

**Draft Report**

**Economic Regulation Authority**

**Review of Proposed Segregation  
Arrangements for:**

***The Pilbara Infrastructure Pty Ltd***

December 2008

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## Contents

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<b>Summary Comments</b>	<b>2</b>
<b>1 Background</b>	<b>10</b>
<b>2 Discussion on Statutory Compliance</b>	<b>12</b>
<b>Appendix: List of Recommendations</b>	<b>44</b>

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## Summary Comments

On 3 July 2008 The Pilbara Infrastructure Pty Ltd (TPI) provided the Economic Regulatory Authority (ERA) with proposed Segregation Arrangements (SA) for the TPI railway network. Under the WA Rail Access Regime, a railway owner is required to put in place SA in order to comply with section 28 of the Railways (Access) Act 1998 (the Act). Before a railway owner puts in place or varies such an arrangement, under section 29 of the Act, the railway owner must obtain the regulator's approval to the arrangement or variation. The ERA is defined as the regulator of the relevant railways network under section 3 of the Act.

The ERA has requested that PricewaterhouseCoopers (PwC) assess TPI's proposed SA from the perspectives of: the legislative requirements set out in the WA Rail Access Regime; relevant technical and financial issues covered in TPI's documents; and the nature of the new railway, including any issues relevant to the particular circumstances relating to its operation. PwC's assessment involves considering whether the provisions of the SA as proposed can be accepted by the ERA as complying with the legislative requirements, or whether specific changes to the SA provisions are considered necessary in order for the ERA to be able to approve the arrangements.

On 14 July 2008, the ERA called for public submissions on the TPI SA and on TPI's Train Management Guidelines (TMG) and Train Path Policy (TPP). TPI's proposed TMG and TPP were also submitted by TPI on 3 July 2008. TPI also submitted other proposed Part 5 instruments to the ERA for approval, in the form of Costing Principles (on 15 August 2008) and Overpayment Rules (14 July 2008).

Public responses to TPI's SA, TMG and TPP were submitted between 26 August 2008 and 5 September 2008. On 13 October 2008, TPI provided the ERA with a response to the public comments by stakeholders on the SA (and on 15 October 2008, provided a response to the public comments on the TMG and TPP).

This report concerns only TPI's proposed TPI SA and addresses issues raised in relation to the SA in the five public submissions received by the ERA and on TPI's responses to the public comments by stakeholders.

This report sets out the results of our assessment of TPI's proposed SA. A summary of the results of our assessment is provided below and further details are provided in sections 1 and 2 of the report:

- As TPI is a vertically-integrated rail freight entity (compared to WestNet Rail (WestNet), which is vertically-separated) and given that there is a sound prospect of third party interest in using the TPI network, the extent of segregation arrangement protections should at least be equal to those previously approved Segregation Arrangement for WestNet in 2003.
- TPI states that its proposal is consistent with access arrangements under the AustralAsia Railway Access Regime applying to the Tarcoola to Darwin railway. We note that the obligations under the Act are different from the obligations under the AustralAsia Railway (Third Party Access) Act 1999. Because the TPI railway network is covered by the WA Rail Access Regime, the TPI SA are required to comply with the

obligations placed on railway owners under the specific provisions of the WA Act.

- It appears that TPI has developed its SA based on an evaluation of the WestNet SA, as evidenced by replication in TPI's document of a significant number of the WestNet measures. However, we note that TPI has, in a number of cases, sought to apply more light-handed approaches than in the WestNet document.
- TPI sets out an organisational structure in its SA, with some separations of key roles that perform access-related functions versus roles that perform other functions, but also makes clear that a number of roles will have functional cross-overs and elements of multi-skilling. In relation to this issue, we recommend that:
  - TPI provide a more detailed description of each position in the organisational structure. The detailed description should classify each position according to whether it performs access-related functions or other functions and identifies the physical location of each position (Recommendation 2);
  - consistent with the approved 2003 SA for WestNet, TPI should ensure access related staff work solely on access related functions and are physically separate from other parts of TPI, ideally this could take the form of a separate access business unit within the rail Infrastructure Division of TPI (Recommendation 7);
  - management reports at group level should only provide aggregate financial and operating data and should not identify individual operators or users (from Recommendation 11); and
  - staff who have signed SA Awareness Statement should not be able to rotate to other Divisions of TPI for one year and this year would need to be spent within the Rail Infrastructure Division in a position not subject to the Awareness Statement (Recommendation 14).
- TPI proposes a two-stage process for implementing segregation arrangements in that, during Stage 1, there will not be complete functional separation in order not to impact the effective and safe implementation of rail and haulage operations, and that the fuller protections of the SA would not apply until Stage 2. Stage 2 is proposed to commence with the signing of the first access agreement. Our assessment of this issue is as follows:
  - It is our view that persons seeking access to the network need the protection of regime documentation as much as would rail operators that have been granted access. Arguably, the strongest need for SA occurs in the negotiations phase, rather than the operations phase, which suggests that it is appropriate to proceed to full implementation from proclamation, rather than the staged approach proposed by TPI.
  - The incomplete functional separation proposed by TPI at Stage 1 is considered to be inconsistent with the requirements of the Act, where a two-stage process to achieve compliance with the segregation obligations is not envisaged.
  - We recommend that the SA are revised so that an equivalent of the TPI Stage 2 segregation model applies from the outset of

the application of the access regime to the network. The model adopted from the outset should be the Stage 2 model as proposed by TPI, but incorporating any changes that may be required by the ERA. (Recommendation 3).

- The proposed SA provide for a Segregation Manual that is to set out the policies and procedures to give effect to the segregation arrangements, including the requirement for staff performing access-related functions, or who otherwise come into contact with confidential information, to sign a Segregation Awareness Statement to confirm their compliance with the requirements of the access regime.

While the Segregation Awareness Statement is largely in the nature of a sign-off document, the Segregation Manual is key to putting in-place measures to provide controls and procedures to ensure that arrangements to segregate access-related functions from other functions both operate effectively and are complied with, as required by section 28(2) of the Act.

The Segregation Manual provisions in the SA largely represent an undertaking to develop the Segregation Manual, rather than the specification of the Segregation Manual.

In light of this, we recommend that further information on the Segregation Manual should be specified in the SA (or in an Appendix to the SA). The further information should include:

- an outline of the Segregation Manual document, in terms of major headings;
- a list of the documents and processes governed by the Segregation Manual, and the relationship of those to the Segregation Manual; and
- other information as discussed in section 2 of this report, including measures and commitments in relation to confidential information, types of behaviour that would breach the segregation requirements and the appropriate corrective action for each breach and internal notification procedures. (Recommendation 18).

In addition, consistent with TPI's position that the Segregation Manual, and any subsequent amendments to it, will be submitted to the Regulator for approval, and in view of the incomplete nature of the segregation arrangements as proposed, we note that TPI has undertaken to submit its Segregation Manual to the ERA for approval which provides an appropriate review process consistent with the Act (Recommendation 19).

- As a general point, TPI's proposed SA have a style that is more in the manner of a submission to explain segregation arrangement principles that TPI wishes to apply in order to comply with the Act, combined with associated justifications for the principles and approaches contained therein, rather than specific regulatory arrangements in accordance with section 28 of the Act. In view of this, we suggest that TPI consider segmenting its current proposed document into an explanatory submission and attached segregation arrangements (Recommendation 4).

## Summary of Statutory Compliance

Below is a brief summary of our views of the compliance of the SA with the requirements of the Act and our main recommendations in that context. This summary information is presented in accordance with the structure of the key SA provisions in the Act. We have not set out below a number of our recommendations in relation to minor variations in SA provisions. All of our recommendations are, however, covered in section 2 of the report and are listed in the Appendix.

- **Duty to segregate (Section 28)**

With the general exception of TPI's proposed two-stage approach to implementing the SA, TPI's arrangements are broadly akin to those in the WestNet SA, in that the general provisions in the TPI SA:

- clearly identify the railway owner and outline the regulatory framework applying to the railways network; and
- provide a clear and concise statement of the objective of the segregation arrangements and list the sections of the Act in which the segregation arrangements are set out.

The SA provide a broad overview of the TPI organisational structure but also present that roles will have cross overs and elements of multi-skilling (so that, particularly during Phase 1, there will not be complete functional separation of access-related functions and other functions within TPI on a day to day basis). The effect of TPI's approach is that there is not a clear segregation of access-related functions from other functions.

In the light of the above, we recommend that TPI provide a more detailed description of each position in the organisational structure and classify each position according to whether it performs access-related functions or other functions (Recommendation 2). In addition to this general recommendation, we also recommend that:

- staff performing the access-related functions who have signed SA Awareness Statements (eg train control and scheduling) should not be involved in performing other functions (Recommendation 5);
- consistent with the SA approved in 2003 for WestNet, TPI should ensure access related staff work solely on access related functions and are physically separate from other parts of TPI, ideally this could take the form of a separate access business unit within the rail Infrastructure Division of TPI (Recommendation 7);
- the SA should preclude the ability of staff to rotate between positions involved in performing access-related functions and positions involved in performing other functions where a person in the position concerned is required to sign, or has signed, a Segregation Awareness Statement (Recommendation 14).

TPI sets out a two-stage process for implementing access and segregation arrangements, in that during the first stage, there will not be complete functional separation and that the fuller protections would commence at the second stage, with the signing of the first access agreement.

The Act does not appear to contemplate a two-stage process. Also, persons seeking access to the network under Stage 1 would need the protection of regime documentation as much as would railway operators granted access to the network (and, as such, would be covered under the proposed Stage 2

arrangements). Accordingly, we recommend that the SA is revised so that the TPI Stage 2 segregation model, incorporating any changes that may be required by the ERA, applies from the outset (Recommendation 3).

We note that TPI's specification of access-related functions (in relation to Stage 2) is generally consistent with that specified in the WestNet SA. While some level of detail in the WestNet document is absent from the SA – essentially matters that are covered by Part 5 instruments – this is not considered to be a material difference between the two arrangements.

The proposed SA provide for a Segregation Manual that is to set out the policies and procedures to give effect to the segregation arrangements, including the requirement to sign a Segregation Awareness Statement above. The Segregation Manual provisions in the SA largely represent an undertaking to develop the Segregation Manual, rather than a specification of the Segregation Manual. In light of this, and in order to comply with the requirements of section 28 of the Act, we recommend that:

- further information on the Segregation Manual should be specified in the SA, or in an Appendix to the arrangements (Recommendation 18); and
- TPI should submit its Segregation Manual to the ERA for approval (Recommendation 19).
- **Protection of confidential information (section 31)**

TPI's proposed arrangements in relation to confidential information are predominantly set out in section 4 of its SA.

TPI's examples of confidential information (in relation to proposed Stage 2 arrangements) are generally consistent with the examples in the WestNet SA. TPI includes additional items on billing information and plans for capacity expansion (in accordance with the operation of TPI's TPP) to the list of examples of confidential information included in the WestNet document, but does not include the WestNet items in relation to Master Train Control Diagrams and Completed Train Control Diagrams).

Based on TPI's proposed two-stage approach, TPI also proposes a more limited definition of confidential information at Stage 1.

Key recommendations in relation to the effective definition of confidential information in section 4.1 of the SA are that:

- given that the Stage 2 segregation model should be applied from the outset of applying the access regime to the network, the Stage 1 definition of confidential information is not valid (effect of Recommendation 3); and
- the items Master Train Control Diagrams and Completed Train Control Diagrams should be added to the TPI examples of confidential information (Recommendation 8).

As some of the processes for disclosure of confidential information are unclear in the SA (such matters include control measures in relation to managing confidential information flows within the executive structure of TPI/FMG), we have made recommendations to clarify or revise such matters in the SA. For example, we recommend that TPI:

- provides a list of documents and other information that it will use to define how it distinguishes confidential information from information that is not specifically protected (Recommendation 8);

- specifies the nature of the contents of management reports on access-related issues to be given to TPI and FMG management and directors – in that management reports at group level should only provide aggregate financial and operating data and should not identify individual operators or users (from Recommendation 11);
- specifies the direct reporting paths in relation to access-related functions and the potential crossover points in the individual positions in relation to access-related versus other functions (Recommendation 11); and
- incorporates in the Segregation Awareness Statement a commitment to safeguard confidential information which would have the same effect as a confidentiality deed (Recommendation 16).

