

## **DRAFT REPORT**

### **Economic Regulation Authority**

### **Review of Proposed Part 5 Instruments of *The Pilbara Infrastructure Pty Ltd*:**

### **Over-payment Rules**

October 2009

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## Summary Comments

In the period between 3 July 2008 and 15 August 2008, The Pilbara Infrastructure Pty Ltd (TPI) submitted to the Economic Regulation Authority (ERA) segregation arrangements and four Part 5 instruments (Train Management Guidelines, Train Path Policy, Costing Principles and Over-payment Rules) for approval under the WA Rail Access Regime.

This report by PricewaterhouseCoopers (PwC) addresses TPI's proposed Over-payment Rules (OPR). Separate PwC reports address TPI's other proposed Part 5 instruments and its proposed segregation arrangements.

The Part 5 instruments, along with the segregation arrangements, are to help provide access to monopoly infrastructure with reasonable quality of service at fair prices, and to prevent below rail infrastructure owners from extracting monopoly rents from third party above rail operators. At the same time, these arrangements are to recognise the need for infrastructure owners to achieve fair and reasonable returns on their investments.

The definition of Part 5 instrument, and the requirement for a railway owner to have in place such instruments, is set out in the Railways (Access) Code 2000 (the Code). In broad terms, the Part 5 instruments comprise:

- the Train Management Guidelines (TMG), which are a statement of the principles, rules and practices that are to be applied and followed by a railway owner in relation to the real-time management of services;
- the Train Path Policy (TPP), which is closely related to its TMG, and deals with the allocation of train paths and the provision of access to train paths that have ceased to be used;
- the Costing Principles (CP), representing principles, rules and practices that are to be applied by the railway owner to determine the floor and ceiling price tests, and to keep and present the railway owner's accounts and financial records pertaining to the determination of these costs; and
- the Over-payment Rules, which in effect, are to provide for the 'wash-up' of any over-recovery of total costs by the railway operator at the end of each successive period of 3 years from the commencement of access.

The Code also sets out the power of the regulator to approve the instruments - with or without required amendments, or to direct a railway owner to amend or replace an instrument with an instrument determined by the regulator. The ERA is the regulator in respect of the WA Rail Access Regime, which is comprised of the Railways (Access) Act 1998 (the Act) and the Code.

The ERA has requested that PwC assess TPI's proposed Part 5 instruments from the perspectives of: the legislative requirements set out in the WA Rail Access Regime; the 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 TPI's Part 5 instruments as proposed can be accepted by the ERA as complying with the requirements of the WA Rail Access Regime, or whether particular changes, or further information in relation to the instrument provisions, are considered

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necessary in order for the ERA to be able to approve the individual instruments.

On 14 July 2008, the ERA called for public submissions on the TPI Segregation Arrangements and on TPI's TMG and TPP. TPI's Segregation Arrangements, TMG and TPP were submitted to the ERA on 3 July 2008.

On 20 August 2008, the ERA called for public submissions on the TPI CP and OPR, which were submitted by TPI on 15 August 2008 and 24 July 2008 respectively.

Public comments were received on the OPR (and CP) on 1 October 2008. On 14 November 2008, TPI provided a response to the ERA on the issues raised in the public submissions from interested parties. This report concerns only TPI's proposed OPR and addresses issues raised in the four submissions from interested parties received by the ERA on the OPR/CP, and in TPI's response to those public submissions.

Particular findings from our assessment of TPI's proposed OPR as submitted to the ERA on 24 July 2008 are provided below and details of our approach and assessment are provided at sections 1 and 2 of this report.

Below are our key recommendations in relation to TPI's proposed OPR. We have not set out below all of our recommendations, in terms of suggested amendments, or the further information in relation to particular provisions, that we consider would be required in order for the ERA to approve the OPR. All of our recommendations are discussed in section 2 of this report and are listed in the Appendix.

### General Issues

- As TPI is a vertically-integrated rail freight entity (compared to WestNet, which is vertically-separated), and given that there is a sound prospect for third party interest in using the TPI network, the extent of the protections to access seekers and operators in the TPI Part 5 instruments should at least equal those in the equivalent WestNet instruments.
- It appears that TPI has developed its Part 5 instruments based on an evaluation of the WestNet Part 5 instruments, as evidenced by replication in the TPI instruments of a significant number of WestNet provisions. However, we note that TPI has, in a number of cases, sought to apply more light-handed approaches than in the WestNet instruments.

### Specific Issues

- In its proposed OPR and CP, TPI defines only one route section for its network, whereas the WestNet OPR and CP prescribe multiple route sections for the WestNet network. Stakeholders present that there is demand from prospective operators for access to parts of TPI's overall network. The ability to negotiate access in relation to part of the network in that case would be consistent with the interests of users. Further, the pricing of such access on the basis of the costs associated only with those parts of the network (rather than the overall network) for which access is sought can be considered to be consistent with the principle of economic efficiency. Given this, we suggest that, similar to the WestNet instruments, the TPI OPR (and CP) should specify multiple route sections on the TPI network. The TPI route sections should be the

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discrete sections of track between sidings, passing loops and terminals. **(OPR Recommendation 1)**. A similar recommendation (**CP Recommendation 5**) is made in our separate report on the TPI CP.

