



5 September 2008

Mr Russell Dumas
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Economic Regulation Authority
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Dear Mr Dumas

**NWIOA Submission – The Pilbara Infrastructure Pty Ltd
Segregation, Train Management Guidelines and Train Path Policy**

The North West Iron Ore Alliance (Alliance) was formed in 2007 to represent the interests of a group of junior iron ore companies operating in the Pilbara region of Western Australia. The Alliance's core objective is to work with communities in the region, all tiers of Government and relevant Agencies, infrastructure providers, existing producers and all other stakeholders to promote the development of a vibrant junior iron ore industry. The Alliance comprises four ASX listed companies with a projected 57 million tonnes capacity by 2014 worth more than \$200 million per annum in royalties. They are:

- Atlas Iron;
- BC Iron;
- Brockman Resources; and ,
- FerrAus.

The Alliance makes these three submissions cognisant that the aim¹ of the Economic Regulation Authority (ERA) rail access regime is to establish and implement a framework that ensures effective, fair; and transparent competition on Western Australia's railway network to achieve a net public benefit to the State. It is also necessary that the various State Agreement obligations of The Pilbara Infrastructure Pty Ltd (TPI) and Fortescue Metals Group (FMG) be taken in to account.

The Alliance has previously congratulated FMG on its success in building infrastructure and exporting ore while making a public commitment to common user access to its infrastructure (Alliance media statement dated 16 May, 2008).

It is the Alliance's view that a contestable market for rail operations will only be facilitated if a level playing field is created for all parties having or seeking access (access seekers) to railway infrastructure and train guidelines and controls appropriate to the task (below rail).

The Alliance submits that the proposed retention by TPI of the railway haulage business of FMG is linked to the overall business of FMG. To keep the haulage business integrated with TPI activities

¹ http://www.era.wa.gov.au/3/195/48/the_regime.pm



during Stage 1 unintentionally provides FMG market power with regard to access negotiation, and as a consequence haulage and mine gate sales. Accordingly the Alliance would submit that the Segregation Arrangements should not be a staged process.

The Alliance also notes that the Segregation Arrangements, Train Management Guidelines and Train Path Policy as presented are inextricably linked to the Port Hedland port considerations. The rail position is heavily influenced by likely shortage of inner harbour capacity and is therefore more influenced by port than mine logistics. This will result in undue uncertainty with the Rail Access arrangements forcing negotiation outside the Access Code and as a consequence make the Rail Access Regime potentially unworkable, reinforcing FMG's market power as a buyer and seller for iron ore.

The Port Access Regime at this stage is not publicly available and approval is to be by the Minister. The Rail Access Regime therefore should exclude port considerations as the Regulator has no jurisdiction with regard to the Port Access Regime and with mooted port development options there may be more than one relevant infrastructure provider and operator in the future. The Train Management Guidelines and the Train Path Policy should only address the TPI Railway and make no reference to the FMG supply chain which is outside the jurisdiction of the Regulator and the Access Regime.

The Alliance suggests that the Regulator set the Segregation Arrangement parameters to allow Third Party access seekers the transparency to negotiate effectively with TPI as a stand alone business that is truly independent of FMG. This concept necessitates TPI treating FMG as an access seeker within the Access Code. FMG effectively is a monopoly provider of rail and port access as well as having dominant market power for rail haulage contracts.

The Alliance requests in consideration of the Access Act section 29 (1) that the Regulator not accept the Segregation Arrangements as proposed by TPI. The Alliance also suggests the Regulator consider, as a minimum, the merit of the Alliance submission suggestions in the Train Management Guidelines and Train Path Policy, particularly with regard to removing reference to the port considerations.

Some Alliance members are in commercial negotiations for rail and port contractual arrangements and an effective Access Regime as envisaged by the State Agreement Act is required as soon as possible. The appropriate Segregation Arrangements must form a structural framework to effect the aim of the Rail Access Regime to achieve a net public benefit to the State and the objectives of Section 2A of the Access Act.

These comments are provided on behalf of the four Alliance members as are the three submissions.

The Alliance considers that the commercial certainty that will be provided to third party users when an effective regime is finalised will be essential for the diversification of the iron ore industry in the Pilbara and will improve regional development opportunities for the Pilbara and its residents.

Thank-you for providing the opportunity to submit.

Yours faithfully,

Meggie Anwyll
Chair
North West Iron Ore Alliance



NORTH WEST IRON ORE ALLIANCE

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The Pilbara Infrastructure (TPI) Rail
Part 5 Instruments submission
for the proposed
Train Management Guidelines

5 September 2008

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Executive Summary

FMG/TPI obtained benefits under State Agreements for the development of its export infrastructure, which were granted on the proviso that Third Parties would have access to the TPI Railway in the future. Third Party access rights granted pursuant to the State Agreement should at least equate to the rights granted under the Code for other Rail Access Regimes.

The North West Iron Ore Alliance (NWIOA) suggest the Regulator set parameters or models for each of the items of information to give Third Party Access seekers the transparency to negotiate with FMG/TPI effectively. This should reflect the significant market power of FMG/TPI as a competitor in the Iron Ore market, considering it is effectively a monopoly provider of rail and port Access, as well as having dominant market power for rail haulage contracts.

The TMG document refers to “... *Access Regimes (the Regimes) to enable third party access to the rail network (the Network) and the port terminal (the Port)*” While the nature of the draft TMG and TPP documents espouse some of the key concepts for the Rail Access Regime without visibility on the Port Access Regime it is difficult to understand the proposed Rail Access Regime when it refers so much control to the Port. The Alliance has concern that the TMG and TPP documents by linking the rail access regime to the port access regime without transparency potentially undermines the purpose of the Rail Regime.

With reference to the Rail Safety Act and associated standards and guidelines and as notes as a principle in the WestNetRail TMG we would add to the purpose of the TMG as follows:

- To ensure operational safety is maintained through compliance with Safeworking rules, regulations and procedures.
- To ensure the integrity of the track and other infrastructure so that the train plan be met.

TPI’s definition of an operator excludes those with access outside of the code. If all above rail haulage operators are not included in the TPI Rail Access Regime, in the event that TPI offered to negotiate access outside of the Code, then the transparency and fairness of capacity and priority decisions will not be achieved.

Several avenues of arbitration and consultation were absent from the draft TMG which are found in the WestnetRail approved document which we propose should be added.

Introduction

The Economic Regulation Authority (**Authority**) is inviting public submissions on the proposed segregation arrangements, train management guidelines (**TMG**) and train path policy (**TPP**) that have been submitted by the railway owner, The Pilbara Infrastructure Pty Ltd (**TPI**), for its recently-constructed railway in the Pilbara.

Alliance member companies will be some of the most likely customers and end users of the proposed access arrangements being put in place for the TPI railway. This submission from the Alliance relates to the TMG submitted by the railway owner, TPI.

Background

The objectives of the rail access regime

The TPI railway was included in the State's rail access regime, consisting of the Railways (Access) **Act** 1998 and the Railways (Access) **Code** 2000, when the Railway and Port (The Pilbara Infrastructure Pty Ltd) **Agreement Act** 2004 amended both the Act and the Code to make the inclusion.

The aim¹ of the rail access regime is to establish and implement a framework that ensures: **1) effective; 2) fair; and 3) transparent** competition, on Western Australia's railway network to achieve a net public benefit to the State.

The Authority has received the proposed segregation arrangements, train path policy and train management guidelines from TPI and invited submissions that must be received by 4:00pm on Tuesday 26 August 2008.

Framework for determinations

The Act provides a framework within which the Authority's determination required under Section 43 of the Code is to be made. Subsection 20(4) states:

In performing functions under the Act or Code, the Regulator is to take into account:

- a) the railway owner's legitimate business interests and investment in the 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 benefits to the public from having competitive markets.

The decision making power given to the Authority under Section 43 of the Code is mandatory in that the Authority must take into account all the factors listed in Section 20(4) of the Act.

¹ http://www.era.wa.gov.au/3/195/48/the_regime.pm

However, the Authority has discretion to allocate such weight to each of the factors listed in Section 20(4) of the Act as it considers appropriate for each particular case.

Railway (Access) Code 2000

Section 43, of the Railway Access Code 2000 requires the railway owner to comply with approved train management guidelines which are described as: the railway owner is to prepare and submit to the Regulator for approval a statement of the principles, rules and practices (the train management guidelines) that are to be applied and followed by the railway owner.

Railway Safety Act 1998

In making this final determination into the Westnet TMG², the Authorities final determination stated that “the TMG will need to comply with the requirements of the Rail Safety Act 1998”. The TPI railway, unlike other Pilbara railways, operates under the Rail Safety Act (**RSA**) administered by the Office of Rail Safety WA.

The Rail Safety ACT 1998: SECT 26 Compliance with rail safety standards, states:

1. The owner and the operator of a railway must comply with-
 - a) the Australian Rail Safety Standard³;
 - b) safety standards-
 - i. prescribed; or
 - ii. approved, as relevant to the operation of this Act, of which written notice has been given to him or her;and
 - c) safety standards with which he or she has agreed to comply under this Act.
2. The owner and the operator of a railway must comply with the provisions of his or her safety management plan.

NAP 2.0 Guidelines

The National Accreditation Package (**NAP**) is a guideline to railways seeking accreditation and those that are accredited. The NAP was developed by the Australian Rail Safety Regulators Panel (RSRP) in consultation with industry during 2004, and endorsed by State and Territory Transport Ministers in December 2004. A revised version of the NAP (version 2.0) was released in December 2005. It has been revised to achieve greater consistency with the revised AS 4292.1:2006 Railway Safety Management - General Requirements. The TPI railway was accredited to the NAP guideline standard by the Rail Safety Regulator.

Section 3.21.1.2 Train Management, of NAP 2.0 Guideline describes Train Management as:

- Establishment and maintenance of train integrity, before and during a journey.
- Train crew possession of route knowledge, including the Safeworking system in use, track, station, stopping place and terminal layout, communications system in use, signalling arrangements, speed limits, emergency procedures and any other local conditions affecting railway safety.
- Identification of changes in the safeworking system.

² Westnet Rail's Part 5 Instruments Review, Final Determination and Approval of the Proposed Train Management Guidelines, 28 August 2006, Economic Regulation Authority WA

³ AS4292:2006 Railway Safety Management

- Traction and train knowledge.
- Securing of rolling stock when stopped or parked.
- Protecting against over-speed operation.
- Train performance-monitoring arrangements.
- Axle loads.
- Securing of loads.
- Other operational procedures.

AS 4292:5 -2006 Railway safety management

Part five, Operations, of the Australian Standard for railway safety defines train management as: All aspects relating to the provision and implementation of train movement, planning, marshalling, consist requirements, dispatch, crewing and inspection, and relevant aspects of train integrity.

Section 6.2 of part five of the Standard lists Train Management as including: Standards and procedures shall be established and maintained for the management of trains by train crews or others involved in respect of the following:

- a) Route knowledge, including the following:
 - i. The safeworking system in use.
 - ii. Track and station layout.
 - iii. Communications system in use.
 - iv. Signalling arrangements.
 - v. Speed limits.
 - vi. Emergency procedures.
 - vii. Any other local conditions affecting railway safety.
- b) Identification of changes in the safeworking system, including the following:
 - i. Means of clearly and unambiguously indicating changes.
 - ii. Means of identifying system boundaries.
 - iii. Frequency and extent of different systems encountered during a journey.
- c) Train knowledge and handling.
- d) Establishment and maintenance of train integrity.
- e) Securing of rolling stock when stopped or parked.

WestNetRail TMG 2006

The Authority approved WestNetRail 2006 TMG and as such we view them as a benchmark for comparison to the TPI proposal.

Review of TPI - TMG

The following sub-sections represent the Alliance members view of the proposed TMG.

1 Introduction

1.1 Background

The background statement refers to “... *Access Regimes (the Regimes) to enable third party access to the rail network (the Network) and the port terminal (the Port)*”

While the nature of the draft TMG and TPP documents expose some of the key concepts for the Rail Access Regime there is no such visibility on the Port Access Regime. The Alliance has concern that the TMG and TPP documents link the rail access regime to the port access regime. For example the train path priorities normally espoused in the decision making matrix overrides the expected rules by giving the port the authority to over-rule the rail priorities.

The Alliance is concerned that this approach sets an uncompetitive precedent for above rail access seekers. Not all rail access seekers will want or need access to the TPI port. This arrangement will obviously unfairly disadvantage non-TPI trains and third party operators.

The Service Level agreement will be undermined by the TPI Port priorities. There will be undue uncertainty with the Rail Access arrangements as a consequence making the Regime potentially unworkable and reinforcing TPI's market power as a buyer and seller for iron ore. At the very least a rail access regime that gives the power to set train priorities to the Port will undermine the above rail access market on the TPI railway as the only practical and commercially acceptable outcome, from a Ore delivery sense, is to either sell the Ore to TPI or have them haul the Ore and handle it at their Port. This will potentially have the effect of ensuring a monopoly power on the haulage of Ore on the TPI railway.

The Alliance contends that this is not the intention of the Code or the Act.

The Alliance strongly urges the Authority not to allow the TPI Port Access Regime and the TPI Rail Access Regime to be linked. Secondly, all references to non-rail entities and roles, but particularly the Port, should be removed from the TPI Rail Access Regimes and TMG, TPP documents.

The TMG & TPP should only address the TPI railway and make no reference to the TPI supply chain. It is outside of the scope of the Authority and the Access Regime under consideration. Or if it is to remain then the Port Regime should be made available for consideration at the same time as the Rail Regime.

1.2 Purpose of the TMG

And we would add the aims of the rail access regime are pertinent to the TMG as it is likely to be appended to the Access Agreement (section 1.3 pre-conditions) that is to establish and implement a framework that ensures: **1) effective; 2) fair; and 3) transparent** competition, on Western Australia's railway network to achieve a net public benefit to the State.

In addition with reference to the Rail Safety Act and associated standards and guidelines and as notes as a principle in the WestNetRail TMG we would add:

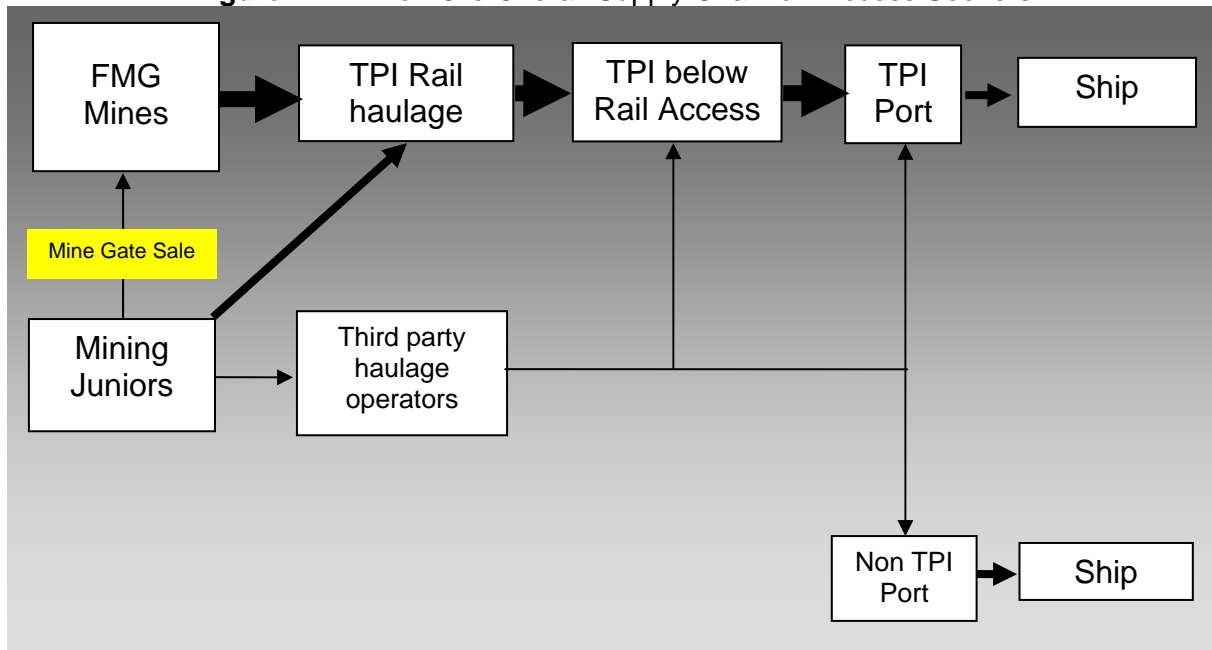
- To ensure operational safety is maintained through compliance with Safeworking rules, regulations and procedures.
- To ensure the integrity of the track and other infrastructure so that the train plan be met.

- To ensure operating integrity, including train crewing, locomotives, wagons and loading so that the train plan can be met.
- To manage the Network based on agreed entry/exit times.

The TMG should be managed in such a way as to encourage maximum use of the rail Network. The TPI assertion that this occurs in the “...context of the overall supply chain” undermines the legitimate purpose and aims of the TPI Access Rail Access Regime by:

If the Authority allows TPI to include the overall supply chain in the TPI Rail Access Regime then in order to meet it’s objectives of 1) effective; 2) fair; and 3) transparent competition the Authority should request TPI to provide the Port Access Regime, if it can, for consideration by the industry so that the linked Regimes may become transparent to ensure fairness to potential users of the Rail and Port facilities.

Figure 1: TPI Iron Ore Overall Supply Chain cw Access Seekers



1.3 Pre-conditions

TPI’s definition of an operator excludes those with access outside of the code. If all above rail haulage operators are not included in the TPI Rail Access Regime, in the event that TPI offered to negotiate access outside of the Code, then the transparency and fairness of capacity and priority decisions will not be achieved. The definition of an operator should read as;

Operator means the Operator or Operator’s which have access to the TPI Network under an Access Agreement or have made an application for Access under Section 8 of the Code.

FMG operates a mining business which has much larger revenues than the TPI rail enterprise and as such it has the potential to distort the priorities and decisions of TPI, without complete Authority oversight of the Access Regime.

The TMG and TPP documents both give overarching power to decide pathing priorities to the TPI Port operator, but the pre-conditions do not require a Port Access agreement to be in place. If the TPI Port operator is to retain all the authority on train paths, which the Alliance believes is an impediment to transparency of access, then Access seekers need to review

the Port Access arrangements to make a meaningful and fair assessment of the potential Rail Access arrangements.