TPI's proposed arrangements for providing and securing access to hard copy and electronic forms of confidential information are broadly similar to arrangements in the 2008 WestNet SA but do not adopt specific measures from the 2003 WestNet SA which relates to WestNet as a vertically-integrated entity within Australian Railroad Group (ARG) (which is an equivalent to TPI being integrated with FMG). We recommend that additional measures to reflect those in the 2003 WestNet SA should be adopted in the TPI SA as follows:

- the access management area in which the hard copy confidential information is held must be locked when not attended by TPI access staff (from Recommendation 12);
- TPI should store electronic access seeker confidential information on a dedicated and stand alone computer file server, separate from the non-access-related functions of TPI and FMG (Recommendation 13); and
- TPI should provide a description of the arrangements for providing and securing access to hard copy and electronic forms of confidential information to a similar level detail as provided in the WestNet SA (from Recommendations 12 and 13).

TPI proposes to maintain a register of those staff, including external contractors/consultants, to whom confidential information is disclosed. We consider that the register would provide an important protection to the interests of persons seeking access to the network and of operators who have signed access agreements. The ability of a third party access seeker to view the register relating to disclosure of its confidential information provides additional assurance that third parties' rights would be protected under the arrangements.

- **Avoidance of conflict of interest (section 32)**

TPI's proposed arrangements in relation to conflict of interest are set out in section 3 of its SA.

Section 3 provides a clear commitment to ensure no conflicts of interest exist (a similar commitment is given in the WestNet SA).

Although we consider there to be some uncertainties in relation to the principles for specifying whether conflicts of interest may exist and the means of managing circumstances where the potential for conflicts may arise (including the precise role of the Commercial/Compliance Officer in managing these issues), these issues are largely considered to be matters of process covered by other recommendations, particularly Recommendations 2 and 18.



- **Duty of fairness (section 33)**

Section 5 of the SA sets out the requirements of section 33 of the Act and, similar to the commitment given in the WestNet SA, provides a commitment to treat all access seekers and train operators fairly in relation to prices, service quality, paths and priority.

TPI acknowledges that its duty of fairness extends to the application of determinations made by the Regulator under Part 5 of the Code.

TPI states that internal TPI access arrangements will be "broadly comparable" to those provided or offered to third parties. This is a similar commitment to that provided in the WestNet SA.

TPI's commitments in relation to its duty of fairness under section 33 of the Act are considered to be appropriate.

- **Maintenance of separate accounts and records (section 34)**

TPI's proposed arrangements in relation to the maintenance of separate accounts and records are set out in section 6 of its SA.

TPI's commitments in section 6 are at least as comprehensive as those in the 2008 WestNet SA relating to WestNet as separate entity (and, in a number of instances, the same text is used as in the current WestNet SA). More extensive commitments in the 2003 WestNet SA, relating to WestNet as a vertically-integrated entity within ARG, are not fully reflected in the TPI SA and are discussed below.

Section 6 of the TPI SA sets out, amongst other things, that TPI will prepare, maintain and report the accounts and financial records required to comply with the Act and Code to assist the Regulator in the performance of the Regulator's duties under the Act or Code in the manner approved by the Regulator. It also specifies that these obligations encompass the preparation and maintenance of separate accounts in relation to TPI's access-related functions versus its other functions.

The above TPI provisions reflect the broad scope of railway owners' obligations under section 34 of the Act and are considered appropriate.

TPI also states that it will present the regulatory accounts in a Regulator-approved format and comply with the Costing Principles approved by the Regulator. The requirement to present accounts in a Regulator-approved format represents a requirement in the regulatory determination on the WestNet SA. The commitment to comply with Costing Principles approved by the Regulator is similar, in principle, to the commitment given in the WestNet SA.

TPI also presents a two-stage approach for the preparation of regulatory accounts involving the FMG Finance Group. As per our Recommendation 3, where we consider that only the full regime protections provided under Stage 2 should apply, our assessment and recommendations in relation to this issue associated with section 34 of the Act relates only to TPI's proposed Stage 2 arrangements.

The SA approved by the Authority for WestNet in 2003, relating to WestNet as a vertically-integrated entity within ARG includes additional detail to the 2008 WestNet SA on the separation of access-related functions from other functions, in terms of information processes and decision-making processes.

These details in the 2003 SA are only broadly reflected in the TPI SA and are that:

- the railway owner should control and manage the information used in preparing the regulatory accounts;
- procedures to ensure protection of confidential information under the billing process are to be set out in the Segregation Arrangements Management Manual (the WestNet equivalent to the TPI Segregation Manual);
- financial information released to the central finance group will be aggregated; and
- persons having access to confidential information in finance and audit groups (including consultants to those groups and external auditors) must sign a Compliance Statement (the WestNet equivalent to the TPI Segregation Awareness Statement).

We recommend that these matters are covered to a similar level of detail in the TPI SA (Recommendation 17), but consider TPI's proposal in relation to Stage 2 accounting separation (where statutory accounting functions and cost accounting functions for the TPI/FMG group would continue to be performed by FMG Finance) to be reasonable from the perspectives of administrative efficiency, appropriate accounting practice (eg in the case of the need to allocate joint costs) and bearing in mind the commitments that will be given by relevant finance staff under Segregation Awareness Statements to protect confidential information.

Recommendations in relation to minor variations in the SA provisions are not set out above. All recommendations are included in the assessment in section 2 of the report (for ease of reference, we have also set out the recommendations in the Appendix to this report).

Our general recommendations include a suggested requirement for TPI to provide a complete list of the definitions used in the document in section 8, and for such definitions to be consistent with the terms used in the Act and the Code (Recommendation 23).

# 1 Background

## *The Pilbara Infrastructure Pty Ltd*

The Pilbara Infrastructure Pty Ltd (TPI) is a subsidiary of International Bulk Ports Pty Ltd, which itself, is a wholly owned subsidiary of Fortescue Metals Group Ltd (FMG).

FMG is developing iron ore mining operations in the vicinity of the Chichester Range in Western Australia's eastern Pilbara (through a wholly owned subsidiary, FMG Chichester Pty Ltd). It is also establishing port facilities at Anderson Point in Port Hedland and a railway link between the port and mine via its subsidiary, TPI.

The railways network owned and operated by TPI is to operate trains between the Pilbara and Point Anderson to facilitate the export of FMG's iron ore. The TPI railways network is covered by the WA Rail Access Regime.

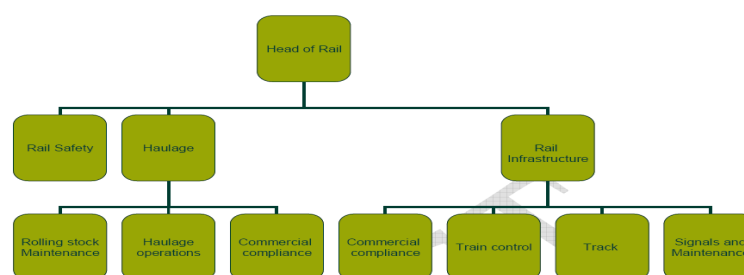
TPI's network has been constructed using specially profiled concrete sleepers and a process of continually welded rail, to ensure the track is up to the task of carrying trains which will weigh some 30,000 tonnes and be in the order of 2.5 kilometres long.

On 5 April 2008, TPI hauled its first load of iron ore 185km from the Hunter Siding near the Cloudbreak Mine to Port Hedland (Point Alexander - Herb Elliott Port). Shipping began from Herb Elliott Port on 15 May 2008.

## *Organisational Structure of TPI*

TPI has established a vertically integrated organisational structure whereby both the access-related rail functions and the rail haulage functions occur within the one entity. However, within TPI, there are separate structures to deal with the management of access-related (infrastructure) and haulage functions (issues around whether the roles of positions within that structure are appropriately segregated between roles that perform access-related functions and those that perform other functions are considered in section 2 of this report).

The TPI organisational structure is summarised in the chart below.



The Public Transport Authority (WA) complies with segregation requirements in the Act whilst utilising a broadly similar vertically integrated structure. In relation to freight, the former Australian Railroad Group (ARG) was also vertically integrated but utilised separate subsidiary companies for access (WestNet Rail) and train operations (Australian Western Railroads). More recently, the sale of ARG to Queensland Railways (above rail) and Babcock & Brown (access/below rail) has further separated the ownership and operations of rail freight.

### ***Statutory requirements summary***

The Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004 amended the Railways (Access) Act 1998 and the Railways (Access) Code 2000 (the 1998 Act and the Code together comprise the WA Rail Access Regime) to bring TPI's railways network under the Western Australian Rail Access Regime. Clause 16 of the State Agreement covers railway access matters specific to TPI's railways network.

Under section 3 of the Railways (Access) Act 1998, (The Act), the meaning of a railways network as regulated under the Act includes the railway constructed pursuant to the TPI Railway and Port Agreement.

Segregation Arrangements are a requirement of the Act, which establishes the following segregation requirements for railway owners:

- Duty to segregate (section 28);
- Matters to be covered as part of duty to segregate (section 30);
- Protection of confidential information (section 31);
- Avoidance of conflict of interest (section 32);
- Duty of fairness (section 33); and
- Maintenance of separate accounts and records (section 34).

The powers of the Regulator in relation to segregation are established in section 29. In particular, the railway owner must obtain the Regulator's prior approval for its segregation arrangements.

A discussion of the compliance of TPI's proposed SA is provided in section 2 of this report.

## 2 Discussion on Statutory Compliance

### Requirement to Develop Segregation Arrangements

Under the WA Rail Access Regime, a railway owner is required to put in place Segregation Arrangements (SA) in order to comply with section 28 of the Railways (Access) Act 1998. Before a railway owner puts in place or varies such an arrangement, under section 29 of the Act, the railway owner must obtain the regulator's approval to the arrangement or variation.

Section 3 of the Act defines the Economic Regulatory Authority (ERA) as being the regulator of the railways networks subject to the Act.

The powers of the ERA under section 29 of the Act allow it to direct a railway owner to amend its SA. Such direction could be given by the ERA at any time. That is, the exercise of this power is not conditional upon the ERA first receiving a proposed SA, or variation to an existing SA, from the railway owner.

Establishing effective segregation arrangements for vertically integrated freight entities can be considered a paramount pre-requisite for a fair system of third party access and every endeavour should be made to initially establish such a system. We note that the recent trend from other Australian regulators of rail access regimes has been to increase the sophistication of protections within ringfencing systems in response to genuine claims of anti-competitive behaviour from vertically integrated monopolies.

Section 30 of the Act provides that "without limiting section 28, in carrying out its obligations under that section a railway owner must ensure that the provisions of sections 31, 32, 33 and 34 are satisfied." The matters set out in sections 31, 32, 33 and 34 of the Act are shown in the box below.

## **Railways (Access) Act 1998, Division 3, Pt 4, Segregation Arrangements**

### **Section 28: Duty to segregate**

- (1) A railway owner must make arrangements to segregate its access-related functions from its other functions.
- (2) A railway owner must have appropriate controls and procedures to ensure that the measures in place under subsection (1):
- (a) operate effectively; and
  - (b) are complied with.

### **Section 31: Protection of confidential information**

- (1) There must be an effective regime designed for the protection of confidential information relating to the affairs of persons seeking access or rail operators from:
- (a) improper use; and
  - (b) disclosure by relevant officers, or other persons, to other officers or employees of the railway owner or other persons, except for proper purposes.
- (2) In this section — "confidential information" means information that has not been made public and that:
- (a) is by its nature confidential;
  - (b) was specified to be confidential by the person who supplied it; or
  - (c) is known by a person using or disclosing it to be confidential.

