



AUSTRALIAN RAIL TRACK CORPORATION LTD

Ref No:

26 August 2008

Mr Russell Dumas
Director – Gas and Rail Access
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

Dear Mr Dumas

**THE PILBARA INFRASTRUCTURE PTY LTD
SEGREGATION ARRANGEMENTS, TRAIN MANAGEMENT GUIDELINES
AND TRAIN PATH POLICY**

ARTC SUBMISSION

Please find attached a submission prepared by the Australian Rail Track Corporation in response to your review of the segregation arrangements, train management guidelines and train path policy proposed by The Pilbara Infrastructure Pty Ltd.

The submission contains no information that ARTC would consider commercial-in-confidence.

For further information regarding the preparation of this submission, could you please contact Mr Glenn Edwards, (08) 8217 4292 (Ph), (08) 8217 4578 (Fax), gedwards@artc.com.au (Email).

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Economic Regulation Authority 28 Aug 2008

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THE PILBARA INFRASTRUCTURE PTY LTD SEGREGATION ARRANGEMENTS, TRAIN MANAGEMENT GUIDELINES AND TRAIN PATH POLICY

ARTC SUBMISSION – AUGUST 2008

Background

The Western Australian Economic Regulation Authority ('Authority') has sought submissions from interested parties on proposals in relation to the segregation arrangements, train management guidelines and train path policy submitted by The Pilbara Infrastructure Pty Ltd ('TPI').

ARTC has actively participated in the consultation processes conducted by the Authority (or its predecessor) and the NCC in relation to the WA Rail Access Regime and the regulatory supervision of the track manager in WA, including:

- The WA Government's Certification application to the NCC;
- Segregation Arrangements, Costing Principles, Overpayment Rules, Train Management Principles, Train Path Policy, Key Performance Indicators and Rate of Return to apply to WestNet Rail ('WNR');
- Floor/Ceiling Determination on the freight network (WNR).

Throughout this involvement, ARTC's positions and comments have largely been based around two broad themes, being:

- the need for a consistent approach to access to the interstate network, including that part of the interstate network in WA; and
- the need for the WA Access Regime and regulatory supervision to ensure that adequate measures are put in place to provide the market with confidence that access to the WA network can be gained in a timely, fair and equitable way when the access provider is vertically integrated

The WA Rail Access Regime applies to all rail networks in WA including from 1 July 2008, the TPI railway.

ARTC is the manager of a substantial part of the national interstate rail network of which the standard gauge network between Perth (including its ports) and Kalgoorlie is an important part. As such ARTC has no direct interest in the TPI railway as an adjoining infrastructure manager, nor as a potential applicant for access.

National Consistency

ARTC's initial access undertaking was approved by the ACCC in 2002, where the ACCC indicated that it saw it as a foundation for the development of a consistent 'national' rail access regime. ARTC has recently received ACCC approval for its second access undertaking to apply to the ARTC network in WA, SA, Victoria and NSW for the next 10 years. Consistency and simplicity of regulation on the interstate network has been demanded by the interstate rail freight industry for many years, and would further reduce the substantial barrier to new entrants to the industry.

The WA Access Regime is, in many areas, broadly consistent with similar provisions incorporated in ARTC's Access Undertaking. However, there are still a number of different treatments that can cause some uncertainty in access to the operator of an interstate service including, for example, provision for capacity transfer, resolution of capacity demand conflicts, open-ness in pricing, and treatment of costs in floor/ceiling limits.

At its 10 February 2006 meeting, the Council of Australian Governments ('COAG') signed a Competition and Infrastructure Reform Agreement ('CIRA') to provide for a simpler and consistent national system of economic regulation for nationally-significant infrastructure, including for ports, railways and other export-related infrastructure. The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

To promote consistency, the CIRA provides for implementation of a simpler and consistent national system of rail access regulation for agreed nationally significant railways using the ARTC access undertaking as a model.

