

## MEMORANDUM

### PORTMAN IRON ORE LIMITED'S COMMENTS ON THE DRAFT DETERMINATION OF THE ACTING RAIL ACCESS REGULATOR IN RELATION TO WESTNET'S PROPOSED SEGREGATION ARRANGEMENTS

1. The Acting Rail Access Regulator ("**Regulator**") issued, on 26 April 2002, a draft of the determination regarding the proposed segregation arrangements ("**Segregation Arrangements**") of WestNet Rail Pty Ltd ("**WestNet**") required under section 28 of the *Railways (Access) Act 1998* ("**Act**") ("**Draft Determination**"). The Draft Determination directs WestNet to implement certain changes to the Segregation Arrangements.
2. The Regulator is seeking public comment in relation to the Draft Determination before finalising the determination regarding WestNet's proposed Segregation Arrangements ("**Determination**").
3. While Portman considers that the Draft Determination directs WestNet to make significant improvements to the Segregation Arrangements which go some way to establishing arrangements that will assist in creating a contestable market for rail access, further changes will need to be made to ensure that those objective of the Act and of the *Railways (Access) Code 2000* ("**Code**") are actually achieved.
4. We note that, following a request by WestNet, the Regulator has taken the view (see pages 4 and 26 of the Draft Determination) that only section 10.3 of the document submitted to the Regulator by WestNet in November 2001 and titled "Segregation Arrangements" ("**WestNet Document**") comprise the Segregation Arrangements. Section 10.3 of that document sets only out the specific segregation arrangements proposed by WestNet. However, the adoption by the Regulator of this view substantially limits the scope of the Draft Determination and the requirement for approval by the Regulator under section 29 of the Code.
5. As submitted in Portman's earlier memorandum to the Regulator setting out its comments in relation to the Segregation Arrangements (paragraphs 2 and 27 of that memorandum), the whole of the WestNet Document and not just the limited and truncated arrangements proposed in part 10.3 must be regarded as the Segregation Arrangements. The specific arrangements and the content of WestNet's obligations set out in part 10.3 of the WestNet Document can only be properly and fully understood and effective when read by reference to the balance of that document. In this regard, we again refer to the comments made by Portman in its earlier memorandum of submissions, which related to the entire content of the WestNet Document.
6. Considering the Regulator's directions on page 26, we consider that the statement of the objectives of the Segregation Arrangements required to be inserted within the opening section should be:

"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."
7. Alternatively, the Regulator should only approve a statement of objective of the Segregation Arrangements formulated by WestNet if that statement expressly refers to

WestNet's obligation to treat all access seekers "equally and fairly in relation to access". This fundamental objective clearly emerges from the requirements of section 28, which should be read by reference to section 2A of the Act and which is to impose on WestNet an obligation to treat all access seekers equally and fairly in relation to rail access, in order to create a level playing field for all parties having or seeking access and, ultimately, a contestable market for rail access.

8. More generally, we consider that the Segregation Arrangements should not be approved to the extent that they are inconsistent with or fail to provide for compliance by WestNet with the "railway owner's" (as defined in section 3 of the Act) obligation to treat all access seekers equally and fairly. This is also a requirement imposed by the "duty of fairness" of the "railways owner" under section 33 of the Act. The Regulator must take into account the objectives of the Act as a whole in exercising his approval discretion under section 29, and not just the requirements of sections 28, 31, 32, 33 and 34.
9. Portman agrees with the amendments required in relation to the definition of "Access Related Function". However, we also consider that one of the most important "Access Related Function" to be carried out by WestNet will be dealing with, not only access agreements, but also proposals for access generally and particularly, proposals that involve an application of section 10, 14 or 15 of the Code. In this regard, this function should be expressly inserted in the definition of "Access Related Function". The segregation arrangements must apply to the exercise of functions by WestNet in the application of these provisions.
10. Further, while the function of setting up and ensuring that suitable measures are in place to create an "effective system of segregation" implies an obligation on WestNet as the railway owner, to comply with the provisions of the Act and the Code, we consider that it is nevertheless important to set out this obligation expressly as an "Access Related Function".
11. Concerning the measures to be adopted by WestNet to protect confidential access-related information (pages 28 and 29 of the Draft Determination), if the Regulator does not insist on WestNet being located in a separate building from any affiliated entities, the measures to be adopted by WestNet must include, as a minimum, an express requirement that there should be a "complete physical separation" between the premises of WestNet's and those of its affiliated entities. We consider that the Regulator should (at this stage, rather than waiting for a later review) insist that all WestNet operations and staff be located in a separate building from all other ARG operations and staff, and use a separate IT system.
12. We also consider that the limitation of the restriction on sharing employees to only those employees holding positions in which they may deal with confidential access related information is insufficient to ensure adequate protection of confidential access-related information. The Regulator should impose a broader prohibition on the movement of *all* employees between WestNet and any affiliated companies, by way of staff sharing, or secondment, or transfer.
13. However, if the Regulator does not impose the prohibition suggested in paragraph 12 above, the Regulator should at least prohibit the sharing of any employees referred to on page 29 of the Draft Determination as holding specified positions which require them to handle confidential access-related information ("**Specified Employees**"), including in the case of an "emergency". This is because the sharing of those employees, under any

circumstances, has the potential to seriously compromise the protection of confidential access-related information.