- We suggest that section 2.1.5, over-payments and under-recoveries, is amended so that TPI is not able to reclaim under-payments from operators at the end of the 3 year period. This is consistent with arrangements in the WestNet OPR. We suggest that any carry-over of under-payments should be limited on the same grounds as in the WestNet OPR. **(OPR Recommendation 4)**.
- Similar to rule 1 in section 3 of the WestNet OPR, we suggest that a rule is added to specify the commencement date for the TPI OPR. The addition of a commencement date is to ensure that over-payment calculations are on a full financial year basis as specified elsewhere in the rules. We also suggest that "financial year" is defined. Inclusion of a financial year definition is consistent with rule 4 of section 3 of the WestNet OPR and would provide consistency with other rules in section 3 of the TPI OPR. **(OPR Recommendation 8)**.
- Rule 13 of section 3 of the TPI OPR is incomplete, as evidenced by the existence of square brackets and a question mark in that section. The guarantees in respect of liquidation referred to in the square bracketed text in rule 13 appear to relate to the WestNet OPR and to the specific role in respect of the application of those rules played by Babcock & Brown Infrastructure as guarantor of payments by WestNet (Schedule 1 to the WestNet OPR). Schedule 1 to the WestNet OPR therefore contains matters in relation to operation of the WestNet rules and the specific role of Babcock & Brown Infrastructure in the WestNet rules would not appear to be applicable to the TPI OPR. We recommend that rule 13 is expanded in order to clarify the operation of the rules through incorporation of additional provisions along the lines of rule 17 of the WestNet OPR and to include arrangements to provide appropriate guarantees for the establishment and operation of the over-payment account. **(OPR Recommendation 11)**.
- Unlike the WestNet OPR, the TPI OPR does not include Review and Consultation provisions. Consistent with our comments in relation to section 7 the TPI CP (Review and consultation), we consider that periodic reviews provide a general benefit of certainty of regulatory process and provide an assurance that the interests of railway owners and users will be balanced on a regular basis. Accordingly, we consider three-yearly reviews, as provided for in the WestNet OPR, to be appropriate for these purposes and to assure parties that the OPR will continue to operate in accordance with the objectives. We suggest that a new section is added to the OPR, entitled Review and Consultation, in order to provide a commitment to three-yearly reviews, commencing from the date of the ERA's approval of these OPR. **(OPR Recommendation 12)**.

Recommendations in relation to minor suggested amendments, or general requests for further information in relation to specific provisions (where such information is considered relevant to the ERA in deciding whether to approve a proposed provision), are not set out above. All of our recommendations in

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relation to TPI's proposed OPR are included in the assessment in section 2 and in the Appendix to this report.

Our general recommendations include the requirement for TPI to provide a complete list of the definitions used in the OPR. The definitions should be consistent with the definitions in the Act and the Code, and with the definitions in the WestNet OPR, where appropriate.

# 1 Background

## ***The Pilbara Infrastructure Pty Ltd***

The Pilbara Infrastructure Pty Ltd (TPI) 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 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.

## ***Statutory requirements summary***

A regulatory regime to facilitate third party access to Western Australian railway infrastructure is provided under the Railways (Access) Act 1998 (the Act), the object of which is to establish a rail access regime that encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations. The Act provides for the Minister to establish a code governing the use of certain facilities for rail operations by persons other than their owners. The Railways (Access) Code 2000 (the Code) made by the Minister, which represents subsidiary WA legislation, was gazetted in September 2000. The Western Australian Rail Access Regime, comprising the Act and the Code, became fully effective on 1 September 2001.

The Economic Regulation Authority (ERA) is the regulator in respect of the access regime provided by the Act and Code. The ERA is responsible for monitoring and enforcing compliance by railway owners with the Act and Code and is otherwise to perform the functions and exercise the specific powers as set out in the Act and Code.

On 1 July 2008, the Railway and Port (The Pilbara Infrastructure Pty Ltd) Agreement Act 2004 (the Agreement Act) amended the Act and the Code to bring TPI's railways network under the Western Australian Rail Access Regime.

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The Agreement Act required TPI to submit to the ERA segregation arrangements (in terms of Division 3, Part 3 of the Act) and the four “Part 5 Instruments” set out in section 40(3) of the Code (train management guidelines, statement of train path policy, costing principles and over-payment rules) no later than seven days after the Act and the Code applied to TPI’s railway network.

TPI’s initial proposed segregation arrangements and Part 5 instruments in response to the legislative requirements were submitted to the ERA in the period from 3 July 2008 and 15 August 2008 as follows:

TPI Arrangement/Instrument	Submission Date
Segregation Arrangements	3 July 2008
Train Management Guidelines	3 July 2008
Train Path Policy	3 July 2008
Costing Principles	15 August 2008
Over-payment Rules	24 July 2008

This report addresses only one of TPI’s proposed Part 5 instruments, being its proposed Over-payment Rules. Separate PwC reports consider TPI’s proposed segregation arrangements and consider its other proposed Part 5 instruments in the form of the Train Management Guidelines, Train Path Policy and Costing Principles. This report does not address the issue of compliance with submission requirements under the Agreement Act.



