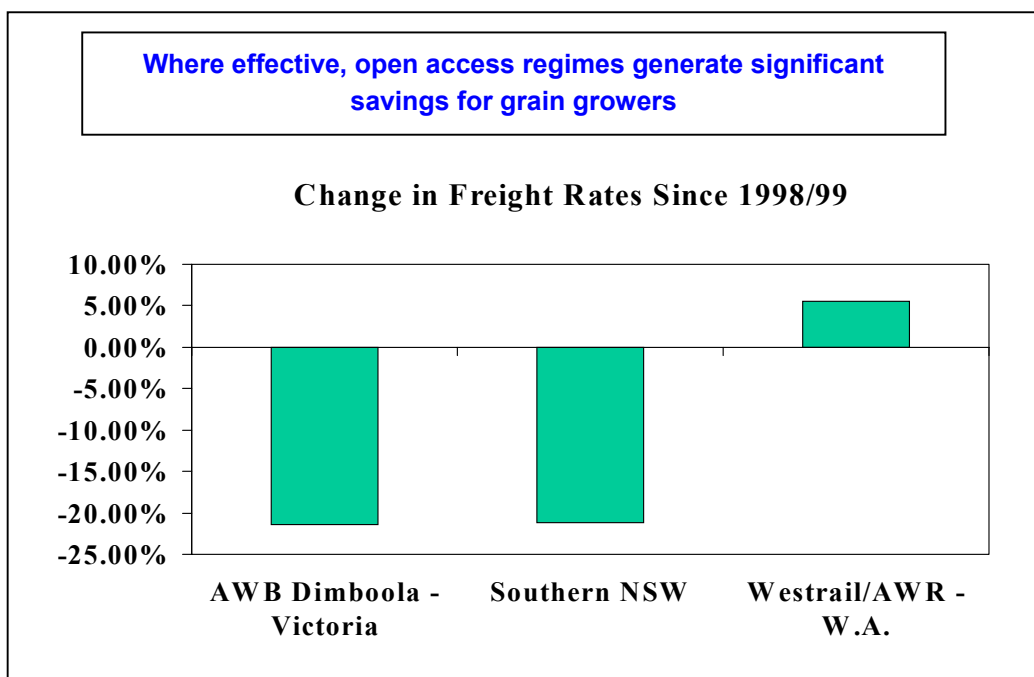
To date, AWB has managed the operation of two freight trains in South Eastern Australia:

- With ATN Access, AWB operates a train in Southern New South Wales (on the Rail Infrastructure Corporation Network) and to AWB’s silo at Dimboola (on the Australian Rail Track Corporations’ (“ARTC”) network) into Port Kembla and Appleton Dock, Melbourne. Since its inception in June 2000, this train has carried over 500,000 tonnes of AWB grain.

- Secondly, Freight Australia operates a contract from Southern New South Wales grain silos into both Port Kembla and Appleton Dock, Melbourne. This train has been successfully operating since March 2000.

ATN's service from AWB's Dimboola grain facility in Western Victoria on the interstate rail track operated by ARTC, has resulted in significant freight rate reductions by Freight Australia. A substantial portion of this freight saving is due to the ability of competing rail freight operators to access the rail lines connecting the Dimboola facility to Melbourne.

Significant rail freight reductions have also resulted from the introduction of the two new rail freight operators on the New South Wales intrastate network to compete with FreightCorp. Freight rates offered by the two new entrants represent sizeable reductions on previously existing rates, while freight rates offered by FreightCorp have also fallen. In both cases, freight benefits of the order of 20% - 25% have been attained for grain growers compared to the 1998/99 season.



During the same period rail freight rates in Western Australia have actually increased by approximately 5.6%. AWB and GPWA contend that productivity gains (and hence reduced freight costs) would be evident if AWR were faced with a genuine presence of above rail competition.

In addition, the reduction in transport costs appears to have also improved rail's share of grain haulage. Whilst it is difficult to make comparison between seasons, there appears to be strong evidence that more grain is now being delivered to silos where effective above rail competition exists. In effect, the rail access regimes with which AWB has experience have created an environment that generates additional tonnes on rail and reduces the need for road transport.



The rail access regimes operating in New South Wales were established in 1997. Since that time, no branchlines have been closed as a result of it.

### **2.3 Expected Impact of the Introduction of Above Rail Competition in W.A.**

Based on AWB's experiences and assuming that a conservative 15% reduction in freight rates resulted from the introduction of competing rail freight operators in Western Australia, transport savings of \$2.03 per tonne would result. AWB and GPWA estimates that this may represent a benefit to growers of around \$14.2 million per annum, assuming an annual rail based export shipping program of seven million tonnes.

Preliminary examination of harvest delivery trends in Victoria and Southern New South Wales indicates that another benefit of effective above rail competition is an increase in grain carried on the rail network at the expense of road. There appears to be no reason why a similar result would not eventuate if above rail competition occurs in Western Australia. Increased demand will benefit both above rail operators and the rail owner.

## **Section 3: Regulator's Role in Assessing the Documents**

### **3.1 Introduction**

As noted above, the Regulator seeks comments to assist in assessing the Documents. In this section, AWB and GPWA discuss the principles and the requirements of the Act and Code according to which the Regulator must generally assess the Documents.

The principles and rules governing the approval of the Documents are to be found in:

specific provisions of the Act;

the factors that must be taken into account by the Regulator in performing his or her obligations under section 20(4) of the Act; and

the objects provision in section 2A of the Act.

### **3.2 Specific Provisions**

Various specific provisions of the Act govern what must be included in each of the Documents. Provisions of direct relevance include:

- (a) in relation to the Segregation Arrangements, sections 28 to 34 of the Act and sections 41 and 42 of the Code;

in relation to the Costing Principles, section 46 of the Code;

in relation to the Train Management Guidelines, sections 41, 43 and 45 of the Code; and

in relation to the Train Paths Policy, sections 41, 44 and 45 of the Code.

The Regulator may not approve the Documents unless the requirements of the specific provisions are satisfied. AWB and GPWA's comments on compliance with the specific provisions are set out in the following sections of this Submission.

### **3.3 Factors that must be taken into account**

The Regulator has an obligation to take certain things into account in performing his functions under the Act or Code: see section 20(4) of the Act. As the Regulator's assessment of the Documents involves the performance of functions under the Act and Code, the Regulator must take the prescribed things into account in assessing each of the Documents.

The factors to be taken into account, which are set out in section 20(4) of the Act, are:

- (a) the railway owner's legitimate business interests and investment in railway infrastructure;

- (b) the railway owner's costs of providing access, including any costs of extending or expanding the railway infrastructure, but not including costs associated with losses arising from increased competition in upstream or downstream markets;
- (c) the economic value to the railway owner of any additional investment that a person seeking access or the railway owner has agreed to undertake;
- (d) the interests of all persons holding contracts for the use of the railway infrastructure;
- (e) firm and binding contractual obligations of the railway owner and any other person already using the railway infrastructure;
- (f) the operational and technical requirements necessary for the safe and reliable use of the railway infrastructure;
- (g) the economically efficient use of the railway infrastructure; and
- (h) the benefit to the public from having competitive markets.