Regulatory Application

It has been ARTC's position in the past that the intensity of access regulation should have regard to the specific characteristics and structure of the industry and markets involved. In particular, where the owner of infrastructure has substantial market power

(as occurs on most commodity based networks) the focus of economic regulation should be on access pricing. Where the owner of infrastructure is vertically integrated or related to a participant in the upstream or downstream market, then the focus of economic regulation should be on third party dealing. Where neither of these characteristics exists, economic regulation should be relatively light handed.

The TPI railway is exclusively focussed toward the transport of iron ore from Fortescue Metals Group (FMG) mining operations in the Pilbara region through its port at Port Hedland to overseas markets. In this market, the infrastructure owner could have substantial market power in relation to other competing operations in the region, and is vertically integrated. As such, the intensity of economic regulation afforded by the rail undertaking has justifiably tended towards being heavy handed in the areas of access pricing and third party dealing.

The question of market power should include consideration of the international market for iron ore and the extent of competition that exists between relevant supply chains both within Australia and overseas.

The proposed segregation arrangements, train management guidelines and train path policy are intended to deal primarily with the vertically integrated nature of TPI (as a subsidiary of FMG) and how it deals with third parties, both in arranging access and during operations compared to related rail operations.

ARTC will provide comments in relation to each of these instruments separately.

Segregation Arrangements

ARTC notes that TPI have proposed an approach and timing based around several premises as follows:

- a concern that, as a greenfields operation, early rail operations should not be adversely affected from a safety, operational or cost perspective, by the separation between rail infrastructure and rail haulage operations created by any segregation arrangements;
- full segregation arrangements have not been imposed on any new railways in Australia;

- the relevant regulatory precedent is the Tarcoola – Darwin access regime, applying to a vertically integrated greenfields railway.
- That the greenfields nature of the TPI railway, and the above regulatory precedent, provide reason to propose a 2 stage implementation of the segregation arrangements.

TPI has proposed that complete functional separation of access related and haulage related functions should not be implemented from commencement of operations until signing of the first access agreement with an access seeker. During this period, TPI has proposed ring fencing obligations to apply to the sharing of a considerable amount of information needed to support safe and effective implementation of rail operations, including matters such as safety, maintenance and scheduling.

Upon the signing of an access agreement, TPI proposes to submit how it will implement more complete segregation no later than 6 months prior to the scheduled commencement of third party rail haulage operations. The more complete segregation would intend that staff involved in performing access related functions, such as train control and scheduling will not perform any haulage related functions.

In relation to the Tarcoola - Darwin railway, ARTC notes the following statements made by the Essential Services Commission in relation to prescribing early guidelines to apply in the areas of price and service.

'1.4.1. Reasons for light-handed regulation

This light-handed approach to regulating access to the Tarcoola-Darwin railway is due to the limits on the below-rail service provider's effective market power due to:

- *significant intermodal competition;*
- *competition in downstream market; or*
- *little congestion on track infrastructure.*

These factors limit the extent to which the below-rail service provider can exercise market power.

Moreover, given the 'greenfields' nature of the AustralAsia rail project, the risks facing investors in the railway need to be carefully considered. Ignoring these risks can undermine the incentives to invest in new infrastructure projects. Therefore, a

careful balance is required between:

- *the interests of access seekers, and the promotion of access and of competition in related markets; and*
- *the interest of the equity providers and financiers, otherwise the viability of the railway would be jeopardised.'*

The Tarcoola – Darwin railway, at the time, was expected to derive initial revenues in a relatively small intermodal market between the southern states and Alice Springs & Darwin, exposed to very strong road competition. As such, the viability of the railway was expected to be under substantial pressures for a number of years. ARTC understands that this, in addition to the greenfields nature of the project, were the primary reasons for the light handed approach.

The TPI railway is being constructed to service a substantially bigger and stronger iron ore market, less exposed to intermodal competition and likely to be viable in a very short period of time. ARTC expects that substantial contracts for iron ore supply would underpin the construction of the railway, in addition to port and mine developments.

ARTC considers the circumstances of the two railways to be quite different, and questions whether the Tarcoola – Darwin regime acts as a precedent for the similarly light handed approach to be adopted for the TPI railway. It would seem that TPI have proposed an even greater relaxation of the segregation requirements to apply in the early stages of operation.