## 2 Discussion on Statutory Compliance

### 2.1 Approach

#### Statutory Requirements – Part 5 Instruments

The Part 5 instruments and the segregation arrangements are to facilitate access to monopoly infrastructure with reasonable quality of service at fair prices, and to prevent below rail infrastructure owners from extracting monopoly rents from third party above rail operators. At the same time, these arrangements are to recognise the need for infrastructure owners to achieve fair and reasonable returns on their investments.

Section 40 of the Code sets out the Part 5 instruments that are required to be approved by the regulator. The key provisions are as follows:

#### 40. Interpretation

“(2) For the avoidance of doubt it is declared that a Part 5 instrument relating to a part of the railways network and the associated infrastructure is binding on the person who is for the time being the railway owner in respect of that part.

(3) In subsection (2)—

“Part 5 instrument” means —

- (a) the train management guidelines;
- (b) the statements of policy;
- (c) the costing principles; and
- (d) the over-payment rules,

for the time being approved or determined under sections 43, 44, 46 and 47 respectively.”

The Over-payment Rules (OPR) provide reconciliation in respect of any over-recovery of total costs by the railway operator at the end of each successive period of 3 years from the commencement of access. Section 47 of the Code provides as follows:

#### 47. Over-payment rules

“(1) As soon as is practicable after the commencement of this Code each railway owner is to prepare and submit to the Regulator a statement of the rules (“**the over-payment rules**”) that are to apply where breaches of clause 8 of Schedule 4 occur on the part of that owner that could not reasonably be avoided.

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(2) The rules referred to in subsection (1) must give effect to the following basic requirements —

(a) the excess referred to in clause 8(4) of Schedule 4 in respect of an operator or group of operators must at all times be within a limit, being a percentage of the relevant costs, from time to time notified in writing to the railway owner by the Regulator;

(b) at the expiry of each successive period of 3 years from the commencement of access by an operator or group of operators there must be no such excess in respect of that operator or group of operators.

(2a) The over-payment rules may make provision for a scheme under which amounts are to be determined that the railway owner is to pay to any relevant operator for the purpose of giving effect to subsection (2)(b).”

Section 47 of the Code also sets out the power of the regulator to approve the OPR - with or without required amendments - and to direct a railway owner to amend or replace the owner's OPR with OPR determined by the regulator.

Under Part 5 of the Code, the ERA must undertake public consultation before approving a railway owner's proposed Train Management Guidelines (TMG) and Train Path Policy (TPP). Public consultation is not required before the OPR and Costing Principles (CP) are approved. We note that in previous assessments, the ERA has subjected all four Part 5 instruments to the same public process.

In relation to its general exercise of powers under the Act or Code, the regulator 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 the benefit to the public from having competitive markets. We note that the regulator has discretion in the way in which it balances, or attaches weight to, the various matters and interests in section 20(4) – for example, where the different interests are in competition or where tensions exist between them.

### Stakeholder Comments

On 14 July 2008, the ERA called for public submissions on TPI's proposed Segregation Arrangements (SA) under section 28 of the Act and on TPI's proposed TMG and TPP under sections 43 and 44 of the Code respectively. TPI's proposed SA, TMG and TPP were submitted by TPI to the ERA on 3 July 2008.

On 20 August 2008, the ERA called for public submissions on the TPI CP and OPR under sections 46 and 47 of the Code respectively. TPI's proposed CP were submitted on 15 August 2008 and its proposed OPR were submitted on 24 July 2008.

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Submissions on TPI's proposed OPR (and CP) were received from the following parties on 1 October 2008:

- North West Iron Ore Alliance (North West Alliance, or NWIOA);
- United Minerals Corporation (UMC);
- Hancock Prospecting Pty Ltd (Hancock Prospecting) – submission comprising a report by ACIL Tasman (ACIL); and
- Australian Rail Track Corporation (ARTC).

On 14 November 2008, TPI made a submission to the ERA on the issues raised in the submissions from the interested parties above.

The submissions from the interested parties above and TPI's submission of 14 November 2008 cover issues in relation to TPI's proposed OPR and CP. The content of these submissions is generally heavily weighted toward the issues in the CP, rather than those in the OPR. This PwC report addresses TPI's proposed OPR and the issues raised in the public consultation process in relation to the OPR. A separate PwC report addresses TPI's proposed CP and the issues raised in consultation on the CP.

### **PwC Assessment Approach**

To assist it in the exercise of its powers, the ERA has requested that PricewaterhouseCoopers (PwC) prepare an assessment of TPI's proposed Part 5 instruments.

PwC's assessment of TPI's proposed Part 5 instruments is from the perspectives of: the legislative requirements above; the 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 in part by the provisions of the WestNet Part 5 instruments as approved by the ERA. While there are differences between the practical arrangements of the different networks of TPI and WestNet, the approved WestNet instruments provide a useful starting point for assessing many of the provisions of the TPI instruments.

