

## MEMORANDUM

### PORTMAN IRON ORE LIMITED'S COMMENTS ON WESTNET'S PROPOSED SEGREGATION ARRANGEMENTS

1. The Acting Rail Access Regulator ("**Regulator**") has called for submission on WestNet Rail Pty Ltd's ("**WestNet**") proposed Segregation Arrangements required under section 28 of the *Railways (Access) Act* 1998 ("**Act**"). The Regulator is required to seek public comment before giving approval to Segregation Arrangements, under section 42 of the Railways (Access) Code 2000 ("**Code**").

The proposed Segregation Arrangements take a very restrictive and limited view as to the requirements of the Act and, as a result, do not comply with the requirements of section 28. Section 2A of the Act provides that the main object of the 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. The requirements of section 28 must be construed in the light of this main object. A contestable market for rail operations will only be facilitated if a level playing field is created for all parties having or seeking access to railway infrastructure ("**access parties**"). The Regulator must ensure that WestNet complies with sections 31, 32, 33 and 34 of the Act but section 30 makes it clear that those sections do not limit the general duty under section 28 to segregate its access related functions from its other functions so that a level playing field is created between access parties, particularly between access parties which are affiliated with WestNet and those which are not affiliated.

There are many provisions of the Act and the Code which are directed towards establishing the level playing field, and the Segregation Arrangements must embrace and implement those other provisions in a consistent and coherent way. Without being exhaustive, the level playing field which will facilitate a contestable market for rail operations will only be established if:

- all information which is obtained by WestNet in the course of conducting its access related functions which is not generally available and which might reasonably be expected to affect the commercial decisions of a rail operator, must be kept confidential within WestNet;
- all decisions within the Australian Railroad Group Pty Ltd group ("**ARG Group**") which relate to access to WestNet's railway infrastructure must be taken without regard to the interests of Australian Western Railroad Pty Ltd ("**AWR**") or any other entity within the ARG Group which has, or may require, access;
- contracts between WestNet and any affiliated entity relating to the provision of access must be on the same terms and conditions and at the same price as other access parties;
- the WestNet railway infrastructure must be operated as a separate and discreet business which is accounted for separately and transparently so that it can be demonstrated that there are no cross subsidies between the regulated activities of WestNet and the unregulated activities of other parts of the ARG Group (eg AWR's rail freight operations);

- the information made available by WestNet as to the operation of the network (eg train timetables, consist information, driver information) must be made available at the same time and in the same detail to all access parties.

These are the broad principles which must be followed and the Segregation Arrangements must set out the detail which achieves a fulsome implementation of these principles, and monitors and reports on their effectiveness.

2. The whole of the document proposed by WestNet, as amended in accordance with this submission, and approved by the Regulator, must be regarded as WestNet's Segregation Arrangements, and not just the limited and truncated arrangements proposed in part 10.3.
3. We consider that the Segregation Arrangements should propose a fundamental objective in accordance with our outline in (1) above. This could be expressed in the following way:

"The fundamental objective of these Segregation Arrangements is to ensure that all persons seeking or having access to the WestNet railway system, including all entities affiliated with WestNet, will be treated equally and fairly in relation to that access."

4. A number of terms are used in the proposed Segregation Arrangements which are not defined, but should be defined, to assist in the interpretation of the document; for example "Access Agreements", "Network", "WestNet Network Rules", "General Appendix and Working Timetables" and most importantly "Confidential Information", which should be defined in the same way as in the Act but should be set out in full in the Segregation Arrangements.
5. The view of WestNet expressed in clause 2.2 is inappropriate. As will be mentioned in this memorandum there are a number of other requirements in the Act, and particularly in the Code, which relate to segregation or are an outworking of the requirements of segregation under section 28. Section 28 must not be given a restrictive or limited interpretation and the Segregation Arrangements should set out all requirements or outworkings of the section 28 broad segregation principle. For example, the prohibition against price discrimination in paragraphs 13(a) and (b) of schedule 4 to the Code are a pricing outcome of the segregation principles, and should be recorded in the Segregation Arrangements.
6. Concerning clause 2.3, it should be a formal requirement of the Segregation Arrangements that no employee of WestNet can be also employed in any other part of the ARG Group and no director of WestNet can be a director of any company within the ARG Group which has, or is likely to have, access to WestNet's railway infrastructure. While this may be the case at present, the formal prohibition must be established for the future.
7. It is misleading for WestNet to claim that "it has no other function than the provision of access to the railway infrastructure". This should be replaced with a statement to the effect that WestNet manages the railway infrastructure and has control of the Network and of access to the Network.
8. The definition of "access related functions" is too limited as it must be ensured that WestNet, and WestNet only, complies with the obligations of the railway owner under

the Act and the Code. The definition of access related functions should be expanded to include:

