Government of **Western Australia**
Department of **Treasury and Finance**

Department of Treasury and Finance

Submission to the Economic Regulation Authority's Issues Paper on the review of the Railways (Access) Code 2000

The views expressed herein are solely those of the Department of Treasury and Finance and not those of the Treasurer or the Government of Western Australia.

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OVERVIEW

On 28 October 2009, the Economic Regulation Authority (ERA) released an issues paper discussing matters relating to the review of the Railways (Access) Code 2000 (the Code) and calling for submissions from interested parties.

This submission outlines the Department of Treasury and Finance's (DTF) response to certain matters raised in the ERA's issues paper as well as proposing other matters the ERA may consider as part of the review.

The following issues are discussed in detail in this submission:

- whether the information specified under sections 6(a) and 6(b) of the Code should be provided on the railway owner's website, as well as published in hardcopy format;
- whether, under section 25 of the Code, the circumstances which constitute disputes (and can therefore be arbitrated under the Code) are appropriate or should be expanded to include disputes which may arise between the railway owner and an entity seeking access under other relevant parts of the Code;
- treatment of land costs within the Code, including:
  - amendment of the definition of operating costs given in Schedule 4, section 1 of the Code to account for any land rental costs related to the construction or operation of rail infrastructure;
  - whether the definition of capital costs outlined in Schedule 4, section 2 of the Code remains appropriate, specifically:
    - whether the current treatment of land costs under section 2 is equitable for newly constructed rail infrastructure; and
    - consequently whether the Gross Replacement Value (GRV) methodology prescribed in clause 2(4)(a) of Schedule 4 is appropriate for evaluating land related costs.
- the treatment and use of information relating to key performance indicators (KPI's) for particular routes or route sections.

PUBLICATION OF INFORMATION

Current Code provisions

Clause 7A(1) of the Code states that a railway owner must make a publication containing the required information available for purchase in hard copy format, where "required information" is defined as:

> *(a) the form of the railway owner's standard access agreement; and*
>
> *(b) the information described in Schedule 2 in respect of the relevant part of the railways network.*

This information must be kept up to date by the railway owner and may be provided to an access seeker for a reasonable charge.

ERA position

The ERA issues paper states that:

"...the Authority's view is that where a railway owner has a website, such information should be also made available on the website in order to facilitate access to this information by prospective access seekers."[1]

DTF response

The DTF considers that the information referred to in clauses 6(a) and (b) of the Code could be made publicly available on the railway owner's website, where the railway owner is willing to do so. This would ensure that no confidential or commercially sensitive information is provided to the public and that railway owners are willing to accept the administrative costs of providing the information on their website.

Given that clause 7(2) of the Code states that the railway owner "must" provide the information to prospective access seekers that request it, the benefits of obligating the railway owner to provide the information on its website will be limited. Furthermore, the Code currently provides for railway owners to impose a reasonable charge for supplying this information to a prospective access seeker. This provision enables the railway owner to recover (some of) the costs of collating and maintaining this information. If the Code were to be amended to obligate the provision of this information publicly on the railway owners website, the administration costs to the railway owner would increase and it may lose the ability to recover (a proportion of) the related costs.

Despite the above, DTF considers that providing the information referred to in clauses 6(a) and (b) of the Code could be beneficial for potential access seekers. However, it may be more appropriate for railway owners to be encouraged to provide this information on their websites rather than prescribing this specifically within the Code.

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[1] Economic Regulation Authority *Review of the Railways Access Code Issues Paper*, October 2009, p. 6

DISPUTES

Current Code provisions

Section 25 of the Code states that:

25 (1) For the purposes of this Division an entity is in dispute with the railway owner if –

(a) the entity has made a proposal for access by it;

(b) the proposal complies, and the entity has complied, with this Code; and

(c) any of the situations in subsection (2) exist.

(2) The situations referred to are –

(a) the railway owner has refused to negotiate on the proposal as required by section 13;

(b) the proponent has notified the railway owner under section 18(3) that there is a dispute between them; or

(c) the entity and the railway owner have entered into negotiations on the proposal but –

(i) have not before the termination day fixed under section 20(2) reached agreement on the provisions to be contained in an access agreement; or

(ii) have before that day jointly made a determination in writing that the negotiations have broken down.