Referencing the conditions of the Access Agreement obviously disadvantages the reviewers of the TMG & TPP as this has not been provided as a draft document.

2 Scheduling Principles

The usual objective of the Scheduling Principles in a railway are to use the route, the rolling stock and crews in the most effective way allowing for all the Operational Constraints. This is not the proposed approach in the TPI documents provided. TPI by providing over-arching decision making power on train paths to the TPI Port have indicated, indirectly, **the objective is to maximise the effectiveness of the Port**. This however is not the purpose of the Rail Access Regime as outlined earlier and this issue needs to be considered in the current and planned environment for the Port and the industry.

Firstly, the current and immediate arrangements are that TPI are the only “open access” port available to the Alliance and other junior miners seeking access. TPI have not provided Access arrangements to the Port and so the assessment of the TMG and TPI do not provide transparency to the coordinating and over-arching arrangements at the Port. The effective monopoly over the rail Access arrangements is compounded here by TPI also being the only supplier of facilities to stockpile and subsequently load ships, the port Access arrangements.

By mid 2010, a limited capacity open access Port will be completed at Utah Point. However the planned capacity and future expansion possibilities are much less than the planned mines for the East and West Pilbara. In effect the planned port will have no effect on TPI’s effective monopoly on Port facilities.

However, given the rapid scale of expansion of infrastructure by the incumbents, not least of all TPI’s new Port and Rail, it is foreseeable with a continued strong market expected for many years that further Port expansions will be realised. It is at least possible and certainly feasible that the TPI railway could be connected to new public access facilities within Port Hedland harbour and potentially to the proposed outer harbour proposal. If this or some other arrangement were to be put in place the TMG & TPP references to the priority of the Ports having the overarching authority on train paths would in our opinion cause confusion and likely make the rail access arrangements unworkable. Considering the likelihood of having more than one Port operator over time, we highly recommend the Authority direct TPI to remove references to the Port from the rail access arrangements. Alternatively we would request those proposed arrangements be made available to parties preparing submissions. Not doing so would disadvantage all Access seekers on the TPI railway and not achieve the States policy objective of expanding the Iron Ore export market as outlined in the then Ministers second reading to parliament on the Agreement:

The purpose of the Bill is to ratify and authorise an agreement,for the development of new multi-user infrastructure in the Pilbara; to facilitate the development of a multi-user railway, multi-user port facilities and additional infrastructure that may be required for the transport and export of iron ore, freight goods and other products;; and to give statutory backing to open access arrangements for the multi-user railway and put in place a process to establish open access arrangements for the port facilities.

And,

The Government anticipates that the multi-user railway and port facilities to be developed under the Agreement will open the Pilbara iron ore industry to new entrants seeking to supply growing demand for iron ore, especially from China.

2.1 Master Train Plan

The Master Train Plan is defined in the TMG & TPP documents as “means a document prepared and maintained by TPI that will register:

- (a) the Service Entitlements of each Operator on the Network, including:
- for Timetabled Traffics, the Train Paths that are allocated to that traffic;
 - for Cyclic Traffics, the number of Train Paths that will be allocated to that Operator per period in accordance with the Operator's Service Entitlement;

The term Traffic and Traffics is used in the definition and body interchangeably. Traffic is the plural form and Traffics should not be used to reduce confusion as to the definition.

The description given for Cyclic Traffic in, 2.1 a) ii) describes the number of Train Paths per week whereas the definition has instead the number of Train paths in a period. We believe the term period, as used in the definition, is more appropriate for the agreement,

The Master Train Plan needs to set out the train operations management approach/regime that allocates resources efficiently, effectively and fairly for the network owner and train operators. This involves many competing objectives and very large sums of money -even not allowing for the very expensive cargo being carried on the TPI railway.

The Alliance contends to ensure some measure of transparency on what services they might conceivably be able to operate on the TPI railway the Master Train Plan Scheduling Principles need to include the following details:

- Train operating pattern regime e.g. Fuel trains operated each week on a Monday night
- Train operating priorities regime e.g. Loaded trains have priority pathing
- Track maintenance possession regime
- Network infrastructure constraints e.g. axle loads
- Network operating constraints e.g. train lengths
- Safeworking methods of the network e.g. interfaces to two methods

Part c) of 2.1 refers to Ad Hoc Services, this should not be in the Master Train Plan but in the Weekly Train Plan. The Weekly Train Plan enables the real time management of Services whereas the Master Train Plan is a register of Service Entitlements. Ad Hoc services by their nature are more closely aligned with real time management of services.

TPI undertakes to “use its best endeavours to consult Operators” with respect to taking possession of the Network to undertake necessary work. Rather than a subjective statement of ‘best endeavours’ the Alliance requests a regime whereby Operators are continuously updated on the competing needs to access the Network including possessions by;

1. Preparing and providing an annual track planned maintenance, enhancement and expansion plan for the network.
2. Preparing and reviewing with the Operators a rolling three month possession plan for all planned maintenance.
3. Preparing and reviewing with the Operators a weekly report on planned possessions for the following three weeks. Including a review of the performance of planned possessions for the previous week.
4. Notifying the Operators immediately in writing of changes to the planned possessions.

2.2 Weekly Train Plan

TPI have proposed that the Weekly Train Plan would be prepared following Train Requests from the Operators and in consultation with the Port Operator with consideration to stockpile management and shipping requirements. This arrangement pre-supposes:

1. There is only one Port or Port operator.
2. The capacity of the Port is the most constrained part of the supply chain. If it were not then presumably that other part of the supply chain would have over-arching authority on train movements e.g. train unloader.
3. The Port acts in the best interests of the contracted Access Seekers and has a meaningful contract with the Access Seekers.
4. The Port has a process to fairly allocate capacity.
5. The Port arrangements are certifiable under the Trade Practices Act.

The Alliance contends that the proposed involvement of the TPI Port even in a consultation role under mines the transparency objective of the Rail Access Regime and should not be allowed by the Authority. Coordination with the Port should be undertaken with transparency and involvement of the Access Seekers. But as outlined in an earlier section the development of more Ports linked to the TPI railway would make the proposed arrangements for the Port deciding train priorities meaningless, unless the proposal is that TPI's Port would have pre-eminence, which would be unacceptable to all Access Seekers.

The weekly train plan should be prepared and published in the same period that notification of a shipping schedule is known e.g. 10 days to facilitate efficient planning and prioritization of the network usage. The aim should be that the Access Seekers should have the best possible information to decide if a shipping program can be supported by access to the railway before committing to the shipping of Ore.

We highly recommend a longer period of planning be added to the TMG e.g. three months to allow all users the opportunity to communicate and consider each others track usage requirements. This may not necessarily be in the form of a Train Plan.

2.3 Contested Train Path

As outlined in earlier sections the Alliance has serious concerns with the proposed arrangements whereby the Port Operator can change train path priorities without reference or regard to the Rail Access Agreements in place between TPI and the Operator.

The proposal at c) is that the Operators might agree amongst themselves. This could only work if transparency was provided on competing demands and the existing status of the Network. To do this the Operators would each have to establish a shadow train controller with information feeds from Train Control to respond to requests to the Operators.

The proposal at d) is that TPI would decide priorities based on who is most behind on their Service Entitlements except that they introduce the concept where the Operator is behind because of circumstances within their control. This is a process used by others that is administratively very demanding. Firstly, in practice each Operator would want to review in a forum their and others performance, including the network provider, so that they are not unduly blamed for others poor performance. The second consequence of this approach is that the information has to be transparently and fairly translated in a format the Train Controller can readily apply. This has been termed the Operating Performance Regime which measures each operators, and trains, performance in a way that the Train Controller can quickly decide what to do using a decision matrix.

TPI would have to provide very good access to operating information to allow Operators to review incidents that impacted on their services. TPI should also be required to explain how they would administer the proposal in practice while providing a fair and transparent process.

3 Real-time Management of Services

3.1 Services presented on time, late or early

3.1.1 On time

No comments at this time.

3.1.2 Early

Ref App B Decision Making Matrix

3.1.3 Late

Ref App B Decision Making Matrix

3.2 Instructions

Where that instruction is unreasonable or impractical for operating and cost reasons the Operator may decline to run the service without penalty to its Service Level performance record.

4 Managing infrastructure issues

The Alliance has a preference for TPI to publish a twelve month network possession plan for planned maintenance, enhancements and expansion work together with the MTP so that they can reasonably anticipate planned closures, their duration and location. In this way the Mine will be able to mirror the availability of the railway optimizing mine maintenance and production to everyone's benefit.

4.1 Network repairs, maintenance and upgrades

4.1.1 Possessions

To be treated fairly and to meet reasonable endeavours to consult TPI need to provide transparency and meaningful dialogue about how the network possessions are to be handled; in particular, planned possessions as outlined in earlier sections of this submission.

4.1.2 Consultation

- a) All possessions should be published whether they affect train paths or not to allow for contingency planning by all Operators
- b) No further comments
- c) <6 hours, 2 days notice: TPI should notify all Operators as path changes as this may affect others, Operators need this for contingency planning.
- d) 6 – 48 hour possessions: TPI should notify all Operators to allow contingency planning to occur.
- e) A rolling three month review of planned possessions should occur at a joint consultative meeting/forum each month chaired by the TPI Head of Rail.
- f) And TPI will provide a revised DWTT so that Operators may have a basis to review the impact on their services.

4.2 Management of emergencies or other incidents

No comments.

4.2.1 Network blockages

We would add:

An operator is not required to provide assistance if it will incur cost and risk unless agreement is reached on how the costs and risks will be shared. Agreement on the terms and conditions for providing assistance may be negotiated within the Access Agreement.

4.3 Train activities following an incident or an emergency

We would add:

To facilitate the communications process, the Operator and TPI shall provide for a 24 hour communications link unless otherwise agreed.

All affected Operators will be consulted as to their positions and needs including factors such as crewing arrangements; sensitive freight; and shipping or production requirements.

4.4 Management of issues affecting daily operations

We would add:

To facilitate the communications process, the Operator and TPI shall provide for a 24 hour communications link unless otherwise agreed.

All affected Operators will be consulted as to their positions and needs including factors such as crewing arrangements; sensitive freight; and shipping or production requirements.

4.5 Disputes

The Access Agreement has not been provided so it is difficult to comment on the proposed process. Disputes should at least follow the disputes process outlined below.

Part 3 of the Code provides for arbitration of access disputes in certain circumstances in relation to the provisions to be contained in a proposed Access Agreement. Those circumstances are set out in Section 25(2) of the Code.

Once an Access Agreement has been entered into disputes will be resolved by a three stage process as follows:

- (a) firstly, negotiation of the dispute between the parties within a 7 day time limit and using reasonable endeavours;*
- (b) secondly, by mediation between the equivalent Chief Executive Officers and after if no agreement has been reached 14 days by expert mediation; and*
- (c) thirdly, by arbitration in accordance with the Commercial Arbitration Act 1985.*

No later than 90 days after the commencement of an Access Agreement, the parties will meet for the purpose of identifying and agreeing on the means of measuring the

performance of each party under the agreement. The agreed means are referred to as Key Performance Indicators.

When agreed, the Key Performance Indicators must be set out in writing signed by both parties. The parties will also agree in writing:

1. the manner in which, and the frequency with which, the Key Performance Indicators are to be monitored and recorded;
2. the consequences in relation to rights and obligations under the Access Agreement or otherwise of not meeting or of exceeding Key Performance Indicators; and
3. any other relevant arrangements relating to the use of Key Performance Indicators in connection with the Access Agreement.

When recorded in writing and signed by the parties the agreed arrangements relating to Key Performance Indicators will constitute part of an Access Agreement. The parties may in writing signed by each of them vary the terms of the Key Performance Indicators. The Key Performance Indicators are relevant to both parties and must be complied with during the access agreement unless a shorter period is specified. TPI and the Operator will monitor the appropriateness of the Key Performance Indicators.

The parties must meet when agreed but not less than quarterly for the purpose of discussing and determining actual performance against the Key Performance Indicators. The parties will jointly determine the appropriateness of the Key Performance Indicators for the purpose of reward or penalty.

And we would add the following new section to the TMG:

TPI will review the TMG, every fifth year after the Authority's approval of this document to determine whether any amendments are required.

Stakeholders have the ability to express any concern to the Authority which may arise at anytime and the Authority will investigate such claims.

The Authority has the power under the Code to amend the TMG at any time and Access Seekers and Operators can at any time request the Authority to consider amendments.

TPI acknowledges the Authority will develop a regime of KPI's, in consultation with stakeholders, to assess the effectiveness of the TMG.

This is in addition to KPI's that will be developed in individual access agreements.

TPIs compliance will be subject to an annual independent external audit. The Authority may select and manage the Auditor with costs paid by TPI. At a minimum the Authority's approval will be required and the final audit report will be made available to the Authority and the public.

The Authority can also commission special audits on any TMG issue or area where additional assurance is sought.

Appendix A. Definitions

No further comments.

Appendix B. Decision-Making Matrix

Rules 2, 3 & 4 refer to “depending on instructions received from the Port (acting to maximise the efficiency of the supply chain as a whole).” In effect, as outlined in earlier sections, the Port, which is not subject to the Act or the Code or even a party to the Access Agreement, has over-arching authority to determine Train Path priorities. The Alliance believes this is unlikely to meet the requirements or objectives of the Rail Access Regime, Code, Act or the Agreement.



NORTH WEST IRON ORE ALLIANCE

PO Box 7505 Cloisters Square WA 6850

The Pilbara Infrastructure (TPI) Rail
Part 5 Instruments submission
for the proposed

Train Path Policy

5 September 2008

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Executive Summary

FMG/TPI obtained benefits under State Agreements for the development of its export infrastructure, which were granted on the proviso that Third Parties would have access to the TPI Railway in the future. Third Party access rights granted pursuant to the State Agreement should at least equate to the rights granted under the Code for other Rail Access Regimes.

The North West Iron Ore Alliance (NWIOA) suggest the Regulator set parameters or models for each of the items of information to give Third Party Access seekers the transparency to negotiate with FMG/TPI effectively. This should reflect the significant market power of FMG/TPI as a competitor in the Iron Ore market, considering it is effectively a monopoly provider of rail and port Access, as well as having dominant market power for rail haulage contracts.

The TMG document refers to “... *Access Regimes (the Regimes) to enable third party access to the rail network (the Network) and the port terminal (the Port)*” While the nature of the draft TMG and TPP documents espouse some of the key concepts for the Rail Access Regime without visibility on the Port Access Regime it is difficult to understand the proposed Rail Access Regime when it refers so much control to the Port. The Alliance has concern that the TMG and TPP documents by linking the rail access regime to the port access regime without transparency potentially undermines the purpose of the Rail Regime.

TPI’s definition of an operator excludes those with access outside of the code. If all above rail haulage operators are not included in the TPI Rail Access Regime, noting that TPI have offered to negotiate outside of the Code, then the transparency and fairness of capacity and priority decisions will not be achieved.

TPI should not have such a broad discretion with respect to determining capacity. Capacity would be better assessed in the context of the efficient operation of the railway, and not the TPI’s overall production process which may have the effect of compromising the efficient operation of the rail. Further Capacity should not be only defined in terms of Train Path types –Capacity is a Train Path plus the Capacity the train can carry as defined by the network infrastructure and standards.

Network Infrastructure and Operating standards need to be outlined by TPI to determine whether it is reasonable to impose those safety standards upon access seekers. The Authority may need to be involved outside of any arbitration process in determining the reasonableness of the standards being applied.

Several avenues of arbitration and consultation were absent from the draft TPP which are found in the WestnetRail approved document which we propose should be added.

Introduction

The Economic Regulation Authority (**Authority**) is inviting public submissions on the proposed segregation arrangements, train management guidelines (**TMG**) and train path policy (**TPP**) that have been submitted by the railway owner, The Pilbara Infrastructure Pty Ltd (**TPI**), for its recently-constructed railway in the Pilbara.

Alliance member companies will be some of the most likely customers and end users of the proposed access arrangements being put in place for the TPI railway. This submission from the Alliance relates to the TPP submitted by the railway owner, TPI.

Background

The objectives of the rail access regime

The State Government's obligations under the Competition Principles Agreement 1995 (as amended to 13 April 2007) the State may establish its own access regimes concerning access to facilities within its jurisdiction. In order to be certifiable under the Competition Principles Agreement, the Regime must be an 'effective access regime'.

The TPI railway was included in the State's rail access regime, consisting of the Railways (Access) **Act** 1998 and the Railways (Access) **Code** 2000, when the Railway and Port (The Pilbara Infrastructure Pty Ltd) **Agreement Act** 2004 amended both the Act and the Code to make the inclusion.

The aim¹ of the rail access regime is to establish and implement a framework that ensures: **1) effective; 2) fair; and 3) transparent** competition, on Western Australia's railway network to achieve a net public benefit to the State.

The Authority has received the proposed segregation arrangements, train path policy and train management guidelines from TPI and invited submissions that must be received by 4:00pm on Tuesday 26 August 2008 with an extension granted to the Alliance till Friday 5th September

Framework for determinations

The Act provides a framework within which the Authority's determination required under Section 43 of the Code is to be made. Subsection 20(4) states:

In performing functions under the Act or Code, the Authority is to take into account:

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

¹ http://www.era.wa.gov.au/3/195/48/the_regime.pm

- g) the economically efficient use of the railway infrastructure; and
- h) the benefits to the public from having competitive markets.

The decision making power given to the Authority under Section 43 of the Code is mandatory in that the Authority must take into account all the factors listed in Section 20(4) of the Act. However, the Authority has discretion to allocate such weight to each of the factors listed in Section 20(4) of the Act as it considers appropriate for each particular case.

Railway (Access) Code 2000

Section 43, of the Railway Access Code 2000 requires the railway owner to comply with approved train path policy which is described as a statement of policy in:

- a) the allocation of train paths; and
- b) the provision of access to train paths that have ceased to be used.

Railway Safety Act 1998

In making this final determination into the Westnet TPP², the Authorities final determination stated that “the TPP will need to comply with the requirements of the Rail Safety Act 1998”. The TPI railway, unlike other Pilbara railways, operates under the Rail Safety Act (**RSA**) administered by the Office of Rail Safety WA.