The broad and general nature of the specified factors makes it clear that the Regulator must take into account a range of competing interests before deciding whether to approve each of the Documents and in exercising his powers under the Act and Code in relation to each of the Documents. In particular, AWB and GPWA draws to the Regulator's attention the requirement that the Regulator take into account:

- the interests of users of the railway infrastructure;
- the economically efficient use of the railway infrastructure; and
- the public benefit in having competitive markets, particularly competitive domestic and export primary produce markets.

It is, therefore, clear from the terms of section 20(4) that the Regulator must take into account a broader range of interests and factors than just those of the railway owner. The Regulator must actively consider, among other things, the effect that each of the Documents will have on railway users and prospective railway users, the economically efficient use of railway infrastructure and the public benefit in having competitive markets, particularly domestic and export markets for primary produce.

### 3.4 Object of the Act

The Regulator has significant discretion under the Act and Code in relation to the approval of the Documents and in the exercise of his or her powers. AWB and GPWA submit that the Regulator must exercise that broad discretion reasonably to give effect to the objectives of the Act.

The main objective of the Act is made clear in the Act itself. Section 2A states that:

"The main object of this Act is to establish a rail access regime that encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations."

Accordingly, the thrust of the Act is to establish a rail access regime that facilitates a contestable market. By facilitating a contestable market, the Act intends to deliver efficient use of, and investment in, railway facilities.

The importance of the promotion of competition in the operation of rail services is reinforced in numerous provisions of the Act. For example, see the long title, section 5, section 12(2) and section 34A. It was also stressed at the time that Parliament passed the Act. In his 2<sup>nd</sup> Reading Speech, the then Minister for Transport stated, among other things, that:

"In signing the intergovernmental competition policy agreements in 1995, the Government endorsed the view that improvements in the competitiveness of the State's economy will improve economic efficiency and enhance overall community welfare for Western Australia...

The...Bill has comprehensively addressed the Government's commitment towards these principles with regard to the operation of Westrail. While the focus has been on increased competition on the government railway network, consideration has also been given to competition that might be inconsistent with the weighting placed by the community on particular social objectives." (Hansard, Wednesday 10 June 1998 at 3613).

Thus, the objective of a competitive (or contestable) market for rail operations is a substantial requirement of the Act and Code. The objective informs the interpretation and application of the particular provisions of, and the exercise of the Regulator's discretions and powers under, the Act and Code. The particular provisions of the Act and Code must be construed in light of, and to give effect to, that objective.

## **Section 4: Segregation**

### **4.1 Introduction**

This section discusses the proposed arrangements for segregating WestNet from the rest of the ARG Group ("**Segregation Arrangements**") required under Part 4 Division 3 of the Act and which must be approved by the Regulator. In doing so, it sets out AWB and GPWA's submissions in response to the Regulator's call for public comment under section 42 of the Code on the Segregation Arrangements. In this section, AWB and GPWA also address what they consider to be specific requirements for achieving effective segregation under the Act.

In exercising his functions under section 29(1) of the Act in relation to the Segregation Arrangements, the Regulator must consider the matters set out in section 41 of the Code and must generally act in accordance with the provisions of the Act and the Code. As noted above, section 20(4) of the Act also requires the Regulator to take into account various things, including the interests of users and the public benefit from having competitive markets. There are also many other provisions of the Act and the Code that are clearly designed to achieve a contestable market for rail operation including, notably section 2A of the Act.

Each element of the Segregation Arrangements must consistently aim to achieve that objective. Thus, the Regulator must be satisfied that the Segregation Arrangements achieve that objective before deciding to approve them.

AWB and GPWA acknowledge that the requirement for full separation of the functions of railway operation and infrastructure provision helps to counter some of the problems that are expected to occur in the context of vertical integration of railway operation and infrastructure services. However, the fact of continuing common ownership poses problems which are not adequately addressed in the WestNet papers. Likewise, some of the proposed arrangements would not result in true segregation or "ring fencing" and are incapable of supporting the objective under the Act and the Code of creating an effective rail access regime.

Finally, AWB and GPWA emphasise that practically effective Segregation Arrangements are particularly important in the current context to reduce the possibility of financial distortion or inappropriate information flows occurring, either of which could result in AWR receiving an unfair commercial advantage over potential competitors. Any bias in favour of AWR would deter rival operators from trying to enter the market and/or would reduce their chances of success. This in turn would reduce the credibility of any threat by AWB and GPWA or others to introduce rival operators if they were unable to achieve reasonable freight rates and levels of service and, would reduce the incentive on AWR to offer such reasonable freight rates and service levels in the first place.

## 4.2 Summary of WestNet paper

Some of the key points set out in the Segregation Arrangements are as follows:

- WestNet's functions include negotiation and management of access agreements, train scheduling and control, safety, operating rules and standards, and infrastructure maintenance;
- WestNet retains "ultimate control" of contractors (including AWR);
- AWR provides train scheduling services on parts of the narrow gauge network;
- No directors of WestNet are also directors of AWR. However, at least one WestNet Director is also a director of ARG;
- WestNet is located in the same building as AWR but on a separate floor;
- ARG has a centralised accounting group which provides services to WestNet. Within that group a specialised accountant will deal with WestNet's accounts. The accountant dealing with AWR will not deal with WestNet accounts;
- WestNet staff will be required to sign a statement relating to their responsibilities under the Code and in relation to confidential information;
- There will be an annual compliance audit conducted by WestNet's internal auditors (an accounting firm);
- ARG senior executives who may receive reports on confidential WestNet matters (including access contracts or negotiations) are the CEO, Deputy CEO, CFO, GM Human resources and GM Compliance; and
- Segregation of computer information systems is provided through individual user IDs and passwords. Access is proposed to be provided only to appropriate information. AWR and WestNet (but apparently not ARG and WestNet) have physically separate computer file servers.

4.3 Compliance of paper with Act and Code AWB and GPWA consider that there is a fundamental flaw in WestNet's argument in relation to the Segregation Arrangements, in that it relies on the proposition that mere compliance with sections 31, 32, 33 and 34 of the Act will achieve compliance with the requirements of section 28 of the Act. It is clear from section 30 of the Act, as well as section 28 itself, that the requirement to comply with those provisions does not limit the general obligation under section 28. The obligation to segregate access related functions from other functions is one which must be read in light of the main objective of the Act, as set out in section 2A (set out above).

The Segregation Arrangements must be consistent with the main object of the Act and set out the detail which will ensure that the requirements of the Act and the Code are fully implemented. Merely complying with sections 31-34 of the Act will not suffice.