14. If the prohibition suggested in paragraph 13 above is not imposed on WestNet, the Regulator should only approve a very limited definition of "emergency" where the use of any Specified Employees cannot otherwise be avoided despite every reasonable endeavour by WestNet to do so. Further, the Regulator must be notified immediately after the "emergency" arises and the sharing of those employees must cease immediately after the emergency has ended.
15. Additionally, we consider that the Specified Employees must expressly include WestNet's accountants and financial advisers and its directors and executives as well as any other employees that may deal, directly or indirectly, with confidential access-related information.
16. Finally, the Segregation Arrangements should be amended to acknowledge that all employees or, if the prohibition suggested in paragraph 12 is not imposed, at least all Specified Employees, sign not only confidentiality deeds but also execute statements that they comprehend the confidentiality requirements of the Code and the Segregation Arrangements. The same requirement should apply to all executive or directors of Australian Rail Group Pty Ltd ("**ARG**"), who should also sign an undertaking not to use access-related information in any way to advantage Australian Western Railroad Pty Ltd ("**AWR**") or other affiliated entities or disadvantage any other access party. This latter proposal is consistent with the requirements of section 33 of the Act. This extends particularly to the Board and CEO of ARG.
17. Concerning the arrangements relating with computer systems and hard copy information, WestNet must be required to include, as a part of its measures to protect confidential information, the procedures that are to govern the decision-making process involved in releasing any information that WestNet obtains in relation to access related functions, to persons other than an appropriate WestNet employee; for example before recording the information on RAMS.
18. We note WestNet's agreement to identify all confidential electronic and hard copy correspondence and all data contained in any filing and data recording system of WestNet as a "confidential access matter" and to restrict access to such data to the Specified Employees. However, this agreement must be expressly acknowledged in the Segregation Arrangements.
19. Concerning accounting and financial information, we consider that the Regulator's direction on page 29 of the Draft Determination, should be extended to require all financial and accounting employees of WestNet's parent, ARG who attend to any WestNet financial and accounting work (including payroll and human resources functions) to be solely dedicated to WestNet and become employees of WestNet and be located within and report only to WestNet. The direction should go further and also prohibit WestNet from, at any stage, being permitted to receive accounting services from any related entity, including AWR. This is a more precise requirement than the requirement contained in the statement that WestNet must be "broadly self-sufficient for finance".
20. In relation to the statement on page 30 of the Draft Determination, that WestNet can share payroll and human resource functions with ARG, we consider that these functions must

be separated. Unless this prohibition is imposed, there will be both a perception of a conflict of interest and a real potential that segregation of confidential access related information and segregation as a whole may become compromised.

21. The Regulator has required WestNet to specify, in advance, the nature of and the content of management reports relating to the operations of WestNet and which will be given to ARG's management and directors (page 29 of the Draft Determination). In this regard, we consider that procedures must be put in place to ensure that all financial information relating to access related functions is contained within WestNet and only passes to the centralised ARG 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 of companies. Any proposed procedures must be considered carefully to ensure that they are effective and are able to be seen to be effective to achieve their purpose.
22. We consider that the Regulator's direction on page 29 of the Draft Determination, that WestNet must ensure that the *name* of the access seeker and preferred train operator are not disclosed, is insufficient to achieve the purpose expressed on page 14 that the procedures to be implemented for the protection of confidential information should not only protect the information from the disclosure, but also its *source*. We consider that WestNet should be prohibited from disclosing, not only the name, but anything which would identify those parties such as the specific entry point of rail access which could be project related, subject only to the extent to which this is contrary to law.
23. The Draft Determination also directs WestNet to set out a further procedure for briefing the CEO of ARG outside of Board meetings, in relation to the access proposals of third parties. Again, this procedure must ensure that the source of confidential information and identifying factors, as well as the information itself are protected.
24. Concerning the measures for dealing with conflicts of interest set out in page 29 of, the Draft Determination, we agree that WestNet must required to provide a commitment that it will ensure that no conflicts of interest exist. However, we consider that certain relationships at Board level, between companies in the ARG group of companies, must also be identified in the Segregation Arrangements and prohibited as relationships that involve an inherent conflict of interest. For example, as stated by Portman in its earlier memorandum of submissions, there should be no director of ARG who is also a director of AWR. We consider that, despite all the measures required to be adopted by WestNet for the protection of confidential information and the avoidance of conflict of interest, it would be impossible for a director of ARG who receives from WestNet 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. To allow an ARG director to be also a director of AWR would give a clear market advantage to AWR and would be contrary the intent of the Act and the Code.
25. Concerning train control and scheduling (page 29 of the Draft Determination), the restriction relation to scheduling functions must specifically include "operational train scheduling services" provided by AWR to WestNet. This is because "operational" train (ie. real time adjustment of master diagrams and schedules) provides the most effective means for AWR or WestNet to discriminate against third parties and prevent them from being able to compete effectively. AWR must not be allowed to provide these services to WestNet, or the Segregation Arrangements will commence operations with rail operators and end users having no confidence in the fair treatment of access parties.