The Rail Safety ACT 1998: SECT 26 Compliance with rail safety standards, states:

1. The owner and the operator of a railway must comply with-
 - a) the Australian Rail Safety Standard³;
 - b) safety standards-
 - i. prescribed; or
 - ii. approved, as relevant to the operation of this Act, of which written notice has been given to him or her;and
 - c) safety standards with which he or she has agreed to comply under this Act.
2. The owner and the operator of a railway must comply with the provisions of his or her safety management plan.

WestNetRail TPP 2006

The 2006 WestNet Rail TPP has been approved by the Authority. In our view it is a relevant benchmark for comparison to the TPI TPP being proposed.

² Westnet Rail's Part 5 Instruments Review, Final Determination and Approval of the Proposed Train Path Policy, 28 August 2006, Economic Regulation Authority WA

³ AS4292:2006 Railway Safety Management

Review of TPI - TPP

The following sub-sections represent the Alliance members' view of the proposed TPP.

1 Introduction

1.1 Background

The background statement refers to “... *Access Regimes (the Regimes) to enable third party access to the rail network (the Network) and the port terminal (the Port)*”

While the nature of the draft TMG and TPP documents expose some of the key concepts for the Rail Access Regime there is no such visibility on the Port Access Regime. The Alliance has concern that the TMG and TPP documents link the rail access regime to the port access regime.

The Service Level agreement will be usurped by the TPI Port priorities. There will be undue uncertainty with the Rail Access arrangements as a consequence making the Regime potentially unworkable.

The Alliance contends that this is not the intention of the Code, Act or the Agreement. Deferral to the Port in the Part 5 Instruments should not be allowed.

The Alliance strongly urges the Authority not to allow the TPI Port Access Regime and the TPI Rail Access Regime to be linked. Secondly, all references to non-rail entities and roles, but particularly the Port, should be removed from the TPI Rail Access regime and TMG, TPP documents.

The TMG & TPP should only address the TPI railway and make no reference to the TPI supply chain. It is outside of the bailiwick of the Authority and the Access Regime.

1.2 Purpose of the TPP

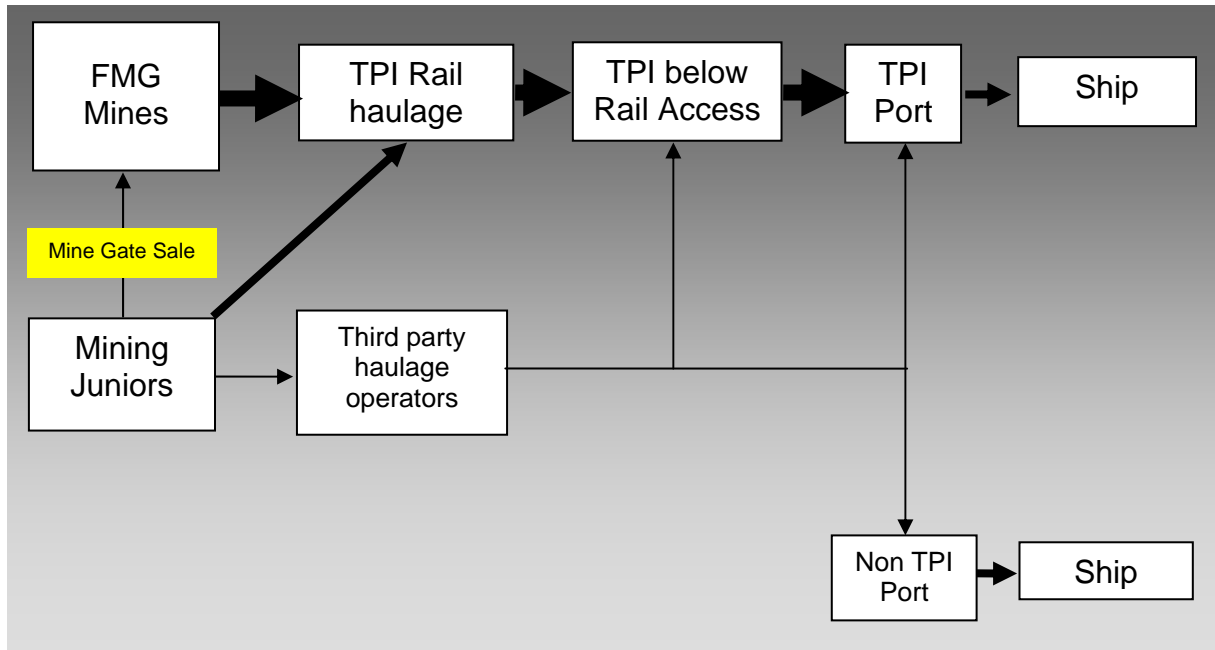
The TPP needs to be structured to ensure that the allocation of Train Paths is undertaken in a manner that ensures fairness of treatment between all Operators not just those under the Code.

The aims of the rail access regime are pertinent to the TPP as it is likely to be appended to the Access Agreement (section 1.3 pre-conditions) that is to establish and implement a framework that ensures: 1) effective; 2) fair; and 3) transparent competition, on Western Australia's railway network to achieve a net public benefit to the State.

The Policy should be managed in such a way as to encourage maximum use of the rail Network. The TPI assertion that this occurs in the “...*context of the overall supply chain*” undermines the legitimate purpose and aims of the TPI Access Rail Access Regime.

If the Authority allows TPI to include the overall supply chain in the TPI Rail Access Regime then in order to meet it's objectives of **1) effective; 2) fair; and 3) transparent** competition the Authority should request TPI to provide the Port Access Regime for consideration by the industry so that the linked Regimes may become transparent to ensure fairness to potential users of the Rail and Port facilities.

Figure 1: TPI Iron Ore Overall Supply Chain cw Access Seekers



The Alliance has a preference for all references to the Port and even the “overall supply chain” to be removed from the TPP and TMG documents. This is because while the TPI Port is the obvious destination at the present time there are projects and plans that will change this in a relatively short period of time and complicate the proposed approach immensely.

It is foreseeable with a continued strong market expected for many years that further Port expansions will be realised. It is at least possible and certainly feasible that the TPI railway could be connected to new public access facilities within Port Hedland harbour and potentially to the proposed outer harbour proposal. If this or some other arrangement were to be put in place the TMG & TPP references to the priority of the Ports having the overarching authority on train paths would in our opinion likely cause confusion and potentially make the rail access arrangements unworkable. Considering the likelihood of having more than one Port operator over time, we highly recommend the Authority direct TPI to remove references to the Port from the rail access arrangements. Alternatively we would request those proposed arrangements be made available to parties preparing submissions. Not doing so would disadvantage all Access seekers on the TPI railway and not achieve the States policy objective of expanding the Iron Ore export market as outlined in the then Ministers second reading to parliament on the Agreement:

The purpose of the Bill is to ratify and authorise an agreement,for the development of new multi-user infrastructure in the Pilbara; to facilitate the development of a multi-user railway, multi-user port facilities and additional infrastructure that may be required for the transport and export of iron ore, freight goods and other products;; and to give statutory backing to open access arrangements for the multi-user railway and put in place a process to establish open access arrangements for the port facilities.

And,

The Government anticipates that the multi-user railway and port facilities to be developed under the Agreement will open the Pilbara iron ore industry to new entrants seeking to supply growing demand for iron ore, especially from China.

1.2.1 Relationship between the TPP and TMG

No further comment with regard to the TPP and more detailed comments are provided in the segregation submission.

1.2.2 Application of the TPP

TPI's definition of an operator excludes those with access outside of the code. If all above rail haulage operators are not included in the TPI Rail Access Regime, noting that TPI have offered to negotiate outside of the Code, then the transparency and fairness of capacity and priority decisions will not be achieved. The definition of an operator should read as;

Operator means the Operator or Operator's which have access to the TPI Network under an Access Agreement or have made an application for Access under Section 8 of the Code.

FMG operates a mining business which has much larger revenues than the TPI rail enterprise and as such it has the potential to distort the priorities and decisions of TPI without complete Authority oversight of the Access Regime. The Alliance proposes the following addition to this section of the TPP:

The Code only requires the TPP to apply to access arrangements negotiated within the Code. TPI, nevertheless, will apply the TPP to each allocated Train Path regardless of whether access applications are made inside or outside of the Code.

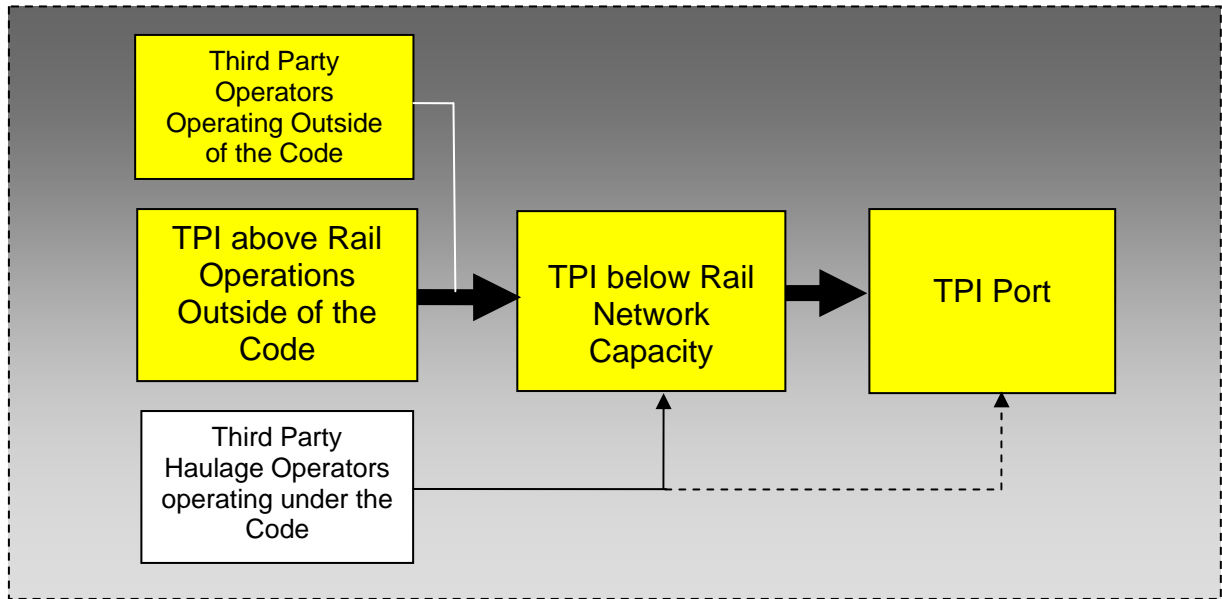
2 Allocation of capacity

2.1 Specification of Capacity

The TPP states that “Each Operator's Access Rights will be specified in terms of a Service Entitlement”.

Operator is defined in the document as “means the Operator or Operators which have access to the Network under an Access Agreement or have made an application for Access under Section 8 of the Code”. By definition this “Operator” does not include TPI above rail operations or the Third Party Operators who have negotiated access outside of the Code. The Alliance is concerned that this exclusion of the largest user of the network will potentially discriminate against third party access haulage operators to the detriment of efficiency, fairness and transparency. We strongly contend that all Operators accessing the TPI above rail network need to be apparent on the Master Control Diagram (and the Master Train Plan) and associated documents to allow effective negotiation of access under the Code.

Figure 2: TPI access seekers not all under the Code



The Service Entitlements is specified as including;

- for Timetabled Traffics, the Train Paths that are allocated to that traffic;
- for Cyclic Traffics, the number of Train Paths that will be allocated to that Operator per period in accordance with the Operator's Service Entitlement;

The term Traffic and Traffics are used in both the definition and body interchangeably. Traffic is the plural form and Traffics should not be used to reduce confusion as to the definition and usage.

The description of Cyclic Traffics in the body differs from the definition in the appendix, the description should read;

b) for Cyclic Traffic, the number of Train Paths that will be allocated to that Operator per period in accordance with the Operator's Service Entitlement.

The specification of capacity grants TPI a broad discretion to determine capacity. Besides the Master Control Diagram (and presumably the Master Train Plan referred to in the TMG document) potential access seekers would also need transparency on the operating regime being applied by TPI, this needs to include the following information:

- Train operating pattern regime e.g. Cyclic Trains are a program of four train paths to meet a ship
- Train operating priorities regime e.g. Loaded trains have priority pathing
- Track maintenance possession regime e.g. Track closed every second Sunday for maintenance
- Network infrastructure constraints e.g. axle loads, train lengths

We suggest this information be included in the description of the Service Entitlement.

The specification of capacity provides operational flexibility that appears to overly favour TPI. A standard measure of capacity needs to be adopted by the Authority to minimise confusion and manipulation by negotiating parties. Capacity is typically described in two ways:

- Train paths, that is the number of trains in each direction for a given time on a section of track, usually illustrated on a train graph (as described by TPI); or

- Gross tonnes per kilometre (GTK), that is the number of tonnes that can be carried through the section of railway for a given mix of train types.

A train path approach is the one most often used by train controllers as it is the most common means of managing corridors. The limitations of this approach are that it does not adequately consider the variation in train performance and train loading. That is, it does not properly account for the range of iron ore wagons that may be used to carry the iron ore, some of which may have a very large capacity to carry iron ore compared to others.

The Alliance recommends capacity should be described in terms of GTK on the section of track being considered. That is, for a given mix of train types, the design payload of those train paths is calculated to properly reflect the capacity of the section. The payload of course needs to reflect the design capacity of the iron ore wagons and not some lesser figure being used for non-railway considerations, such as the mine not producing enough iron ore to ensure each iron ore wagon is full.

Adopting a train path approach can be manipulated by inefficient train management and may not reflect the true capacity of the line or section. It is not recommended for describing the capacity of a corridor of railway on its own.

2.2 Analysis of Capacity

The TPI specification of capacity provides a broad discretion to determine the capacity and more importantly the available capacity.

The Alliance suggest that this is likely to result in TPI as a competing operator requiring more paths than is needed locking out third party operators.

The Alliance submitted in the previous section that capacity should be described in terms of GTK on the section of track being considered.

2.2.1 Master Control Diagram

No comments.

2.2.2 Access Applications

In April 1995, the Commonwealth, State and Territory Governments committed to implement reforms which included the provision for third party access to nationally significant infrastructure. The Commonwealth Parliament enacted Part IIIA of the Trade Practices Act 1974, establishing a national regime which access may be sought to a range of infrastructure that cannot be economically duplicated, including certain rail networks, electricity grids and gas pipelines. In 1998, Western Australia proceeded to develop its legislative reforms governing access to its railway infrastructure in support of the national reform process as outlined earlier in this document. The State Government's obligations under the Competition Principles Agreement 1995 (as amended to 13 April 2007) the State may establish its own access regimes concerning access to facilities within its jurisdiction. In order to be certifiable under the Competition Principles Agreement, the Regime must be an 'effective access regime': The Competition Principles Agreement provides that a State access regime should incorporate various principles, including that:

- the owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

TPI offer to negotiate Access outside of the provisions of the Code. We note that this is not unusual but that other Regulated Access Providers usually apply the same approved processes to the non-Code operators. By not applying the same processes FMG/TPI potentially reinforces its market monopoly power over the access seeker by:

- Not providing transparent processes
- Unfairly disadvantaging access seekers under the Code

The Alliance contends to be fair the following sentence be added to this section:

The Code only requires the TPP to apply to access arrangements negotiated within the Code. TPI, nevertheless, will apply the TPP to each allocated Train Path regardless of whether access applications are made inside or outside of the Code.

2.2.3 Capacity Analysis

A further consideration when calculating capacity is the need to take into account the variability of train performance. A train graph represents the ideal world. However, in reality, the trains will operate at different speeds. This is usually taken into account when describing the train performance in a section on a train graph – that is the train graph represents a compromise on the performance of most trains. If train graphs are produced by a simulation, some form of variation in performance is usually specified. However, this approach is only usually adopted in research projects and not generally applied in day to day operations.

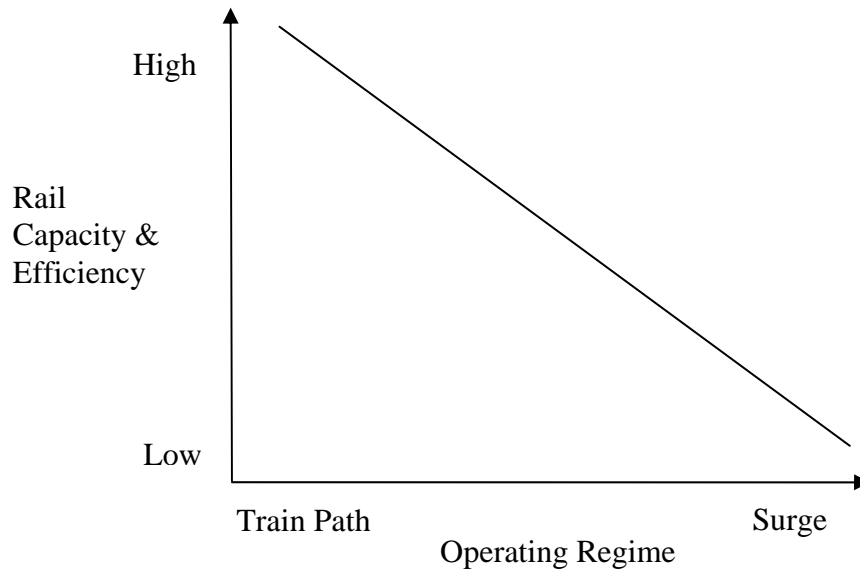
Adopting a train path approach can be manipulated by inefficient train management and may not reflect the true capacity of the line or section. It is not recommended for describing the capacity of a corridor of railway.