In AWB's and GPWA's view, the objective of the Segregation Arrangements should be to mimic, in effect, the outcomes achieved in other States by structural separation of the infrastructure owner and the rail operator.

Broadly speaking, the Segregation Arrangements must expressly address:

- (a) the regulation of the disclosure of information obtained by WestNet in the course of conducting its access related functions. Measures must be introduced so that information which is not generally available and which might reasonably be expected to affect the commercial decisions of an access party is kept confidential within WestNet. Other relevant information as to the operation of the network which is made available by WestNet, such as timetabling, must be made available at the same time and in the same detail to all access parties;
- (b) an appropriate process within the ARG Group for making decisions which relate to access to WestNet's railway infrastructure. Such decisions must be made without regard to the interests of any other entity within the ARG Group that may have or may require access, such as AWR;
- (c) the regulation of any present or future contractual relationship (whether formal or informal) between WestNet and any affiliated entity, for the provision of access. The relevant entity or entities must be granted access on the same terms and conditions and at the same price as other access parties; and
- (d) the need to ensure that the WestNet railway infrastructure is effectively operated as a separate and discrete business which is accounted for separately and transparently. This is crucial to demonstrate to the Regulator and potential access seekers that there are no cross subsidies between the regulated activities of WestNet and the unregulated activities of other parts of the ARG Group.

Finally, it is crucial in properly addressing the above issues, to ensure that appropriate systems are put in place to monitor and report on the effectiveness of the Segregation Arrangements.

#### **4.4 Confidentiality of information**

A major justification for requiring effective segregation is that it reduces the possibility for information about (potential) new operator services to be obtained by the operator's potential rival (AWR). In this way it mimics the operation of competitive markets where a typical competitive tool is to try to keep certain information from rivals.

Such information flows are undesirable where they reduce the level of contestability by deterring potential new operators from entering the market. Prior to starting a service, a new operator would have to obtain technical information from WestNet and would have to provide information about its operations, rolling stock etc. Much of this information would be of commercial value to a competitor. For example, if AWR learned of the new operator's approach to WestNet, especially at the early stages of negotiation between a customer and a potential new rail operator, it could act to undermine the rival's prospects by putting various types of pressure on the customer (especially if the new entrant was looking at only part of the customer's business, which is likely to be the case in grain).

AWB notes that the successful introduction of new operators in NSW and on the Victorian interstate track was undertaken in different circumstances - where there was complete vertical separation (including separation of ownership) and where effective access regimes were in place.

In the absence of such structural separation, a problem with confidentiality obligations is the difficulty of practically enforcing those requirements. The most valuable information can sometimes be merely an informal indication of what manoeuvres are taking place, rather than the provision of a formal document such as a copy of a letter about potential access. Informal information can be conveyed subtly by means that a regulator usually cannot detect or track. To this end, it is important not only that adequate measures are prescribed to preserve confidentiality, but also that the method for enforcing the requirement of confidentiality is also addressed.

AWB and GPWA submit that WestNet's proposed arrangements are incapable of ensuring the protection of confidential information necessary for an effective access regime and for compliance with the provisions of the Act and the Code. The Segregation Arrangements must be strengthened by requiring that:

- there be a process for deciding on the release of any information that WestNet obtains in relation to access related functions to persons (other than WestNet staff). The process must be clearly described and will need to apply before any such information is recorded on the Rail Access Management System;
- financial information relating to access related functions stay contained within WestNet and only be made available to ARG in a form that will render it incapable of providing details that would provide a market advantage to any other entity within the ARG Group;
- there be effective separation of employees of WestNet from those of AWR or any other part of the ARG Group;
- all executives and employees of WestNet sign undertakings of confidentiality and familiarity with the requirements of the Act and the Code and the Segregation Arrangements; and



- penalties be imposed for the inappropriate provision and/or release of confidential information within the ARG Group or to a third party by any director or employee of WestNet.

#### **4.5 Common accounting service**

The allocation of common or joint costs between WestNet and ARG is discussed in this and the following chapter. In the context of segregation, WestNet's use of ARG's common accounting service and staff, which also service AWR, raises concerns. The various restrictions which are envisaged (specialised accountants, protection of information etc) do not suffice, for example, to ensure that commercially sensitive information of other rail operators and access seekers is kept confidential within WestNet. AWB and GPWA therefore recommend that rigorous safeguards are introduced to guarantee that no employee of the ARG Group, outside of WestNet, can become aware of such confidential information. If this is not practicable, WestNet should be required to set up its own entirely separate accounting service (including separate accounting staff employed by WestNet) and have its own separate computer server. In addition, the measures proposed in the previous chapter in relation to the handling of financial information must be implemented.

#### **4.6 Compliance audits**

The WestNet paper proposes audits of compliance, with the segregation arrangements to be undertaken by WestNet's (and ARG's) auditor. There is a potential conflict here — the auditor's client relationship (and substantial income) is with ARG, and there may not be sufficient incentives for the auditor in respect of the performance of its compliance audit. AWB and GPWA suggest that the Regulator require:

- an internal monitoring and investigation system to ensure the Segregation Arrangements are being complied with and internal investigation and reporting to the Regulator of alleged breaches on 6 monthly basis;
- review of the Segregation Arrangements at the end of one year of their implementation;
- external auditing (by a truly independent auditor jointly appointed by the Regulator) of WestNet's compliance. This must be carried out at specified regular intervals and when an actual or an alleged breach of the Segregation Arrangements takes place; and
- the payment of liquidated damages or damages to be assessed where there is a breach of the Segregation Arrangements.

#### **4.7 Personnel issues**

The Segregation Arrangements allow for a significant number of key individuals (including the senior ARG executives) to have access to confidential WestNet information, including, in particular, confidential information of access parties, in circumstances that could undermine the ability of competitors to effectively access the railway infrastructure.

Whether or not the individuals involved are of integrity, they are placed in situations in which they may have clear conflicts of interest. The commercial interests of the ARG and the fiduciary duties of its directors, are not compatible with access by operators other than AWR. We are unaware whether the ARG constitution contains any safeguards that ensure, for example, that the senior ARG executives do not use any confidential information of other rail operators or access seekers they become aware of to favour the commercial interests of the ARG Group or AWR.

Whether or not the ARG constitution contains such safeguards, AWB and GPWA propose that the Regulator require that the Segregation Arrangements specify that:

- all employees and contractors of WestNet sign undertakings of confidentiality and familiarity with the requirements of the Act and the Code and the Segregation Arrangements;
- the senior ARG executives sign undertakings of confidentiality; and
- penalties be imposed for the inappropriate provision and/or release of confidential information within the ARG Group or to a third party by any employee or contractor of WestNet, or by any senior ARG executive.

