



Public Transport Authority

# Over Payment Rules

UNCONTROLLED

# Over Payment Rules

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# 1. INTRODUCTION

## 1.1 Background

The purpose of the *Railways (Access) Act 1998* (the Act) and the *Railways (Access) Code 2000* (the Code) 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.

The Act requires nominated parts of the rail network managed by the Public Transport Authority of Western Australia (“PTA”) to be made available for access by third party rail operators. Schedule 1 of the Code lists the sections of the PTA rail network covered by the Code.

PTA is established under the *Public Transport Authority Act 2003* to direct, manage, maintain and control the Government Railways in Western Australia.

The Economic Regulation Authority (ERA) was established on 1 January 2004 and became responsible for the administration of the Act and the Code which were previously the responsibility of the Office of the Rail Access Regulator.

## 1.2 Relevance of the Over-payment Rules

Section 47(1) of the Code requires each railway owner to prepare and submit to the ERA a statement of rules (“the Over-payment Rules”) that are to apply where breaches of the Ceiling Price Test occur on the part of that Railway Owner that could not reasonably be avoided.

The Ceiling Price Test is defined under Schedule 4, Clause 8 of the Code, and refers to a Ceiling Price Test that must be met for each operator in isolation (sub-clause 1 and 2) as well as a combinatorial Ceiling Price Test (which is the Ceiling Price Test referred to in sub-clause 3). Clause 8 states that the total revenue earned on a particular route must not exceed the total costs attributable to that route.

In the event that over-payment occurs, these over-payments are deemed to be allowable within the Code provided the following applies:

1. the Railway Owner can show that over-payments could not be reasonably avoided;
2. the over-payment must be at all times within a percentage limit;
3. all over-payments must be cleared (reimbursed to Operators) within each successive 3 year period; and
4. the method of reimbursing Operators must follow rules set out in the Over-payment Rules.

This document outlines the Over-payment Rules that will apply to the Public Transport Authority (PTA). These Over-payment Rules provide a mechanism to:

1. calculate the amount by which Total Revenue earned on a particular route section exceeds the total costs attributable to the route section and infrastructure; and
2. reimburse operators who are provided with access under the Code to that route section and infrastructure in the event of an overpayment.

## **2. BASIS OF THE OVER-PAYMENT RULES**

### **2.1 Definition of Route and a Route Section**

The route section is the basic unit to which the Over-payment Rules apply. A route section is a section of the railway network that has been divided for management and costing purposes.

The following division of the network has been proposed by PTA and approved by the ERA. These route sections were selected on the basis of differences in track characteristics and traffic densities, and may be redefined over time, subject to approval by the ERA.

Perth to East Perth

East Perth to Midland Terminal

Perth to Kenwick Junction

Kenwick Junction to Armadale

Armadale to Mundijong

Perth to North Fremantle

North Fremantle to Robb Jetty

Perth to Currambine

The term “route” referred to in this document has the meaning ascribed in Clause 8, Schedule 4 of the Code. A negotiated route could equate to a route section (or part thereof) or be a combination of several route sections.

### **2.2 One Regulatory Ceiling**

Each route section has one regulatory ceiling that will apply to all Operators when negotiating access prices, and will be the basis of determining whether ceiling Total Revenue earned on a particular route section has exceeded allowable Total Costs.

These Total Ceiling Costs will be calculated by PTA using methods set out in the Costing Principles, and submitted for approval by the ERA as required by Clauses 9 and 10 of Schedule 4 of the Code.

### **2.3 What constitutes revenue in the Ceiling Price Test under Clause 8, Schedule 4 of the Code**

In assessing the extent of over-payments under Section 47 and Clause 8(3), Schedule 4 of the Code, all Access and Non-Access Revenue received by PTA for a route section, or part of a route section, and associated Railway Infrastructure will be included to calculate the Total Revenue attributable to that route section of the network.

Total Revenue is the sum of Access Revenue and Non-Access Revenue

Access Revenue is deemed to be all income received by PTA for the provision of rail access to Operators.

Non-Access Revenue may include private and government contributions, in accordance with the ERA's approved set of *Costing Principles to Apply to the Public Transport Authority*.

Access Revenue from Operators with Access Agreements negotiated outside the Regime ("non- Regime operators") will also be included in evaluating PTA's compliance with the Floor Price Test and Ceiling Price Test of the Code. Furthermore, in assessing the extent of over-payment under Section 47 of the Code, Access Revenue from non-Regime operators are included in the Ceiling Price Test. However, since the Code does not provide non-Regime operators a legal entitlement to any refund for any over-payment, such over-payments will be returned to PTA unless otherwise specified in an Access Agreement with an Operator.