The WestNet instruments provide a useful starting point for assessing many of the provisions of the TPI instruments, given:

- the similarity of many of the provisions in the respective instruments; and
- that the approval of the WestNet instruments embodies the ERA's preferred 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 (compared to WestNet, which is vertically separated) and given that there is a sound prospect for third party interest in using the TPI network, we consider it reasonable that the extent of the protections to access seekers and operators in the TPI Part 5 instruments should at least equal those in the equivalent WestNet instruments. We note in this regard that a number of the comments and recommendations in the stakeholder submissions seek amendment to the TPI instruments by incorporation of operator protections and other measures from the WestNet instruments.

Our assessment in this report considers whether the provisions of the TPI OPR as proposed can be accepted by the ERA as complying with the requirements of the WA Rail Access Regime, or whether particular changes, or further information in relation to the instrument provisions, are considered necessary in order for the ERA to be able to approve the OPR.

## 2.2 PwC Assessment of TPI Over-payment Rules

This section 2.2 below sets out our assessment of TPI's proposed OPR.

Our assessment of issues is in the general sequence in which the particular issues arise within TPI's OPR.

A large proportion of the OPR provisions are considered to be appropriate. A total of 13 recommendations are made in relation to particular changes or further information required in relation to the instrument provisions that we consider necessary in order for the ERA to be able to approve the OPR.

For ease of reference, we have also set out our recommendations in the Appendix to this report.

Headings used in this section below are from TPI's proposed OPR.

### 1 Introduction

In principle, and also in relation to many of its details (eg paragraphs 1 and 4), this section 1 is consistent with section 1 of the WestNet OPR of August 2006, which were approved by the ERA.

We suggest that a neutral tone is adopted at sentence 3 of paragraph 2, by adopting the following wording adapted from the Code: "The Code provides that this provision will not be breached where payments exceed Total Costs if Over-Payment Rules approved or determined under section 47 of the Code are complied with." This is a drafting suggestion only.

### 2 Basis of the Over-payment Rules

#### 2.1.1 Definition of Route Sections

This section 2.1.1 deals with the same issues as section 2.1 of the WestNet OPR.

Paragraph 1 sets out that the network is divided into route sections for management and costing purposes. This reflects the definition of route section in the Code and the effective definition given in paragraph 1 of section 2.1 of the WestNet OPR.

At paragraph 2, TPI is proposing only one Route Section, being the Cloud Break to Port Hedland Route, whereas WestNet adopts multiple Route Sections in relation to four different Routes.

Issues associated with TPI's proposed single route section for its entire network, and stakeholder views of this proposal, are discussed in relation to section 2 of the TPI CP in our separate report on the CP and is addressed by CP Recommendation 5 in that report.

In response to TPI's proposal to designate the railway constructed from Cloud Break to Port Hedland as a single Route Section, stakeholders present that there is demand from prospective operators for access to parts of TPI's overall network and that disaggregated access arrangements

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(supported by designation of different route sections) to parts of the network are required on that basis.

The North West Alliance, at page 4 of its submission, states:

“... This approach [the single route section as proposed by TPI] overly aggregates costs and does not provide transparency or fairness to access seekers as it is likely that there will be many access seekers, based upon existing mining and exploration tenements, between Cloudbreak and Port Hedland.

A fairer and more transparent approach would be to define sections of the entire railway between Cloudbreak and Port Hedland by those sections of track, including multiple line track, between sidings, passing loops and terminals. In this way access charges will more fairly reflect the costs over which the access occurs.”

A similar suggestion to the above is made at page 8 of the UMC submission. The views expressed by NWIOA and UMC on this issue relate both to section 2.1.1 of the TPI OPR and to Appendix C of the TPI CP.

ACIL for Hancock Prospecting, at page 5 of its submission, also comments that in order to meet the needs of access seekers requiring access to only part of the network, disaggregation of the network into different route sections would be required. To that effect, ACIL recommends the following (its recommendation in this case is in relation to the TPI CP, but ACIL also makes a similar comment on page 18 in relation to the TPI OPR):

“TPI should reassess its route sections as proposals for access are received, in addition to reassessments made following expansions and extensions of the current railway. The Costing Principles also needs to define the process whereby Route Sections would be re-defined and associated ceiling and floor costs re-calculated.”

In its 14 November 2008 response to the submissions from the interested parties, TPI states that no clarity on the matter of route sections has emerged since TPI submitted its proposed OPR (and CP) to the ERA, with only some general approaches having been made by possible operators. TPI states that it prefers to define route sections on the basis of existing rail usage and that there will be future opportunities for route sections to be redefined as the situation changes.

We consider that an ability to negotiate access in relation to part of the network would be consistent with the interests of users. Also, pricing of access on the basis of the costs associated only with those parts of the network (rather than the overall network) for which access is required can be considered to be consistent with the principle of economic efficiency. The provision of access in accordance with the demand and costs associated with an individual operator's use of the network could also be considered to be consistent with the object of the Act which is to establish a rail access regime that encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations.

As TPI's instruments are to facilitate a contestable market for rail operations and as demand for use of the railway facilities by third party operators may relate to only part of TPI's overall network, we consider it important for the

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facilitation of a contestable market for rail operations that different route sections are specified up front.

### **OPR Recommendation 1**

We suggest that, similar to the WestNet OPR, the TPI OPR should specify multiple route sections on the TPI network. The TPI route sections should be the discrete sections of track between sidings, passing loops and terminals. A similar recommendation applies to the TPI CP.