#### **4.8 Services provided by AWR**

The WestNet paper refers to services provide by AWR, including train scheduling on parts of the network (it does not state which parts). WestNet asserts that it maintains “ultimate control” but this is a vague concept. AWR may in practice be in a position to take actions through the services it provides to WestNet, particularly train scheduling services, that affect the interests of a competitor.

AWB and GPWA recommend that the Regulator require that, within 6 months, WestNet cease to use AWR to provide services to it that affect the interests of other rail operators and access seekers, such as train scheduling services. In addition, WestNet should be allowed to use AWR as its services provider only if there is a special need to do so (eg. emergency response services).

#### **4.9 Additional measures**

Additional measures that should also be considered include requirements in the Segregation Arrangements that:

- there be a procedure for dealing with access proposals, which establishes a detailed queuing policy to prevent any access party receiving inappropriate priority in dealing with its access proposal;

- in relation to clause 6, the details of access arrangements entered into by WestNet prior to the proclamation of the Code be provided and made publicly available.
- to the extent that there is a special need for AWR to provide services to WestNet (eg. emergency response services), the provision and the prices for those services first be approved by the Regulator.

#### **4.10 Cost of Transparency**

AWB and GPWA recognise that improvements to price transparency come at an additional cost to access seekers, but believe that these costs are necessary to the extent that they assist in creating a competitive environment for above rail operators.

For example, if the cost of the above initiatives cost \$3.0 million annually, this equates to around 10 cents/tonne across the tonnage carried on the WestNet system. To the grains industry, this increase is less than one per cent of current average freight rates. However, based on AWB's experience, above rail competition will generate significantly greater savings.

## **Section 5: Costing**

### **5.1 Introduction**

In this section, AWB and GPWA make comments that may assist the Regulator in assessing WestNet's proposed Costing Principles. Issues associated with the specific provisions of the Code are addressed first, followed by a discussion of more general issues.

### **5.2 Summary of Code provisions**

Some of the key pricing provisions of the Code (as set out in Schedule 4) are that:

- capital costs comprise depreciation and a return on capital based on gross replacement value (GRV) a weighted average cost of capital (WACC) approved by the Regulator, and on the economic life of the infrastructure. The GRV value is to reflect actual and reasonably projected demand and modern equivalent assets.
- The access price is not to be less than the 'floor' of incremental cost (of an operator on a route).
- Price is not to exceed the total stand-alone cost attributable to the route.
- The Regulator may approve WestNet's cost or determine cost.
- Prices may reflect differences in cost or risks of particular operations, the standard of infrastructure, and "relevant market conditions".

### **5.3 Summary of WestNet paper**

The main provisions of WestNet's Costing Principles paper ("**Costing Principles**") are:

- "Infrastructure" includes rail, sleepers, ballast, formation, signalling and structures.
- Most current infrastructure is considered to be consistent with modern equivalent assets apart from one section which should be updated to concrete sleepers. WestNet says it regularly tests the market for costs, materials and construction etc. and for determination of design, construction and project management fees (it proposes contractors overhead 12.5%, engineering and design 16.5%, profit and risk margin 5%).
- Economic lives for different types of infrastructure have been proposed (annex seven).
- The Regulator's allowable WACC is 8.2% pre tax real.
- WestNet has applied a pre tax real weighted average cost of capital of 11% pa to the construction cashflows "to reflect the financing charge" to apply only during construction.
- Track maintenance is outsourced and WestNet says the rates are competitive. Signalling and communication is done in-house due to the immaturity of the market. The outsourced infrastructure contracts "are charged to WestNet based on hourly rates".

- Ten categories of overhead cost have been defined. Services provided by ARG (eg. accounting accreditation and safety and payroll), are also included in the overheads, calculated on the basis of the proportion of WestNet use compared with total ARG use (measurement not defined).
- Train control costs and related functions are allocated by train numbers. Maintenance related functions are allocated by gross tonne kilometres.
- The ceiling price will increase by CPI.

#### 5.4 Specific Issues

WestNet's obligation to provide Costing Principles is set out in section 46 of the Code. That section states that the Costing Principles are to be "a statement of principles, rules and practices...that are to be applied and followed by the railway owner:

- (a) in the determination of costs referred to in clauses 7 and 8 of Schedule 4; and
- (b) in the keeping and presentation of the railway owner's accounts and financial records so far as they relate to the determination of those costs."

AWB's and GPWA's comments in relation to limb (a) of section 46 are set out below.

In relation to limb (b) of section 46, AWB and GPWA note that the Costing Principles do not appear to address the principles, rules and practices that are to be followed by WestNet in keeping and presenting its accounts in so far as they relate to the determination of the costs referred to in clauses 7 and 8 of Schedule 4: for example, see section 1.2 of the Costing Principles.

Accordingly, AWB submits that it is not open to the Regulator to approve the Costing Principles. Indeed, it appears that WestNet may not have complied with its obligation under section 46 because the Costing Principles do not contain what the provision states that they must contain.

It also appears to be the case that the Costing Principles do not address the issue of whether they are consistent with the requirements of the Corporations Law (now the *Corporations Act*) relating to financial administration. That is a requirement of section 46(5) of the Code. AWB and GPWA have not been able to undertake an assessment of such compliance, but encourages the Regulator to do so.

## 5.5 General Issues

The Costing Principles are of fundamental importance to the effectiveness of the access regime established by the Act and Code. If approved, they will significantly affect the extent to which competition emerges in the market for rail operations. While AWB and GPWA acknowledge that the actual prices paid to WestNet will be determined by negotiation under the provisions of the Code, that position will always be subject to the "Floor Price Test" and the "Ceiling Price Test" under Schedule 4 of the Code: see clause 6 of Schedule 4 of the Code. If clause 9 of Schedule 4 of the Code does not apply, the Costing Principles will have a governing role in the determination of the relevant costs for the purposes of the Floor Price Test and the Ceiling Price Test in relation to particular access proposals.

Given that fundamental importance, and the effect that variations in access prices can have on the extent of competitive entry into the market, it is imperative that the Regulator fully analyse the Costing Principles put forward by WestNet. The Regulator must do so taking into account all of the factors set out in section 20(4) of the Act and in light of the main objective of the Act in promoting competition. In this regard, WestNet submits that the Regulator should consider whether approval of the Costing Principles will have the effect of entrenching principles, rules and practices that deliver unsustainable and economically unjustifiable price ceilings and floors which are inconsistent with the public benefit in the promotion of competition and the interests of users of the railway infrastructure.

For the reasons set out in the following parts of this Submission, AWB and GPWA submit that the WestNet Costing Principles, if approved, would be inconsistent with the interests of current and potential rail access users and with the public benefit in competition in markets. Equally, approval of the Costing Principles would be inconsistent with the achievement of the main objective of the Act. In general terms, AWB and GPWA consider that the Costing Principles are inadequate both in substance (for example, the resulting costs could be too high and/or wrongly allocated) and process (for example, in terms of a lack of transparency).