Therefore, the Alliances propose the analysis of capacity needs to include consideration of:

- the effect extra trains will have operationally, which needs to be modelled based on 'reasonably practical' test, that is what can be achieved versus the effort required to achieve it;
- that capacity analysis needs to be transparent to be fair to the access seeker.
- that TPI undertakes to at all times maintain dialogue with the Operator to ensure all alternatives are explored

TPI have proposed to specify Service Entitlements upon a basis of Timetable and Cyclic Train Paths. When determining the capacity of a section of railway the operating regime being applied and the mix of traffic patterns have a large influence on network capacity. Figure 3 below illustrates the contrast between the types of traffic proposed by TPI. Uniform train paths allow the highest levels of capacity and efficiency of the network because it maximises track usage. On the other hand cyclic pathing, or surge capacity, represents a much lesser capacity and less efficient operating regime for the railway. Both are used in mining operations but surge capacity is generally preferred because it minimizes ore handling onto the ship – in effect the ship pulls the ore from the mine. This together with a proposed regime of giving priority to the needs of the Port in the TPP and TMG documents has the potential to undermine the capacity and efficiency of the TPI railway if not checked by the Authority.

Figure 3: Effect of the Operating Regime on Capacity



2.3 Capacity Allocation

We note the draft Costing Principles make mention of Capacity and related topic of Optimisation in section 3.1.1 as follows:

Capacity of infrastructure – TPI considers that the network as constructed can meet current and reasonably projected demand. As a greenfields development, TPI does not consider that any optimisation should occur on its network. If TPI seeks to include the costs of additional infrastructure to meet projected demand it will demonstrate:

- the basis of the demand projection; and
- a commitment to the capital expenditure.

Route optimisation – as a greenfields development, TPI will assume that the optimised network is provided by the rail track within the existing corridor of the land and, hence, route alignment and infrastructure configuration is optimal and efficient.

We will make more comment on this in our submission on Costing Principles.

Train Path Capacity Allocation needs to be transparent at four levels:

1. The analysis that determined capacity of the railway as outlined earlier for existing operations.
2. The existing used capacity of the railway based on the Greenfield basis of design for the TPI railway. Including information on actual utilisation –that is what trains ran including their train paths, manifest, axle loads.
3. Determine the extra capacity, included in the analysis, required for planned and committed projects.
4. Finally, the train path capacity and network operating regime and rules for the allocation to the access seeker.

With this information TPI and the access seeker can then begin the joint analysis of capacity for the access seekers trains.

3 Management of capacity

3.1 Permanent variations to Train Paths

No comments at this time.

3.2 Resumption of Capacity

No comments at this time.

3.3 Review of Service Entitlements

No comments at this time.

4 Other

We would add to the document these further undertaking by TPI.

Cancellation of Services using Train Paths

TPI will adopt the following policy in granting an Operator the right to cancel Train Paths without penalty and the specific provisions of the policy agreed between TPI and the Operator will be contained in the relevant Access Agreement.

An Operator may cancel an individual Train Path under any one of the following circumstances (but only if the occurrence of these circumstances is beyond the reasonable control of the Operator):

(i) where public holidays effect the operation of the Train Path;

(ii) for each Scheduled Train Path 5 times per year commencing from the date the path was first approved;

(iii) there are mechanical difficulties with the rolling stock used or operated by the Operator;

(iv) there is a failure of any part of the Operator's equipment used or to be used in connection with a service;

(v) repair, maintenance or upgrading of the Network is being carried out or there is some other event which materially affects the Operator's use of all or any part of the Network (including, without limitation, derailment, collision or later running trains) which occurs on the TPI Network;

(vi) the Operator is unable to load trains because of a lack of product at terminals or is unable to unload product at terminals or ports because of insufficient storage space or because of mechanical difficulties with the loading or unloading equipment at terminals or ports;

(vii) because of the seasonal nature of the services.

The Operator must give TPI as much notice of cancellation as is possible in the relevant circumstances.

Authority Approval

Where a request for a Train Path or Train Paths or a request for an additional Train Path may preclude other entities from gaining access to that infrastructure the Train Path(s) will not be granted without the approval of the Authority in accordance with Section 10 of the Code. If the ERA grants approval then TPI will commence negotiations.

Consistency between documents

TPI will ensure where possible, that those sections of an access agreement which relate to requirements set out in the TPP or TMG documents are referenced to the relevant clauses in these documents to ensure consistency is maintained between the access agreement and these documents.

Dispute Resolution

Part 3 of the Code provides for arbitration of access disputes in certain circumstances in relation to the provisions to be contained in a proposed Access Agreement. Those circumstances are set out in Section 25(2) of the Code.

Once an Access Agreement has been entered into disputes will be resolved by a three-stage process as follows:

(a) firstly, negotiation of the dispute between the parties with a 7 day time limit and using reasonable endeavours;

(b) secondly, by mediation between the equivalent Chief Executive Officers and after 14 days if no agreement is reached by expert mediation; and

(c) thirdly, by arbitration in accordance with the Commercial Arbitration Act 1985.

Consultation & Review

TPI will review the TPP, every fifth year after the Authority's approval of this document to determine whether any amendments are required.

Stakeholders have the ability to express any concern to the Authority which may arise at any time and the Authority will investigate such claims.

The Authority has the power under the Code to amend the TPP at any time and Access Seekers and Operators can at any time request the Authority to consider amendments.

TPI acknowledges the Authority will develop a regime of KPI's, in consultation with stakeholders, to assess the effectiveness of the TPP. This is in addition to KPI's that will be developed in individual access agreements.

TPI's compliance will be subject to an annual independent external audit. The Authority may select and manage the Auditor with costs paid by TPI. At a minimum the Authority's approval will be required and the final audit report will be made available to the Authority and the public.

The Authority can also commission special audits on any TPP issue or area where additional assurance is sought.

4.1 Non-discrimination

No comments at this time.

4.2 Dispute resolution

The Alliance does not have a copy of the proposed Access Agreement referred to by TPI. However all disputes should only be dealt with as outlined in Section 25 of the Code. No case has been put to depart from this legislated approach.

Appendix A. Definitions

No further comments other than those already described in the previous sections.

Operating Safety Standards

TPI is a new railway that was built in just two years. Operating safety standards have a huge bearing on capital and operating costs of access seekers. Unlike other open access railways TPI's standards are not well known by potential access seekers. In addition, it is not clear that the current standards are appropriate or reasonable of access seekers who are likely to have a much smaller scale of operation than TPI themselves.

Safety standards need to be outlined by TPI to determine whether it is reasonable to impose those safety standards upon access seekers. The Authority may need to be involved outside of any arbitration process in determining the reasonableness of the standards being applied.



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The Pilbara Infrastructure (TPI) Rail
Part 5 Instruments submission
for the proposed

Segregation Arrangements and
supporting provisions

5 September 2008

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Executive Summary

The North West Iron Ore Alliance (Alliance) members require access to an existing railway on terms that facilitate competitive and cost effective above rail operations to enable many projects in the Pilbara region to progress through to production. This would also have the effect of stimulating the current level of exploration and resource development in the Pilbara generally.

The Alliance strongly support the underlying intent and the actions taken so far by the Government and Fortescue Metals Group (FMG) to put in place an alternative rail transport corridor for iron ore and other minerals in the east Pilbara that offers rail access to third parties on fair terms.

A contestable market for rail operations will only be facilitated if a level playing field is created for all parties, including FMG, having or seeking access to railway infrastructure. In practice, however, FMG's 100% ownership of The Pilbara Infrastructure Pty Ltd (TPI), the highly integrated nature of their operations, and the ongoing constraints to port capacity provides very strong incentives for commercial and operational decisions within rail operations to favour the development and delivery of FMG products to port over those of third parties.

The Alliance considers that as a vertically integrated rail operator:

- TPI has not provided any conclusive evidence that:
 - the separation of above and below rail operations would materially affect safety, operation and cost for a railway at the greenfield stage; or
 - segregation of above rail and below rail will affect integration of mine, rail and port logistics in its own related business;
- TPI is inappropriately predicating the Segregation Arrangements (Arrangements) on the optimisation of the FMG supply chain, rather than efficient use of the railway.

The Alliance would submit that the proposed retention of the integration of the TPI railway haulage business is linked to the overall business objectives of FMG and provides FMG with significant market power in its negotiations with third parties. This points conclusively away from Arrangements that involve the staged process proposed by TPI.

As currently proposed the two stage process proposed by TPI involves therefore major conflicts of interests. It also lacks clarity in relation to pricing equivalence and accounting treatment. The Alliance considers the extent of market power available to FMG outside the Code, including control of critical port facilities (port access is integrally linked to rail access) points to the need for full and immediate implementation of the Arrangements contemplated by the Act.

The Alliance does not consider that the Arrangements comply with the intent of the Act, including the strict interpretation of the Segregation Obligations.

- The Alliance is of the view that the two stage process contemplated in the Arrangements is not contemplated in the Act and hence is inappropriate.
- The Alliance does not accept that the Adelaide to Darwin railway regulatory regime provides either a legal or commercial precedent for the TPI Arrangements. The only

correct legislative basis for development of the Arrangements is the Railways (Access) Act 1998.

- The Arrangements are drafted in an imprecise manner which will further inhibit an access seeker's confidence in its ability to secure access on fair and reasonable terms.

As such, the Arrangements fail to satisfy the requirements of the Act and are incapable of providing potential access seekers with:

- comfort that appropriate arrangements are in place to enable TPI, as the railway owner, to comply with section 28 of the Act;
- the requisite protection against TPI and TPI Related Parties misusing Access Seekers' confidential information; and
- comfort that TPI cannot and will not favour TPI Related Entities in the performance of TPI functions (due to the imprecise nature of TPI's proposed approach to compliance with sections 28, 30-34 of the Act).

The deficiencies described above are likely to discourage potential access seekers from submitting Access Applications, which may distort competition in the markets in which the access seekers compete with TPI and TPI Related Entities.

Because TPI Related Entities will compete with third party Access Seekers, the Alliance submits that the deficiencies described above must be rectified in order to minimise the perception that through providing both Access Related Function and Non-Access Related Functions, TPI could exploit an unfair competitive advantage for TPI Related Entities.

The Alliance notes that the Regulator has the power, under the Act to supplement its own segregation arrangements. The Alliance is firmly of the view, however, that it is in the interests of all stakeholders that TPI be required to correct significant deficiencies in the draft Arrangements before the Regulator considers approving them

The Alliance therefore submits that the Arrangements proposed by TPI should not be approved by the Regulator under section 29(1) of the Act at this stage.

There is a demonstrated need for strong regulatory oversight of TPI. This is particularly important in relation to early interactions between TPI and third party access seekers, such as Alliance members, and the resulting commercial decisions in relation to access. This is particularly with regard to access outside the Code and it is suggested that the Regulator consider that TPI treat FMG as an access seeker inside the Code.

The draft Train Management Guidelines and Train Path Principles documents provide some sense of key elements of the Rail Access Regime. By contrast, the access rules applying to TPI and other facilities at Port Hedland are not publicly available and not subject to independent regulatory oversight. The Alliance is hence concerned that the Segregation Arrangements currently appear to link the rail access regime to a non-transparent port access regime. TPI provides no legal or commercial rationale in relation to the Act as to why third party rail access should be driven by port priorities in this way. The Alliance contends that FMG's mine optimisation objectives are the fundamental driver of the mine, train control and port management.

The Alliance would submit that maintaining the integrated structure of the TPI railway haulage business linked to the overall business of FMG confers on FMG significant market power with regard to third party negotiations. By using its preferred position in port and rail, FMG/TPI can maximise their total returns by increased FMG iron ore sales. It also avoids formal access scrutiny because direct third party purchases or haulage arrangements sit outside the coverage of the Rail Access Act and Code. The Alliance is concerned that this approach sets an anti-competitive climate for above rail access seekers. There will be undue uncertainty with the rail access arrangements as a consequence making the Regime potentially unworkable and reinforcing FMG's market power as a buyer and seller of iron ore.

The Alliance contends that this is not the intention of the Code or the Act and the Alliance strongly urges the Authority:

- not to allow the TPI Port Access Regime and the TPI Rail Access Regime to be linked; and
- to ensure all references to non-rail entities and roles, particularly the Port, be removed from the TPI Rail Access Regimes documents.

The Alliance would request that the Regulator be cognisant of the above matters and set parameters and requirements for the Arrangements to allow third party Access seekers the transparency to negotiate effectively with TPI. These should consider the considerable market power of FMG as a buyer of iron ore, effectively a monopoly provider of rail and port access as well as having dominant market power for rail haulage contracts.

In summary, the Alliance suggests that the Regulator should direct TPI to move immediately to separate its access activities and access related activities from its other activities as if the access activities are being carried out by a different entity. This should involve:

- The TPI railway infrastructure being operated as a stand-alone business accounted for separately and transparently so it can be demonstrated that there are no cross subsidies between the other Associates or entities of FMG;
- TPI establishing a functionally and organisationally separate access activities business unit within TPI, with its own quarantined accounting and reporting arrangements and comprehensive definition of access related functions consistent with those applied to other vertically integrated railways subject to rigorous third party regimes; and
- Prior to Regulatory approval of the Arrangements, the detailed delineation and public exposure of concepts, processes and information required to deliver the intent of the Act in relation to the protection of confidential information, avoidance of conflicts of interest, separation of accounts and reports and compliance.

The Alliance recognises the proposed approach may add to the compliance costs of TPI but accepts these should be fully incorporated into the access charge facing Alliance members seeking access. The Alliance believes this would be a negligible and necessary cost of delivering the aim of the Rail Access Regime to achieve a net public benefit to the State and the objectives of Section 2A of the Act.

1. Introduction

This submission is provided by the North West Iron Ore Alliance (Alliance) in response to a call by the Economic Regulation Authority (ERA) for public submissions on the Segregation Arrangements that have been proposed by the railway owner, The Pilbara Infrastructure Pty Ltd (TPI), for its recently-constructed railway in the Pilbara. These proposed arrangements are set out in a letter from TPI's parent company, Fortescue Metals Group Ltd (FMG), to the Authority dated 3 July 2008 (which also includes train path policies and train management guidelines that are the subject of separate submissions from Alliance).

The Alliance was formed in 2007 to represent the interests of a group of dynamic iron ore companies operating in the Pilbara region of Western Australia. The Alliance's core objective is to work with communities in the region, government, infrastructure providers, existing producers and other stakeholders to promote the development of a vibrant junior iron ore industry. The Alliance comprises four members:

- Atlas Iron;
- BC Iron;
- Brockman Resources; and
- FerrAus

Rail is the only cost effective and environmentally acceptable method of moving iron ore produced from geographically remote Pilbara mining tenements to coastal export infrastructure. Given the very strong resistance of long entrenched operators – Rio Tinto and BHP Billiton – to facilitating third party rail access, TPI below rail facilities potentially offer the most cost effective method of delivering ore transport services to the eastern Pilbara.

Implementation of stringent Segregation Arrangements is a critical precondition for the development of iron ore resources outside the control of FMG, Rio and BHP Billiton. To assist the Authority in understanding the need for very stringent segregation and supporting Arrangements (including train path policy and train managements guidelines) to deliver an effective rail access regime the Alliance the main body of the attached submission covers the:

- Options for delivering effective third party access on TPI; and
- The Alliance suggested model for segregation and associated arrangements.

To supplement the material in the main body of the submission, annexures to the submission set these regulatory issues in their broader commercial context and also provide more detailed commentary on issues associated with Section 31-34 of the Access Act.

2. Background

The FMG/TPI State Agreement enshrines the principle of multi-user access to rail capacity built under the agreement. In introducing the Bill formalising the agreement, the Government has made clear the underlying policy objective in the Second Reading of the Bill:

The Government is facilitating the development of the new multi-user infrastructure to promote the growth of the Western Australian iron ore industry in the expectation that it will help new producers in the Pilbara capitalise on continuing strong global iron ore

demand, build industry capacity and increase the State's share of the world iron ore market..... The Government anticipates that the multi-user railway and port facilities to be developed under the Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement will open the Pilbara iron ore industry to new entrants seeking to supply growing demand for iron ore, especially from China. ¹

This intent is also reflected in the Preamble to Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement 2004.²

As a critical element in giving effect to an effective multi-user access regime for the railway, the Government announced that the legislation would provide for the TPI rail assets to be subject to the Railways (Access) Act 1998 and the Railways (Access) Code 2000.³ Section 2A of the Access 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".⁴ The Access Act and the Code provisions are directed toward establishing a level playing field and empowering the Regulator to seek these objectives under section 29 of the Access Act.

The aim of the rail access regime is to establish and implement a framework that ensures: **1) effective; 2) fair; and 3) transparent** competition, on Western Australia's railway network to achieve a net public benefit to the State.

3. Policy and commercial drivers in relation to third party access to TPI facilities

The Alliance strongly supports the underlying intent and the actions taken so far by the Government and FMG to put in place an alternative rail transport corridor for iron ore and other minerals in the east Pilbara that offers rail access to third parties on fair terms.

Looking forward, however, the Alliance is concerned that the commercial structures and incentives now in place have the potential to create significant barriers to adequate and timely rail capacity to facilitate the development of the Alliance and other non-related party resources. In particular, there are three related features of the commercial and operational context to which the Alliance wishes to draw attention that are crucially relevant to third party access regulatory design and oversight:

¹ RAILWAY AND PORT (THE PILBARA INFRASTRUCTURE PTY LTD) AGREEMENT BILL 2004 *Second Reading speech by Parliamentary Secretary (16 November 2004)*

² The State for the purpose of promoting development of the iron ore industry and employment opportunity generally in Western Australia, and for the purposes of promoting the development of multi-user infrastructure facilities in the Pilbara region of Western Australia, has agreed to assist the development of the above multi-user facilities upon and subject to the terms of this Agreement. (Schedule 1, para D)

³ Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004, Part 3.

⁴ Railways (Access) Act 1998

- The divergent incentives facing TPI and its owners when considering choices between carrying related party tonnages and facilitating third party carriage on TPI's rail infrastructure;
- FMG objectives with regard to its own mining and marketing operations in relation to product quality and the resulting incentive to secure tonnage either on a haulage basis or direct purchase at the mine gate outside the purview of the Access Code; and
- The very close linkages between port capacity, the owners' mine operations and train management.

Differing TPI incentives facing related and third party tonnages

As a vertically integrated iron ore supplier confronting a third party access request, FMG/TPI will face a trade off between commercial returns available from either the gross margin on related party iron ore tonnages shipped to market or the rail access (or possibly freight haul) charges derived from third party tonnages. The former will always be very much larger than the latter.⁵ The current iron ore market dynamics place a premium on capturing market share. Together with internal firm specific managerial incentives (which at senior level are aligned between FMG and TPI executives due to overlapping or common roles), this means that incumbents are acutely focussed on maximising the growth in their own tonnages, not that for the Pilbara as a whole. Given a choice, therefore, between facilitating the development and shipment of products from their own tenements and those of third parties, they will always choose the former and have correspondingly less incentive to facilitate third party developments.