### **Section 32: Avoidance of conflict of interest**

The arrangements under section 28 must be such as to ensure that a relevant officer does not have a conflict between his or her duties —

- (a) as a person concerned in the performance of access-related functions, on the one hand; and
- (b) as a person involved in other business of the railway owner, on the other.

### **Section 33: Duty of fairness**

In performing their functions relevant officers must not have regard to the interests of the railway owner in a way that is unfair to persons seeking access or to other rail operators.

### **Section 34: Maintenance of separate accounts and records**

A railway owner must ensure that its accounts and records are in such form as to enable:

- (a) all income, expenditure, assets and liabilities relating to the carrying out of its access-related functions to be properly recorded and distinguished from the railway owner's other income, expenditure, assets and liabilities;
- (b) where necessary, any item of income, expenditure, assets or liabilities which relates only in part to the carrying out of its access-related functions to be apportioned in a fair and reasonable manner.

In deciding whether to approve a railway owner's arrangements under section 29 of the Act, the ERA is to take into account the factors in section 20(4) of the Act. The factors in section 20(4) include the interests of the railway owner, the interests of access seekers and of the community. We note that the ERA has discretion in the way in which it balances, or attaches weight to, the various matters and interests in section 20(4), where the different interests are in competition or where tension exists between them.

## **The TPI Segregation Arrangements**

On 3 July 2008 TPI provided the ERA with proposed Segregation Arrangements for the TPI railway network consistent with TPI's duty to segregate under section 28 of the Act.

Under section 29 of the Act, the ERA must approve SA before they can be applied.

An ERA determination in relation to the approval of SA would involve assessing compliance of the SA with the segregation provisions of Division 4 of Part 3 of the Act (covering sections 28 to 34 of the Act as generally shown above) and taking into account the factors in section 20(4) of the Act.

To assist in the exercise of its powers, the ERA has requested that PricewaterhouseCoopers (PwC) prepare an assessment of TPI's proposed SA.

### **Stakeholder Comments**

On 14 July 2008, the ERA called for public submissions on the TPI SA and on TPI's Train Management Guidelines (TMG) and Train Path Policy (TPP). TPI's proposed TMG and TPP were also submitted by TPI on 3 July 2008. TPI also submitted other proposed Part 5 instruments to the ERA for approval, in the form of Costing Principles (on 15 August 2008) and Overpayment Rules (24 July 2008). This paper concerns only the TPI SA.

The public submissions called for in relation to the SA were due on 26 August 2008, although extensions were granted to some parties, as shown below. Submissions were received from the following parties:

- North West Iron Ore Alliance (North West Alliance) – submission dated 5 September 2008. This submission contains separate papers on the SA, TMG and TPP;
- United Minerals Corporation (UMC) – submission dated 5 September 2008, containing separate papers on the SA, TMG and TPP;
- Hancock Prospecting Pty Ltd (Hancock Prospecting) – submission dated 2 September 2008, which comprises separate reports by ACIL Tasman (ACIL) and GHD, with each report addressing the three TPI proposals;
- Australian Rail Track Corporation (ARTC) – submission dated 26 August 2008; and
- Yilgarn Infrastructure (Yilgarn) – submission dated 26 August 2008. The Yilgarn submission is comprised of a covering letter and a copy of a submission previously provided to the National Competition Council.

On 13 October 2008, TPI provided the ERA with a response to the public comments by stakeholders on the SA.

PwC's assessment of TPI's proposed SA addresses issues raised in the above public submissions in relation to the SA and on TPI's responses to the public comments by stakeholders.

### **PwC Assessment Approach**

PwC's assessment of TPI's proposed SA is from the perspectives of: the legislative requirements above; relevant technical and financial issues covered in TPI's documents; and the nature of the new railway, including any issues relevant to the particular circumstances relating to its operation.

In assessing these matters PwC has been guided by the provisions of the WestNet SA (as approved in April 2003) relating to WestNet as a vertically-integrated entity within ARG. This WestNet SA is directly relevant to TPI as a vertically-integrated access provider and operator. We note that a revised

WestNet SA was approved by the ERA on 8 April 2008 which relates to WestNet as a separate entity. The 2008 WestNet SA differs from the 2003 SA in that it removes references to WestNet being within the ARG structure and removes some specific segregation measures that were to be in place when WestNet was part of ARG. Differences between the two WestNet SA are commented on in section 2 of this paper. Unless the 2008 WestNet SA is expressly referred to in this paper, references in this paper to the WestNet SA are to the previous WestNet SA which were approved by the Authority in 2003.

While there are differences between the practical arrangements of the different networks of TPI and WestNet, the WestNet SA provides a useful starting point for assessing many of the provisions of the TPI SA, given:

- the similarity of many of the provisions in the respective SA; and
- that the approval of the WestNet arrangements embodies a preferred regulatory balancing of the matters in section 20(4) of the Act.

However, it should be noted that as TPI is a vertically integrated rail freight entity and given that there is a sound prospect of third party interest in using the TPI network, the extent of segregation arrangement protections in the TPI SA should at least be least equal to those in the approved 2003 WestNet SA when WestNet was a vertically-integrated entity within ARG.

UMC, at page 6 of its paper in relation to the SA, in effect, submits that the WestNet SA represent an appropriate benchmark for the TPI SA, although UMC seeks the TPI arrangements to be benchmarked against the 2008 SA. We are however of the view that the 2003 WestNet SA is the appropriate base for this exercise given that it deals with a WestNet/ARG structure that is directly comparable to that of TPI/FMG.

Our assessment considers whether the provisions of the TPI SA as proposed can be accepted by the ERA as complying with the legislative requirements, or whether particular changes to the SA provisions are considered necessary in order for the ERA to be able to approve the arrangements.

## **PwC Assessment of TPI Segregation Arrangements**

This section below sets out our assessment of TPI's proposed SA. Our assessment of issues below is in the general sequence in which the particular issues arise within TPI's document.

A large proportion of the SA provisions are considered to be appropriate. However, a total of 23 recommended amendments to the document are considered to be appropriate in order for the ERA to be able to approve the arrangements. For ease of reference, we have also set out the recommendations in the Appendix to this report.

Headings used in this section are as per the proposed SA.

### **1 Introduction**

#### **1.1 Background**

This section, similar to section 1.1 of the WestNet SA, identifies the railway owner and outlines the regulatory framework applying to the network.



## 1.2 WA rail legislative requirements

This section provides a clear and concise statement of the objective of the segregation arrangements and lists the sections of the Act in which the segregation requirements are set out. Similar statements are provided in the WestNet SA, although the WestNet SA also provides information on railway owners' obligations in sections 31 to 34 of the Act.

### Recommendation 1

For completeness, the TPI SA should cover the matter covered in paragraph 3 of section 1 of the WestNet SA (that, under section 29 of the Act, the Regulator may impose other segregation requirements on a railway owner in addition to those in sections 31 to 34).

ACIL, for Hancock Prospecting, at page 9 of its paper, comments that the TPI SA should include a clear statement of the objectives of the segregation arrangements. We do not consider it crucial for the TPI SA to contain a paraphrased version of the requirements of sections 31 to 34 of the Act in the manner of section 1 of the WestNet SA, which is the suggestion made by ACIL/Hancock Prospecting.

## 1.3 Implementation of segregation arrangements

This section summarises TPI's principles and processes to segregate its access-related functions from its other functions. Issues associated with the information provided in section 1.3 are discussed in relation to the individual subsections below.

### 1.3.1 Corporate structure of TPI and FMG

Section 1.3.1 provides a broad overview of TPI as a railway owner and TPI's organisational structure. In other sections of the SA, TPI provides titles of key positions and, in relation to those positions, identifies some access-related functions or identifies some relationship of those positions to the proposed segregation arrangements (eg in the case of management reporting). TPI notes that there will be crossovers and multi-skilling across access-related functions versus other functions. TPI also states, in relation to its proposed Stage 1 arrangements, that there will be considerable sharing of information between business units to support the effective and safe implementation of the rail and haulage operations, including on matters such as safety, maintenance and scheduling.

The effect of TPI's approach is that there is not a clear segregation of access-related functions from other functions as required by section 28 of the Act.

### Recommendation 2

We suggest that TPI should provide a more detailed description of each position in the structure, its classification according to whether it performs access-related functions or other functions and the physical location of each position.

Other recommendations in relation to TPI's segregation of its access-related functions from its other functions are discussed below in relation to TPI's

proposed two-stage process for implementing access and segregation arrangements.

### 1.3.2 Timing of implementation

This section sets out the view by TPI that its approach to the segregation obligations is consistent with the precedent of the Tarcoola to Darwin railway regulated under the AustralAsia Railway Access Regime. We note that the obligations under the Railways (Access) Act 1998 are different to those under the AustralAsia Railway (Third Party Access) Act 1999 and that the WA Act sets the relevant legislative requirements for the WA Rail Access Regime.

Because the TPI railway network is covered by the WA Rail Access Regime, the TPI SA are required to comply with the obligations placed on railway owners under the specific provisions of the WA Act, not the legislation which applies to the Tarcoola to Darwin railway.

A number of the stakeholder submissions also present the view that the Tarcoola to Darwin railway does not present a relevant precedent for the arrangements to apply to the TPI network. Such views are based on both commercial and legal grounds (the North West Alliance, pages 3 and 16 of its SA paper; UMC, page 8 of its SA paper; ACIL/Hancock Prospecting at page 6 and ARTC at page 6 of its submission). The North West Alliance at page 3 of its SA paper states as follows:

"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."

GHD, for Hancock Prospecting, focuses on the Adelaide to Darwin railway being an inappropriate model for regulation of the TPI network because the Adelaide to Darwin railway "has other obligations that are relevant only to road competition, a factor not present in the TPI railway."

TPI sets out a two-stage process for implementing access and segregation arrangements, in that during the first stage, there will not be complete functional separation so as not to impact the effective and safe implementation of the rail and haulage operations, and that the fuller protections would not apply until the second stage, which would commence with the signing of the first access agreement. In relation to Stage 1, TPI states as follows:

"For this stage, TPI proposes that there will not be complete functional separation of access-related functions and haulage functions within TPI on a day to day basis."

This proposal by TPI is to be assessed under the requirements of the WA Rail Access Regime, specifically, under Division 3 of Part 4 of the Act. Key provisions in this regard are:

- section 28(1) of the Act, which provides that: "A railway owner must make arrangements to segregate its access-related functions from its other functions.";

- section 28(2) of the Act, which provides that: “A railway owner must have appropriate controls and procedures to ensure that the measures in place under subsection (1):
  - operate effectively; and
  - are complied with.”; and
- section 30 of the Act, which sets out some of the matters which must be covered by the segregation arrangements, namely at a minimum that the provisions of sections 31, 32, 33 and 34 of the Act are to be satisfied.

Section 28(2) contemplates effective operating procedures being in place in order to “ensure” that the measures in section 28(1) are complied with. Further, “segregation” of access-related functions from other functions in section 28(1) is not presented in a qualified manner.

In the context these requirements, however, we note that TPI states that, at least during Stage 1, “there will not be complete functional separation of access-related functions and haulage functions.”

The Act does not appear to contemplate a two-stage process that would concern the matters set out in sections 31, 32, 33 and 34. Instead, the Act requires TPI to submit a proposed segregation arrangement to the Regulator for approval which covers, at least, the matters set out in sections 31, 32, 33 and 34. If the proposed segregation arrangement did not address these matters in full, then it could not be approved by the Regulator. Accordingly, the incomplete functional separation proposed by TPI at Stage 1 is considered to be inconsistent with the requirements of the Act, where a two-stage process to achieve compliance is not envisaged.

Stakeholder submissions also present the view that the two-stage process does not comply with the Act. The North West Alliance, at page 3 of its SA paper, states as follows:

“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.”

ACIL, for Hancock Prospecting, at page 6 of its submission expresses a similar view.

The North West Alliance, at page 16 of its SA paper, also provides a more general view of the two-stage process in terms of the requirements of the Act as follows:

- “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”.