General issues and difficulties that arise in the Costing Principles are as follows:

- One of the components of the proposed definition of "infrastructure" (the inclusion of formations) is not included in the equivalent definition in the Code. Its addition will add substantially to the ceiling cost.

- The proposed margins for contractors' overheads, engineering and design, and profit and risk, total 34%. In AWB's experience with capital projects a more reasonable figure would be 15-18%. A lower figure is in part justified by the low-risk nature of the likely types of project – many of which are "off the shelf" type upgrades, requiring minimal design and overhead inputs. As a more specific comment in relation to clause 2.3 of the Costing Principles, AWB suggests that, in the least, the engineering and design overhead should be limited to 12.5% and not 16.5%. AWB and GPWA submit that these proposed margins are consistent with standard industry practice.
- The inclusion of a financing charge during construction period could lead to "double-dipping" considering that there will be allowed WACC on the project. WestNet's proposed level for this charge of 11% is higher than the Regulator's 8.2% for the WACC (both pre tax real). If a financing charge is allowable, it should be no more than the WACC approved by the Regulator.
- The paper does not clearly state how overhead costs will be allocated within ARG, ie. how is WestNet's proportion of use determined? This is an important transparency and pricing issue. In relation to clause 4.1 of the Costing Principles, WestNet's overhead costs must be those which are assessed as economically efficient and not those which WestNet simply incurs in conducting its business. Further, the allocation of the corporate overhead function by ARG should only be passed on to access parties if they are also the efficient costs of providing those overhead functions. The Regulator should assume that, because of the relationship between the parties, those costs are not efficient costs. Further, WestNet must demonstrate that the allocation of the cost of corporate overhead functions accurately represents the proportion of those functions which relate to the activities of WestNet.
- In clause 4.2 and Table 7.2, the Costing Principles deal with the allocation of overheads. The Costing Principles also need to provide detail as to the principles, rules and practices that will be applied and followed in establishing the floor price and the ceiling price for particular routes and particular access parties. The total revenue received by WestNet must be allocated between routes or parts of routes, and between access parties having access to that route or part of it, on a fair and reasonable basis. Furthermore, they must be described in detail in the Costing Principles.
- WestNet proposes that the regulatory ceiling be escalated by CPI. AWB and GPWA contend that the CPI (an index that reflects price changes to a large number of items), is not relevant to a specific, narrow field of activity such as rail infrastructure costs. AWB and GPWA suggest that any escalation incorporate a productivity and efficiency allowance, so that the ceiling would be increased by less than the chosen escalator.

- In clause 1.2, WestNet indicates that it is prepared to discuss access with interested parties outside of the Code. In AWB and GPWA's view, all access applications and grants of access should be dealt with under the Act and Code regime. Not doing so could lead to inconsistency and discrimination in the terms and conditions (including pricing) of access in the market. Among other things, it will also create the risk that parties will not adhere to Train Management Guidelines, the Train Path Policy and the Costing Principles and lead to inefficient use of the railway infrastructure.
- In clause 2.1, WestNet refers to "Gross Replacement Cost" rather than "Gross Replacement Value". The use of the concept of "Gross Replacement Value" is fundamental under the Code. In employing the concept, the Code requires that the capital value be established by determining the cost of a modern equivalent asset and taking account of the value already employed (ie. taking account of the depreciation of the asset). AWB and GPWA requests that the Regulator confirm that the Costing Principles will apply on that basis and that they be amended to clarify the point.
- In clause 2.2, WestNet states that the existing Network infrastructure meets all current and reasonably projected demand for uses taken together. However, it then qualifies the statement in a footnote. The status of this matter should be clarified.
- As the annuity calculation is undertaken annually in arrears, the charges resulting from that calculation must be paid by access parties annually in arrears: see clause 2.6 of the Costing Principles.
- AWB and GPWA have major concerns about WestNet's views on operating costs. Schedule 4 of the Code clearly states the operating costs that are relevant for the purposes of pricing: see clause 4 of Schedule 4 of the Code. The costs are intended to be those that would be incurred by a body managing the railways network and adopting efficient practices applicable to the provision of railway infrastructure, including the practice of operating a particular route in combination with other routes for the achievement of efficiencies. In effect, the operating charges that WestNet can pass on are only those operating and maintenance costs that would be incurred by a reasonable and prudent operator operating that Network in a reasonable manner. Costs resulting from outsourcing can only be recovered by WestNet if the Regulator is satisfied that they are "efficient costs", as this phrase is generally understood. This is an objective and theoretical test, based upon the assumption required under the Code that the network is comprised of modern equivalent assets which have provided the value previously provided by those assets over their life to date. The actual operating costs of the network as it exists, including liabilities to contractors providing operational and maintenance services, are not relevant in determining the operating costs which can be passed through to access parties in WestNet's track access charges. This matter is further discussed below.



- The Costing Principles must make it clear as to which aspects of maintenance related costs are included in operating and maintenance costs and which are included in the value of the capital base of the Network. If the capital base includes an allowance for future capital expenditure, WestNet must not be able to include the cost of such improvements in the maintenance aspect of its operating costs. Capital works should properly be dealt with in establishing the capital value of the network. That forecast capital expenditure would then of course be excluded from non-capital operating costs.
- The actual capital base and the operating costs which are used to determine the floor price and ceiling price for the purposes of clause 9 of Schedule 4 to the Code will be considered in detail at the time they are published. It may be that the way in which the Costing Principles are applied will demonstrate other deficiencies in the Costing Principles, which will be highlighted at that time.
- There must be only one regulatory ceiling and one regulatory floor for the route required for the relevant access party (see clause 9 of Schedule 4). The Costing Principles are silent on the allocation of total revenue from the WestNet network to relevant routes on that network. As allocation is an important part of any regulatory tariff setting process, the relevant methodology should be specified in the Costing Principles and be assessed by the Regulator.
- The economic life tables in clause 7.1 seem to show specific economic lives in years; this should be clarified. It is inconsistent for WestNet to assume that its infrastructure is new and yet suggest that it has a limited life.

## **5.6 WestNet's cost levels**

The Costing Principles imply that WestNet has efficient costs because (in some cases) of outsourcing and (in other cases) because of market testing. However, AWB and GPWA are aware that outsourcing implemented by Westrail was seen within the industry as being unsophisticated, based on hourly rates (as referred to in the Costing Principles) and a duplication of the design and supervision functions by Westrail and by the contractors. The result was that outsourcing did not result in the normally expected reduction in costs. It was a crude piece rate system rather than a full outsourcing of maintenance. Also AWB and GPWA note that some work continues to be done in-house.