We consider that OPR Recommendation 1 above, by requiring the network to be defined in terms of its basic route section building block elements from the outset, would address ACIL's underlying issue and that a specific process in the OPR for defining route sections is not necessary.

### **2.1.2 Regulatory Ceiling**

In principle, and in respect of many of its details, this section 2.1.2 is consistent with section 2.2 of the WestNet OPR.

ACIL for Hancock Prospecting, at pages 18 and 21 of its submission, makes the following comment, and provides the following recommendation, in relation to this section:

"TPI's proposals largely follow the wording of WestNet Rail's over-payment rules. A small difference is that TPI refer to a ceiling, whereas WestNet is specific that there is one ceiling to apply to each route section."

"For clarity, in section 2.1.2 TPI should specify that each route section has one regulatory ceiling that will apply to all operators."

In relation to the issue raised above, we consider the wording of the TPI OPR to be sufficiently clear in presenting that one ceiling will apply per route section (ie the TPI wording "A Route Section has a regulatory Ceiling that will apply to all Operators ...").

### **2.1.3 Revenue for the purposes of the Ceiling Price Test**

In principle, and in respect of many of its details, this section is consistent with section 2.3 of the WestNet OPR.

At sentence 2 of paragraph 2, we suggest replacing "the access regime will not provide" with "since the Code does not provide", where the suggested wording is consistent with that used at sentence 3, paragraph 5, section 2.3 of the WestNet OPR. This is a drafting suggestion only.

ACIL for Hancock Prospecting, at page 21 of its submission, states that: "It would be helpful for TPI to define access revenue and non-access revenue in the text of this section of their proposal." Given that TPI has provided a definition of these terms in section 5, we do not consider it necessary for the definitions to be restated in this section 2.1.3 (OPR Recommendation 13 below, however, highlights an issue with the definition of non-access revenue, which should be addressed).

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### 2.1.4 Breaches of the Ceiling Price Test

This section 2.1.4 is broadly consistent with paragraphs 2 and 3 of section 2.4 of the WestNet OPR.

Paragraph 2 of section 2.1.4 states as follows:

“If, despite efforts to reasonably avoid breaches of the Ceiling Price Test, a breach/breaches occur, then TPI will advise the ERA of the circumstances and will follow the procedure set out in these over-payment rules to deal with such overpayments.”

The equivalent provision of the WestNet OPR is paragraph 3 of section 2.4, which states as follows:

“If breaches of the Ceiling Price Test occur as a result of variations in traffic volume or revenue that are deemed to be temporary or unpredictable in nature, then WNR will advise the ERA of such circumstances and will follow the procedure set out in these over-payment rules to deal with such over-payments.”

ACIL for Hancock Prospecting notes, on page 18 of its submission, that:

“The Regulator has indicated that where breaches are considered to be permanent, due to the result of long term factors, the railway owner will immediately need to negotiate a new access price with all affected parties using the route section.”

In light of the above, ACIL recommends on page 21 of its submission that the relevant provisions of section 2.1.4 of the TPI OPR should be restricted to breaches that arise as a result of temporary or unpredictable variations in traffic volumes or revenues.

We concur with the recommendation made by ACIL and consider that the provisions in paragraph 3 of section 2.4 of the WestNet OPR should be reflected in paragraph 2 of section 2.1.4 of the TPI OPR.

#### **OPR Recommendation 2**

We recommend that paragraph 2 of section 2.1.4 should be restricted to breaches of the ceiling price test that occur as a result of variations in traffic volume or revenue that are deemed to be temporary or unpredictable in nature.

Paragraph 1 of section 2.4 of the WestNet OPR states the following, which is not stated in the TPI OPR:

"Section 47(1) of the Code states that the Over-payment Rules are to apply where breaches occur on the part of that owner that “could not reasonably be avoided”.”

We consider that addition of the above statement to the TPI OPR would result in the OPR more fully setting out the rules to be applied under the Code.



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### **OPR Recommendation 3**

We suggest that the following statement from section 2.4 of the WestNet OPR is incorporated into section 2.1.4 of the TPI OPR:

- "Section 47(1) of the Code states that the Over-payment Rules are to apply where breaches occur on the part of that owner that "could not reasonably be avoided"."

### **2.1.5 Over-payments and under-recoveries**

This section 2.1.5 is generally consistent with paragraphs 1 to 4 of section 2.5 of the WestNet OPR.

Paragraph 5 of this section 2.1.5 is based on the example at section 4 of the WestNet OPR and, in general, is consistent with the description of that example given in paragraph 5 of section 2.5 of the WestNet OPR.

Both the TPI OPR and the WestNet OPR deal with over-payments on a similar basis, to the extent of using the same wording - "Net over-payment in a three year period will be paid back to Operators according to these Over-payment Rules."

In relation to underpayments, paragraph 4 of section 2.1.5 of the TPI OPR is an amended version of sentence 1 of paragraph 4 of section 2.5 of the WestNet OPR. The TPI paragraph 4 states as follows:

"Conversely, net under-recoveries at the end of a three year period will be paid by Operators to the Railway Owner according to these Rules."

Sentence 1 of paragraph 4 of section 2.5 of the WestNet OPR states:

"Conversely, where under-recovery occurs the Operator is not required to pay WNR compensation for such under-recovery."