- complying with the obligations of the railway owner under the Act and the Code;
  - preparing and having approved by the Regulator, train management guidelines, train path policy, costing principles and overpayment rules;
  - dealing with access proposals generally and particularly in relation to the requirements of sections 10, 14 and 15 of the Code; and
  - calculating, and having approved by the Regulator, floor price and ceiling price costs for each route of the railway system.
9. In paragraph (viii) of the definition of access related functions the term, (which should be defined), is "WestNet's Network Rules".
  10. The provision of any services by AWR to WestNet and, in particular, the prices for those services must be approved by the Regulator. Further, AWR must be prohibited from providing any services where it could exercise a discretion which could disadvantage other access parties. For example, AWR should be prohibited from providing train scheduling services on any part of the network.
  11. Concerning clause 4.1, the Segregation Arrangements should set out detailed procedures for all correspondence between WestNet and access parties to be marked "WestNet Access Matter" whether this is hard copy or electronically recorded. The filing and data recording system of WestNet must similarly be clearly marked as WestNet Access Matter files for both hard copy and electronic recordings. The Segregation Arrangements must specify how it is to ensure that access to that information is restricted to WestNet staff.
  12. The Segregation Arrangements must detail the decision making process involved in releasing any information that WestNet obtains in relation to access related functions to persons other than WestNet staff, for example before recording the information on the Rail Access Management System ("**RAMS**"). A senior officer, who understand the nature of market sensitive and confidential information, must be responsible for putting information on the RAMS.
  13. The Segregation Arrangements must expressly provide that in presenting information, WestNet's has an obligation to ensure that the confidential source of that information is protected, subject only to the extent to which this is contrary to law.
  14. Concerning clause 4.2, the Segregation Arrangements must ensure that financial information relating to access related functions is contained within WestNet. Financial information should only pass to the centralised accounting group in such aggregated form as is incapable of providing details which would provide a market advantage to any other entity within the ARG Group. WestNet should also employ its own financial accountant and should not be permitted to receive accounting services from AWR. Even an a financial accountant employed to provide services to WestNet and bound by a confidentiality undertaking will still be an employee of AWR who is remunerated by AWR and whose loyalty and interest will therefore be linked to AWR. However, if the regulator does not insist on this requirement, then the accountant dealing with WestNet's revenues and operating budgets must , at the very least, be required to sign the statement

as to his comprehension and performance of the confidentiality requirements of the Code and the Segregation Arrangements. Concerning clause 4.3, the officers of Australian Railroad Group Pty Ltd ("**ARG**") to whom confidential WestNet matters may be reported must not have any role in the management of AWR (except in their capacity as executive officers of AWR's parent company, ARG) and must specifically undertake to:

- not disclose confidential WestNet matters to any other person or entity in the ARG Group; and
- not to use any information acquired by them from WestNet in making a decision which advantages AWR (or any other entity in the ARG Group which has or requires track access) or disadvantages other access parties.

15. Concerning clause 5.1, it would be inappropriate for there to be any movement of staff from WestNet to AWR even on a temporary basis, and this must be provided in the Segregation Arrangements.

All employees and contractors of WestNet must also be required to sign undertakings as to confidentiality and familiarity with the requirements of the Code and the Segregation Arrangements. This includes professional service advisors such as lawyers and accountants.

16. It is noted that WestNet operates on a separate floor from AWR. There must be a requirement contained in the Segregation Arrangements that WestNet's premises are, at all times, completely physically separated from any other entity within the ARG Group which has, or may require, track access. Some ring fencing arrangements have required the regulated business to be physically located in a separate building from all other businesses within the company group. If the Regulator does not insist upon WestNet being located in a separate building from each other entity within the ARG Group which has, or may require, track access then the Regulator must be satisfied that there is a complete physical separation between WestNet and those other entities.

17. Concerning clause 5.2 it is noted that there is and will be no directors of AWR who will also be directors of WestNet. As previously mentioned, this must be a formal requirement of the Segregation Arrangements.

We note that there is one WestNet director who is also a director of ARG. The Segregation Arrangements must also require that there should be no director of ARG who is also a director of AWR. It would be impossible for a director of ARG who receives details of proposals relating to access to the WestNet railway infrastructure not to be seized with the information that he receives in his ARG board capacity, when considering AWR matters.

Additionally, there must be a requirement in the Segregation Arrangements for each of the directors on the ARG board that in making decisions in relation to WestNet's business no special regard to the interests of AWR is to be given so that there is an abiding obligation upon ARG directors to assess the approval or otherwise of access related functions in a manner which does not advantage AWR. This is consistent with the requirements of section 33 of the Act.