AWB and GPWA therefore suggest that WestNet's costs be benchmarked against those of well run railways elsewhere to help determine whether they are efficient. This will not be easy as there is no Australian equivalent of a privately owned, vertically integrated operator with lightly used lines except for Freight Australia (in Victoria) and ATN (in Tasmania) which does not publicly disclose this sort of information. Other Australian infrastructure providers are either publicly owned (and hence possibly inefficient) and/or vertically separated and/or have track which is much more heavily used than WA grain lines. Hence the benchmarking may need to use overseas data as well as Australian data (eg US, NZ). AWB and GPWA, therefore, request that the Regulator undertake an independent engineering and economic evaluation of WestNet's Costs.

### **5.7 Level of expenditure**

The assumption that all but one part of the network reflects the standard of a modern equivalent asset does not allow for the possibility that parts of the network may have been kept up at a standard which is excessive in relation to the task, or are inadequate in relation to the task (there are differing maximum axle loads and multiple speed restrictions on the grain rail network). In other words, the balance between capital and operating expenditure may not have been optimal on all parts of the network.

AWB and GPWA, as the major customers for the grain network, will wish to influence the standard of infrastructure provided, and the associated price/quality trade-off. We do not see in the Costing Principles draft paper a mechanism to require WestNet to respond to customer views on this issue. The investment strategy of a railway owner, including investment mix, is a fundamental management and ownership function. Perhaps the only opportunity to influence such decisions is in relation to whether the assets are modern equivalent (or over-engineered). However, a prudent infrastructure owner will consult with access parties before making significant capital and operating expenditure decisions as it reduces the risks of attack later. We do not consider there is a requirement to include this notion in the Principles

### **5.8 Allocation of Costs**

The Costing Principles' in general are of a high-level general-principles nature, and the detailed basis of calculation is not stated. In particular, AWB and GPWA would be concerned if as stable long term customers they ended up paying for overhead costs which really relate to a series of one-off problems related to other customers. Overhead costs should be broken down more than suggested in the Costing Principles and allocated to particular lines of business wherever possible.

## 5.9 Sunk Costs

The main point AWB and GPWA wish to make on cost is that mechanistic application of the ceiling price test could result in access charges that are many times higher than can be justified. The ceiling is based on a number of elements, including gross replacement value and a rate of return. GRV will be of the order of \$5 billion dollars whereas the amount paid for the whole railway (including rolling stock, other assets and goodwill) was well under one billion dollars.

Many of the grain lines are relatively lightly used and it is questionable whether, if they did not already exist, they would now be replicated. In other words the capital costs associated with them should be regarded as sunk and not justifying any return. The light use also means that the infrastructure lasts for extremely long periods, provided that routine and cyclical maintenance is performed – for many elements of the infrastructure, deterioration is a function of time rather than wear and tear.

The access charge then should only cover maintenance and overheads. This approach is consistent with correct economic signals as there is little further investment in the grain network taking place (beyond commitments made by ARG at the time of purchase from the Western Australian Government) and as there is provision for recovering any capital expenditure on upgrading. The alternative of allowing an access price to move even part way up from incremental cost (as appears to have been offered indicatively by WestNet to the grain industry) could result in a major increase in grain freight rates provided by AWR or a rival and could provide AWR with profits out of proportion to its actual investment in the rail system. In this context, it is imperative that the Regulator consider the nature of the factors in s 20(4) of the Act and the main object of the Act.

The Code does not appear to provide clear guidance on this matter apart from a reference to market conditions — which will still allow WestNet to determine somehow that grain market conditions allowed a substantial rate increase. The AWB and GPWA would not accept such an outcome and so a dispute would be triggered and an arbitrator would then have to come to view.

The sunk cost approach has been applied under the Victorian rail access regime (most of Victoria's non-metropolitan network is grain lines). The NCC, in a December 2001 draft report prior to certification of the regime, has tentatively accepted this approach, subject to further stakeholder comment.

## Section 6: Impact of Ineffective Segregation on Competition

### 6.1 Incorrect allocation of costs

Incorrect allocation of costs between AWR and WestNet or inefficient expenditure on the track by WestNet could significantly impact on access charges, particularly on lightly utilised branchlines. This could effectively create a price barrier to rail companies seeking to haul grain on the WestNet network

The impact could be particularly severe on lightly utilised branchlines. As an indicative example, the effect of an annual incorrect allocation of \$0.5 million to WestNet from ARG is significant, particularly on networks with relatively low tonnage.

<b>Indicative Example:</b>	Impact of \$500,000 per annum being incorrectly allocated annually from AWR to WestNet.	
<b>Track Density</b>	<b>Low</b>	<b>High</b>
<b>Tonnes/Line Section:</b>	100,000	1,000,000
<b>Incorrectly allocated Costs:</b> (From Rail Operations to Track Function)	\$500,000	\$500,000
<b>Impact on Access Charge</b> (\$/tonne)	<b>\$5.00</b>	<b>\$0.50</b>
<b>Assumed Freight Rate:</b> (\$/tonne)	<b>\$14.00</b>	<b>\$14.00</b>
<b>Impact of incorrect allocation:</b> (% of total freight cost)	<b>35.7%</b>	<b>3.6%</b>

The effect of the above would allow the AWR to reduce its costs, but increase the access charge for new entrants. This outcome is a “double hit” for potential competitors seeking access: they face high access charges and must attempt to compete against an above rail operator that has benefited from artificially lowering its cost base.

## 6.2 Proposed WestNet Access Charge Compared to Other Access Regimes

AWB and GPWA (in line with the provisions of the Code) sought an indicative price that a rail operator may pay for access to the WestNet network to haul grain. An indicative price of 1.5 cents/gross tonne kilometre (gtk) was provided by WestNet.

AWB understands that east coast rail operators pay access charges in the order of 0.30 to 0.50 cents per gtk for grain haulage. The variance between the WestNet indicative quotation has a substantial impact on a typical grain train travelling 260 kilometres.

<b>Case Study: Cost of Rail Access in Western Australia compared to NSW/Victoria</b>		
<b>Assumptions:</b>		
Haulage Distance (one way):	260 km	
No of wagons/train:	55	
Wagon Capacity:	52 tonnes	
	<b>Western Australia</b>	<b>East Coast</b>
<b>Assumed Access Charge: (cents/gtk)</b>	1.5	0.45
<b>Rail Access Cost (\$/tonne):</b>	\$7.25	\$2.18
<b>Assumed Freight Rate (\$/tonne):</b>	\$14.00	\$14.00
<b>Rail Access Charge as a % of Freight Rate:</b>	51.8%	15.6%
<b>Residual Funds Available For Freight Operations (\$/tonne):</b>	\$6.75	\$11.82

In the above example, the rail operator attempting to compete in Western Australia will be \$5.07/tonne less competitive compared to operating a train on the East Coast. This amount equates to a 36% variance of a typical \$14.00 transport cost.

Clearly, if the access regime is implemented as intended by WestNet, the proposed access charge will significantly limit any potential above rail competition. Without this competitive pressure, AWB and GPWA contend that the benefits of an effective rail access regime (set out in Section 4 of this submission) are unlikely to be realised in Western Australia.