FMG mining and marketing drivers

The production profile of FMG's deposits in relation to grade and other quality characteristics provides a strong incentive for the company to secure tonnage either on a haulage basis or direct purchase at the mine gate to supplement its product specifications via direct negotiation with third party producers. All such arrangements are outside the purview of the Access Code, as would currently be the case for all FMG tonnages carried over TPI's infrastructure. The FMG's need for third party ore and the current exclusion of FMG from a defined access seeker have the potential to severely limit the reach of regulatory oversight over TPI's third party access since the combination of FMG and haulage/mine gate ore will mean that much of ore traffic carried over the TPI rail facilities will not be subject Authority third party regulation.

The interplay between rail capacity access and port capacity allocation

Currently, iron ore exports from Port Hedland are constrained by port capacity⁶, not by rail capacity. Port capacity is likely to remain the critical bottleneck until such time as the proposed Outer Harbour development proceeds. A recent announcement by Minister

⁵ See Annexure A – Market context

⁶ WA Department for Planning & Infrastructure: Port and Related Infrastructure Requirements to Meet the Expected Increases in Iron Ore Exports from the Pilbara. February 2007

MacTiernan on port allocation indicated the Outer Harbour would not be expected prior to 2015. The Alliance expects therefore that at least until 2015, FMG will likely seek to dominate TPI port capacity allocation in the Inner Harbour regardless of its commitments to provide third party port access. Current evidence suggests that it will be in a strong position to do so, for two reasons.

First, public statements by the Government in relation to the TPI agreement acknowledge that a base level of FMG capacity allocation is essential to support the investment:

*The initial investment in the railway and port facilities to be developed under the agreement is likely to be underpinned by demand for iron ore transport and export services from FMG Chichester. However, any excess capacity of the railway and port facilities will be available to other customers in accordance with the applicable access regime [emphasis added].*⁷

Second, FMG has already stated an intention to expand output to 200 million tonnes per annum (mtpa), well above the “base level” 45mtpa allocated in port capacity under the TPI Agreement, with highly uncertain implications for the level and timing of available spare capacity.⁸

- The potential addition of Alliance railing requirements for direct shipped ore of nearly 30 million tonnes in 2011, rising to over 60 million tonnes by 2015 (Exhibit 1) places a premium on equitable and efficient allocation of existing rail capacity and the timely and cost effective allocation of expansions.⁹

Table 1: Nominal capacity by year for the Alliance Members – Port Hedland

Company (Mtpa Sales)	CALENDAR YEAR											
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Brockman Resources	1	2	8	10	15	15	20	25	25	25	25	25
Atlas Iron	1	6	9	12	17	22	22	22	22	22	22	22
BCIron	0	2	5	5	5	5	5	5	5	5	5	5
FerrAus	1	2	6	10	15	15	15	15	15	15	15	25
TOTAL	3	12	28	37	52	57	62	67	67	67	67	77

This table must be read with the Member’s standard disclaimer regarding forward looking statements.

In summary, by using its preferred position in port and rail, FMG/TPI can maximise their total returns by increased FMG iron ore sales and potentially avoid access scrutiny via direct third party purchases or haulage arrangements.

⁷ RAILWAY AND PORT (THE PILBARA INFRASTRUCTURE PTY LTD) AGREEMENT BILL 2004 Second Reading speech by Parliamentary Secretary (16 November 2004)

⁸ The Age, Business News, 21 July 2008 <http://business.theage.com.au/business/fortescue-metals-signals-bold-expansion-20080720-3i8n.html>

⁹ Hancock Resources might be expected to have a railing requirement of a further 30-40mtonnes by 2015.

Effective regulatory design and oversight are critical

Against this background, the interplay of commercial and regulatory arrangements governing access to FMG's TPI rail system is now critical to delivering the Government's policy objectives in a fair and efficient manner. This includes the Arrangements addressed in this submission and the four Part 5 Instruments that are the subject of separate submissions.

This is because:

- Of the high degree of uncertainty about whether, and if so on what terms, third party access will be forthcoming on non-TPI rail assets.
- The competitive dynamics discussed above are likely to increasingly apply to decision-making within FMG/TPI in relation to capacity allocation between its own mining output and that from third parties, notwithstanding FMG's commendable performance to date in delivering the new rail infrastructure in the east Pilbara.

The current ownership and management structure of TPI effectively align FMG and TPI commercial interests in focusing capacity allocation and/or expansion on serving FMG's needs. Looking forward, this has the potential to become a significant barrier to third party access.

Problems of information asymmetry mean that determining the actual capacity of a rail system, and through this, determining the "excess capacity" anticipated in the Government's second reading speech, is a major challenge for regulators or other outside parties. Thus, despite the FMG initial public responses to the Government's requirement for greatly improved rail (and port) access for third parties in the Pilbara, the future delivery of this access will require very careful attention to the interplay of commercial incentives and regulatory oversight of capacity allocation and management arrangements.

Set out below are considerations relating to alternative approaches to managing these issues as a basis for then evaluating the TPI proposed Arrangements under the Access Code.

4. Options for delivering effective third party access on TPI

Defining the regulatory challenge – general considerations

In general, the specific details of access regimes should be based on the access provider's market and industry position.¹⁰ Hence, the characteristics of an access regime for a service provider related to entities operating in upstream or downstream markets should differ for a provider with no such interest, on the basis that the commercial motives of the two providers are different and such motives govern the way the providers operate. In addition, the access regime should be differentiated on the basis of whether or not the provision of services uses a natural monopoly facility that confers market power on the provider of the services.

A third party access regime applicable in circumstances where the access provider is related to entities with upstream or downstream market significance (vertically integrated) should

¹⁰ See for example the ARTC evidence to the Productivity Commission review of National Competition policy (2004)

generally be more prescriptive and detailed (see Exhibit 2).¹¹ This is necessary to minimize the anti-competitive behaviour that would otherwise arise. This contrasts with an open access regime where the access provider has no upstream or downstream interests, has access revenue as its principle source of income and has a commercial imperative to promote competition in the use of the facility in order to grow the market. Within each of the two types of regimes, the extent of issues covered and the degree of prescription should be largely dependent on the extent of the access provider's market power.

Exhibit 2: Implications of market structure and power for regulation

Structure \ Market Power	Significant \longrightarrow None	
	Vertically Integrated	Third Party Access Regime Highly Prescriptive Focus on anti-competitive behaviours and monopoly pricing
Vertically Separated	Open Access Regime Only prescriptive with respect to denial of access and monopoly pricing.	Open Access Regime Little or no prescription

Source: ARTC Submission to Productivity Commission Inquiry into National Competition Policy (2004)

Structural solutions preferred

It is clear from the discussion in section 3 that FMG/TPI (and other Pilbara vertically integrated iron ore rail operators) falls within the scope of the top left hand box in Exhibit 2. Given the major challenges facing regulators in overcoming entrenched incentives to foreclose or otherwise impede third party access, structural changes that directly realign commercial incentives are generally to be preferred.

The strongest regulatory/policy response to this entrenched market power is normally to enforce separation of infrastructure ownership from train operation. This is intended to ensure that all train operators are given fair and unbiased access to the infrastructure.¹² This separation comes at a potential cost via the efficiency impacts when synergy is lost from the separation of above and below rail operations.

¹¹ i.e. covering access application, negotiation and pricing, dispute resolution, service performance, anticompetitive conduct, accounting separation and ringfencing.

¹² BTRE 114 The reasoning is that a vertically-integrated railway operator will always favour its own train operations over a third-party train operator, in financial, operational and timetable decisions. By contrast, a vertically-separated infrastructure manager is assumed to be indifferent between (or at least less likely to favour) specific operators.

In the case of TPI, however, there is another structural option that avoids the issues of separating above and below rail operations and aligns the commercial interests of the rail operator to treat FMG and third party access on equitable terms. This would involve the early and complete structural separation of TPI from FMG. FMG has already signalled, via the Government, an intention to sell down a minority stake in TPI.¹³ The implementation of total structural/organisational separation would most effectively overcome the challenges of making separation arrangements work and, perhaps more importantly, provide incentives to maximise usage of above and below rail capacity via both track access and/or the provision of third part haulage services.

Such a structural separation can be made without compromising the reasonable commercial aspirations of FMG since the separated TPI would be an attractive investment proposition for long term investors seeking secure and stable income streams via long term haulage and access contracts.¹⁴

Without that structural separation, the Alliance considers that FMG's commercial incentives to grow its own exports are so strong that it will be very difficult for the Regulator to ensure TPI as the infrastructure operator enter into fair and even handed access negotiations for third party access.

Notwithstanding clearly defined train path and train management guidelines, in the absence of action to orientate the rail operator's incentives to maximise freight traffic across the infrastructure, there will always be a strong temptation and ability for the integrated company to ensure both strategic and day to day operational decisions favour the owner over third party users.

The current risk profile of commercial and structural arrangements for rail transport facing new entrants are likely to lead to pressure for either the creation of duplicate infrastructure (with the attendant sub-optimal use of infrastructure, expanded environmental footprint, etc) and/or delay in bringing additional high quality direct shipped ore to market. This would frustrate the stated policy objectives of the Government in facilitating the TPI development.

Need for strong regulatory oversight

The Alliance recognises that the issue of structural separation is outside the purview of the ERA. In the absence of this separation, there is a demonstrated need for very strong regulatory oversight of TPI. This is particularly important in relation to early interactions between TPI and third party access seekers, such as Alliance members, and the resulting commercial decisions in relation to access. This is particularly important in relation to access

¹³ *FMG has stated that it intends to dilute its interest in TPI to no more than 40 per cent, so the mining and infrastructure components of the Pilbara iron ore and infrastructure project will be separately funded and managed* (Second reading speech op cit)

¹⁴ On 7 May 2004, FMG shareholders voted to sell up to 60% of the Pilbara Infrastructure Fund "so as to ensure that Fortescue Metals will not hold a majority ownership of the new open-access facilities" and FMG stated that it was envisaged that after the commissioning of the infrastructure, the Pilbara Infrastructure Fund would be floated on the Australian and an international Stock Exchange: FMG Quarterly Report for the period ending 30 June 2004.

outside the Code and it is suggested that the Regulator consider that TPI treat FMG as an access seeker inside the Code.

The Alliance would submit that the Stage 1 concept of maintaining the integrated structure of the railway haulage business of TPI linked to the overall business of FMG confers on FMG significant market power with regard to third party negotiations. This relates to the unstated FMG objectives discussed in section 3 above with regard to its own mining and marketing issues in relation to product quality and potential to secure tonnage either on a haulage basis or direct purchase at the mine gate.

These early interactions will be important in setting the tone and direction in terms of the delivery of the Government's stated policy intent in relation to promoting accelerated and diversified development of Pilbara iron ore and other mineral resources via effective third party access to TPI rail infrastructure.

The segregation arrangements and the Part 5 Instruments are critical framework documents. But it will also be important for the Authority to exercise close and effective oversight of the practical interactions that take place between TPI and access seekers. In situations, such as this, where the financial stakes of the negotiating process are high for access seekers and providers, then greater oversight throughout the process is likely to be most efficient. Thus, the Alliance strongly supports the ERA's role in requesting from the railway owner, on a confidential basis, a full set of internal prices and related information following receipt of a section 21 request from an access seeker.¹⁵ As noted above, the Alliance believes this oversight should extend to FMG's haulage arrangements by bringing FMG within the definition of an access seeker.

5. Alliance views on FMG/TPI segregation arrangements

TPI proposals and rationale in overview

TPI is claiming a greenfields railway operation would be affected by the separation between rail infrastructure and rail haulage operations with regard to safety, operations and cost.

With regard to access regulation TPI argues that "full segregation arrangements have not been imposed on any new railways in Australia since the introduction of the National Competition Principles Agreement in April 1995".¹⁶

¹⁵ *It is proposed that Section 21 of the Code should be strengthened to allow the Authority, following receipt of a Section 21 request, to request from the railway owner the internal prices and related information by route section for relevant parts of the network with such information to be provided within 10 working days. This would improve the Authority's ability to quickly express an opinion as to whether the price sought by the access seeker in negotiations for access is consistent with prices charged to associates of the railway owner.*

(Final Report: Review of the Western Australian Railways (Access) Code 200023 September 2005)

¹⁶ TPI Segregation Arrangements Submission to ERA July 2008, at 1.3.2, para 2

TPI is claiming that there is a precedent of the Tarcoola to Darwin railway certified access regime¹⁷ in which "there is no legislative requirement for the access provider to separate its access related and rail operator functions".

TPI is proposing, on the basis of the greenfield nature of the operations and the regulatory precedence, a two stage implementation of the Segregation Agreement with Stage 1 keeping the infrastructure and haulage components as one entity whilst, and until, six months before any initial negotiated access agreement comes into effect. TPI assert that the segregation proposals for Stage 1 are adequate to avoid the commercial aspects of the total FMG business from influencing rail access negotiations with access seekers.

In Stage 2 TPI propose that they "will ensure those staff performing access-related functions, such as train control and scheduling will not perform any haulage-related functions"¹⁸. The Stage 2 proposals also do not change the common role performed by the TPI Head of Rail, the FMG Chief Operating Officer (COO), the FMG Chief Executive Officer (CEO) and the common Directors on the FMG and TPI Boards.

Under these arrangements it would be impossible for a Director (or the executives nominated in the proposal) who receives details of proposals relating to access, or other access information, not to be aware of the information they receive in their FMG Board capacity, when considering TPI matters.

An extremely important assumption underlying FMG/TPI's overall approach to access management (reflected particularly in the train path management guidelines and train path policies) is that rail operations should effectively be subordinate to mine –port logistics within FMG/TPI operations:

"TPI consider that this reporting arrangement (as above) is necessary because of the need to closely integrate the operation of the mine, rail and port logistics chain infrastructure owned by FMG and TPI".

General rationale for and overall effect of TPI proposed arrangements is unsatisfactory

Against the overall background set out earlier in this paper, the Alliance considers the segregation proposals submitted to the Authority on 3 July by FMG/TPI, when combined with the train path and train management proposals, are not such as to provide confidence to access seekers and investors that treatment by the access provider will be equitable and will not compromise the access seekers commercial interests. A contestable market for rail operations will only be facilitated if a level playing field is created for all parties, including FMG, having or seeking access to railway infrastructure.

The Alliance would make two comments on the rationale and justification for the proposed two stage approach.

First, from the outset there has been no ambiguity about the intent of the TPI agreement with respect to the Government's policy objectives in assisting the planning and construction of

¹⁷ AustralAsia Railway (Third Party Access) Act 1999 (SA & NT)

¹⁸ TPI Segregation Arrangements Submission to ERA July 2008, at 1.3.2, Stage 2, page 7, dot point

the rail and port facilities by FMG/TPI. FMG should have been fully aware of the nature of the ring fencing rules within the WA Access Code to which TPI would be subject as a result of the Agreement. As such, the Alliance can see no case in principle for derogation from the full rigour of the regime given the asymmetry in incentives and information facing FMG/TPI and third party access seekers. To do otherwise would run the risk of repeating the highly unsatisfactory outcomes generated to date from earlier State agreements.

Second, the Alliance does not accept FMG's contention that the regulatory treatment established under the AustralAsia (Third Party Access) Code is a relevant precedent from an economic or commercial perspective for the TPI segregation arrangements (the issue of any legal basis for such an approach is discussed in more detail below). There were critical and special features that explain the light handed regulation in relation to segregation for the new AustralAsia railway that only involves requirements to protect confidential information and keep separate accounts. In summary, these are:

- The commercial outlook for the Tarcoola-Darwin railway was (and is) highly uncertain due to intermodal competition from road and ship for existing north-south traffic and the speculative nature of possible new traffics (for example, via land bridging of container traffic through Darwin).
- The existence of the large public subsidy applied to the capital cost of the railway to bridge the financing gap caused by the uncertain risk profile and associated low public cost-benefit ratio generated by the project.
- The resulting underlying incentive structure facing Freightlink management (who hold the track on a 50 year lease and manage access) is to increase traffic from all sources, including third party hauliers.

None of these considerations apply in the case of TPI.

Equally importantly, in the presented Segregation Arrangements TPI has not verified any case that the separation of above rail materially affects safety, operation and cost for a railway at the greenfield stage. Nor has TPI presented any case that segregation of above rail and below rail will affect integration of mine, rail and port logistics in its own business.

The premise by TPI is that the Segregation arrangements be considered in the context of the overall supply chain and specifically in the optimisation of the FMG supply chain, presumably in relation to part (a) of the Determination Framework (the railway owners legitimate business interests and investment in the railway infrastructure). However, the Alliance would submit that the optimisation of the FMG supply chain does not equate to efficient use of the railway.

The Alliance would request that this interpretation be given in the context of the meaning of part (a) relating to TPI only and that the Regulator ensures that the Access Regime is managed in such a way as to encourage maximum usage of the rail network.

The proposed arrangements do not comply with the Act

The Arrangements state that “there is no legislative requirement for the access provider to separate its access-related and rail operator functions”.¹⁹ The Alliance strongly disputes this. In particular, section 28 of the Act states that “A railway owner must make arrangements to segregate its access-related functions from its other functions”. Further, section 28(2) states that TPI “must have appropriate controls and procedures to ensure that the measures in place under subsection (1) ... operate effectively and are complied with.”

The legislative purpose of the Act, including section 28 is clear - the operations and management of FMG’s effective monopoly assets in TPI should be placed on a stand-alone basis to be managed independently of FMG’s competitive arms of its business. The Arrangements fail to meet this objective in several ways:

- The proposed “stage 1” fails to meet the requirements of section 28 of the Act.
- The Arrangements fail to constitute effective “controls and procedures” that will “ensure that the measures in place...operate effectively and are complied with”. The Alliance notes the clear intention of the Act in this regard; access related functions and other functions must be segregated; and controls and procedures must be put in place to “ensure” that the measures are both “effective” and “complied” with. Given the clear objects of the Act which includes to “promote competition in the operation of rail services...” the Alliance submits that this is a strict and fundamental threshold which the Arrangements must meet before the Regulator can, or should, approve them.