18. In clause 6 there is reference to access being provided to a related entity under commercial access arrangements outside of the Code. This is a fundamental

misconception of WestNet that access can be provided outside of the Code. While the Code accommodates the negotiation of prices, all access must accord with the principles and requirements of the Code. For example, the requirements of paragraph 13 of schedule 4 to the Code apply to negotiation of prices for access generally and it is structurally unsound for certain tariffs and costs to be outside the access and pricing regime established by the Code and others to be within it. WestNet cannot be contending that it could enter into a commercial access arrangement with a related entity that was outside the requirements of paragraph 13 of schedule 4, or that WestNet could avoid giving copies of such related party access arrangements to the Regulator under section 39 of the Code.

19. The reference to the "Act" in the first line in paragraph 3 of clause 6 should be reference to the "Code".
20. Although it is not expressly required by the Act or the Code, the most effective way of ensuring that there is no discrimination or unfairness in the provision of services as between related entities of WestNet and other access parties for the purposes of section 33 of the Act is for the Regulator to be required to approve the terms, conditions and prices of any access agreement between WestNet and its affiliated entities. This is a feature of almost all third party access and pricing regimes (eg see section 7 of the National Third Party Access Code for National Gas Pipeline Systems) and should be implemented as a requirement in the Segregation Arrangements.
21. In clause 6, the grandfathering of all pre-existing access arrangements is mentioned. Full details of access arrangements entered into by WestNet prior to the proclamation of the Code on 1 September 2001 should be provided and made publicly available, especially pre-existing access agreements between WestNet and AWR. Industry should know exactly the nature and extent of current contractual commitments of WestNet existing over particular routes on the WestNet railway infrastructure.
22. Concerning clause 7, any employees of ARG, both at executive and board level, who receive or are likely to receive any information relating to WestNet which is confidential in nature, must execute statements that they comprehend the confidentiality requirements of the Code and the Segregation Arrangements and that they will not divulge any information acquired by them in their capacity as an ARG executive or director, or use that information in any way to advantage AWR or disadvantage any other access party.
23. Concerning clause 8, the Segregation Arrangements must detail an internal monitoring and investigation system in order to determine if the Segregation Arrangements are being complied with. For example, each manager in the WestNet organisation should be required to report monthly to the chief executive officer saying that he has made appropriate investigations and that during the relevant month there have been no breaches of the Segregation Arrangements. The report can be broken into relevant segments such as the divulgence of confidential information to entities other than WestNet, the taking of decisions in the interests of an affiliated entity of WestNet, the passing on of different levels of information to different access parties, etc. There should hopefully be nothing to report, but the process serves as a regular reminder of the requirements of the Segregation Arrangements.

The Segregation Arrangements must also provide for an internal investigation of alleged breaches with a reporting system in respect of those investigations and the outcome of

those investigations. There should be a 6 monthly report to the Regulator on the monitoring, investigation and investigation reporting procedures.

24. The review of the Segregation Arrangements should be undertaken at the end of one year at least in the first instance so that any adjustments can be made, rather than waiting for 2 years.
25. Concerning clause 10.2 and as previously submitted, the persons providing accounting services within the ARG Group that have total access on all financial modules across all companies in the group must be required to sign a statement acknowledging comprehension of the requirements of the Code and the Segregation Arrangements and undertaking to keep confidential all information in relation to WestNet and not to use that information for any purpose other than for which it was provided to WestNet.
26. The information provided to access parties through the RAMS (or in any other manner) must be the same for all access parties. In other words, AWR must receive no more, or better, information with respect to train timetables, consist information, driver information etc than is received by any other access party. The provision of accurate information relating to the operation of the railway system by WestNet to all access parties equally is a fundamental aspect of segregation and fairness.
27. Concerning 10.3, we have previously indicated that the Segregation Arrangements must comprise the whole of WestNet's proposed paper, as expanded and amended in accordance with this submission, and not just the summarised, limited and truncated version set out in 10.3.
28. In addition to the internal monitoring and investigation system proposed to be carried out to determine if the Segregation Arrangements are being complied, the Segregation Arrangements must also provide for an external auditing of WestNet's compliance to be carried out at specified regular intervals and when an actual or an alleged breach of the Segregation Arrangements takes place. The Segregation Arrangements should also provide for the payment of liquidated damages where a breach of the segregation Arrangements found to have occurred. A reasonable pre-estimate of damages should be estimated for varying types of breach based on whether they it is a relatively minor or a serious breach.
29. Paragraphs 13(a) and (b) of schedule 4 to the Code are directed at WestNet not discriminating in relation to prices for track access generally but specifically between affiliated access parties and non affiliated access parties. As this is a fundamental aspect of segregation, this should be expressly detailed in the Segregation Arrangements.
30. The Segregation Arrangements should detail 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.