## **Section 7: Train Management Guidelines**

### **7.1 Introduction**

This section discusses the proposed guidelines for the management and administration of the rail network by WestNet ("TMGs") required to approved by the Regulator under the Code.

AWB and GPWA submit that the TMGs should not be approved in their current form for the reasons discussed in this section. The primary reason is that the level of authority and discretion that the TMGs grant to WestNet are both unnecessary and inappropriate. The grant of such authority and discretion is not within the scope of the Act or the Code and does not enhance the objectives of the Act and the Code.

### **7.2 Restraints on WestNet**

Broadly, AWB and GPWA are concerned about the absence of any restraints on WestNet (in sections 3.1 and 4.4) to ensure that customer disruption costs caused by track works, breakdowns and the like are minimised. For example, under the TMGs as currently proposed, WestNet is effectively granted "carte blanche" to impose speed and weight restrictions. In this regard, the current definition of "Instructions" is particularly problematic. WestNet should only have the power to give notice of speed and weight restrictions under the TMGs in response to an emergency or to preserve safety on the Network.

In addition, no Key Performance Indicators or penalties are set out in the TMGs to regulate WestNet's conduct in managing the network and there is no distinction between planned and unplanned maintenance and to what extent (if any) maintenance should be allowed to affect the operations of access parties .

AWB and GPWA submit that the bulk of maintenance should be planned in advance and carried out in accordance with a maintenance plan. There should be no disruption of scheduled train paths when planned maintenance is being carried out (eg planned maintenance on grain lines should only be carried out at times they are not normally used). Unplanned maintenance should be confined to responding to an emergency or to ensure safety of the network after an incident has occurred (eg. floods and accidents).

### **7.3 Scheduled vs Non Schedule Trains**

Much of the draft WestNet paper on train management guidelines is straightforward, but AWB and GPWA are uneasy because a basic assumption seems to be a distinction between scheduled and unscheduled trains, which does not suit the reality of grain freight. . The paper states (in section 1.2) that "[it] will apply in a non-discriminatory way between all users of the Network so as to maintain the order of priority of the Scheduled Train Paths." The definition of "scheduled train paths" differs between the guidelines and policy papers.

Grain trains are not scheduled in the sense that there is repeated pattern of timetabled movements, but they are not unscheduled in the sense of occasional/ad hoc movements. Grain trains operate in large number though the year, but the number varies according to the size of harvest and the timings vary according to shipping schedules and other logistical constraints. However, there is a consistent “core task” that demands regular time slots, especially train unloading at Kwinana.

AWB and GPWA are concerned that grain trains might given less importance than regularly scheduled trains simply because of the nature of the business. In terms of economic importance, grain trains in WA should rank much more highly than casual unscheduled freight trains.

#### **7.4 Network Blockage**

AWB and GPWA make the following comments in relation to the arrangements for clearing a Network blockage in clause 3.2:

- a) There must be some provision for cost recovery and charges to be imposed to support the arrangements set out in this clause, allowing the cost incurred by an access party whose locomotive and crew are used by WestNet in clearing a Network blockage to be recovered from WestNet and, in turn, allowing WestNet to charge for the service provided in assisting the clearing of the failed train.
- b) In deciding to use the crew and locomotive of a particular access party to clear a Network blockage, WestNet should be required take into account relevant factors such as the cost of using the crew and locomotive of that access party instead of the crew and locomotive of another access party. WestNet must, where possible, seek to minimise the loss and damages incurred by the access party providing the locomotive and crew used to clear the blockage and the costs incurred by the access party whose train failure blocked the passage of trains.
- c) Finally, each access party must provide an indemnity against all costs and damages incurred by other access parties (including consequential damages) as a result of a train failure and Network blockage caused by that access party.

#### **7.5 Key Performance Indicators**

As previously mentioned in this section, the KPIs are not set out in the TMGs. Rather, section 5 of the TMGs refers only to a process by which parties will endeavour to agree on key performance indicators, after an access agreement has been signed.

AWB and GPWA submit that the TMGs must set out universal key performance indicators relating to the Network generally and should be required to report its performance as against those indicators to the Regulator on a regular basis. The indicators should deal with at least following:

- a) disclosure by WestNet of speed restriction and/or axle load restriction notices given by WestNet;

- b) disclosure by WestNet the number of delays to scheduled train paths caused by WestNet in general operation;
- c) the instances when WestNet has used its emergency maintenance powers to affect scheduled train paths; and
- d) a general obligation to report on the performance of WestNet as lessee and operator of the track.

## 7.6 Access Party

The TMG's assume that an access agreement will be entered into by an operator and WestNet and that it is the operator who runs the services on the network. However, the Code clearly contemplates that a party who obtains access to the rail network may engage the services of a separate entity to carry on the rail operations (see section 14 of the Code). The TMGs must be amended to reflect the Code and should therefore also specify that only the entity that carries out the rail operations (the "operator") needs to be, and remain accredited under the *Rail Safety Act 1998*.

## 7.7 GENERAL POINTS

AWB and GPWA make the following additional submissions:

- Generally, the TMG's often deal with matters that are of a contractual nature and should be dealt with in the access agreement between WestNet and the access party, such as, for example, WestNet's exclusion of liability in clause 3.1 of the TMGs.
- There are several problems with definitions in the TMGs. The lack of definition for terms that should be defined means that the TMGs cannot in their present form operate effectively. The TMGs also requires clarification of vague terms, for example "temporary" (p6 para 7), "ordinarily given (p6 para 8), "earliest possible time (p7 clause 3.4), and "WestNet rules" (p10 clause 4.4). The matrix in section 4.3 requires completion and further explanation.
- Significant typographical and formatting errors further detract from the clarity of the document. These should be corrected.
- Clause 3.1 sets out WestNet's management of the use of the Network. The provisions of this clause must be made subject to clause 4.2 of the TMGs.
- In addition, the use of the term "late" in 3.1 is uncertain. A train that presents for departure on or within 15 minutes of the scheduled departure time and keeps within 15 minutes of its scheduled train path for the whole of the Service (with the exception of delays caused by WestNet) should not be deemed to be "late" entering the Network or running within the Network. The use of the term "unhealthy Train" should also be governed by the same concept, meaning that a train is only an "unhealthy Train" if it does not depart within 15 minutes of its scheduled time or fails to keep to within 15 minutes of its schedule time on the network. Clause 3.1(c) should refer to 15 minutes and not 10 minutes.