The Alliance also submits, that as a matter of principle, the use by TPI of the AustralAsia Railway Access Regime ... both as a precedent and as an effective access regime²⁰ is not relevant to the content of the Arrangements and TPI’s operations. TPI’s Segregation Obligations and the Arrangements are the subject of, and must comply with the Act, not different legislation in another Australian jurisdiction, and for a business which, as noted above, is fundamentally different to the nature of the Pilbara railways, and the businesses of TPI and access seekers.

The Arrangements state that “having regard to the regulatory precedent established by the certified access regime applying to the Tarcoola to Darwin railway, TPI proposes that its segregation arrangements be implemented in two stages.”²¹ The Alliance submits that this also is not relevant to the Arrangements and TPI’s operations, for the same reasons described above. Further, a two stage approach is in no way consistent with section 28 of the Act; the Act does not contemplate a phased implementation of the railway owner’s obligations to segregate its access related functions from its other functions.

It appears that TPI’s position is that it is not required to comply fully with the Segregation Obligations, but instead that it should implement arrangements which, it asserts, are more applicable to its operations. In this regard, as stated above, the Arrangements refer to the

¹⁹ Page 6 of Arrangements.

²⁰ Page 6 of Arrangements.

²¹ Page 6 of Arrangements.

AustralAsia Railway Access Regime and seek to rely on that Regime as an appropriate comparison and base-case. However, the AustralAsia Railway Access Regime is implemented under different legislation in another jurisdiction for fundamentally different commercial circumstances. The Alliance submits that the following arrangements (in order of priority) would form a more suitable basis (or reference point) for the Arrangements (noting however that the Arrangements must first and foremost comply with the Act):

- the Essential Services Commission Victorian Rail Access Regime (VRAR) Ring Fencing Rules, which are applied to Pacific National's Victorian freight operations;
- the WestNet segregation arrangements (also implemented under the Act); and
- the 2001 Queensland Rail Access Undertaking (and the QCA deliberations on the Undertaking, which provide informative insights into the critical importance of appropriate segregation arrangements in facilitating a contestable market for rail operations).

Consistent with our comments above regarding the AustralAsia Railway Access Regime, none of the above regimes form a “regulator precedent” which can merely be adopted for these purposes; however, the Alliance submits that those regimes are more closely aligned to the objects of the Act (including section 28) than the AustralAsia Railway Access Regime.

Two stage implementation not permitted under the Act

The Alliance considers that section 28 of the Act is clear; the Act does not allow TPI to initially implement relaxed segregation arrangements (which the Alliance considers do not comply with section 28 of the Act) and then more stringent segregation arrangements at a future and indeterminate date. Notwithstanding that the two stage/segregation level approach is without legislative basis, the initial “stage 1” arrangements are likely to cause serious concerns for potential access seekers.

The Alliance considers that a two staged implementation of the segregation arrangements can only serve to heighten access seekers’ concerns about the efficacy of the Arrangements and provide no confidence that TPI will not be able to use monopoly power to inhibit the development of above rail competition.

The Alliance is particularly concerned with the stated rationale that “As a greenfields operation, TPI is concerned that its 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”. Fundamentally, the Alliance considers this statement is contrary to the objects of the Act and the basis upon which the State of Western Australia entered into the relevant State Agreement with FMG and TPI. It is of considerable concern that TPI would propose a two staged approach given TPI’s own clear statement that “TPI recognises that organisational separation is a key means of preventing conflicts of interest arising in relation to the provision of access-related functions²²”.

²² Arrangements, page 10.

The Alliance requests that the Regulator must at all times consider that, as a vertically integrated business, FMG could potentially use monopoly power in the below rail market to gain an unfair advantage for FMG. For example, TPI could pass confidential information about third party Access Seekers and their proposed operations to FMG's competitive arm, thereby conferring an inappropriate competitive advantage.

The Arrangements state that the "two stage process provides a reasonable balance between the interests of TPI and third party Access Seekers". There is, however, no legislative basis for applying this criteria when setting the Arrangements.

The third party's perception of the leakage of confidential information between effective monopoly and contestable arms of a vertically integrated enterprise could seriously undermine confidence in the above rail market which would distort the evolution of this market.

Accordingly, the Alliance submits that:

- a staged implementation of the Arrangements is inappropriate and will erode Access Seekers' confidence in the efficacy of the Arrangements; and
- the segregation arrangements must be rigorous and open to scrutiny so as to promote confidence in their efficacy.

Proposed FMG/TPI model does not meet policy objectives or meet access seeker interests

In summary, the Alliance submits that it is unacceptable from a third party access seeker's perspective, for only pro forma segregation arrangements to apply until such time as six months prior to a first Access Agreement takes effect, with TPI staff performing both access and haulage functions. More importantly, information of a confidential nature in relation to third party access requests will be available to a wide range of senior executives whose remuneration and incentives are linked directly to FMG's commercial performance. This gives rise to major potential conflicts of interest and a potential incentive on FMG and TPI to delay signing such an agreement since it avoids the need to move to functional separation of critical access and haulage functions.

As discussed below, retention of an integrated structure severely affects the other sections of Division 3 of the Access Act particularly in relation to sections 31-34 and there would need to be in place very stringent accounting separation and conflict of interest management arrangements. These would need to exceed those currently applied to the common carrier rail operations under the WA Code. These would also need to be applied at the outset and not staged to avoid prejudicing access seekers ability to convince customers and investors that timely and cost effective access will be achievable.

Port Considerations to be excluded from application of rail access regime

The Alliance submits that it is also essential that third party rail access be entirely separated from considerations relating to the logistical operations of TPI's port facilities. Under the current train path policy they are effectively linked with provision for port priorities to overrule normal rail priorities. Were this allowed to stand it would severely compromise the above rail

TPI access market since it would effectively force third party producers either sell the ore to TPI at the mine gate or have them haul the ore and handle it at their port facilities.²³

In summary, the Alliance does not consider a compelling case has been made by TPI for giving precedence to mine and port logistics in TPI rail operations such as to justify the proposed staged segregation arrangements.

Lack of detailed information on critical design issues

Generally, the Alliance considers that the Arrangements lack an appropriate level of detail about how TPI will satisfy its Segregation Obligations. In a number of instances the Arrangements refer to further arrangements being implemented, the detail of which is omitted at this stage. The Arrangements must set out and explain how TPI will satisfy its Segregation Obligations, instead of referring to the further, vaguely described, arrangements which it proposes to implement. Further detail in this regard is provided in Annexures B-D.

6. Alliance suggested model for segregation and associated arrangements

The commercial and managerial incentives looking forward discussed earlier point clearly to the need to apply from the outset rigorous organisational and accounting separation between those parts of TPI responsible for below rail access (including operations and system expansions) and the rest of TPI and FMG.

The Alliance therefore suggests that the Authority should direct TPI to move immediately to separate its access activities and access related activities from its other activities as if the access activities are being carried out by a different entity. Set out below are Alliance's suggestions to the Regulator on: the need for and coverage of framing principles for the Arrangements; the organisational, staffing and information management within TPI; and more detailed design provisions in relation to supporting requirements under Section 31-34 of the Access Act. These proposals draw on the relevant WA and other State-based third party access frameworks.²⁴

The Alliance recognises the proposed approach may add to the compliance costs of TPI but accepts these should be fully incorporated into the access charge facing Alliance members seeking access. The Alliance believes this would be a negligible and necessary cost of delivering the aim of the Rail Access Regime to achieve a net public benefit to the State and the objectives of Section 2A of the Act.

Suggested framework principles

- The TPI railway infrastructure must be operated as a stand alone business which is accounted for separately and transparently so it can be demonstrated that there are no cross subsidies between the other Associates or entities of FMG;

²³ This issue is discussed in more detail in the companion NWIOA submissions on Train Path Policy and Train Management Guidelines.

²⁴ i.e. WestnetRail, Queensland Rail and the Victorian Rail Access Regime Ring Fencing Guidelines.

- Access to be negotiated in a competitively neutral environment;
- Access negotiations to be conducted in a timely and on a commercial basis between TPI and access seekers;
- All entities or persons seeking or having access to the TPI network, including all entities affiliated with FMG, will be treated fairly in relation to that access and price and terms discrimination is prohibited;
- All decisions within FMG which relate to access to the TPI network (especially with regard to those executives nominated in the TPI proposal and the Boards of FMG/TPI) must be taken without regard to the interests of FMG (except those required under the Corporations Act or any other Associate or entity within the Group which has or may require access); and
- All information which is obtained by TPI in the course of conducting its access related functions which is not generally available and which might reasonably be expected to affect the decisions of other entities of FMG must be kept confidential within TPI.

Organisational framework

- TPI to establish a functionally and organisationally separate access activities business unit within TPI, with its own quarantined accounting and reporting arrangements and comprehensive definition of access related functions consistent with those applied to other vertically integrated railways²⁵;
- TPI to ensure that the access activities business unit does not carry out other activities;
- TPI to ensure that the access activities business unit has separate staff with their own work areas from which staff of other business units are physically excluded (except specified shared service staff);
 - This should include a register of the names and positions of the staff, identifying, in respect of each member of staff (including the executive officer or officers to whom all staff report either directly or indirectly), the name and position of that person and whether that person is shared services staff, staff involved in the conduct of access activities or staff involved in the conduct of other activities.
- TPI to establish and maintain stringent information technology access controls between the access activities business unit and other functions.

Section 31 – Protection of Confidential Information

The proposal is vague on some matters compared to say the WestNetRail Confidential Information Arrangements²⁶ and it is suggested that the following be considered:

²⁵ Pacific National Access Arrangement, Essential Services Commission, June 2006

²⁶ WestNetRail, Segregation Arrangements, Revised Submission to the Regulator, Section 4

- Some examples of confidential information are given in the proposal and that this be expanded as an aid as to how TPI distinguishes confidential information from other information including both input and output information;
- An annual independent audit of compliance with arrangements for treatment of confidential information be undertaken;
- Greater detail on system security of electronic confidential information be provided;
- A hard copy Information Control Procedure be developed (as part of the Segregation Manual)
- Financial information should only pass to the centralised accounting group in such an aggregated form so that it is incapable of providing a market advantage to any other entity within the Group,
- In addition to the Segregation Awareness Statement any staff or contractors accessing confidential information should be nominated and covered by a confidentiality deed particularly with regard to information passed between TPI and FMG,
- The access seeker and TPI sign their own confidentiality deed as part of the negotiation process,
- Access agreements incorporate a confidentiality clause
- If access has commenced outside the Code and an access seeker subsequently makes an access application under the Code, TPI and the access seeker should agree on what information previously supplied by the access seeker is subject to the confidentiality provisions of the Segregation Arrangements.

Further detail is provided in Annexure B – Protection of Confidential Information.

Section 32 – Avoidance of Conflict of Interest

The TPI proposals state in broad terms that TPI will develop control measures to manage potential conflicts of interest both in handling access seekers confidential information in Stage 1 and extend these to common Directors of both Boards in Stage 2. TPI do not provide any framework of what these control measures would consist of or how they would work and it is suggested that the Regulator should review these to ensure that they meet the requirements of the Access Act and Code.

In particular the Alliance suggests that the decisions of common Directors need to be stringently covered at the outset. Desirably, there should be no common membership of the FMG and TPI Boards. In the presence of the current overlap the Alliance submits that:

- there should be a requirement in the Arrangements for each of the Directors of the FMG Board that in making decisions in relation to TPI's business that no special regard to the interests of FMG is to be given so that there is an abiding obligation upon FMG Directors to assess the approval or otherwise of access related matters in a manner which does not advantage FMG. This is consistent with the requirements of section 33 of the Access Act;

- Additionally, Directors can potentially avoid conflicts of interest by not being briefed by TPI on “deal level” information and provided with aggregated financial information so that such information is incapable of providing a market advantage to any other entity within the Group whilst providing sufficient detail for Directors to fulfil their corporate obligations.

Where the CEO and the Board require more detailed information in order for them to carry out their responsibilities TPI should implement a protection mechanism which would also apply when briefing the CEO outside of Board meetings.

The Alliance would therefore request that the Regulator should be satisfied that adequate documented protocols and security measures with regard to sharing of information duty of fairness and rectification of conflicts of interest with FMG entities and the TPI/FMG Boards are in place to ensure the fiduciary responsibilities of Directors were not compromised. Similar provisions should apply to shared executive staff.

Further detail is provided in Annexure C – Avoidance of Conflict of Interest.

Section 33 – Duty of Fairness

In keeping with the proposed organisational arrangements, the Alliance requests the Regulator to ensure that there is a commitment by TPI to treat all access seekers and train operators (associates and Third parties) fairly in relation to prices, service quality, train paths and priorities.

The Alliance suggests that the Regulator develop in consultation with TPI key performance indicators (KPI's) to assess and monitor the effectiveness of the Arrangements (e.g. such as breaches), service quality and cost efficiency. The Australian Rail Track Corporation (ARTC) periodically publishes KPI's relating to service reliability, service transit time, infrastructure condition and unit costs. TPI could publish similar indicators in such a way as to separate performance between third parties so as to enable fairness in treatment to be assessed.

The Alliance considers openness is the best approach to ensuring fairness of treatment and more importantly demonstrating this to the market. As well as publishing KPI's the Alliance considers indicative pricing (e.g. pricing for the most common) service should be published.²⁷ An important issue is that any price differentiation between operators reflects a fair assessment of the different costs and risks borne by the access provider, and the value the market places on the path. TPI should not be in a position to favour operators that operate like services and are competing in the same end markets. In this regard the Alliance suggests that all access agreements including the FMG agreement be provided to the Regulator and FMG be treated as an access seeker within the Code. Industry should know

²⁷ For example, the Queensland Competition Authority required Queensland Rail to publish reference pricing with respect to common coal hauls for this purpose. Similar arrangements are prescribed by the Essential Services Commission in respect of Pacific National's Victorian intrastate rail infrastructure.

exactly the nature and extent of current contractual commitments of TPI existing over particular routes on the TPI network.

The information provided to access seekers must be the same for all access seekers including FMG. The provision of accurate information relating to the operation of the railway system by TPI to all access parties is a fundamental aspect of segregation and fairness.

The Arrangements should 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 six monthly report to the Regulator on the monitoring, investigation and reporting procedures. In addition external auditing of TPI's compliance should be carried out at regular specified intervals and when an actual or alleged breach of the Arrangements takes place. The Arrangements should also provide for the payment of liquidated damages where a breach of the Arrangements is found to have occurred.

The Arrangements should detail a procedure for dealing with access matters and the order in which they are treated to prevent any access seeker receiving inappropriate priority in dealing with its access matters or proposals.

Section 34 – Separation of Accounts & Reports

As stated previously the TPI railway infrastructure must be operated as a stand alone business which is accounted for separately and transparently so it can be demonstrated that there are no cross subsidies between the other entities of FMG. In addition TPI would need to ensure that reporting to FMG be only at an aggregated level.

The Alliance agrees with the TPI Stage 2 objective that TPI be self sufficient for regulatory accounting, access pricing and revenue management and, in this case only, this could be implemented as a staged process.

With regard to Regulatory accounting the Regulator should require that the accounts contain sufficient information and to be presented in such a manner as would enable verification by the Regulator of the calculation of the various costs.

Compliance

The Alliance submits that:

- TPI should, as a matter of priority, prepare and submit the proposed Segregation Manual to the Regulator for approval and that the Regulator should issue the manual for public comment before approving it;
- the Segregation Manual should:
 - include detailed procedures and practices with which all TPI personnel and contractors must comply to ensure that TPI complies with the Arrangements and the Segregation Obligations; and
 - be publicly available;
 - TPI should be required to promptly report any suspected breach of the manual, the Arrangements and the Segregation Obligations to the Regulator and affected Access Seekers; and

- in relation to the annual compliance audits under clause 7.2 of the Arrangements, each audit report should be made public within a prescribed period (say 45 days) after its completion.

Further, the Alliance submits that if the Regulator considers or suspects that a breach of the segregation manual, the Arrangements or the Segregation Obligations has occurred, the Regulator should be able to require TPI to conduct and report on further audits, in the same manner as the annual audits under clause 7.2 of the Arrangements.

Annexure A - Market context

Evolution of global iron ore market

The Alliance considers that the time period to 2015 is a critical time window for Australian governments (Federal and State) and project proponents in establishing the nation's mineral resources export capacity for subsequent decades. While mineral prices remain high, international capital markets are willing to commit the funds to build new long life infrastructure such as Pilbara rail and port.

China's growth trajectory will change significantly over the next decade as the pace of urbanisation slows, working age population peaks, and the economy shifts from an infrastructure construction intensive phase to an economy with a stronger focus on services and personal consumption.

Analysis by the ANU China Economy and Business Program indicates the transition will likely be underway by around 2020. The Alliance expects that by around 2015, global capital markets will be anticipating that transition period with its attendant expected decline in commodity prices. Therefore, the Alliance considers that new investment proposals in mining (and related infrastructure) post 2015 will face a much more challenging environment. Unless the mining projects are built (or securely financed) by 2015, they are less likely to proceed.

Physical/geological configuration of resources

Recent exploration success in the east Pilbara has supported the growth of four new iron ore developers; Atlas Iron, BC Iron, Brockman Resources and FerrAus. Together, these companies have formed the North West Iron Ore Alliance to push for rail and port infrastructure access to support the growth of "junior" iron ore producers in the Pilbara. In addition, Hancock Prospecting is seeking to develop the Roy Hill 1 hematite deposit and have future expansion potential at Roy Hill South and Roy Hill 2. The location of these emerging iron ore projects is set out in Figure 1. A critical reason why these assets await development is because they do not at present have any secure access to an economically efficient means of transporting their output to market.

An assessment of current discovered resources of Direct Shipped Ore (DSO) quality product and an estimate of the potential economic resource base and annual production capacity is set out in Figure 2. Together, these projects have the potential to deliver 80-90 million tonnes of iron ore annually to Port Hedland by 2013 and up to 150 million tonnes by 2020.