ARTC recognises that there are costs associated with the application of economic regulation to the infrastructure owner. These can be quite substantial irrespective of whether the infrastructure is greenfields or already established. Established entities Queensland Rail and Westrail, some years ago, were required to undergo significant upheaval and substantial cost in order to meet the requirements of economic regulation. ARTC could even contemplate the cost being lower for an entity starting from scratch. Such costs are to be weighed up against the benefits accruing as a result of retaining a vertically integrated structure (vis-à-vis separation), which are also quite high.

ARTC accepts TPI's genuine concerns about the impact of segregation in relation to safe and efficient operations but is not aware of any detriments to these aspects of business that are exposed to complete and sometimes more heavy handed segregation requirements.

In determining whether TPI's proposals in relation to segregation arrangements are reasonable in the circumstances, the Authority needs to balance the stated concerns and interests of TPI against those of access seekers.

ARTC expects that there is a likelihood that, in the current market climate, third parties will seek access to the TPI railway sooner rather than later. It has recently been reported that a Pilbara junior iron ore minor has signed a port access agreement with FMG, giving it access to its Port Hedland port facility. The miner was also expected to negotiate a rail haulage agreement with FMG to transport ore to the port.

As such, any benefits to TPI of the two stage process are likely to be limited in any event, to the point that initial segregation may be more cost effective.

Finally, it is not clear that TPI have implemented the initial stage of the proposed arrangements as yet including preparation of documents, despite the initial stage having commenced. This would create uncertainty in relation to any current access sought by third parties.

In relation to the specific provisions of the segregation arrangements, ARTC notes that TPI, in many instances have adopted similar provisions to those existing in the current Segregation Arrangements for WestNet Rail. Where this has occurred, ARTC has no strong objection.

Where TPI have omitted certain elements of the WestNet arrangements, the Authority needs to establish the reasonableness for TPI's position. As a general principle, ARTC would consider it reasonable for elements of WestNet's arrangements to be relevant to TPI, amended to suit any particular circumstances.

Train Path Policy (TPP)

Where vertical integration exists, as in this case, there are often different commercial motivations to that of a vertically separated provider. Where vertical integration exists, there are many ways to favour the related above rail operator over a third party operator, and difficult for a regulatory regime to prohibit all anticompetitive behaviours. This means that the TPP and TMG need to be scrutinised with this in mind, to ensure transparency and fairness wherever possible, and provide confidence to third party operators.

The purpose of TPI's TPP is to "...provide a framework to apply in relation to the allocation and management of Network Capacity..." With respect to the sections contained within the TPP, ARTC provides the following comments.

Section 1.2 Purpose of the TPP

The Code only requires the TPP to apply to access arrangements negotiated within the Code. ARTC would argue, however, that the TPP should apply to each allocated train path regardless of whether access applications are made, and access agreements negotiated, within or outside of the Code.

Where the access provider is integrated, it would be difficult to prevent favourable treatment being given to a related entity where such elements of the TPP could be negotiated outside the Code, unless there is complete transparency surrounding the negotiation. Services should be operated on the network in a non-discriminatory way, and the TPP applying to all access agreements negotiated outside the Code, resolves the issues around availability and, importantly, transparency.

ARTC notes that WestNet's TPP includes an explicit commitment that it 'will apply the T.P.P to each allocated Train Path regardless of whether access applications are made inside or outside of the Code'. Whilst TPI's TPP includes a commitment that 'the TPP will apply to all Operators with whom TPI has an Access Agreement', it is not clear that it would irrespective of whether the agreement was negotiated within or outside the Code. ARTC would welcome a more explicit commitment along the lines of that made by WestNet.

Section 2.3 Capacity Allocation

The TPP states that access rights will be allocated subject to the application which, in the opinion of TPI, is 'most favourable to it'. ARTC supports a transparent process being applied in determining this outcome which should clearly outline how the allocation of train paths is to occur. Allocation of train paths needs to be undertaken in a manner that does not unfairly discriminate between operators, and should promote confidence to third party access seekers in that they will be treated on the same basis as any related party.