In relation to the above provisions, ACIL for Hancock Prospecting at page 19 of its submission, comments as follows:

"However, TPI's proposals regarding under-payments appear to be internally inconsistent. On the one hand, and unlike WestNet Rail, TPI is proposing that net under-payments be repaid by operators at the end of the three year period. TPI then goes on to propose a limited set of circumstances whereby the underpayment can be carried forward. This provision is unnecessary if operators are required to pay back the under-payments, and appear to reflect the wording of WestNet Rail's over-payment rules, under which operators are specifically not required to pay back under-payments."

In view of the above, at page 22 of its submission, ACIL recommends that "TPI should not be able to reclaim under-payments from operators at the end of the 3 year period. Carry-over of under-payments should be limited, as for WestNet Rail and proposed by TPI."

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In relation to this issue, ARTC, at page 6 of its submission, comments that:

“ARTC has advised that it considers these rules<sup>1</sup> are weighted too heavily in the direction of the interests of operators (and insufficiently addresses the reasonable commercial interests of the track owner).”

ARTC also comments as follows:

“ARTC notes that the ‘unders-and-overs’ account arrangements recommended by the Independent Pricing and Regulatory Tribunal of NSW (“IPART”) appears to allow access pricing to be adjusted each year to reflect prior year under and over-recoveries, and minimizing the ongoing effect of volume fluctuation on revenue. This approach mitigates the risk of operators overcompensating the track owner when volumes are higher (as does the WA regime), but also mitigates the risk to the track owner of under-recovery of cost when volumes are lower.”

The ARTC considers that an approach such as that adopted by IPART would represent “a fairer balance between the management of respective risk of the parties involved.”

As noted in section 2.1 of this report above, our assessment of the TPI Part 5 instruments is from the perspective of the requirements of the WA Rail Access Regime. The ERA’s general exercise of powers under the Regime, it is to take into account the factors in section 20(4) of the Act. Those factors include the interests of the railway owner, the interests of access seekers and the benefit to the public from having competitive markets. In this regard, the ERA has discretion in the way in which it balances, or attaches weight to, the various matters and interests in section 20(4).

In PwC determining whether to recommend that the ERA should approve a particular arrangement as proposed by TPI, or to require amendment to the arrangement in order that it can be approved, we have used the WestNet instruments as a benchmark for the protections to be incorporated into the TPI instruments. The approved WestNet instruments provide a guide to our assessment on the basis that they embody the ERA’s preferred balancing of the matters in section 20(4) of the Act. We concur with ACIL for Hancock Prospecting that the TPI OPR should adopt equivalent measures on the carry-over of under-payments to the measures in the WestNet OPR.

### **OPR Recommendation 4**

We suggest that section 2.1.5 is amended so that TPI is not able to reclaim under-payments from operators at the end of the 3 year period. Any carry-over of under-payments should be limited on the same grounds as in the WestNet OPR.

Section 4 in the WestNet OPR, Application of the Over-payment Rules, does not have a direct equivalent in the proposed TPI OPR.

Section 4 in the WestNet OPR provides examples of the application of the rules. ARTC, at page 8 of its submission, recommends that the TPI OPR

<sup>1</sup> This is a comment by ARTC in relation to its observation, also on page 6 of its submission, that “The ERA has stated in previous determinations that a net under-recovery over the three year period does not mean that operators will be required to make up the railway owner’s revenue to the ceiling.”

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should also include illustrative examples to ensure clarity as to how the OPR are to be applied. We note that the principles from the material example in section 4 of the WestNet document (Example 4) are effectively covered by paragraph 6 of section 2.1.5 of the TPI OPR (which reflects the explanation of WestNet's Example 4 given in paragraph 5 of section 2.5 of the WestNet OPR). We consider the TPI OPR to provide reasonable clarity on this issue and do not consider it necessary for the TPI OPR to include examples in the manner of those set out in the WestNet OPR.

### 2.1.6 Allocation of Access Revenue

The rules in this section 2.1.6 (ie rules 1 and 2) appear to be directly from section 2.6 of the WestNet OPR.

#### **OPR Recommendation 5**

For completeness, we suggest that the following additional provisions (taken from paragraphs 3 and 4 of section 2.6 the WestNet OPR, with minor drafting changes only) are added to section 2.1.6 in order to more fully set out the operation of the rules:

- "Recovery of capital costs on branch or feeder lines ranks ahead of shared lines on the basis that there is no other traffic on these lines to fund the dedicated infrastructure and unless those costs are covered the line may close."; and
- "Where TPI and the Operators have reached agreement to a different Access Revenue allocation arrangement in an Access Agreement that arrangement would prevail."

ACIL for Hancock Prospecting and ARTC, at pages 22 and 8 of their respective submissions, recommend that a similar provision to the second dot point in OPR Recommendation 5 is included in the TPI OPR.

### 2.1.7 Allocation of Non-access Revenue

This section 2.1.7, in terms of its principles most details, is consistent with section 2.7 of the WestNet OPR.