TPI, on page 2 of its 13 October 2008 response to the public comments by stakeholders, makes the following comments in relation to its proposed two-stage process in the SA

“TPI reiterates its commitment to an appropriate segregation arrangement before and after third party haulage arrangements are pursued. That is, before contracts are entered into, the negotiation of access is undertaken by officers who are ringfenced from the rest of the organisation.

Consequently, pursuing the more prescriptive or extensive Segregation Arrangements at this stage will do nothing to reduce the issues surrounding conflicts of interest because no third party train services are being run.”

In relation to the comments by TPI, we have noted above that a two-stage process to achieve compliance is not envisaged by the Act and, as discussed further at page 22 below, the SA is not sufficiently clear in relation to the ringfencing of the officers<sup>1</sup> who undertake access negotiations from the rest of TPI.

In addition, we consider that persons seeking access to the network under TPI’s proposed Stage 1 would need the protection of regime documentation as much as would railway operators who have already been granted access to the network (and, as such, would be covered under the proposed Stage 2 arrangements). Arguably, the strongest need for SA occurs in the negotiations phase, rather than the operations phase, which suggests that there is equivalent merit in full implementation from proclamation, relative to staged implementation as proposed by TPI.

Stakeholders also express the view that the two-stage process is inappropriate given the market power of TPI/FMG. The North West Alliance, at page 1 of the covering letter of its submission, states as follows:

“To keep the haulage business integrated with TPI activities 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.”

UMC makes a similar point at page 5 of its SA paper.

Views of stakeholders in relation to the market power of TPI/FMG and the potential misuse of that power by TPI/FMG are discussed below.

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<sup>1</sup> The SA presents that, at least during Stage 1, negotiation will be undertaken by only one TPI officer – the Commercial/Compliance Officer (see section 1.3.2 of the SA).

**Recommendation 3**

We note TPI's stated position that, during Stage 1, there will not be complete functional separation and consider the two-stage approach proposed by TPI to be inconsistent with the requirements of the Act.

We suggest that TPI should revise its SA so that an equivalent of its Stage 2 segregation model applies from the outset of the application of the access regime to the network. The model to be adopted should be the Stage 2 model as proposed by TPI, but incorporating the changes as required by the Regulator (where this paper suggests changes that the ERA may require).

ACIL, for Hancock Prospecting, at page 8 of its submission proposes a similar change to the SA as per Recommendation 3, as follows:

“Accordingly, we recommend that the Stage 1 arrangements be dropped and Stage 2 apply throughout, including prior to the signing of an access agreement.”

Adoption of the more complete segregation arrangements of the Stage 2 model from the outset would also assist in addressing stakeholder concerns relating to the misuse of market power by TPI/FMG. The North West Alliance, ARTC and ACIL/Hancock Prospecting, in particular, express the view that incomplete separation between the access-related functions and the other functions within the vertically integrated structure of TPI/FMG means that TPI/FMG would have capability and incentive to operate the network for the benefit of related party iron ore tonnages shipped to market to the detriment of third party tonnages. In relation to this issue, we note the following views expressed:

“FMG will be marketing iron ore in world markets in direct competition with potential Access Seekers. Information regarding future haulage volumes and time frames could easily be misused, and certainly have the potential to give rise to conflicts of interest.” (ACIL, for Hancock Prospecting, page 8); and

“We submit that an independent operator has an incentive to and will be more likely to provide access on a basis that serves the needs of the greatest number of tenement holders and the greatest volume of ore, than an operator whose infrastructure is vertically integrated with its own mining operations.” (from section 6.2(d), page 10 of the Yilgarn submission to the National Competition Council)

The North West Alliance, at page 2 of the covering letter to its submission, also expresses the view that external factors (in particular, the likely shortage of inner harbour capacity) serve to exacerbate the issue of TPI/FMG market power. UMC, at page 6 of its SA paper, expresses a similar view. Based on such views, the North West Alliance recommends as follows:

“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.”

Recommendation 3 above, by moving straight to Stage 2 access with its greater separation of access-related functions from other functions, would assist in safeguarding against any misuse of market power by TPI/FMG. Adopting Stage 2 access from the outset, given the greater segregation of roles than under Stage 1, would also assist in protecting confidential information and in protecting against conflicts of interest.

In the executive summary of its paper on the SA, the North West Alliance refers to a group of factors which, in its view, “points conclusively away from Arrangements that involve the staged process proposed by TPI”. In the light of such factors, the North West Alliance states that:

“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”

Additionally, the North West Alliance states that:

“TPI is inappropriately predicating the Segregation Arrangements (Arrangements) on the optimisation of the FMG supply chain, rather than efficient use of the railway.”

TPI, on page 3 of its 13 October 2008 response, makes the following comments in relation to views as expressed above:

“TPI’s network and haulage operations are administered by the Office of Rail Safety (ORS) under the Rail Safety Act 1998. A Railway Safety Management System has been approved by the ORS where network and haulage functions share a common system.” (TPI also shows an example of the need for close harmonisation of safety activities between its access-related functions and its other functions)

“Moreover, effective supply chain coordination requires efficient use of the rail network and is consistent with the interests of all access seekers/holders.

In the context of the Code, the coordination between the rail and port operations is covered more directly by the Train Management Guidelines and Train Path Policy documentation rather than the Segregation Arrangements.”

We note that rail safety issues will be managed by the ORS under the Rail Safety Act and that the SA (incorporating our recommended amendments) would not interfere with the rail safety regime. The issue in relation to integrating rail access and port access objectives in the SA, and in TPI’s Part 5 instruments under the Code, is that the port access regime is separate from the WA Rail Access Regime under which the SA and Part 5 instruments are to be prepared by a railway owner and approved by the ERA. As the WA rail regime is focused on the objects of railway access and not on joint objects of railways networks and of other industry sectors such as ports, objectives in relation to other industry sectors, or of the joint supply chain of FMG, should not be included in the TPI SA.

TPI Stage 2 model, although providing more complete segregation of functions than its Stage 1 model, provides a lesser level of safeguards than

the WestNet SA and, in a number of areas, is not considered to be fully compliant with the requirements of the Act, particularly because it does not provide complete separation of access-related functions from other functions. These issues are discussed below in relation to Recommendation 7 below.

**Recommendation 4**

TPI's proposed SA have a style that is more in the manner of a submission explaining the segregation arrangement principles that TPI wishes to apply in order to comply with the Act, combined with some associated justifications for the principles and approaches contained therein, rather than specific regulatory arrangements in accordance with section 28 of the Act.

In light of this, and in addition to our recommendations in relation to providing greater specificity within the SA provisions, we suggest that TPI considers segmenting its proposal into an explanatory submission with attached segregation arrangements (see also Recommendation 18 below).

The TPI SA is not clear in relation to which TPI employees will perform functions regarding the negotiation of access applications and the performance of access-related functions generally:

- the statement at paragraph 3 under the heading "Stage 1" at section 1.3.2, provides as follows:

"The entirety of the access application/negotiation process will be undertaken by a Commercial/Compliance Officer within TPI."
- statements dealing with similar issues are made in other places of the document, for example:
  - paragraph 4 of section 4.1 under the heading "Stage 1" states:

"Requests for Access and the access negotiation process will be managed by TPI's Commercial/Compliance Officer."
  - paragraph 2 of section 4.2.2, TPI states:

"Under Stage 2, Access Holder's confidential information is only accessed by the Commercial/ Compliance Officer (or other staff in the TPI Network group responsible for negotiating access) for the purpose of either negotiating or administering an access agreement."
- paragraph 4 under the heading "Stage 1" at section 1.3.2 states as follows:

"In terms of support services, there will be shared FMG/TPI staff in finance, IT, human resources and payroll functions."

Issues of uncertainty in relation to the roles of staff performing access-related functions versus other functions are commented on by the North West Alliance at page 37 of its SA paper. These issues are, in part, dealt with by Recommendation 2, whereby we suggest that the details of the particular positions involved should be specified.

Paragraph 2 under the heading "Stage 2" at section 1.3.2 appears to confirm TPI's intention that, at stage 2, staff performing the access-related functions of train control and scheduling will not be involved in performing other functions. A similar statement is provided at paragraph 1 under the heading "Stage 2" at section 3. The TPI statements in this regard are consistent with requirements placed on WestNet by the 2003 regulatory determination.

**Recommendation 5**

The requirement that staff performing the access-related functions who are subject to SA Awareness Statements (eg train control and scheduling) will not be involved in performing other functions should be embodied in segregation arrangements applied to the TPI network from the outset.

**Recommendation 6**

The principle set out by TPI in paragraph 2 under the heading "Stage 2" at section 1.3.2 involves the use of terms that are not defined in the Act or Code, such as "haulage-related functions" and "infrastructure and haulage operations". As a general recommendation, we consider that terms consistent with the Act and Code should be adopted for reasons of clarity and completeness (relevant terms should be identified (capitalised) in this section and defined in section 8 of the SA). See Recommendation 23 at section 8.

As commented above, the TPI Stage 2 model provides a lesser level of safeguards, and less complete separation of access-related functions from other functions, than the approved WestNet SA. Amongst the additional measures in the WestNet SA are that:

- paragraph 3(i) of section 4 provides that the staff involved in access management will be in a separately secured area that will be locked when not attended; and
- paragraphs 3 and 4 of section 5 provide clear prohibition on staff being rotated between different functional areas of WestNet/ARG (where the staff are required to sign the WestNet Compliance Statement).

**Recommendation 7**

To provide separation of access-related functions from other functions as required by section 28 of the Act, to further assist in clarifying the roles and responsibilities of staff in the performance of access-related functions versus other functions, and to reflect the arrangements under the approved WestNet SA, we recommend that:

- TPI should ensure access related staff work solely on access related functions and
- Access related staff are physically separate from other parts of TPI, ideally this could take the form of a separate access business unit within the rail Infrastructure Division of TPI.

Similar changes to the TPI SA to those set out in Recommendation 7 are suggested by the North West Alliance at pages 5 and 20 of its SA paper; by



UMC at pages 10 and 11 of its SA paper; and by ACIL/Hancock Prospecting at page 6 of its submission.

In relation to the issue of the separation of functions within TPI/FMG, North West Alliance and UMC present that TPI should be independent from FMG. The wording used by North West Alliance at page 2 of its cover letter, and by UMC at page 6 of its SA paper, is effectively the same. The North West Alliance wording is as follows:

“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.”

The North West Alliance and UMC also suggest that the ERA should consider treating FMG as an access seeker inside the Code.

In relation to these further positions of stakeholders, we consider the structural separation of TPI from FMG to be outside the scope of this review and the issue of the definition of operator to be a matter that relates to the TPI TMG and TPP, rather than the TPI SA.

In addition, the North West Alliance presents, at page 41 of its SA paper, that changes to the organisational structure must be approved by the regulator as follows:

“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.”

While we do not consider it appropriate for the SA to specify a role for the ERA in approving changes to the structure of TPI, we note that material structural changes that could impact on the SA may be affected by regulatory considerations, given the role of the ERA in approving the Segregation Manual (Recommendation 18), where that role would include approving amendments to the Segregation Manual made necessary by organisational changes.

GHD, for Hancock Prospecting, at page 7 of its submission, expresses the view that a standard access agreement should accompany the TPI documents. GHD/Hancock Prospecting states as follows:

“..without a Standard Access Agreement, which is widely published in other jurisdictions in Australia, and which is a template for the form and content of the contract between TPI and a Third Party operator, it is difficult to tell whether the Agreement will in fact provide fairness to the third party.

The WA Railway Access Regime requires standard access agreements to be published under a separate process (under section 6 of the Code) and, as such, it is not necessary for the SA to specify that standard access agreements must be published.

## **2 Specification of access-related functions**

The specification of access-related functions in this section is consistent with that set out in section 2 of the WestNet SA.