Section 3.1 Variation to Train Paths

With respect to variations to train paths, ARTC would expect, in the type of markets that the TPI railway will serve, that scheduling should permit variation required to meet variable demand for product and cyclic nature of operations, subject to the reasonable interests of the infrastructure provider being met.

Section 3.3 Review of Service Entitlements

The TPP does not currently include circumstances under which operators are able to cancel train paths. ARTC sees no reason why operators should not be able to cancel a path under certain circumstance which should be outlined in the TPP, and this should be included to provide clarity around such an occurrence.

OTHER COMMENTS

ARTC notes there are some issues that have not been dealt with in the TPP and would suggest inclusion:

On-selling of train paths

ARTC's Indicative Access Agreement which forms part of the Access Undertaking, specifically provides for a path to be on-sold providing the related 'trade agreement' satisfies certain criteria.

ARTC sees no reason why TPI could not provide for the selling or trading of paths. This should be an option particularly in the case of take or pay contracts where operators should have the opportunity to sell a train path subject to provisions that satisfy TPI that the risk is no greater in terms of track deterioration or capacity, or financially.

Consultation and review

ARTC feels it appropriate that the TPP include a section on the requirement for TPI to review the TPP at periodic intervals, through a consultation process to enable input from stakeholders and to take into account any changes to the industry. Any changes must be approved by the ERA. Also, this section should note that the ERA has the power under the Code to amend the TPP at any time and access seekers and operators can at any time request the ERA to consider amendments.

ARTC is also a strong supporter of the development and publishing of key performance indicators to enable individual parties to have confidence that all parties are treated the same regardless of if they are related or unrelated to TPI.

Train Management Guidelines (TMG)

The objective of TPI's Train Management Guidelines is to "... provide a framework to apply to the real time management of Services..." (TPI's TMG, page 3). With respect to the sections contained within the TMG, ARTC provides the following comments.

Section 1.2 Purpose of the TMG

The Code only requires the TMG to apply to access arrangements negotiated within the Code. As with the TPP, ARTC would argue that the TMG should apply to each allocated train path regardless of whether access applications are made inside or outside of the Code, and wording be modified to reflect this (as described earlier in relation to the TPP). This will resolve any issues around transparency and would likely result in more effective network control.

Section 2.1 Master Train Plan

ARTC points out that there appears to be no obligation requiring operator compliance with the Code of Practice. It is not clear to ARTC why TPI may have omitted this provision.

Section 3.2 Instructions

Section 3.2 states:

"TPI is not responsible for any delay suffered or cost incurred by the Operator in complying with an instruction and the Operator releases TPI from any claim arising from such compliance."

ARTC acknowledges that it is fair to put a reciprocal sentence in which states:

"The Operator is not responsible for any delay suffered or cost incurred by TPI in the Operator complying with a proper instruction of TPI, and TPI releases the Operator from any such claim arising from such compliance."

This is consistent with the approaches of both ARTC and WestNetRail.

Section 4.4 Management of issues affecting daily operations

In this section, the TMG does not make mention of the standard(s) to which TPI will maintain the network. ARTC supports maintenance of the track in at a fit for purpose condition.

Long range possessions management process

Prior to commencing any works (maintenance, repairs, upgrades) a track owner should take all reasonable steps to notify operators of the works as soon as is practical, to minimise disruption, and use best endeavours to provide an alternative path. Both ARTC and WestNet make this commitment.

WestNet clearly outlines its long range possession management process along with the method for communication and consultation with operators, in its TMG. Where a specific train path is expected to be affected, details should be made available to the operator at the earliest practical time.

The concern operators may have in the case of a vertically integrated access provider is understandable. With vertical integration there is the possibility for an access provider to develop a maintenance program giving some advantage to a related operator over a third party operator. This may not have a significant impact from any one instance but has the potential to impact performance significantly if repeated regularly. ARTC therefore recommends that any long range maintenance planning practices need to be clearly specified and outcomes communicated to all parties wherever possible.

Consultation and Review

The comments made about consultation and review with regards to the TPP also apply to the TMG. The TMG should be reviewed at periodic intervals and ARTC supports the development and publishing of key performance indicators.