ACIL for Hancock Prospecting, at pages 21 and 22 of its submission, makes the following comment and provides the following recommendation in relation to section 2.1.7:

"TPI's proposals follow the wording in WestNet's over-payment rules. Although they do not specify that annuity from capital contributions should be allocated to the operator making the contribution, this is in fact done in over-payment rules themselves."

"TPI should indicate that for the purpose of allocating over-payments to operators, the annuity based on any capital contribution will be attributed to the operator who made the payment."

We note that the wording of section 2.1.7 in this regard closely corresponds with the wording in section 2.7 of the WestNet document. We consider that addition of ACIL's recommended wording would provide further clarity on the operation of the rules in section 2.1.7.

**OPR Recommendation 6**

We recommend that section 2.1.7 should include a statement to the effect that, for the purpose of allocating over-payments to operators, the annuity based on any capital contribution will be attributed to the operator who made the payment.

**2.1.8 Allocation of an over-payment**

This section 2.1.8 is broadly consistent with section 2.8 of the WestNet OPR.

However, this section appears incomplete given that it contains text in square brackets. The text in square brackets is consistent with the meaning of operator as used by TPI in these rules (given that the rules do not define "access agreement" and hence the Code definition of access agreement may be relied upon - so that an operator becomes a person who has entered into an access agreement under the Code).

Section 2.1.8 appears to preclude TPI from agreeing to refund persons to whom access is provided otherwise than under the Code. However, the last paragraph of section 2.1.3 raises this possibility - in that it presents that the regime does not provide a legal entitlement for "non-regime operators" to a refund for over-payment, "unless otherwise specified in the access agreement with the Operator." The potential application of over-payments to "non-regime operators" is also indicated at rule 9 of section 3 (which repeats rule 13 of section 3 of the WestNet rules). We consider that generally the TPI OPR leaves open the possibility for TPI to agree with a non-regime operator an arrangement to provide the operator refunds for over-payments.

This section 2.1.8 reflects paragraph 2 of section 2.8 of the WestNet OPR. The WestNet OPR however set out that the overpayment allocation to an operator will be determined in proportion to the operator's contribution to the aggregate of all operators' access and non-access revenues above the floor for the route section concerned. ARTC, at page 8 of its submission, recommends in effect that the additional wording as per the WestNet OPR should be included in section 2.8.

**OPR Recommendation 7**

In order to provide a clearer expression of the operation of the rules in relation to allocations of over-payments, we suggest that the following words are inserted after the word "Route Section" at the second sentence of section 2.1.8:

- "divided by the aggregate of all Operators access revenue and Non Access Revenue above the floor recorded on the route section".

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### 3 Over-payment rules

The rules in this section 3 are generally the same rules as set out in section 3 of the WestNet OPR.

#### **OPR Recommendation 8**

Similar to rule 1 in section 3 of the WestNet OPR, we suggest that a rule is added to specify the commencement date for the TPI OPR. The addition of a commencement date is to ensure that over-payment calculations are on a full financial year basis as specified elsewhere in the rules (for example, rules 5 and 6).

We suggest at the existing rule 1, that "financial year" is defined in terms of this section 3. Inclusion of a financial year definition is consistent with rule 4 of section 3 of the WestNet OPR and would provide consistency with other rules in this section 3 of the TPI OPR.

A simple financial year basis would be consistent with the requirement in section 47(2)(b) of the Code that reconciliation payments to operators due to over-payment are to be made "at the expiry of each successive period of 3 years from the commencement of access ...", provided that the commencement of access is on 1 July. Rules 6, 7, 11 and 12 appear to have been drafted assuming a financial year basis to calculations and therefore a 1 July commencement date. If the commencement date is to be other than 1 July, a different annual calculation basis, and different reporting and reconciliation dates will be required.

ACIL for Hancock Prospecting, at page 23 of its submission, similarly recommends that further information is provided in the rules, in terms of the following (amongst other inclusions recommended by ACIL in relation to section 3):

- "The date when the over-payment rules will commence.
- The dates of its financial year beginning and end."

A different periodicity than a financial year basis would pose practical difficulties, given a general reliance of cost calculations (particularly, in relation to capital costs as based on asset value) upon standard accounting reports - where such reports tend to be appropriately detailed (and auditable) in respect of financial year data.

The formula used by TPI at rule 3 is from rule 6 of the WestNet OPR, but TPI omits the notes associated with the WestNet formula. This is noted by ACIL at page 23 of its submission, which suggests for clarity that the following further details should be added to the rules:

"The notes to the formula in point 3 should include the fact that total annual access and non access revenue includes the revenue of non-regime operators, and that non regime operators entitled to a share of the net over-payment by virtue of provisions in their access agreement will be calculated using the same formula."

ARTC, at page 8 of its submission, makes a similar recommendation.

#### **OPR Recommendation 9**

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We recommend that the notes associated with the formula in rule 6 of the WestNet OPR are incorporated into rule 3 of the WestNet OPR.

ARTC, at page 8 of its submission, also provides the following comment and recommendation in relation to rule 7:

“TPI states it will credit interest to the Overpayment account, calculated daily on the balance in the account using a rate equal to the 10 year long term bond rate as at June 30 each year. TPI should make it clear around what happens if June 30 falls on a non-business day.”