Dissimilar to the WestNet SA, section 2 of the TPI SA does not fully refer to other parts of the Railways (Access) Code 2000 (the Code) that such access functions apply to, such as the costing principles, overpayment rules, the calculation of floor and ceiling costs and Regulator approval of costs (which are matters listed in paragraph 1(i) of section 2 of the WestNet SA). ACIL, for Hancock Prospecting, at page 8 of its submission, suggests that a similar provision should be added to the TPI SA. We do not consider it essential for such information to be included in the TPI SA, given that the matters noted are covered by TPI's Part 5 instruments, by its general segregation obligations under the Act and by the requirements of the Code in relation to the negotiation of access agreements.

## **3 Avoidance of conflict of interest (section 32)**

Section 3 of the TPI SA covers matters that are specified in the WestNet SA in section 5 (Conflicts of Interest) and section 4 (Confidential Information). Principles and processes proposed by TPI for the management of confidential information in this section 3 are also covered in section 4.2 of the TPI SA (Confidential information flows).

This section 3 provides a commitment from TPI to ensure no conflicts of interest exist. A similar commitment is given at paragraph 1 of section 5 of the WestNet SA.

At paragraph 1 of this section, TPI states that it interprets "other business" of the railway owner as "anything other than the management and control of the use of the railway infrastructure." It is recommended that terms consistent with the Act and Code are adopted for reasons of clarity and completeness (Recommendation 23 at section 8).

At paragraph 1 under the heading "Stage 1" at section 3, TPI states that "Under Stage 1 of these segregation arrangements, TPI commits that no person will perform duties concurrently for both TPI and FMG where a conflict of interest exists."

The general commitment above is appropriate, but the undertaking given by TPI in the remainder of that paragraph is unclear. For example, it is uncertain, given the wording above, whether the Commercial/Compliance Officer would solely perform access-related functions (the reference to "TPI or FMG" implies that the Commercial/Compliance Officer may undertake access-related functions and other functions) and we are unsure of the matters covered by the phrase "activities that could affect the operations of Access Seekers". In terms of this section 3, such "activities that could affect the operations of Access Seekers" should be defined (Recommendation 23 at section 8).

Uncertainties around the above matters should be addressed via the requirement at Recommendation 2 to specify roles and responsibilities of individual positions and at Recommendation 7 to physically separate access-related positions from other positions.

At paragraph 4 under the heading "Stage 1" at section 3, TPI states that, in relation to the management and board structure of both TPI and FMG, it "will develop control measures" to manage potential conflicts of interest in handling access seekers' confidential information." It is uncertain what "control measures" are proposed to be adopted in this context. It is noted in relation to these matters that management will be required to sign Segregation Awareness Statements (referred to in the following paragraph of the SA). It is suggested that TPI define and list the relevant control measures. It is suggested below that this is done via the Segregation Manual (see Recommendation 18 below).

TPI's arrangements for confidential information in this section are, however, only specified in broad terms relative to the level of specification in section 4 of the WestNet SA. The requirement for greater specificity of these arrangements - for a clearer distinction between TPI's access-related functions and other functions; and for specifying the management of confidential information flows (including at executive and Board levels within TPI and FMG) – is discussed in relation to section 4.2 below.

In summary, although we consider there to be some uncertainties in relation to the principles for specifying whether conflicts of interest may exist and the means of managing circumstances where the potential for conflicts may arise (including the precise role of the Commercial/Compliance Officer in managing these issues), these issues are largely considered to be matters of process covered by other recommendations, particularly Recommendations 2 and 18.

#### **4 Protection of confidential information (section 31)**

This section sets out the definition of "confidential information" from section 31(3) of the Act.

##### **4.1 Definition of confidential information**

The effective definition of confidential information given in relation to Stage 1 is different from the definition given in the Act (the differences are largely in the TPI definition being narrower in scope than the definition in the Act – this being in order to reflect the limits associated with TPI's proposed Stage 1). Paragraph 2 in relation to Stage 1 sets out two examples of items of confidential information – these are consistent with items in the WestNet SA (items (i) and (ii) from paragraph 1 of section 4 in the WestNet SA).

TPI appropriately broadens the effective definition of confidential information at Stage 2 to be more consistent with the broad definition in the Act. The additional examples given by TPI under Stage 2 in relation to what constitutes confidential information include items (iii) and (iv) from the list in the WestNet SA. TPI also adds items on billing information and plans for capacity expansion (in accordance with the operation of TPI's TPP) to the list of examples: these items are not included in the WestNet SA.

The TPI examples do not include items (v) and (vi) from the WestNet list (in relation to Master Train Control Diagrams and Completed Train Control Diagrams).

The statement in paragraph 5 of section 4.1 of the SA 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 not appropriate in that application of section 31(2) of the Act deems the prescribed information to be confidential information (this point is made by North West Alliance at page 36 of its SA paper).

Given our view that the SA should be revised so that an amended Stage 2 segregation model should applied from the outset of the application of the access regime to the network (Recommendation 3 above), TPI's Stage 1 definition of confidential information is not considered to be appropriate.

**Recommendation 8**

We suggest that the following amendments are made to the SA provisions in relation to confidential information:

- the examples of confidential information given at paragraph 1 of section 4 of the WestNet SA, in terms of item (v) in relation to Master Train Control Diagrams and item (vi) in relation to Completed Train Control Diagrams, should be added to the TPI examples;
- TPI should provide a list of documents and other information that it will use to define how it distinguishes confidential information from information that is not specifically protected. The list should cover both “input” and “output” type information (this list could be contained in the Segregation Manual discussed at section 7.1 below – see Recommendation 18);
- the statement to the effect that at commencement of the full access regime confidential information will include confidential information disclosed as part of the operation of an access agreement should be deleted; and
- all examples of confidential information provided in the SA should be based on terms that are consistent with the terms used in the Act and Code.

**4.2 Confidential information flows**

Similar to section 3 above in relation to conflicts of interest, TPI provides general information in this section 4.2 on how confidential information will be handled given the joint management and board structure of TPI and FMG.

At paragraph 1 of this section, TPI states that the Commercial/Compliance Officer will only disclose an access seeker's confidential information "for the purpose of and to the extent necessary to progress an Access Application or respond to an Access Seeker's request."

**Recommendation 9**

The condition for the Commercial/Compliance Officer being able to disclose confidential information is unclear. We suggest that TPI provides clear examples of the circumstances and the specific information that would be disclosed under such a condition.

TPI should consider clarifying the extent to which the Commercial/Compliance Officer will be the sole custodian of each type of confidential information and who else will have access to the proposed confidential information (this would be covered under Recommendation 2).

At paragraph 5 of this section, TPI states that the Commercial/Compliance Officer will maintain a register of those staff, including external contractors and consultants, to whom confidential information is disclosed. TPI will also provide for third party access seekers to view the register relating to disclosure of their confidential information. Later in the document, TPI makes clear that the register will acknowledge receipt of the confidential information by the recipient and will confirm the recipient's awareness of the confidential nature of the information through the acknowledgement of the Segregation Awareness Statement by the recipient.

The proposed register referred to by TPI would provide an important protection to the interests of persons seeking access to the network, and also to operators who have signed access agreements.

In addition, the ability of a third party access seeker to view the register relating to disclosure of its confidential information provides additional assurance that third parties' rights would be protected under the arrangements.

**Recommendation 10**

In relation to the proposed register of staff, management, board members and external contractors and consultants to whom confidential information is disclosed, we suggest that:

- the register should record the position titles of those parties on a consistent basis to the information on position roles to be provided in accordance with Recommendation 2; and
- persons on the register should enter into confidentiality deeds (this is already required of consultants under section 4.3.2 of the SA). It suggested that this is achieved by incorporating confidentiality deed provisions into the Segregation Awareness Statement (see Recommendation 16 below).

TPI proposes, at Stage 2, to maintain a distribution list for information that is strictly limited to the small number of FMG's senior executives and board members identified as being necessary to disclose access seeker confidential information for the purpose of progressing an access application. Also, in TPI's view, "a level of convergence of internal confidential information flows is unavoidable in vertically integrated organisations." (from paragraph 6 of section 4.2).

It is unclear how confidential information will be protected in such situations of convergence. We consider that protection should be provided by

segregating TPI's access-related functions from its other functions and that TPI should provide a greater level of specification of the measures to protect confidential information. Our suggestions in relation to specifying measures to protect confidential information are set out in Recommendation 11 below, while our suggestions in relation to segregation of access-related functions from other functions are provided in other recommendations in this report (in particular, Recommendations 5 and 7).

**Recommendation 11**

We suggest that TPI list and define the relevant control measures in relation to managing confidential information flows, including within the executive and Board structure of TPI/FMG, though the following:

- detailing the procedures it will follow for the protection of confidential information that will allow the Boards of TPI and FMG to carry out their statutory duties;
- specifying the direct reporting paths in relation to access-related functions;
- specifying that management meetings in relation to access-related issues will not include representatives of the arm of TPI, or related entities of TPI, involved in operating train services;
- specifying the nature of the contents of management reports on access-related issues to be given to TPI and FMG management, directors and Board members, in that management reports at group level should only provide aggregate financial and operating data and should not identify individual operators or users; and
- when confidential information is provided to management, directors and Board members, it must be clearly identified as such.

Our suggestions in Recommendation 11 deal with a number of issues raised in the stakeholder submissions in relation to the joint nature of the management and Boards of TPI/FMG giving rise to potential conflicts of interest. Measures suggested by stakeholders that are incorporated into our Recommendation 11 are as follows:

- the aggregation of data in reports to the Boards and joint management of TPI/FMG (suggested by the North West Alliance, UMC and ACIL/Hancock Prospecting); and
- that management, directors and Board members should have an obligation to ensure a decision in relation to TPI's business is not based on the interests of FMG (suggested by the North West Alliance and UMC),

The measures suggested in Recommendation 11 above would be supported by staff, management, directors, Board members and external contractors and consultants to whom confidential information is disclosed having to sign a Segregation Awareness Statement and being placed on a register of persons to whom confidential information is disclosed, with that register being available to be viewed by access seekers and operators.

The requirements covered by Recommendation 11 could be addressed in the Segregation Manual (see Recommendation 18 below).

#### 4.2.1 Hard copy access

This section sets out general arrangements for providing and securing access to hard copy confidential information. At a very broad level, this section reflects the WestNet arrangements – ie at paragraph 3(i) of section 4 of the WestNet SA.

The WestNet SA, however, provides for clear separation of staff performing access-related functions from staff performing other functions. Also, the WestNet SA describes arrangements for providing and securing access to such hard copy information at a more specific level than the description provided in section 4.2.1 of the TPI SA.

##### **Recommendation 12**

Consistent with the WestNet arrangements for providing and securing access to hard copy information, we recommend that:

- the access management area in which the hard copy confidential information is held must be locked when not attended by TPI access staff; and
- TPI should provide a description of the arrangements for providing and securing access to such hard copy information to a similar level detail as provided in the WestNet SA.

#### 4.2.2 Electronic access

TPI's proposed arrangements for electronic access under Stage 1 are broadly similar to those set out at paragraph 3(ii) of section 4 of the WestNet SA.

At paragraph 2 of the section headed "Stage 2", TPI provides as follows:

"The Commercial/Compliance Manager, in liaison with the Head of Rail, must authorise all access to third party's confidential data held in the operations management system and will only grant access to persons who have signed Segregation Awareness Statements."

This particular arrangement is similar to the process in paragraph 3(iii) of section 4 of the WestNet SA (where sign-off is by a single person, in this case, the General Manager WestNet [the Commercial Manager in the case of the 2008 WestNet SA]).

A description of the roles and responsibilities of TPI staff, and details of the particular positions involved, should be specified in accordance with Recommendation 2.

The WestNet SA at paragraph 3(ii) of section 4 contains additional detail in relation to computer security controls to protect confidential information compared to the broad description in the TPI SA. The WestNet arrangements provide as follows:

- “When a user logs on to the ARG computer network their access to shared files, information systems, e-mail and the ability to generate reports is automatically restricted to their company and section”; and
- “When a user logs on to a specific information system the functions they have and the company related information they can access and report on is restricted according to their user ID and the approval of the General Manager”.