### **2.4 Breaches of the Ceiling Price Test**

Section 47(1) of the Code states that the Over-payment Rules are to apply where breaches occur on the part of the Railway Owner that "could not reasonably be avoided".

PTA will assess revenues earned on particular route sections on a periodic basis to determine whether there is likely to be a breach of the Ceiling Price Test. Where it is possible to forecast potential over-payments, PTA will seek to negotiate new access prices with affected Operators to ensure that Total Revenue remains within the Ceiling.

If breaches of the Ceiling Price Test occur as a result of variations in traffic volume or revenue that are deemed to be temporary or unpredictable in nature, then PTA will advise the ERA of such circumstances and will follow the procedure set out in these over-payment rules to deal with such over-payments.

## 2.5 Over-payments and under-recoveries

Over-payment is defined as the amount of Total Revenue received by PTA for a route section that exceeds the Total Costs attributed to the route section for a one-year period.

Conversely, “under-recovery” refers to a situation where the Total Revenue to the railway owner on a route section for a one year period are less than the Total Costs attributed to that route section.

The ERA has determined that net over-payments will be assessed over a successive three period, during which over-payments in a particular year may be balanced out by under-recoveries in a subsequent year. Net over-payment in a three-year period will be paid back to Operators according to these Over-payment Rules.

Conversely, where under-recovery occurs an Operator is not required to pay PTA compensation for such under-recovery. However, where a net under-recovery occurs in a particular 3 year period, there are circumstances under which PTA will be allowed to carry-over this net under-recovery as an “accounting balance”, which may be used to offset over-payments in the subsequent three year period. The circumstances where this will be allowed to occur are set out in Example 4 in Section 4 of these Over-Payment Rules.

Example 4 refers to a situation where, as a result of having to reimburse operators during the three-year period because the breach is greater than 10 percent of the ceiling (refer to the Over-payment Rule #5 in Section 3), there are insufficient funds in the interest bearing account for PTA to recoup an under-recovery that has occurred during the same three-year period. In this instance, PTA will put a case to the ERA to carry the under-recovery credits over to the next three years up to the amount PTA has been required to refund to operators as a result of exceeding the 10 percent limit. If allowed, the carry forward will only apply for that one additional successive three year period.

## 2.6 Allocation of Access Revenue

Under Section 9(1)(c)(i) of the Code, PTA is only required to provide one Floor and one Ceiling price for a proposed access to a route (ie. from origin to destination) even though the access proposal could transverse over multiple route sections as defined in the Code.

Since price is determined on the route basis, and Total Costs are determined on a route section basis, it is necessary to distribute Access Revenue earned over a particular route against the costs of individual route sections. The distribution of such Access Revenue will be done according to the following rules:

1. Access Revenue derived from a route can only be allocated to the route sections on that Route.
2. PTA will allocate Access Revenue to cover the costs attributed to the applicable route sections in the following order:

- a. Incremental Costs against all applicable route sections;
- b. up to the Ceiling on all applicable branch or feeder (dedicated) route sections; and
- c. up to the Ceiling on all applicable shared route sections.

The justification for the ordering of the allocation process is based on economic principles. First, to avoid cross subsidisation between route sections, Access Revenue allocated to each route section must at least cover the Incremental Cost. Second, recovery of capital costs on branch or feeder lines ranks ahead of shared lines on the basis that there is no other traffic on these lines to fund the dedicated infrastructure and unless those costs are covered the line may close.

Where PTA and the Operators have reached agreement to a different revenue allocation arrangement in an Access Agreement that arrangement would prevail.

## **2.7 Allocation of Non-Access Revenue**

The allocation of Non-Access Revenue, private or government contributions will be only allocated to the route section for which the contribution was received. Where a capital contribution is made the value of the contribution to be used in the Ceiling Price Test is to be expressed as an annualized amount taking into account the Total Cost, expected life and Weighted Average Cost of Capital (WACC) determined by the ERA. Where capital is spent over multiple route sections the actual expenditure will be split into each route section at the time the expenditure is incurred. The allocation principles for Access revenue do not apply to Non-Access Revenue.

## **2.8 Allocation of an Over-payment**

Where an Over-payment on a route section results from the Ceiling Price Test all Operators who have negotiated their access agreement inside the Code who have contributed to the Total Revenue on that route section will be entitled to a share of the Over-payment.

The proportion of Over-payment due to each Operator will be determined by each Operator's annual Access Revenue and Non-Access Revenue above the Floor accumulated on a route section divided by the aggregate of all Operators' Access Revenue and Non-Access Revenue above the Floor recorded on the route section over the preceding twelve month period from July to June.