- WestNet's warranty in clause 7.1.2 of its ability to grant rights of access to the Network must not be made subject to the Government Lease (as defined in the TMGs), unless that document is first disclosed to access seekers.
- Clause 4.4 should be amended to expressly require WestNet to maintain the Network to the standard required for WestNet to maintain its accreditation as a track owner, whether or not WestNet is technically required to be an "Accredited Owner".
- In the management of emergencies and carrying out appropriate maintenance under the TMGs, WestNet must be under an obligation to restore the Network and all trains to the scheduled train paths as soon as is reasonably possible.
- The TMGs should be reviewed within one year or the later of the date on which they are first approved by the Regulator or the date on which an access party first commences operations on the Network. The review should include WestNet, the Regulator and all parties operating on the Network during that period.
- In clause 7.1.2, as previously mentioned, the limitation on the warranty as to the entitlement to grant the rights of access (as being subject to the provisions of the Government Lease) is unacceptable unless access parties are given the opportunity of ensuring there is nothing inconsistent with the access rights contained in the Government Lease.
- The content of clause 7 and, in particular, clauses 7.1.3, 7.1.4 and 7.1.5 must be included in the access agreement whether or not they are included in the Guidelines.
- WestNet must be required to also undertake to, at all times, maintain accreditation as a track owner under the Rail Safety Act 1998 and all subordinate legislation.

## **Section 8: Train Path Policy**

### **8.1 Introduction**

Section 44 of the Code requires the Regulator to approve a statement of policy ("**Train Path Policy**") which must then be observed by the railway owner and a proponent in negotiation and creation of an access agreement. A Train Path Policy applies to the allocation of train paths and the provision of access to train paths no longer in use.

Section 45 of the Code provides that the Regulator can only approve or determine a Train Path Policy after a period of public consultation. Section 41 of the Code requires the Regulator to have regard to the submissions made under section 45 and to the public interest. Other factors the Regulator must take into account and the main objective of the Act are set out earlier in this submission.

This section sets out AWB and GPWA's submissions on the Train Path Policy proposed by WestNet.

### **8.2 TRAIN PATHS**

The Policy should clarify the following terms:

- scheduled train paths;
- conditional train paths; and
- unscheduled train paths.

There appears to be an inconsistency between the concept intended by the use of those terms.

AWB and GPWA submit that the Policy should establish that:

- scheduled train paths are the contractual rights of an access party to use the network between the times and the locations specified in its access agreement with WestNet (and identified in the master control diagram);
- conditional train paths are the contractual rights of an access party to use the network between agreed times and locations on the happening a specified event. The clarification of this type of contractual right is crucial to ensure that access requirements for the freight of grain are adequately met. The concept of conditional train paths should allow for seasonal variations related to the size and timing of grain harvest throughout the year, shipping schedules and other logistical constraints; and

- unscheduled train Paths are either scheduled or conditional train paths which, if they are not being used by the relevant access party, may be granted to another access party subject to the original access party retaining the right to use that train path if it has the freight capacity to do so.

### 8.3 REMOVAL OF TRAIN PATHS

AWB and GPWA submit that:

- section 3.6 on the removal of train paths for under-utilisation is inadequate in its current form.
- given the characteristics of grain freight and the variations required in response, for example, to harvest size and shipping schedules, AWB and GPWA's submit that the removal of train paths for under-utilisation should only apply to conditional train paths where the access party consistently fails to use a train path in circumstances where the prescribed condition has been applicable (for example, a seasonally related condition has been applicable but the train path is nevertheless not utilised);
- cancellation of trains in accordance with an access agreement should not to be regarded as under-utilisation;
- under-utilisation caused by force majeure applying to an access party should not result in removal of a train path;
- WestNet should be entitled to cancel a train path if an access party loses the contract to carry freight for a customer, and re-assign the train path to a new access party that has capacity to utilise that train path (for example, the access party who has won the new contract to carry the customer's freight). This will give parties wishing to gain access more certainty when bidding for contracts to carry freight on the network;
- The concept of "three month history" is inappropriate. The review should be undertaken by comparing the access party's contracted scheduled train paths with its current and expected reasonable business requirements.

### 8.4 Additional Comments

AWB and GPWA submit that the Train Path Policy raises the following additional issues:

- The term "Government Lease" ("the Lease") is defined in the Policy but does not appear in the text. Regardless of whether or not "Government Lease" was intended to be used in the document text, WestNet's commitments under the Policy must not be subject to the terms of the Lease. Unless the Lease is made available to the access parties, there is no opportunity to determine whether or not the rights under the access agreements and to the scheduled train paths are consistent with WestNet's rights under the Lease.

- The access party may contract the carrying out of the rail operations to a rail operator. The rail operator therefore must be appropriately accredited. The policy needs to accommodate the fact that the Access Party need not be the operator of the rail services.
- Existing contractual arrangements for access in place at 1 September 2001 must include access arrangements (whether formal or informal) between WestNet and AWR (clause 3.1).
- The Policy provides insufficient explanation of the management and operation of the "Master Control Diagram". There is a lack of clarity in relation to locomotive and rolling stock movements, train crew movements and train path schedules (clause 3.2). The Policy needs to clarify:
  - a) which components are established in a reasonably permanent way; and
  - b) which components remain flexible.
- In order to minimise the temporary variation to train paths, any instruction given by WestNet must be limited to achieving the specified outcome. In other words, the instructions must be relevant to the type of harm they seek to prevent (clause 3.3).
- Routine maintenance should be provided for in establishing the scheduled train paths. WestNet must not be able to affect scheduled train paths for planned routine maintenance (except in the case of an emergency or to ensure safety). Consultation with the operator should occur at a specified time before maintenance. The Policy refers to "a reasonable time," which is too uncertain (clause 3.5).
- In relation to track possessions for maintenance and other work, there is only vague protection against excessive possession times or unreasonably short notice. Terms such as "all reasonable steps", "as soon as reasonably practicable", and "best endeavours" may have little meaning in practice (clause 3.5).
- The reference to access applications being made outside the Code must be removed. All applications and arrangements must comply with the Code to ensure consistency and fairness between parties. All the WestNet documents should apply consistently to all parties to ensure the effective operation of the master control diagram, scheduled train paths etc.
- There must be appropriate awarding of train paths amongst access seekers to ensure competition works effectively. An access seeker should not necessarily be awarded a train path simply if it was first to apply. The access seeker must first establish that it has the capacity to use the path.

- In relation to competition for the same train path, preference is given to the operator who first requested it. This may work against access by new operators. For example, should AWB and GPWA choose a new operator to serve the potentially congested Esperance line at the same time that Portman asks for more paths for iron ore trains, the longstanding grain operation might have to give way to the new mineral expansion (clause 7).
- Dispute resolution procedures are set out in Part 3 of the Code. Issues under the Policy that may give rise to disputes should be individually identified. This ensures a right to access the dispute resolution procedures (clause 8).
- The Policy should be reviewed in one year with all parties present including WestNet and the Regulator (clause 9).

**SUBMISSION TO**  
**OFFICE OF THE RAIL ACCESS**  
**REGULATOR**

**THE WESTERN AUSTRALIAN**  
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