Paragraph 3(ii) of section 4 of the WestNet SA also sets out that WestNet has physically separate computer file servers from others in the ARG Group. In relation to this issue, the North West 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” (from page 39 of the North West Alliance SA paper).

**Recommendation 13**

Consistent with the 2003 approved SA for WestNet when it was a vertically-integrated entity, we recommend 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.

We also recommend that TPI should describe the arrangements for accessing confidential electronic information to a similar level of detail to that set out in the WestNet SA and, in particular, to ensure that a user of the computer system is automatically restricted to information relating to that user’s functional area and section within TPI.

Consistent with Recommendation 3 above (that the full-featured SA should apply from the commencement of the application of the access regime to the network), the amended Stage 2 arrangements for management of hard copy and electronic forms of confidential information should apply from commencement of the regime.

It is expected that details of the arrangements for the joint sign-off role of the Commercial/Compliance Manager and the Head of Rail (in relation to authorising access to confidential data in the operations management system) would be specified in the Segregation Manual (under Recommendation 18).



#### 4.3 Staff issues

##### 4.3.1 Transfers

TPI's proposed arrangements regarding staff transfers are broadly specified in section 4.3.1. The proposed arrangements in relation to Stage 1 are basically the same as Stage 2, except that under Stage 1, the arrangements are predominantly focussed on the position of the Commercial/Compliance Officer.

Although broadly specified, the arrangements seek to provide that staff cannot transfer between roles involved in performing access-related functions and roles performing other functions, where the staff concerned "have had access to Access Seeker/Holder's confidential information or the activities of the area could affect the Access Seeker/Holder's operations." In the case of a permanent transfer, this limitation is to apply for a period of three months. These principles are set out in paragraph 2 of section 4.3.1 of the SA.

In the WestNet SA which was approved in 2003, WestNet was required to:

- preclude staff from being shared between (or working for both) the infrastructure and operator arms on the company on jobs covered by a confidentiality deed (the only exception being in the case of emergencies, with WestNet required to define the conditions that constitute an emergency); and
- preclude staff of associated companies being rotated into WestNet positions relating to access and dealing with confidential information.

The relevant provisions of the WestNet SA are at paragraphs 3 and 4 of section 5, Conflicts of Interest, as follows:

- "Staff will not be rotated between WestNet and related entities into positions that have been identified in the Segregation Arrangements Management Manual as requiring Compliance Statements."; and
- No person can be shared by WestNet and AWR if the duties being undertaken for WestNet are duties that would require the person to sign a Compliance Statement."

The ability of staff to rotate between positions involved in performing access-related functions and other functions after a specified period of time may have efficiency benefits, particularly during the early stages of providing access. However, such rotation should not compromise the protection of confidential information, allow conflicts of interest to arise, or generally result in ineffective segregation of access-related functions from other functions. We note that staff dealing with confidential information will have to sign a Segregation Awareness Statement incorporating the obligation to protect confidential information. This would provide a degree of protection of confidential information and would protect against conflicts of interest. However, in our view, a three month period before a rotation or transfer can take place is too short a time period – particularly in view of the WestNet SA prohibiting staff rotations between access-related positions and other positions where a person in the position concerned is required to sign, or has signed, the equivalent of the TPI Segregation Awareness Statement.

ACIL, for Hancock Prospecting, at page 11 of its submission, presents that the TPI SA, in effect, should adopt similar staff rotation limits to the WestNet SA. ACIL/Hancock Prospecting states as follows:

“Staff should not be rotated between TPI rail infrastructure division and related entities into positions that are covered by the Segregation Awareness Statement.”

The North West Alliance, on the other hand, at page 37 of its SA paper, submits that staff may rotate between positions involved in performing access-related functions and other functions after a period of at least one year.

Our recommendation in relation to staff rotations below seeks to provide similar safeguards as in the WestNet SA, but also a degree of flexibility in relation to a category of staff rotation that is not prescribed in the WestNet SA, ie staff movements in the case of positions not identified as being required to sign a Segregation Awareness Statement.

**Recommendation 14**

We suggest that the TPI SA should preclude the ability of access related staff who have signed (or are required to sign) a SA Awareness Statement from transferring to positions in other TPI divisions for a period of at least one year. Staff who are subject to the SA Awareness Statement would need to move to roles not subject to the Awareness Statement within the Rail Infrastructure Division of TPI prior to moving to other TPI divisions.

Other access related or Rail Infrastructure Division staff (that is, staff who are not identified as being required to sign a Segregation Awareness Statement) may freely transfer to other TPI divisions.

We consider that emergencies would constitute a special case, where exceptions to the measures in Recommendation 14 may be reasonable in order to ensure the safe and reliable operation and use of the network.

**Recommendation 15**

In the light of the importance of ensuring the safe and reliable operation and use of the network, TPI may wish to consider adopting the exception to the prohibition on staff rotations between access-related functions and other functions in the case emergencies, as set out in paragraph 6 of section 5 of the WestNet SA. Rotation of relevant staff under emergency conditions should only occur after the railway owner advises the ERA of 1) the circumstances of the emergency; 2) the expected duration of the emergency; and 3) the specific measures being taken by the railway owner to protect confidential information and to protect against conflicts of interest (eg while the rotation is in effect).

#### 4.3.2 Consultants

TPI's proposed arrangements for applying the segregation obligations of staff members to consultants employed by TPI from time to time are consistent with the commitment given by WestNet at paragraph 2 of section 2 of its SA (ie to ensure any contractor is aware of and complies with any obligations applied by the Act and the Code). The TPI arrangements are considered appropriate in this context.

#### 4.4 Documentation

##### 4.4.1 Segregation Awareness Statement

The SA set out, in a number of places, that staff performing access-related functions, or who otherwise come into contact with confidential information, are to sign a Segregation Awareness Statement. The Segregation Awareness Statement is to be developed pursuant to a Segregation Manual, which also appears to be still to be developed by TPI. The Segregation Manual would thus set out the policies and procedures to give effect to the segregation arrangements, whereas the Segregation Awareness Statement would largely be a sign-off document for staff to confirm that they are aware of their responsibilities and obligations under the WA Rail Access Regime, specifically as it relates to confidential information.

The Segregation Awareness Statement is equivalent to the Compliance Statement in the WestNet SA, whereas the Segregation Manual is equivalent to the Segregation Arrangements Management Manual in the WestNet SA.

##### **Recommendation 16**

The Segregation Awareness Statement appears not to have been developed. The SA as submitted simply provide an undertaking to develop a Segregation Awareness Statement. This is considered reasonable in the context that the Segregation Awareness Statement will be largely a simple compliance statement. However, to maximise the safeguards for confidential information, we suggest that the Segregation Awareness Statement incorporates a commitment to safeguard confidential information which would have the same effect as a confidentiality deed.

##### 4.4.2 Advice regarding confidentiality

This section 4.4.2 contains effectively the same arrangements as in paragraphs 5 and 6 of section 6 the WestNet SA. The arrangements are that, pursuant to the Code, the railway owner is to inform access seekers of their rights to confidentiality when negotiating inside and outside the access regime, and is to have in place a protocol for access seekers who commence negotiations outside the access regime and subsequently make an access application under the regime.

ACIL, for Hancock Prospecting, at page 13 of its submission, notes that the last sentence in section 4.4.2 should refer to negotiations being inside or outside of the Code, not the WA Rail Access Regime. We suggest that the wording change identified by ACIL/Hancock Prospecting should be adopted as a minor drafting change.

## 5 Duty of fairness (section 33)

This section sets out the requirements of section 33 of the Act.

Similar to the commitment given at paragraph 1 of section 6 of the WestNet SA, paragraph 2 of this section 5, commits to treat all access seekers and train operators fairly in relation to prices, service quality, paths and priority.

TPI's acknowledgement that its duty of fairness extends to the application of determinations made by the Regulator under Part 5 of the Code at paragraph 3 of this section 5 is, in effect, the same as the commitment given by WestNet at paragraph 4 of section 6 of its SA.

The mechanism cited by TPI for ensuring its duty of fairness, at paragraph 2 under the heading "Stage 1" (that it will follow the steps specified in Parts 2 to 4 of the WA Rail Access Code for the negotiation of Access Agreements, as well as observe legislative confidentiality requirements), is similar to that given in the WestNet SA<sup>2</sup> and reflects TPI's statutory obligations.

In relation to this issue, ACIL, for Hancock Prospecting, at page 13 of its submission states as follows:

"TPI states that it will apply the steps specified in parts 2 to 4 of the Code as part of its observation of its duty of fairness. Hancock Prospecting will want clarification on whether this is the case even for access agreements being negotiated outside the Code (in which case Part 2 to 4 would not ordinarily apply). If this is not TPI's intention, then additional comfort is required on how the duty of fairness is to be observed."

In responding to this issue in its 13 October 2008 submission, on page 4, TPI states as follows:

"In response to comments about TPI potentially negotiating access agreements outside the Code, it is not clear why TPI needs to provide additional comfort on how the duty of fairness is to be observed in this circumstance given Code obligations/requirements are not relevant for such negotiations."

We note that entities seeking access to the railway infrastructure have recourse to negotiating access under Part 3 of the Code and that TPI's effective commitment in relation to the duty of fairness in this regard is effectively the same as that of WestNet section 6 of its SA, which reflects the statutory obligations of the railway owners. We do not consider that TPI should face additional obligations in relation to the duty of fairness to those of WestNet.

Paragraph 3 of this section 5 sets out that, under Stage 2, internal TPI access arrangements will be "broadly comparable" to those provided or offered to third parties. The commitment given in this regard by TPI is however non-specific: this is also noted in stakeholder submissions (eg by

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<sup>2</sup> For example, the access-related functions in section 2(i) of the WestNet SA, which comprise, amongst other functions "Compliance with the provisions of the Act and Code and with requirements of the Regulator under that legislative framework including but not limited to ... undertaking the steps defined in Parts 2 and 3 of the Code for the negotiation of Access Agreements."

the North West Alliance and by UMC at page 20 and page 10 respectively of their papers on the SA). However, the commitment reflects that given at paragraph 2 of section 6 of the WestNet SA and is considered appropriate, that we consider the TPI SA should contain equivalent safeguards to the WestNet SA (TPI, in its 13 October 2008 response to the public comments by stakeholders, also emphasises the equivalence of its commitment with that given in the WestNet SA).

The North West Alliance, at page 22 of its SA paper, suggests that indicative access prices (eg for the most common access service) should be published. In relation to this issue, it also states as follows:

“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, on page 4 of its 13 October 2008 response to the public comments by stakeholders, provides the following response to the suggestion that indicative access prices should be published as part of its duty of fairness under section 33 of the Act:

“There is not requirement under the Code for the development of indicative access prices.

Under the Code, a railway owner must provide an access seeker with the floor price and ceiling price for access (Clause 9). In addition, an access seeker has the right to seek ERA’s opinion on whether the railway owner’s proposed access price meets the relevant requirements of the Code (Clause 21(1)).”

Given the information requirements placed on railway owners and the safeguards provided to access seekers under the WA Rail Access Regime as noted above, we do not consider it necessary that the SA should specify that TPI will publish indicative access prices.

The North West Alliance, at page 22 of its SA paper also provides the following comments in relation to the duty of fairness provisions of the SA:

“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.”

On page 5 of its 13 October 2008 response, TPI provides the following comments in relation to the suggestion that access agreements, including the FMG agreement, should be provided to the ERA:

“There is no requirement under the Code for an access provider to submit access arrangements to the ERA, nor does WestNet appear to make such a commitment in its segregation arrangements.”

We note that section 39 of the Code requires a railway owner to give a copy of an access agreement to the Regulator as soon as is practicable after the agreement is entered into, and that this section also sets out other

requirements in relation to the Regulator making a register of access agreements and for making the register available for inspection by any person. Accordingly, we consider the above issue to be already dealt with under the WA Rail Access Regime and that it is not necessary for such a requirement to be incorporated into the TPI SA.