The repayment will be apportioned based on the total annual payments above the Floor for access by each Operator on the route as a proportion of the total revenue. An operator paying only the Incremental Cost on the route will not be considered for any refund as this would compromise the Floor Price Test in the Code.

### 3. THE OVER-PAYMENT RULES

1. The Over-payment Rules commence 1 July 2003.
2. The Over-payment Rules apply where breaches of the ceiling could not reasonably be avoided.
3. PTA is to calculate over-payments in respect of each route section for a financial year.
4. In these overpayment rules, financial year is the year beginning on 1 July and ending on 30 June.
5. Where an over-payment is greater than the 10 percent amount allowable for breaches of the ceiling for that route section for the financial year, PTA must reimburse the operators on that route section for the amount of the over-payment calculated according to the pro-rata formula in paragraph 6 by 30 September of the following financial year.
6. Payments to Operators (who have negotiated their Access Agreement inside the Code) will be apportioned, based on the total annual Access Revenue above the Floor by each Operator on the route. The following formula is to apply:

$$\frac{\text{An operator's}^{(a)} \text{ annual Access Revenue above the Floor + Non-Access Revenue (received from that Operator) for the Route Section}}{\text{Total Annual Access Revenue}^{(b)} \text{ above the Floor + total Non-Access Revenue, for the Route Section}^{(c)}} \times \text{Amount of Net Over-Payment + Interest accrued for the Route Section}^{(d)}$$

Notes:

(a) Only Operators who have negotiated inside the Code are eligible for a share of the net Over-Payment

(b) Includes Regime and non-Regime operators

(c) Government contributions are not included.

(d) Government contributions are included when calculating the amount of net over-payments.

These will be offset by a corresponding increase in the Ceiling.

Non Regime Operators are entitled to a share of the net Over-payment if provisions in their access agreement entitle them to any over-payment. Accordingly, their share will be calculated using the same formula outlined above

7. PTA is to establish in its accounting records an account to be known as the Over-payment Account.
8. The Over-payment Account is to be credited with all over-payments that are equal to or less than the 10 percent amount allowable for breaches of the Ceiling level for the financial year.
9. Any over-payment for the previous financial year shall be calculated by 31 July of each year and credited to the Over-payment Account. The overpayment will be treated as if it was credited to the Over-payment Account on 1 July of each year.

10. PTA will also credit to the Over-payment Account interest calculated daily on the balance from time to time standing to the credit of the Over-payment Account.
11. Interest is to be credited at a rate equal to the 10 year long term bond rate as at 30 June each year but if 30 June falls on a day which is not a business day then the rate published on the first day after that date.
12. At the end of the 3 year period commencing on 1 July 2003 and the end of each subsequent 3 year period the amount standing to the credit of the Over-payment Account must be distributed by PTA to Operators (who have negotiated inside the Code) for the amount of the over-payment calculated according to the pro-rata formula in paragraph 6 by 30 September.
13. Payments in respect of non-regime operators will be retained by PTA, subject to the terms of any agreement to the contrary.
14. No payment is to be made from the Over-payment Account without the prior approval of the ERA.
15. The Over-payment Accounts must be audited each year by an independent auditor appointed by PTA at PTA's expense. The audit must be completed by 31 August. The audit will ensure that each of the amounts credited to the Over-payment Account is correct and in respect of the audit for the year which is the end of the 3 year period that the interest credited and payment of amounts from the Over-payment Account is appropriate and consistent with the Over-payment Rules. The auditor's report is to be provided to the ERA as soon as it is completed, and is to be confirmed by the ERA.
16. If the audited and confirmed over-payment is different to that calculated by PTA in paragraph 9 or 10, an adjustment is to be made to the Over-payment Account as if it occurred on 31 July.
17. The following provisions are to be included in Railway Access Agreements between PTA and Operators which are negotiated inside the Code:
  - Within seven (7) days of the date of this agreement PTA must, in accordance with Rule #7 of the Over-payment Rules, establish within its books of account an account to be styled "Over-payment Account" and must maintain that account at all times during the continuation of this agreement.
  - PTA must at all times operate the Over-payment Account in a manner consistent with the requirements of the Over-payment Rules and must make payments to the operator in a manner and at the times contemplated by the Over-payment Rules.

#### 4. APPLICATION OF THE OVER-PAYMENT RULES

The examples shown in Table 1 below demonstrate how these rules apply. Years 1, 2 and 3 show over-payments and under-recoveries (denoted by a minus sign) for a route section. All Operators are also assumed to be in the Regime and have met their Floor costs.

The annual interest rate assumed is 5% compounded, which given the deposit occurs annually would only apply to year one and two deposits. It is also assumed that the Ceiling cost for the route section in the examples below is \$100,000, and over-payments in excess of \$10,000 are reimbursed immediately.