Figure 1: Location of emerging iron ore projects in the east Pilbara

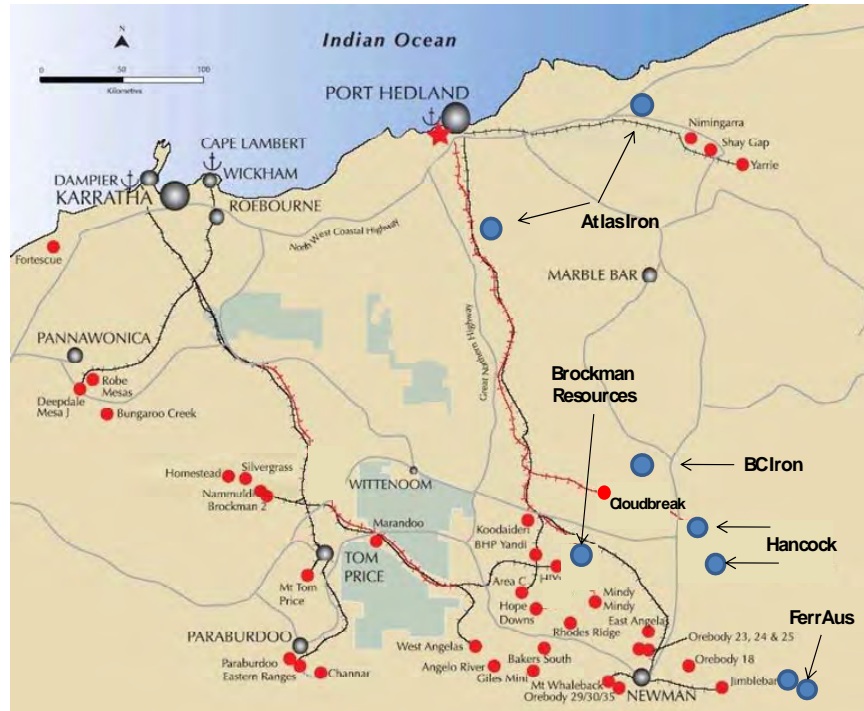


Figure 2: Discovered and Potential Non-BHP Billiton controlled Hematite and Magnetite Ore Resources in the east Pilbara.

Million Tonnes		Bedded Ore			Channel Iron Deposits		Detrital		Magnetite Resources	Annual Production (Mtpa)	
		Reserves	Resources	Potential Total	Resources	Potential Total	Resources	Potential Total		2013	2020
Atlas Iron Limited										17	22
	Pardoo	7.4	24.1	40							
	Abydos	7.4	15.1	140							
	Ridey Magnetite							1300@36.8%Fe			
BCIron Limited					28	50				5	5
Brockman Resources Limited					58	80	1500	1500		15	25
FerrAus Limited										15	25
	Davidson Creek		7.4	155							
	Robertson Range		45	160							
Total		14.8	91.6	495	86	130	1500	1500	1300	57	77

Policy and commercial drivers in relation to third party access to TPI facilities

Consideration and evaluation of appropriate arrangements governing the segregation by railway owners of access functions from other operational functions must have regard to the Government's policy objectives in relation to TPI and the incentive structures facing the owners/operators of TPI in relation to third party access.

WA Government Policy Objectives

It has been a long standing policy objective of successive Western Australian Governments to optimise the development of the Pilbara's mineral resources by encouraging the shared use of the critical transport infrastructure required to deliver products to export markets:

An effective rail access regime is required in order to give effect to the Government's intention of exiting railway owners to provide access to their facilities on a commercial basis, striking a balance between the interests of existing infrastructure owner, potential access seekers and the broader community. Effective third party access to existing infrastructure is conducive to improved industry efficiency and competitiveness, by avoiding sub-optimal development and uneconomic duplication of rail infrastructure. This takes into consideration the adverse environmental and social impacts of unnecessary duplication of rail infrastructure, including land corridors, in the Pilbara.²⁸

Hence, the early State Agreements supporting the development of the now BHP Billiton and Rio Tinto operated iron ore deposits all explicitly required the original developer to provide haulage services on the new rail systems for third parties. However, the drafting of those agreements in the 1960's and 1970's did not provide an effective basis for access to haulage services. As the Government has pointed out²⁹, to date there is not a single instance of successful negotiation of arms-length, third party access to either the BHP Billiton or Rio Tinto rail networks (the only exceptions have been where the third party was a Joint Venture mining operation with the rail network owner also being the Joint Venture operator).

This has prompted a number of third party access seekers, supported by the WA Government, to seek declaration of these railways under Part IIIA of the *Trade Practices Act 1974*. An access case, brought by FMG, is currently before the National Competition Council (NCC), with a final recommendation expected from the NCC to the Federal Treasurer within a matter of weeks. Even if the Treasurer were to declare the services subject to the application, however, there can be no guarantee that access will be forthcoming in a timely and cost effective fashion. Both Rio Tinto and BHP Billiton have declared their continued strong opposition to allowing third party operators to run trains over their networks. The result of any declaration would therefore likely be protracted access negotiations with ongoing disputation and arbitration causing further long delays, opportunity costs and legal costs. The FMG application to the NCC relating to the Mount Newman line commenced in 2004 and is still unresolved with much litigation having occurred.

As an alternative way of delivering the Government's resource development objectives, the WA Government is seeking to develop a Pilbara rail access regime applying to rail haulage

²⁸ Submission to the National Competition Council by the Government of Western Australia: Application under Part IIIA of the *Trade Practices Act 1974* for the Declaration of the Services provided by Hamersley Iron Ltd, Mount Goldsworthy Joint Venture Participants and Robe River Joint Venture railway facilities. (April 2008, para 1.4)

²⁹ *ibid*, para 1.8.

services only (PRAIC).³⁰ This would retain the vertically integrated ownership and operatorship of the rail network in the hands of BHP Billiton and Rio Tinto, with the operators potentially offering haulage services to third parties. The Alliance supports the Government's work in this area but notes that the proposed regime would appear to entrench the advantage of the existing network owners through capital and operating cost/pricing structures and through effective control of the access negotiation process.

Given BHP Billiton's public statements rejecting mandated third party access on their railways and Rio Tinto's claims of the value destruction associated with third party access³¹, it is very doubtful whether PRAIC will offer a timely rail access solution for new entrant iron ore producers in the Pilbara. The Government itself has pointed to uncertainties in relation to the outcome:

The detail of the Regime is still being developed, and although it is a desirable outcome, there is no guarantee that the final Regime will be certifiable under Part IIIA of the [Trade Practices] Act.³²

Against this background, the development and effective implementation of the State Agreement³³ supporting the FMG iron ore developments in the east Pilbara/Chichester Range becomes pivotal in delivering the Government's policy objectives. This agreement is between three parties – the Western Australian Government, FMG as the mine owner and guarantor to the rail and port logistics company "The Pilbara Infrastructure Ltd" (TPI), and TPI as the owner and operator of the rail system and port export facility.

TPI is a wholly owned subsidiary of FMG but FMG have indicated their interest in an eventual sell down of their equity interest in TPI. This ownership structure creates special challenges in relation to assuring delivery of effective third party access (see section 5 below)

The FMG/TPI State Agreement enshrines the principle of multi-user access to rail capacity built under the agreement. In introducing the Bill formalising the agreement, the Government has made clear the underlying policy objective in the Second Reading of the Bill:

The Government is facilitating the development of the new multi-user infrastructure to promote the growth of the Western Australian iron ore industry in the expectation that it will help new producers in the Pilbara capitalise on continuing strong global iron ore

³⁰ Department of Treasury and Finance, Government of Western Australia: Pilbara Railways (Third Party Haulage) Regime. Public Consultation Paper June 2008.

³¹ *The moment you move to multi-user infrastructure, you lose 10 per cent to 20 per cent of your efficiency ... and Australia faces an annual NPV (net present value) loss of \$30 billion,* ' Mr Walsh said. (Source AAP, 4 August 2008)

³² Submission to the National Competition Council by the Government of Western Australia: Application under Part IIIA of the *Trade Practices Act 1974* for the Declaration of the Services provided by Hamersley Iron Ltd, Mount Goldsworthy Joint Venture Participants and Robe River Joint Venture railway facilities. (April 2008, para 1.18.

³³ Government of Western Australia: Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Bill 2004.

demand, build industry capacity and increase the State's share of the world iron ore market..... The Government anticipates that the multi-user railway and port facilities to be developed under the Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement will open the Pilbara iron ore industry to new entrants seeking to supply growing demand for iron ore, especially from China. ³⁴

This intent is also reflected in the Preamble to Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement 2004.³⁵

As a critical element in giving effect to an effective multi-user access regime for the railway, the Government announced that the legislation would provide for the TPI rail assets to be subject to the Railways (Access) Act 1998 and the Railways (Access) Code 2000.³⁶ Section 2A of the Access 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".³⁷ The Access Act and the Code provisions are directed toward establishing the level playing field and empower the Regulator to seek these objectives under section 29 of the Access Act.

The Alliance strongly support the underlying intent and the actions taken so far by the Government and FMG to put in place an alternative rail transport corridor for iron ore and other minerals in the east Pilbara that offers rail access to third parties on fair terms.

Looking forward, however, the Alliance is concerned that the commercial structures and incentives now in place have the potential to create significant barriers to adequate and timely rail capacity to facilitate the development of Alliance resources. These concerns relate to both the proposed segregation arrangements per se and the proposed tight linkages between the rail and port access regimes in order to optimise FMG's mine-rail-port logistics.³⁸

These issues are discussed in more detail in the next section, first from a general perspective and then in relation to the particular circumstances of FMG/TPI.

Competitive dynamics of regulation in freight railways – general considerations

It is well recognised that vertically integrated train operators present the greatest challenges for effective regulation intended to deliver equitable third party access while maintaining incentives to invest in system maintenance and capacity expansion. This reflects a

³⁴ RAILWAY AND PORT (THE PILBARA INFRASTRUCTURE PTY LTD) AGREEMENT BILL 2004
Second Reading speech by Parliamentary Secretary (16 November 2004)

³⁵ The State for the purpose of promoting development of the iron ore industry and employment opportunity generally in Western Australia, and for the purposes of promoting the development of multi-user infrastructure facilities in the Pilbara region of Western Australia, has agreed to assist the development of the above multi-user facilities upon and subject to the terms of this Agreement. (Schedule 1, para D)

³⁶ Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004, Part 3.

³⁷ Railways (Access) Act 1998

³⁸ Train Management Guidelines and Train Path Policy

combination of economies of scale and scope between above and below rail operations, which tends to entrench the market power of incumbents.³⁹

The relatively higher level of sunk and fixed costs in railroads means that difficulties in creating the right incentives for investment impose a heavier cost in railways than elsewhere, and mean that the trade-off in access pricing between short-term efficiency and long-term efficiency (i.e., both full cost recovery and pro-competitive investment) is more stark in railways than elsewhere. The apparently non-vanishing economies of density in train operation mean that even if a given infrastructure grid is opened to entry by competing train operators, that operator that achieves a “first mover” advantage is likely to keep it, and to be able to set and adjust its tariffs in such a way as to prevent the development of significant competition.⁴⁰

There are also significant problems of information asymmetry in relation to system capacity and costs.

The State Government notes the difficulty in assessing rail infrastructure capacity due to the information asymmetries that exist between the infrastructure owners and access seekers (and interested parties).⁴¹

In general, the manager of an integrated system has some incentive to allow access to below rail infrastructure third parties because they can contribute to infrastructure fixed costs. However, if the manager is a monopoly provider of a particular transport service where the train operator/shipper has high downstream market power then there is generally a lower incentive to produce efficiently and/or a tendency to shift a disproportionate share of its costs on to the access seeker:

The requirements for regulatory oversight differ between integrated and separated railways. Sometimes access seekers intend to compete for the integrated railway infrastructure manager’s traffic. In those cases, managers have an incentive to offer unfair terms of access relative to those that it charges for its own train services. The regulator will, therefore, need to ensure that unfair access terms are not used to frustrate that competition.⁴²

With a vertically-integrated infrastructure manager negotiating with rival freight operator..., the integrated freight railway operators are likely to see third party freight access seekers as threatening their own freight revenue. Consequently, they will be less inclined to encourage access and see less incentive to negotiate access terms that would be acceptable to the seeker.⁴³

³⁹ See Optimising harmonisation in the Australian railway industry: Report 114 (Bureau of Transport and Regional Economics, 2006)

⁴⁰ Structural Separation and Access Pricing in the Railways Sector: Sauce for the Goose Only? Russell Pittman* Antitrust Division, US Department of Justice

⁴¹ NCC WA sub Ibid para 3.2

⁴² BTRE: Report 114, page 179, op cit

⁴³ BTRE: Report 114, page 180 op cit.

Competitive dynamics of regulation – special considerations in relation to the Pilbara & TPI/FMG

Considerations relating to the downstream market power and incentives of integrated iron ore producers to facilitate rail access give rise to even larger regulatory challenges than diversified operators.

As noted above, experience to date has shown that incumbent iron ore producers in the Pilbara (BHP Billiton and Rio Tinto and their antecedents and associates) have blocked third party access to their rail infrastructure, whether in the form of third party, above rail operations or via the provision of haulage services by the integrated operator. As noted earlier, there is no certainty that the PRAIC process will deliver third party haulage services on acceptable and timely terms.

The unwillingness of incumbents to provide third party access is sometimes claimed as conclusive proof of the existence of cost externalities imposed on integrated operators by third party access:

Since the incumbent railway owners are also mine owners, it is very likely they possess sufficient information to price discriminate. In fact, they could avail themselves of the resource rents associated with the ore production of third parties with relative ease through providing access. Therefore, if access imposed no risk of cost externalities on their logistics chains, there would clearly be an incentive for mining companies to provide it. The fact they do not suggests these externalities are perceived (or calculated) to exceed the resource rents which might be earned from third parties. In other words, the logistics chain may become more costly and deliver less product with an access regime than without it.⁴⁴

The underlying rationale for this conclusion misses or underplays a number of important points:

- The importance of time to market. Over the longer term world iron ore markets will likely revert to a much more perfectly competitive model, but the current balance between demand and supply of iron ore into Asian markets provides important pricing power to Pilbara producers. These circumstances place a premium from a Government and societal perspective on maximising the exploitation of Pilbara iron ore (and other minerals) for two reasons, one applying to the short to medium run, the other applying to the long run.
 - Maximising output now takes advantage of the current cycle to maximise the extent to which the Australian economy can benefit from the high prices of this cycle.
 - This will also foreclose or reduce entry from non-Australian production which can have long term benefits for Australia.

⁴⁴ Competition Policy and Railway Investment – Project Summary (Nick Wills-Johnson Planning and Transport Research Centre, Curtin University of Technology, Feb 2007, page 16).

- The interplay between rail capacity access and port capacity allocation. Currently, iron ore exports from Port Hedland are constrained by port capacity⁴⁵, not by rail capacity. Port capacity is likely to remain the critical bottleneck until such time as the proposed Outer Harbour development proceeds. A recent announcement by Minister MacTiernan on port allocation indicated the Outer Harbour would not be expected prior to 2015. The Alliance expects therefore that at least until 2015, FMG will likely seek to dominate TPI port capacity allocation in the Inner Harbour port capacity regardless of its commitments to provide third party port access. By potentially discriminating against third party rail access seekers, FMG/TPI can maximise their total returns by increased FMG iron ore sales.

The market dynamics discussed above, together with internal firm specific managerial incentives, mean that incumbents are acutely focussed on maximising the growth in their own tonnages, not that for the Pilbara as a whole:

- Gross margins for Rio and BHP Billiton shipped ore for 2007 were in the range 50-60% before this year's 50-70% price rises.⁴⁶ This compares with freight haulage margins that are a fraction of these returns.
- There is no reason to believe FMG's operating economics are significantly different to Rio/BHP Billiton. Given a choice, therefore, between facilitating the development and shipment of their own tenements and those of third parties, these companies will always choose the former and have a strong incentive to frustrate third party developments. It can be argued there is a positive duty to that companies shareholders to do just this.

Hence, there is no one-to-one mapping of economic and commercial interests between the Government (as ultimate owner/steward of the resources) and private companies.

This divergence of interests is likely to become sharper in the presence of a BHP Billiton/Rio Tinto merger as the merged entity seeks to deliver the major cost savings that have been claimed as the major shareholder benefit from the merger.

It is also very unlikely that the resulting configuration would be consistent with a rail and port system that would be optimised for resource production across the Pilbara.

The claimed preferred first best solution to rail access – effective price discrimination exercised commercially by integrated incumbent operators – would not deliver the Government's policy objectives for Pilbara resource development. Indeed, in these circumstances, the same analysis acknowledges the crucial role of effective regulation in finding the right balance between Government and commercial objectives:

⁴⁵ WA Department for Planning & Infrastructure: Port and Related Infrastructure Requirements to Meet the Expected Increases in Iron Ore Exports from the Pilbara. February 2007

⁴⁶ *Prices have rocketed, and what was previously a low-margin business is now, for want of a better word, a goldmine. Rio's Pilbara operations have a gross margin – ebitda (earnings before interest, tax depreciation and amortisation) to sales – of 58%. BHP's is 54%. (London Sunday Times, Resources Section, 20 January 2008).*

*An unregulated railway will extract its sunk costs plus some resource rents. A regulator can force it to extract only its sunk costs, with the potential outcome that more small mines are made viable and output expands. In effect, regulation allows the industry to achieve a better second-best outcome.*⁴⁷

The importance of facilitating effective access to export markets by new players has been explicitly recognised by the WA Government in relation to port access where the Minister for Planning and Infrastructure recently announced the reservation of two new multi-user berths in the Port Hedland inner harbour for use by Alliance members and other potential junior producers.⁴⁸

⁴⁷ Op cit, page 15.

⁴⁸the Western Australian Minister for Planning and Infrastructure Hon Alannah MacTiernan in consultation with the Port Hedland Port Authority confirmed the reservation of two new multi-user berths in the Port Hedland inner harbour for use by Alliance members and other potential junior producers. The two berths would have the capacity for up to 50 million tonnes of iron ore exports per annum, sufficient to cater for the initial production of its member companies - Atlas Iron Limited, BC Iron Limited, Brockman Resources Limited, and FerrAus Limited. NWIOA Media Announcement, 6 August 2008.