The North West Alliance, at page 23 of its SA paper also suggests the following:

“Industry should know exactly the nature and extent of current contractual commitments of TPI existing over particular routes on the TPI network.”

In its 13 October 2008 response, TPI emphasises that there is no requirement under the Code for a railway owner to reveal to the industry the nature and extent of current contractual commitments, and also notes how entities seeking access are able to obtain information of rail operations on the routes for which they are seeking access (the means for obtaining information include requests under section 7 of the Code). We agree with TPI's position on this issue and note that, in addition to the general avenues for access seekers and operators to obtain information which are noted by TPI, that under section 39(5) of the Code, any person may inspect the register of access agreements and determinations maintained by the Regulator. The nature of such information to be made publicly available under the WA Rail Access Regime is prescribed by section 39(5) of the Code – the Regime does not require the details of the access agreements to be made public.

## **6 Preparation of accounts and records (section 34)**

Paragraph 1 of this section 6 is effectively the same as paragraphs 1 and 2 of section 7 of the 2008 WestNet SA (relating to WestNet as a separate entity), in that it sets out that the railway owner will prepare, maintain and report the accounts and financial records required to comply with the Act and Code, to assist the Regulator in the performance of the Regulator's duties under the Act or Code in the manner approved by the Regulator. It also specifies that these obligations encompass the preparation and maintenance of separate accounts in relation to TPI's access-related functions versus its other functions. Paragraph 1 reflects the broad scope of the railway owners' obligations under section 34 of the Act and is considered to be appropriate.

The need for separate accounts in relation to TPI's access-related functions versus its other functions is commented on in stakeholder submissions (eg The North West Alliance, at page 5 of its SA paper, states that a functionally and organisationally separate access activities business unit within TPI should have “its own quarantined accounting and reporting arrangements”).

Paragraph 2 of this section 6 provides that TPI will present the regulatory accounts in a Regulator-approved format and comply with the Costing Principles approved by the Regulator. The requirement to present accounts in a Regulator-approved format represents a requirement in the regulatory determination on the WestNet SA. The commitment to comply with Costing Principles approved by the Regulator is similar, in principle, to the commitment given at the final paragraph of section 7 of the WestNet SA.

Under Stage 1, TPI proposes that regulatory accounts would be prepared by FMG's Finance Group and that, at Stage 2, TPI would be self sufficient for regulatory accounting purposes, with the exception that statutory accounting and cost accounting functions would continue to be performed by FMG Finance.

Our assessment of this proposal is based on the Stage 2 arrangements, given our views on the two-phase implementation approach discussed in relation to section 1.3.2 above.

We consider there would be material efficiencies (in financial operations and management) from statutory accounting functions for the broader group being performed by FMG Finance. There is also, in our view, a sound case for cost accounting functions to be undertaken by a central accounting group, given the need to deal the allocation of joint costs and the desirability of adopting consistent costing practices across the entities. The arrangements proposed by TPI at Stage 2 are considered to be logical and efficient in this context. It is noted that the arrangements proposed by TPI in this regard are safeguarded by the other segregation arrangements: in particular, by the requirement for relevant staff to sign Segregation Awareness Statements and the maintenance of the register of staff who deal with confidential information (discussed at section 4.2 above).

Section 7 of the 2003 WestNet SA, relating to WestNet as a vertically-integrated entity within ARG, includes additional detail to the 2008 WestNet SA in relation to separation of access-related functions from other functions, in terms of information processes and decision-making processes. These details in the 2003 SA are broadly reflected in the TPI SA and are that:

- the railway owner should control and manage the information used in preparing the regulatory accounts;
- procedures to ensure protection of confidential information under the billing process are to be set out in the Segregation Arrangements Management Manual (the WestNet equivalent to the TPI Segregation Manual);
- financial information released to the central finance group is to be aggregated; and
- persons having access to confidential information in finance and audit groups (including consultants to those groups and external auditors) must sign a Compliance Statement (the WestNet equivalent to the TPI Segregation Awareness Statement).

The points above are covered by general measures in the TPI SA, including the requirement for relevant staff to sign a Segregation Awareness Statement. However, in order to strengthen the safeguards for management of confidential information at the combined entity level in relation to income, expenditure, asset, liability and other reporting data, we suggest that the specific measures under Recommendation 17 below are incorporated into the TPI SA. As per the discussion above of some accounting functions for the broader group being performed by FMG Finance, we do not consider it to be practical or efficient for all the processes relating to the preparation of regulatory accounts to be controlled and managed by a finance team within the access business of TPI (see Recommendation 7). We note also that

various safeguards will apply to finance staff concerned (these safeguards would include the suggested measures set out in Recommendation 17).

**Recommendation 17**

In order to ensure that financial information in relation to access-related functions is properly distinguished from information related to other functions, and to protect confidential information, the following measures should be adopted:

- TPI staff should control the data used to generate invoices for access customers and there should be procedures to ensure that such billing-related confidential information is protected;
- the collection of the payments to be performed by FMG Finance should be based on information supplied by the Commercial/Compliance Officer. Detailed information supporting invoicing should be provided direct to customers by TPI;
- data for reports produced by FMG Finance to be aggregated to prevent disclosure of confidential information (see also Recommendation 11); and
- FMG Finance and auditors given access to confidential information are to sign a Segregation Awareness Statement (this point effectively also covered by staff and consultants having to sign a Segregation Awareness Statement).

## 7 Compliance

### 7.1 Development of Segregation Manual

The Segregation Manual is to set out the policies and procedures to give effect to TPI's segregation arrangements. The Segregation Manual is to include the requirement for staff who perform access-related functions, or who come into contact with confidential information, to sign a Segregation Awareness Statement to confirm that they are aware of their responsibilities and obligations under the WA Rail Access Regime.

The Segregation Manual is equivalent to the Segregation Arrangements Management Manual referred to in the WestNet SA, although the scope of policies and processes covered by the TPI Segregation Manual are considered to be broader than the arrangements covered in the document referred to in the WestNet SA.

Similar to the Segregation Awareness Statement, TPI's Segregation Manual appears not to have been developed. The SA arrangements for the Segregation Manual as submitted largely represent an undertaking to develop the Segregation Manual. As the Segregation Manual would represent a policy document setting out controls and procedures, there is a greater need for such arrangements to be set out in detail and approved by the Regulator before the access regime commences, compared to the Segregation Awareness Statement (which, as noted above, is more in the form of a sign-off document).

Stakeholders also express concerns about the absence of details of the segregation controls and procedures that could be expected to included the



Segregation Manual. In addition, the North West Alliance, at page 23 of its paper<sup>3</sup> on the SA states as follows:

"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."

TPI, on page 2 of its 13 October 2008 submission, provides the following response to the requirement that the Segregation Manual should be made available for public comment and approved by the ERA:

"Westnet committed to develop a Segregation Arrangements Awareness Manual (SAAM) in its approved Segregation Arrangements (April 2008). However, it is not clear whether a SAAM has been approved by the ERA. Certainly, no draft WestNet SAAM has been released by the ERA for public comment. On equity grounds, TPI would anticipate a similar process to be adopted."

Our assessment of this issue involves considering whether an undertaking to develop a particular instrument, in this case, a Segregation Manual, rather than having such an instrument in place setting out details of segregation controls and procedures:

- would appropriately represent controls and procedures to ensure that arrangements to segregate access-related functions from other functions (a) operate effectively; and (b) are complied with (these requirements are specified in section 28(2) of the Act); and
- would satisfy other necessary and specific regime requirements, in particular, to ensure that a relevant officer does not have a conflict between his or her duties (in accordance with section 32 of the Act).

Although the role of the Segregation Manual in TPI's segregation arrangements is generally set out in the document, specific content, including policy guidance, to be included in the Segregation Manual, is not clearly set out. Without further information on such matters, we do not consider the current level of detail provided in relation to the Segregation Manual is consistent with the requirements of the Act above (in particular, section 28(2)). Our view in relation to this issue is also reflected in the comments provided in the stakeholder submissions, to the effect that the current form of the SA are imprecise and do not amount to regulatory arrangements in terms of section 28 of the Act.

In relation to TPI's comments that it is unclear whether a WestNet Segregation Arrangements Management Manual has been approved and that no WestNet manual has been released for public comment, we note from the ERA's website that a WestNet manual has been approved (on 8 April 2003) but that the manual is not publicly available. We agree with TPI that its Manual should be submitted to the ERA for approval.

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<sup>3</sup> UMC also makes a similar statement at page 12 of its SA submission.

#### **Recommendation 18**

We note that TPI states that the Segregation Manual, and any subsequent amendments to it, will be submitted to the Regulator for approval. In relation to Stage 2, TPI presents that any necessary changes to the Segregation Manual will be submitted for approval prior to the commencement of that stage. Given this position of TPI, and our views in relation to providing complete Stage 2 protections at the outset of the regime, we consider that further information on the Segregation Manual should also be provided in the SA from the outset.

The further information could be incorporated into the existing section 7.1 or as an Appendix to the SA. While we do not consider it necessary to have a fully detailed Segregation Manual included with the initial SA, we suggest that further information defining the SA content should be included with the SA, comprising the following:

- an outline of the Segregation Manual document, in terms of major headings;
- a list of the documents and processes governed by the Segregation Manual, and the relationship of those to the Segregation Manual (ie whether they are part of the Segregation Manual or maintained under a separate, defined process);
- the form of the register of recipients of confidential information; and
- a commitment that the Segregation Manual will detail the appropriate segregation arrangements, including measures and commitments in relation to confidential information from section 3 above, types of behaviour which breach segregation requirements and the appropriate corrective action for each breach and internal notification procedures.

#### **Recommendation 19**

Consistent with TPI's position that the Segregation Manual, and any subsequent amendments to it, will be submitted to the Regulator for approval, and in view of the incomplete nature of the segregation arrangements as proposed, we suggest that TPI should submit its Segregation Manual to the ERA for approval.

### **7.2 Audit and compliance**

Similar to paragraphs 1(i) and 1(ii) of section 8 of the WestNet SA, this section sets out that TPI will provide a detailed annual independent external audit of compliance with other aspects of the segregation arrangements on a negative assurance basis. It also states that the Regulator is to select and manage the auditor with costs paid by the railway owner; and that, at minimum, the Regulator's approval of the scope of the audit will be required and the final audit report will be made available to the Regulator and the public.

At paragraph 5, TPI commits to report any breach of the segregation arrangements of which it becomes aware to the Regulator in writing within 10 business days. The equivalent provision of the WestNet SA (paragraph 1(iii) of section 8) provides for reporting within 5 business days.

**Recommendation 20**

We suggest that TPI provide justification for adopting 10, rather than 5 business days, for reporting breaches of the segregation arrangements to the Regulator. If there is no reasonable justification for adopting a longer time period than in the WestNet SA, the time period in the WestNet SA should be applied.

TPI's acknowledgement at paragraph 5, that the Regulator may undertake special audits on any issue or area where additional assurance is sought, is consistent with paragraph 2 of section 8 of the WestNet SA and is considered appropriate.

The commitment at paragraph 6, that TPI will undertake awareness training for relevant staff in relation to the obligations under the WA Rail Access Regime is consistent with paragraph 3 of section 8 of the WestNet SA and is considered appropriate.

At paragraph 7, TPI commits to report key performance indicators on compliance with segregation arrangements to the Regulator in order to provide confidence in the integrity of the SA. This paragraph is consistent with paragraph 1(i) of section 8 of the WestNet SA, which only states a commitment by WestNet to report KPIs (ie not specific measures to be reported).

**Recommendation 21**

Although the TPI provision is more complete than the equivalent provision in the WestNet SA, we suggest that the following additional point should be added to the KPIs listed in the TPI SA:

- "and any other key performance indicators which indicate the effectiveness of segregation arrangements that are developed by the Regulator in consultation with TPI."