In this regard, we note that the following additional words are attached to rule 11 of the WestNet OPR, which is the equivalent rule to TPI rule 7:

“...but if 30 June falls on a day which is not a business day then the rate published on the first day after that date.”

### **OPR Recommendation 10**

We suggest for completeness that rule 7 should make clear around what happens if June 30 falls on a non-business day. To this effect, we suggest that the following text is appended to the existing TPI rule 7:

- “...but if 30 June falls on a day which is not a business day then the rate published on the first day after that date.”

As noted above, the potential for over-payments to be applied to "non-regime operators" is indicated at rule 9 (which is equivalent to WestNet rule 13).

Rule 13 of section 3 of the TPI OPR is incomplete, as evidenced by the existence of square brackets and a question mark in that section. The guarantees in respect of liquidation referred to in the square bracketed text in rule 13 appear to relate to the WestNet OPR and to the specific role in respect of the application of those rules played by Babcock & Brown Infrastructure as guarantor of payments by WestNet (Schedule 1 to the WestNet OPR). Schedule 1 to the WestNet OPR therefore contains specific matters in relation to operation of the WestNet rules. The specific role of Babcock & Brown Infrastructure in the WestNet rules would not appear to be applicable to the TPI OPR.

ACIL for Hancock Prospecting at page 23 of its submission, recommends that, for reasons of clarity, the TPI OPR should incorporate the detailed provisions given in Schedule 1 of the WestNet OPR, with point 13 of the rules expanded in line with the WestNet rules.

### **OPR Recommendation 11**

We recommend that rule 13 is expanded in order to clarify the operation of the rules through incorporation of additional provisions along the lines of rule 17 of the WestNet OPR and to include arrangements to provide appropriate guarantees for the establishment and operation of the over-payment account.

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### 4 Compliance

This section 4, in terms of its principles and details, is consistent with paragraphs 2 and 3 of section 5 of the WestNet OPR.

Paragraph 1 of section 5 of the WestNet OPR provides a regular review of rules as follows:

"WestNet will review the Overpayment Rules every third year after the ERA's approval of this document to determine whether any amendments are required."

As noted in paragraph 2 of section 4 of the TPI OPR, the Code provides for the Railway Owner to amend or replace the rules at any time with the approval of the Regulator and alternatively for the Regulator to amend or replace the rules at any time by direction to the Railway Owner. Similar to our comments in relation to section 7 the TPI CP (Review and consultation), we consider that periodic reviews provide a general benefit of certainty of regulatory process and provide an assurance that the interests of railway owners and users will be balanced on a regular basis. Accordingly, we consider three-yearly reviews, as provided for in the WestNet OPR, to be appropriate for these purposes and to assure parties that the OPR will continue to operate in accordance with the objectives.

Similar views to the above are expressed in the submissions from ACIL and ARTC. At page 23 of its submission, ACIL recommends as follows:

"TPI should state that it will review the over-payment rules every third year to determine whether any amendments are required.

TPI should state that indicate that access seekers and operators can at any time request the ERA to consider amendments to the over-payment rules."

#### **OPR Recommendation 12**

We suggest that a new section is added to the TPI OPR, entitled Review and Consultation, in order to provide a commitment to three-yearly reviews, commencing from the date of the ERA's approval of the OPR.

In addition, we suggest that the new section incorporates the following text, adapted from section 5 of the WestNet OPR:

- "The ERA has the power under the Code to amend the Overpayment Rules at any time and Access Seekers and Operators can at any time request the ERA to consider amendments."

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### 5 Definitions

The definitions section of the OPR is incomplete and includes errors. ACIL for Hancock Prospecting, at page 23 of its submission, makes a similar comment.

#### **OPR Recommendation 13**

The TPI OPR should contain a complete list of the definitions used therein. The definitions listed should be consistent with the definitions in the Act and the Code, and with the definitions in the WestNet OPR, where appropriate. Definitional issues to be addressed in the TPI OPR include:

- "access agreement" - not defined in the rules;
- "non-regime operator" – not defined in the rules;
- "Ceiling Price Test" - wording issues;
- "financial year" - not defined in the rules;
- "Non-access Revenue" - appears to have been taken from the WestNet rules and includes inappropriate reference to "WNR".



## Appendix: List of Recommendations

### **OPR Recommendation 1**

We suggest that, similar to the WestNet OPR, the TPI OPR should specify multiple route sections on the TPI network. The TPI route sections should be the discrete sections of track between sidings, passing loops and terminals. A similar recommendation applies to the TPI CP.

### **OPR Recommendation 2**

We recommend that paragraph 2 of section 2.1.4 should be restricted to breaches of the ceiling price test that occur as a result of variations in traffic volume or revenue that are deemed to be temporary or unpredictable in nature.

### **OPR Recommendation 3**

We suggest that the following statement from section 2.4 of the WestNet OPR is incorporated into section 2.1.4 of the TPI OPR:

- "Section 47(1) of the Code states that the Over-payment Rules are to apply where breaches occur on the part of that owner that "could not reasonably be avoided"."

### **OPR Recommendation 4**

We suggest that section 2.1.5 is amended so that TPI is not able to reclaim under-payments from operators at the end of the 3 year period. Any carry-over of under-payments should be limited on the same grounds as in the WestNet OPR.

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