Annexure B – Critical detailed information

Generally, the Alliance considers that the Arrangements lack an appropriate level of detail about how TPI will satisfy its Segregation Obligations. In a number of instances the Arrangements refer to further arrangements being implemented, the detail of which is omitted at this stage. The Arrangements must set out and explain how TPI will satisfy its Segregation Obligations, instead of referring to the further, vaguely described, arrangements which it proposes to implement. For example, in relation to the implementation of the Stage 2 segregation arrangements, the Arrangements state that:

- TPI “will submit the relevant documentation to the Regulator to demonstrate how it will implement its Stage 2 obligations”;⁴⁹
- TPI “will develop control measures to manage potential Board level conflicts of interest...⁵⁰”;
- TPI “commits to develop a Segregation Manual”⁵¹; however there is no indication as to when this will be done;
- the “key additional obligation TPI will bear under Stage 2 relates to **more complete** function separation [Alliance emphasis]”;⁵² and
- “staff performing access-related functions ... will not perform any haulage-related functions and the restrictions on the internal flow of information will correspondingly increase”.

The drafting of the Arrangements is generally unclear and confusing. The Alliance submits that imprecision in drafting the Arrangements in itself creates significant uncertainty for Access Seekers. Significant imprecision in the application of the Arrangements can, of itself, operate as a significant barrier to entry as Access Seekers cannot understand with any degree of precision how their access rights under the Act and the Code may be interfered with.

For example, the Arrangements state:

- (paragraph 1.3.1) “the rail assets subject to declaration under the WA Rail Access Regime...” The Act and the Code use the defined term “rail infrastructure”, whereas the Arrangements’ ‘rail assets’ is undefined and imprecise. Further, clearly the Act and Code do not provide for any ‘declaration’ of rail assets (or rail infrastructure, as defined in the legislation);
- (paragraph 1.3.1) “the rail assets ... are owned and will be operated by TPI...”, and “[TPI] is responsible for the construction of a **railway** from the Pilbara to Port Hedland...[Alliance emphasis]” Contrasted to the Arrangements, the Act and Code use the defined term “railway owner” which means “the person having the

⁴⁹ Page 7 of Arrangements.

⁵⁰ Page 11 of Arrangements.

⁵¹ Page 21 of Arrangements.

⁵² Page 7 of Arrangements.

- management and control of the use** of the railway infrastructure [Alliance emphasis].” The Act and Code use the defined term “railway infrastructure”;
- (paragraph 1.3.2) “While the organisation structure, as provided in section 1.3, will be implemented **from the outset** there will be **considerable** sharing of information between business units to support the **effective...**” [Alliance emphasis];
 - (paragraph 1.3.2) “Stage 1 will apply from the **commencement of TPI’s railway operations**” [Alliance emphasis]; there is no guidance as to what this means and when this occurs;
 - (paragraph 1.3.2) “From time to time, **as required**, the Commercial/Compliance Officer within TPI will receive advice from other areas of TPI” [Alliance emphasis]; there is no guidance as to when such advice may be “required” and according to what principle;
 - (paragraph 4.3.2) “Consultants who work for the company for a **specified period of time** will be included as a staff member for the purpose of the [Arrangements]” [Alliance emphasis]; there is no guidance as to what the specified period of time is; is it 1, 10, 100 days or some other period?;
 - (paragraph 1.3.2) “Importantly, TPI commits that FMG staff **involved in the mining or marketing of iron ore** will not perform access-related functions at any stage” [Alliance emphasis]; on one level this could be interpreted to apply to all FMG staff given the nature of FMG’s business;
 - (paragraph 3) “TPI interprets “other business” as anything other than the **management and control of the use of the railway infrastructure**” [Alliance emphasis]; we are not sure what these words mean; and
 - (paragraph 5) “TPI will ensure that the **key** terms and conditions of internal access agreements will be **broadly comparable** to those provided or offered to third party Access Seekers” [Alliance emphasis]; this wording is so broad and imprecise as to render the commitment meaningless.

In relation to the parts of the Arrangements on which this submission does not comment, the Alliance is generally comfortable with the approach TPI has adopted.

Annexure C - Protection of Confidential Information

The Alliance understands that TPI will provide, amongst other services, services to Access Seekers by way of access to TPI's rail infrastructure (**Access Related Functions**) and rail haulage services to TPI Related Entities (**Non-Access Related Functions**).

The Segregation Obligations require TPI to segregate its Access Related Functions from its Non-Access Related Functions. The Arrangements fail to satisfy this obligation.

The implementation of appropriate controls and procedures to protect confidential information is a fundamental and critical element of any segregation arrangement. The Alliance is concerned with the current lack of precision in the drafting of the Arrangements in this regard.

The following issues are of particular concern.

Definition of “confidential information”

The Arrangements adopt an interpretation of “confidential information” that is independent from the definition provide in section 31(2) of the Act. Whether information falls within the Act's definition of confidential information is a matter of fact. There should be no difference between the level of protection of confidential information provided during the proposed two stages.

Paragraph 4.1 of the Arrangements states that “In Stage 1, confidential information will only include information disclosed as part of an Access Application or access negotiations”. The Alliance submits that this statement is incorrect. Whether information constitutes “confidential information” as defined in section 31(2) of the Act, and is therefore the subject to the Segregation Obligations, is a matter of fact. It is concerning that TPI seeks to limit the definition of confidential information in Stage 1 in the way that is proposed. Further, TPI offers no clear rationale for limiting the definition of confidential information in Stage 1 in the way proposed.

The statement in paragraph 4.1 of the Arrangements that “In Stage 2, confidential information will include, in addition to Stage 1 confidential information, confidential information disclosed as part of the operation of an access Agreement” is similarly incorrect; the application of section 31(2) of the Act deems the prescribed information to be confidential information.

Giving effect to the confidentiality obligations

The Alliance considers that the Arrangement should be amended to include a statement that, if required by either party, the parties must enter into appropriate confidentiality arrangements to reflect TPI's confidentiality obligations under the Act and the Arrangements. This will provide an Access Seeker with an enforceable right to ensure that TPI complies with its confidentiality commitments. The Alliance considers that (as in other jurisdictions, for example Queensland) it is particularly important that this is the case because, prior to signing an Access Agreement, Access Seekers will not have directly enforceable rights regarding the protection of their confidential information.

Commercial/Compliance Officer and other employees with Access Related Functions

The Arrangements are inconsistent in relation to which TPI employees will perform functions regarding the negotiation of Access Applications. The Arrangements state that:

- “The entirety of the access application/negotiation process will be undertaken by a Commercial/Compliance Officer within TPI”,⁵³
- “Requests for Access and the access negotiation process will be **managed** by TPI’s Commercial/Compliance Officer [Alliance emphasis]”,⁵⁴ and
- “TPI staff responsible for negotiating access will only disclose Access Seeker or Access Holder confidentiality information for the purpose and to the extent necessary to progress an Access Application.”⁵⁵

The Arrangements state that “TPI’s Commercial/Compliance Officer may need to disclose the Access Seeker’s confidential information to the train control and track managers...”⁵⁶ Although it may be necessary for the Commercial/Compliance Officer (and other employees with Access Related Functions) to disclose confidential information in this way and for this purpose, and possibly for other purposes related to Access Related Functions, the Alliance submits that it is not necessary for the identity of the Access Seeker to be disclosed, and the Arrangements should require the identity to be kept strictly confidential in all such instances.

If a TPI employee has a role in both TPI’s Access Related Functions and its Non-Access Related Functions, Access Seekers would be unable to accept that the TPI employee could (or would) disregard and not use the Access Seeker’s confidential information when performing its role in TPI’s Non-Access Related Functions. This issue is also discussed below in relation to TPI’s obligation to avoid conflict of interests (Annexure C). However, on the grounds that TPI must protect Access Seeker’s confidential information, the Alliance submits that employees with Access Related Functions must not also have Non-Access Related Functions.

In relation to employees who move from having Access Related Functions to having Non-Access Related Functions, the Alliance submits that they should not exercise any Non-Access Related Functions for a period of at least one year after performing the Access Related Functions. TPI’s proposed period of three months is too short, and is likely to cause concern for Access Seekers that within a short period of time after disclosing confidential information, the information could be used by TPI in its Non-Access Related Functions.

Internal reporting functions

⁵³ Page 6 of Arrangements.

⁵⁴ Page 13 of Arrangements.

⁵⁵ Page 14 of Arrangements.

⁵⁶ Page 14 of Arrangements.

The Arrangements state that “TPI is required to provide management reports to both its own Board and to the Head of Rail, COO, CEO and FMG Board members only.”⁵⁷

The Alliance submits that the information contained in reports to TPI’s Board and Head of Rail, and to FMG’s COO, CEO and Board, should, wherever possible only disclose confidential information if it is absolutely necessary and then only to the extent required to enable those senior managers and directors to fulfil their legal obligations.

Segregation Awareness Statements

While it is not clear from the drafting of the Arrangements, the Alliance assumes that the Segregation Awareness Statements will form part of the Segregation Manual and, as such, the form of those statements will need to be approved by the Regulator. The Alliance considers that the Segregation Awareness Statements (and the Segregation Manual) present a critical opportunity for TPI to instil within TPI a culture of compliance with the Arrangements. Accordingly, as a minimum, the Alliance submits that the Segregation Awareness Statements should:

- Create legally enforceable obligations between the relevant employee and TPI to comply with the Arrangements, including the Segregation Manual; and
- Make it clear that TPI requires strict compliance with those arrangements and that non compliance will be treated as a serious disciplinary matter.

Hard copies of confidential information

The Arrangements state that “Any written or electronic confidential information received by the Commercial/Compliance Officer in performing access-related functions will be kept on files within TPI premises”.⁵⁸ We query what this means in practice. The Arrangements do not deal with the fact that the TPI premises might also house business units relating to TPI’s Non-Access Related Functions. The Alliance submits that the Access Seekers’ confidential information storage facility must be a secured compactus or equivalent facility, access to which is strictly limited to only the Commercial/Compliance Officer.

The Arrangements are inconsistent, stating that “These files will only be accessible **to the Commercial/Compliance Officer** who will control **access of other TPI staff**...[Alliance emphasis]”⁵⁹ The Alliance submits that the Arrangements should clarify how physical access will be controlled and should clearly state which categories of staff or consultants will be entitled to access that information (and on what basis).

Further, the Alliance submits that if the Commercial/Compliance Officer proposed to provide any Access Seeker confidential information to any third party in circumstances where it may be reasonable to assume that a conflict of interest may arise (or a breach of confidence may occur) then TPI should be under an obligation to consult with the relevant Access Seeker in good faith before any such disclosure is made.

Electronic copies of confidential information

⁵⁷ Page 14 of Arrangements.

⁵⁸ Page 15 of Arrangements.

⁵⁹ Page 15 of Arrangements.

Regarding the control of electronically stored Access Seeker confidential information, the Arrangements propose that TPI will share an information technology system with FMG. This is an example of the Arrangements' failure to adequately acknowledge TPI's obligation to segregate its Access Related Functions from its own (i.e. not FMG's) Non-Access Related Functions. Further, the Arrangements state that confidential information held electronically "will be subject to limited access"; the Alliance is concerned with the imprecise nature of this drafting, particularly given the critical importance of protecting third party confidential information.

The Alliance submits that TPI should store electronic Access Seeker confidential information on a dedicated and stand alone computer file server, separate from both FMG and TPI's Non-Access Related Functions. In relation to Queensland Rail's Draft Undertaking, the QCA stated that "One lesson from the UK electricity regulator (OFFER) drawn from its assessment of vertically integrated public electricity suppliers is that the security of information for customers and competitors can only be achieved through the separation of data and the implementation of strict controls on the ability of internal businesses to access data.⁶⁰ OFFER argues that allowing a largely integrated form of information system gives no incentive to the integrated business to identify clearly where data is owned, who is responsible for maintaining it or even if it is necessary for the business."⁶¹ The principle applies directly to TPI's storage of electronic Access Seeker confidential information.

The Alliance notes that the Arrangements also state that the Head of Rail will only grant access to third party confidential information to persons who have signed Segregation Awareness Statements. The Alliance submits that this should also be expanded to clearly state that such information will also only be available to people who must have access to that information in order to progress the Access Application (i.e. strictly on a needs to know basis only).

⁶⁰ OFFER/OFGAS, Separation of Businesses: Proposals and Consultations, May 1999, p38.

⁶¹ Queensland Competition Authority, *Draft Decision on QR's Draft Undertaking, Volume 2 - The Draft Undertaking*, December 2000, p109.

Annexure D - Avoidance of Conflict of Interest

In relation to ensuring the avoidance of conflict of interest, the Arrangements are deficient in numerous respects, particularly during the proposed Stage 1.

Generally, the Arrangements state in general and imprecise terms that TPI will develop processes and measures to deal with conflicts of interest both in handling access seekers confidential information in Stage 1 and extend these to common Directors of both Boards in Stage 2. However, the Arrangements do not specify in any meaningful way what that processes and procedures are.

Without any legislative basis the Arrangements state that “the flow of information between business units will be considerable to support safe and effective rail and haulage operations. The access to and interchange of information would be uncontrolled during [stage one]...”⁶² The Alliance submits that this is entirely inconsistent with the Act and is a worrying premise upon which to base the Arrangements.

The Arrangements state that “TPI interprets ‘other business’ as anything other than the management and control of the use of the railway infrastructure.”⁶³ This interpretation is excessively narrow. The definition of “access-related functions” in clause 24 is clear, and “other business” is clearly anything other than the “access-related functions”.

The Arrangements deal with the avoidance of conflict of interest largely in terms of controlling the disclosure of Access Seekers’ confidential information; the avoidance of conflict of interest obligations are broader than the obligations regarding the disclosure of confidential information. The Arrangements state that “TPI will develop control measures to manage potential conflicts of interest **in handling Access Seeker’s confidential information** [Alliance emphasis]”⁶⁴; the obligation to avoid (ie not manage - see below in this regard) conflicts of interest is not limited to the handling of confidential information.

The Arrangements state that “Under Stage 1...TPI commits that no person will **perform duties concurrently** for both TPI and FMG where a conflict of interest **exists** [Alliance emphasis]”⁶⁵, and “TPI will develop control measures to **manage** potential conflicts of interest.”⁶⁶ In this regard, the Arrangements fail to satisfy the obligation under section 32 of the Act to ensure that a conflict of interest does not exist (i.e. to ensure that a conflict of interest does not **arise**). The reference to FMG is also a further example of the Arrangements’ failure to adequately acknowledge TPI’s obligation to segregate its Access Related Functions from its (i.e. not just FMG’s) Non-Access Related Functions. Further, we do not understand what “perform duties concurrently” means. On one reading, this means that a person can perform duties for both TPI and FMG even if a conflict exists provided he or she does not do so “concurrently” (i.e. at the same time).

⁶² Page 10 of Arrangements.

⁶³ Page 9 of Arrangements.

⁶⁴ Page 10 of Arrangements.

⁶⁵ Page 10 of Arrangements.

⁶⁶ Page 10 of Arrangements.

The Arrangements fail to adequately deal with how TPI will comply with section 32 of the Act in relation to its Board and Head of Rail, and FMG's COO, CEO and Board, all of whom the Arrangements acknowledge will have conflicts of interest in performing their roles.

Under clause 3.1 of Queensland Rail's 2005 Access Undertaking, Queensland Rail establishes an organisational structure for the segregation of the management of its rail infrastructure (i.e. access) from its train services (i.e. haulage). "Network Access" is established as a Queensland Rail business group, separate and distinct from Queensland Rail's "Operational" business group. Under clauses 3.1(b) and 3.1(c) of that Access Undertaking, the Group General Manager of Network Access and the Group General Managers of the Operational business groups report directly to the Queensland Rail Chief Executive. Under this structure, potential conflicts of interest are limited to only the highest level of management. If Queensland Rail wishes to vary this organisational structure, clause 3.1(d) of that Access Undertaking requires it to submit an undertaking to, and for approval by, the Queensland Competition Authority. Only upon approval may Queensland Rail implement the varied organisational structure.

The Alliance submits that in order for TPI to comply with section 32 of the Act, it must implement an organisational structure which limits the potential for conflicts of interest to arise (including in relation to access to confidential information) to the highest level of management possible. Further, the Arrangements should state that the Regulator must approve any changes to that organisational structure if it could reasonably be expected that those changes could adversely impact on TPI's compliance with the Arrangements.

The Alliance's submissions regarding confidential information and employees transferring from Access Related Functions to Non-Access Related Functions also apply in relation to the avoidance of conflict of interest.

The Alliance submits that TPI should, on reasonable request, make records available to an Access Seeker to determine whether the segregation arrangements, including conflict of interest obligations, have been complied with. Without access to such records, it would be very difficult for an Access Seeker to seek enforcement of TPI's obligations. While the Regulator can access such records under the Act/Code, the Alliance expects that the Regulator would generally only initiate a review on a referral by an Access Seeker.

Duty of fairness

The Arrangements state that "Under Stage 2 ... TPI will ensure that the key terms and conditions of internal access arrangements will be **broadly comparable** to those provided or offered to third party Access Seekers [Alliance emphasis]."⁶⁷ The Alliance submits that the "broadly comparable" threshold is unacceptably vague and incapable of providing non-TPI Access Seekers with confidence that they will be treated fairly compared with TPI, in its capacity as a haulage provider, and FMG. The

⁶⁷ Page 20 of Arrangements.

Maintenance of separate accounts and records

TPI should ensure that the Arrangements are capable of being applied and are complied with in relation to FMG's finance group preparation of TPI's accounts and financial records.

Compliance

The Alliance submits that:

TPI should, as a matter of priority, prepare and submit the proposed Segregation Manual to the Regulator for approval and that the Regulator should issue the manual for public comment before approving it.

The Segregation Manual should:

- include detailed procedures and practices with which all TPI personnel and contractors must comply to ensure that TPI complies with the Arrangements and the Segregation Obligations; and
- be publicly available;

TPI should be required to promptly report any suspected breach of the manual, the Arrangements and the Segregation Obligations to the Regulator and affected Access Seekers; and in relation to the annual compliance audits under clause 7.2 of the Arrangements, each audit report should be made public within a prescribed period (say 45 days) after its completion.

Further, the Alliance submits that if the Regulator considers or suspects that a breach of the segregation manual, the Arrangements or the Segregation Obligations has occurred, the Regulator should be able to require TPI to conduct and report on further audits, in the same manner as the annual audits under clause 7.2 of the Arrangements.