TPI, on page 6 of its 13 October 2008 response to the public comments by stakeholders on the SA, responds to stakeholder comments that liquidated damages should apply where a breach of the SA is found to have occurred (eg this is suggested by the North West Alliance at page 23 of its submission). TPI's response is as follows:

"There is no requirement under the Code, nor precedent established by WestNet's segregation arrangements, that necessitates TPI committing to such a penalty provision."

We agree with TPI's general position on this issue and note that standard penalty provisions exist in the Act in relation to failure to comply with Segregation Arrangements and that the Act and Code provide powers to the ERA to commission special audits on any issue or area where it requires additional assurance.

### 7.3 Complaints handling

This section provides an appropriate commitment to implement a complaints handling procedure and states that the ERA has wide powers to investigate any alleged breaches of the segregation arrangements.

Paragraph 2 of this section provides that TPI will use reasonable endeavours to:

- advise the Regulator within 30 days of any complaint it receives; and
- complete its internal investigation and advise the complainant of the result within 30 days of receiving the complaint.

We note in relation to this matter that ACIL, for Hancock Prospecting, at page 16 of its submission, states that TPI should use all reasonable endeavours to advise the Regulator within 10 days of any complaint it receives.

#### **Recommendation 22**

While we consider the process proposed by TPI to be reasonable, we suggest that TPI justify the basis for providing 30 days to notify the Regulator/complainant.

### 8 Definitions

This section provides a limited list of terms defined by TPI for the purposes of the SA.

#### **Recommendation 23**

It is suggested that TPI provide a complete list of the definitions used in the document. Such definitions should be consistent with the definitions in the Act and the Code, and with the definitions in section 9 of the WestNet SA, where appropriate.

Recommendation 23 reflects comments by stakeholders. For example, by UMC at page 10 of its SA paper.

## Appendix: List of Recommendations

For ease of reference, this Appendix sets out the list of PwC's recommendations from section 2 of this report in relation to TPI's proposed SA.

### **Recommendation 1**

For completeness, the TPI SA should cover the matter covered in paragraph 3 of section 1 of the WestNet SA (that, under section 29 of the Act, the Regulator may impose other segregation requirements on a railway owner in addition to those in sections 31 to 34).

### **Recommendation 2**

We suggest that TPI should provide a more detailed description of each position in the structure, its classification according to whether it performs access-related functions or other functions and the physical location of each position.

### **Recommendation 3**

We note TPI's stated position that, during Stage 1, there will not be complete functional separation and consider the two-stage approach proposed by TPI to be inconsistent with the requirements of the Act.

We suggest that TPI should revise its SA so that an equivalent of its Stage 2 segregation model applies from the outset of the application of the access regime to the network. The model to be adopted should be the Stage 2 model as proposed by TPI, but incorporating the changes as required by the Regulator (where this paper suggests changes that the ERA may require).

### **Recommendation 4**

TPI's proposed SA have a style that is more in the manner of a submission explaining the segregation arrangement principles that TPI wishes to apply in order to comply with the Act, combined with some associated justifications for the principles and approaches contained therein, rather than specific regulatory arrangements in accordance with section 28 of the Act.

In light of this, and in addition to our recommendations in relation to providing greater specificity within the SA provisions, we suggest that TPI considers segmenting its proposal into an explanatory submission with attached segregation arrangements (see also Recommendation 18 below).

### **Recommendation 5**

The requirement that staff performing the access-related functions who are subject to compliance statements (eg train control and scheduling) will not be involved in performing other functions should be embodied in segregation arrangements applied to the TPI network from the outset.

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#### **Recommendation 6**

The principle set out by TPI in paragraph 2 under the heading "Stage 2" at section 1.3.2 involves the use of terms that are not defined in the Act or Code, such as "haulage-related functions" and "infrastructure and haulage operations". As a general recommendation, we consider that terms consistent with the Act and Code should be adopted for reasons of clarity and completeness (relevant terms should be identified (capitalised) in this section and defined in section 8 of the SA). See Recommendation 23 at section 8.

#### **Recommendation 7**

To provide separation of access-related functions from other functions as required by section 28 of the Act, to further assist in clarifying the roles and responsibilities of staff in the performance of access-related functions versus other functions, and to reflect the arrangements under the approved WestNet SA, we recommend that:

- TPI should ensure access related staff work solely on access related functions and
- Access related staff are physically separate from other parts of TPI, ideally this could take the form of a separate access business unit within the rail Infrastructure Division of TPI.

#### **Recommendation 8**

We suggest that the following amendments are made to the SA provisions in relation to confidential information:

- the examples of confidential information given at paragraph 1 of section 4 of the WestNet SA, in terms of item (v) in relation to Master Train Control Diagrams and item (vi) in relation to Completed Train Control Diagrams, should be added to the TPI examples;
- TPI should provide a list of documents and other information that it will use to define how it distinguishes confidential information from information that is not specifically protected. The list should cover both "input" and "output" type information (this list could be contained in the Segregation Manual discussed at section 7.1 below – see Recommendation 18);
- the statement to the effect that at commencement of the full access regime confidential information will include confidential information disclosed as part of the operation of an access agreement should be deleted; and
- all examples of confidential information provided in the SA should be based on terms that are consistent with the terms used in the Act and Code.

#### **Recommendation 9**

The condition for the Commercial/Compliance Officer being able to disclose confidential information is unclear. We suggest that TPI provides clear examples of the circumstances and the specific information that would be disclosed under such a condition.

TPI should consider clarifying the extent to which the Commercial/Compliance Officer will be the sole custodian of each type of confidential information and who else will have access to the proposed confidential information (this would be covered under Recommendation 2).

#### **Recommendation 10**

In relation to the proposed register of staff, management, board members and external contractors and consultants to whom confidential information is disclosed, we suggest that:

- the register should record the position titles of those parties on a consistent basis to the information on position roles to be provided in accordance with Recommendation 2; and
- persons on the register should enter into confidentiality deeds (this is already required of consultants under section 4.3.2 of the SA). It suggested that this is achieved by incorporating confidentiality deed provisions into the Segregation Awareness Statement (see Recommendation 16 below).

#### **Recommendation 11**

We suggest that TPI list and define the relevant control measures in relation to managing confidential information flows, including within the executive and Board structure of TPI/FMG, though the following:

- detailing the procedures it will follow for the protection of confidential information that will allow the Boards of TPI and FMG to carry out their statutory duties;
- specifying the direct reporting paths in relation to access-related functions;
- specifying that management meetings in relation to access-related issues will not include representatives of the arm of TPI, or related entities of TPI, involved in operating train services;
- specifying the nature of the contents of management reports on access-related issues to be given to TPI and FMG management, directors and Board members, in that management reports at group level should only provide aggregate financial and operating data and should not identify individual operators or users; and
- when confidential information is provided to management, directors and Board members, it must be clearly identified as such.

**Recommendation 12**

Consistent with the WestNet arrangements for providing and securing access to hard copy information, we recommend that:

- the access management area in which the hard copy confidential information is held must be locked when not attended by TPI access staff; and
- TPI should provide a description of the arrangements for providing and securing access to such hard copy information to a similar level detail as provided in the WestNet SA.

**Recommendation 13**

Consistent with the arrangements for WestNet as a vertically-integrated entity, we recommend 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.

We also recommend that TPI should describe the arrangements for accessing confidential electronic information to a similar level of detail to that set out in the WestNet SA and, in particular, to ensure that a user of the computer system is automatically restricted to information relating to that user's functional area and section within TPI.

**Recommendation 14**

We suggest that the TPI SA should preclude the ability of access related staff who have signed (or are required to sign) a SA Awareness Statement from transferring to positions in other TPI divisions for a period of at least one year. Staff who are subject to the SA Awareness Statement would need to move to roles not subject to the Awareness Statement within the Rail Infrastructure Division of TPI prior to moving to other TPI divisions.

Other access related or Rail Infrastructure Division staff (that is, staff who are not identified as being required to sign a Segregation Awareness Statement) may freely transfer to other TPI divisions.

**Recommendation 15**

In the light of the importance of ensuring the safe and reliable operation and use of the network, TPI may wish to consider adopting the exception to the prohibition on staff rotations between access-related functions and other functions in the case emergencies, as set out in paragraph 6 of section 5 of the WestNet SA. Rotation of relevant staff under emergency conditions should only occur after the railway owner advises the ERA of 1) the circumstances of the emergency; 2) the expected duration of the emergency; and 3) the specific measures being taken by the railway owner to protect confidential information and to protect against conflicts of interest (eg while the rotation is in effect).



**Recommendation 16**

The Segregation Awareness Statement appears not to have been developed. The SA as submitted simply provide an undertaking to develop a Segregation Awareness Statement. This is considered reasonable in the context that the Segregation Awareness Statement will be largely a simple compliance statement. However, to maximise the safeguards for confidential information, we suggest that the Segregation Awareness Statement incorporates a commitment to safeguard confidential information which would have the same effect as a confidentiality deed.

**Recommendation 17**

In order to ensure that financial information in relation to access-related functions is properly distinguished from information related to other functions, and to protect confidential information, the following measures should be adopted:

- TPI staff should control the data used to generate invoices for access customers and there should be procedures to ensure that such billing-related confidential information is protected;
- the collection of the payments to be performed by FMG Finance should be based on information supplied by the Commercial/Compliance Officer. Detailed information supporting invoicing should be provided direct to customers by TPI;
- data for reports produced by FMG Finance to be aggregated to prevent disclosure of confidential information (see also Recommendation 11); and
- FMG Finance and auditors given access to confidential information are to sign a Segregation Awareness Statement (this point effectively also covered by staff and consultants having to sign a Segregation Awareness Statement).

#### **Recommendation 18**

We note that TPI states that the Segregation Manual, and any subsequent amendments to it, will be submitted to the Regulator for approval. In relation to Stage 2, TPI presents that any necessary changes to the Segregation Manual will be submitted for approval prior to the commencement of that stage. Given this position of TPI, and our views in relation to providing complete Stage 2 protections at the outset of the regime, we consider that further information on the Segregation Manual should also be provided in the SA from the outset.

The further information could be incorporated into the existing section 7.1 or as an Appendix to the SA. While we do not consider it necessary to have a fully detailed Segregation Manual included with the initial SA, we suggest that further information defining the SA content should be included with the SA, comprising the following:

- an outline of the Segregation Manual document, in terms of major headings;
- a list of the documents and processes governed by the Segregation Manual, and the relationship of those to the Segregation Manual (ie whether they are part of the Segregation Manual or maintained under a separate, defined process);
- the form of the register of recipients of confidential information; and
- a commitment that the Segregation Manual will detail the appropriate segregation arrangements, including measures and commitments in relation to confidential information from section 3 above, types of behaviour which breach segregation requirements and the appropriate corrective action for each breach and internal notification procedures.

#### **Recommendation 19**

Consistent with TPI's position that the Segregation Manual, and any subsequent amendments to it, will be submitted to the Regulator for approval, and in view of the incomplete nature of the segregation arrangements as proposed, we suggest that TPI should submit its Segregation Manual to the ERA for approval.

#### **Recommendation 20**

We suggest that TPI provide justification for adopting 10, rather than 5 business days, for reporting breaches of the segregation arrangements to the Regulator. If there is no reasonable justification for adopting a longer time period than in the WestNet SA, the time period in the WestNet SA should be applied.

#### **Recommendation 21**

Although the TPI provision is more complete than the equivalent provision in the WestNet SA, we suggest that the following additional point should be added to the KPIs listed in the TPI SA:

- "and any other key performance indicators which indicate the effectiveness of segregation arrangements that are developed by the Regulator in consultation with TPI."

**Recommendation 22**

While we consider the process proposed by TPI to be reasonable, we suggest that TPI justify the basis for providing 30 days to notify the Regulator/complainant.

**Recommendation 23**

It is suggested that TPI provide a complete list of the definitions used in the document. Such definitions should be consistent with the definitions in the Act and the Code, and with the definitions in section 9 of the WestNet SA, where appropriate.