26. Generally, the requirement imposed on WestNet to complete train control and scheduling functions internally (or via a non-ARG entity) should extend, at least in relation to AWR or any other ARG group entity, any services where a discretion could be exercised that could disadvantage other access parties. In addition, any services that are able to be provided by AWR to WestNet (other than the prohibited services) and the prices for those services should be required to be approved by the Regulator.
27. Concerning the "duty of fairness" imposed on WestNet as the rail owner (page 30 of the Draft Determination), we consider that WestNet must acknowledge that its "duty of fairness" imposes an obligation on it to treat any affiliated entities and all third parties access seekers *equally*. In this regard, it is not sufficient that terms and conditions offered to affiliated entities will be "broadly comparable" to those provided or offered to third parties (page 30). An obligation of "equitable" treatment alone by WestNet may not, in all cases, be sufficient to establish the level playing field that is sought to be established by provisions of the Act and the Code and which is intended to facilitate the creation of a contestable market for rail operations. This will only be created in circumstances where third parties can be sure of receiving "fair treatment" in relation to access and can be assured that the rail owner will not give preferential treatment to an affiliated company.
28. Further and as a corollary of the submission made in paragraph 27 above, we consider that 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 and the Regulator should be required to approve such contracts before they have effect. A requirement that they be "broadly comparable" is not sufficient. While it is noted on page 19 of the Draft Determination, that no evidence has been provided to the Regulator to suggest that WestNet is providing preferential treatment to affiliated companies, unless a requirement to treat all access parties equally is imposed, WestNet will have an opportunity to favour AWR and other affiliated entities and third parties cannot be sure of "fair treatment" in the commercial sense. Non discrimination between access parties is a clear objective of the Act and the Code (see section 16). The Regulator's proposal, as expressed under page 20 of the Draft Determination, to benchmark access prices offered by WestNet with prices offered elsewhere, monitor all contracts and provide information (to the extent permitted under section 50(3) of the Code), when approached by an access seeker under section 21 of the Code is, by itself, not sufficient to achieve this purpose. Additionally, consistent with the requirements of fair treatment and accounting transparency, all contracts between WestNet and an affiliated entity that relate in any way to the rail system should be required to be approved by the Regulator.
29. Further, we again submit that 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.
30. Finally, the "duty of fairness" and its requirement for equal treatment of all access parties also extends to require WestNet to expressly commit to providing information through the RAMS in a manner that results in entities affiliated with WestNet receiving no more, or earlier, or more accurate information with respect to the operation of the railway system by WestNet (eg train timetables, consist information, driver information, etc) that any other access party. The provision of uniform information as to both time and content to all access parties is critical to establishing a "level playing field".
31. In relation to the statement in the Draft Determination, that access seekers may negotiate inside and outside the access regime and the costing principles stipulated by clause 13 of

Schedule 4 of the Code (pages 18 and 30) we note that this is a view fundamentally different to our understanding of the Code. As stated in Portman's earlier memorandum, while the Code accommodates the negotiation of prices, all access must accord with the principles and requirements of the Code. WestNet cannot be contending that it could enter into a commercial access arrangement with an affiliated 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. This matter must be reconsidered and clarified by the Regulator. Other than section 37 of the Code which indicates that access agreements can have different terms (which is consistent with the liberty to negotiate and arbitrate), there is no suggestion that the principles and policy requirements of the Act and the Code do not apply equally to all access. It is nonsense to suggest that an access agreement could be negotiated "outside of the Regime" and be such that it was unfair to access parties in the regime without breaching the Act and the Code. In WestNet's definition of Access Related Functions, the words "(either under the Regime or on a commercial basis)" must be deleted.

32. Further, we again submit that although it is expressly required by the Act or the Code, in order to ensure 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, the Segregation Arrangements should require the Regulator to approve the terms, conditions and prices of any access agreement between WestNet and its affiliated entities.
33. It is also crucial, to ensure that the Segregation Arrangements achieve the purpose for which they are required under the Act and the Code, that WestNet should be required to provide to the Regulator and make publicly available, full details of access arrangements entered into by WestNet prior to the proclamation of the Code on 1 September 2001. This is particularly important in the case of pre-existing access agreements between WestNet and AWR. Without this requirement, there can be no assurance that the terms and conditions are "broadly comparable" if that remains the Regulator's standard in this matter, (which, as previously submitted, is not sufficient).
34. Finally, concerning the measures required to be implemented to ensure that WestNet complies with the Segregation Arrangements, WestNet should further identify the officer or officers within WestNet who must be responsible for monitoring and ensuring compliance with the "Compliance Plan" and whose duty it is to report breaches of the Segregation requirements, on a day-to-day basis.