Example 4 refers to the one exception the carrying over of under-recovery credits to the next three-year period may apply. In this example, the PTA incurred a breach of 20 percent above the Ceiling in year 1. At the end of year 1, it has to reimburse operators \$10,000 and deposit \$10,000 into the interest bearing account. However, in year 2, PTA incurred an under-recovery of 15 percent. Assuming that the revenue from access is exactly at the Ceiling in year 3, there are now insufficient funds to compensate PTA in the interest bearing account for the three-year period. In this example, the ERA may approve a carry-over in under-recovery credits of \$5,000.

If an Operator has negotiated access outside the Regime then its share of the over-payments would go to PTA. For instance, if in Example 3 that route section comprised only non-Regime operators then the total accrued principal in the interest bearing account, i.e. \$15,000, and interest earned, i.e. \$1,275, would go to PTA.

**Table 1. Examples illustrating operation of the Over-payment account**

	Example 1	Example 2	Example 3	Example 4
<i>Net annual over or under payment</i>				
Year 1	\$10,000	\$10,000	\$10,000	\$20,000
Year 2	-\$10,000	-\$30,000	\$5,000	-\$15,000
Year 3	\$0	\$0	-\$10,000	\$0
<i>Total of the 3 year period</i>	\$0	-\$20,000	\$5,000	\$5,000
<i>Reimbursed to operators</i>	\$0	\$0	\$0	\$10,000
<i>Accrued Principal in account</i>	\$10,000	\$10,000	\$15,000	\$10,000
<i>Accrued Interest in account</i>	\$1,025	\$1,025	\$1,275	\$1,025
<i>Refund to PTA</i>	\$10,000	\$10,000	\$10,000	\$10,000
<i>Refund to operators</i>	\$1,025	\$1,025	\$6,275	\$1,025
<i>Carry forward of credit</i>	\$0	\$0	\$0	\$5,000

## 5. REVIEW AND CONSULTATION

PTA will formally consult with the ERA at the end of the five years of operation of the Over-payment Rules to determine whether any amendments are required.

PTA's compliance with the Over-payment Rules will be subject to an annual independent external audit. The ERA may select and manage the auditor with costs paid by PTA. The ERA will approve the scope of the audit and the final audit report will be made available to the ERA and the access proponents.

The ERA has the power under the Code to amend the Over-payment Rules at any time and access seekers and operators can at any time request the ERA to consider amendments.

## 6. DEFINITIONS

Access Agreement	means an agreement entered into by an Operator and PTA governing access for the Operator to run services on the Network
Access Related Function	means the functions involved in arranging the provision of access to Railway Infrastructure under the Code.
Access Revenue	means revenue received by PTA from Operators for rail access, under an Access Agreement.
Act	means the <i>Railways (Access) Act 1998</i>
Ceiling	means the sum equal to Total Costs
Ceiling Price Test	means an Operator (or group of Operators) that is provided with access to a route and associated Railway Infrastructure who must pay for the access not more than the Total Costs attributable to that route and that infrastructure.
Code	means the <i>Railways (Access) Code 2000</i> established under the Act.
Costing Principles	means the principles, rules and practices determined by the ERA in accordance with Section 46 of the Code.
Economic Regulation Authority (ERA)	means the Western Australian Independent Rail Access Regulator under Section 13 of the Act.
Floor	means the sum equal to the total Incremental Costs.
Floor Price Test	means an Operator that is provided access to a route and associated Railway Infrastructure must pay for the access not less than the Incremental

	Costs resulting from its operations on that route and use of that infrastructure.
Incremental Costs	means Incremental Costs as defined in Clause 1, Schedule 4 of the Code.
Network	means the track and infrastructure controlled by PTA to which access has or can be granted under an Access Agreement.
Non-Access Revenue	means revenue received by PTA that may include private and government contributions in accordance with the ERA's approval set of Costing Principles to apply to PTA.
Operator	means the Operator or Operators which have access to the PTA Network under an Access Agreement.
PTA	means the Public Transport Authority of Western Australia established by the <i>Public Transport Authority Act 2003 section 5</i> .
Railway Infrastructure	has the same meaning assigned to Railway Infrastructure in Section 3 of the Code.
Railway Owner	means the person having the management and control of the use of the Railway Infrastructure.
Total Costs	means the total of all: <ul style="list-style-type: none"> <li>▪ operating costs;</li> <li>▪ capital costs; and</li> <li>▪ overheads attributable to the performance of the Railway Owner's access related functions whether by the Railway Owner or an associate</li> </ul> as defined in Clause 1, Schedule 4 of the Code.
Total Revenue	means the sum of Access Revenue and Non-Access Revenue