ERA position

The ERA issues paper states that:

"The key issue of relevance to Part 3 (Division 3) of the Code would appear to be the limited set of circumstances which an entity seeking access can refer to arbitration under the Code. Any disputes which may arise between the entity seeking access and the railway owner in relation to the provision of information prior to the proponent making a proposal pursuant to section 8 are not considered to be disputes ...

Submissions are invited on ... whether, under section 25, the circumstances which constitute "disputes" under the Code (and which can therefore be arbitrated under the Code) are appropriate or should be expanded to include disputes which may arise between the railway owner and an entity seeking access under other relevant parts of the Code."[2]

DTF response

DTF would support an expansion of the circumstances which constitute a dispute under the Code, provided that the definition of a dispute can legally be amended to include disputes that arise at any stage after a route has been included in Schedule 1 of the Code (i.e. from the time the Code is applied to a certain railway).

In determining whether the definition of a dispute currently contained in the Code should be expanded, the ERA may need to ascertain whether it would be legally possible to amend the Code so that it comes into force before the Part 5 instruments (as defined in clause 40(3) of the Code) have been approved. If it is determined that this amendment is legally possible, then the dispute provisions could be expanded by:

- amending clause 25(1) to refer to an entity requesting preliminary information from the railway owner under section 7 of the Code (including the necessary consequential amendments to clause 25(2)); or
- removing clause 25(1) in its entirety and amending clause 25(2) to expand the list of circumstances that constitute a dispute, accounting for the fact that the Code comes into force from the date of inclusion of a particular route in Schedule 1 of the Code.

Expansion of the dispute provisions may expedite the process of negotiating an access agreement under the Code, as the parties will be able to refer matters to arbitration in a greater range of circumstances, removing opportunities for parties to 'game' the negotiation process and providing greater certainty.

[2] Economic Regulation Authority *Review of the Railways Access Code Issues Paper*, October 2009, p. 10 - 11

LAND COSTS

The Code was initially developed to cover the freight railways in the State's southwest, railways which were previously state owned and did not incorporate any 'greenfields' type development. However, since the enactment of the Code, the issue of 'greenfields' railway developments has become prominent, with the construction of Fortescue Metals Group's Pilbara railway and the planned railway linking the Midwest and the proposed Oakajee iron ore port.

As in any 'greenfields' development, the costs related to land are a major element of the overall project costs. The Code, as currently drafted, does not permit railway owners to recoup any of the land-related costs from third parties through the access charge, even though these costs could reasonably be included as either capital or operating costs (dependent on the ownership or rental arrangements in place for the land). This is a major issue for both new and potential railway owners, as well as the State, and as such the provisions within Schedule 4 the Code that cover capital and operating costs require amendment. DTF contends that the amendments outlined below should be considered by the ERA as part of this review.

Current Code provisions

Schedule 4 of the Code outlines the treatment of capital and operating costs in determining the price that is to be paid for access. In clause 1, operating costs are defined as:

Operating costs in relation to railway infrastructure includes –

> *(a) train control costs, signalling and communications costs, train scheduling costs, emergency management costs, and the cost of information reporting; and*
>
> *(b) the cost of maintenance of railway infrastructure calculated in the basis of cyclical maintenance costs being evenly spread over the maintenance cycle,*

and if, for particular infrastructure, modern equivalent assets are determined to be appropriate for the purposes of clause 2(4)(c)(ii), the operating costs in relation to that infrastructure are the be the costs that would be incurred were that infrastructure replaced using modern equivalent assets.

Capital costs are defined in section 2 of Schedule 4, with these provisions currently excluding land from the definition of railway infrastructure. Section 2, Schedule 4 defines capital costs as:

(1) In this Schedule –

Capital costs means the costs comprising both the depreciation and risk-adjusted return on the relevant railway infrastructure.

(2) For the purposes of this clause, railway infrastructure does not include the land on which the infrastructure is situated or of which it forms part.

(2a) Despite subclause (2), railway infrastructure is to be taken, for the purposes of this clause, to include a cutting or embankment that is made after the commencement of this Code for any reason, but the value of such cutting or embankment as railway infrastructure is not to include the value of the land of which it forms part.

(3) The costs referred to in the definition in subclause (1) are to be determined as the equivalent annual cost or annuity for the provision of the railway infrastructure calculated in accordance with subclause (4).

(4) The calculation is to be made by applying –

(a) the Gross Replacement Value (GRV) of the railway infrastructure as the principal;

(b) the Weighted Average Cost of Capital (WACC) as the interest rate; and

(c) the economic life which is consistent with the basis for the GRV of the railway infrastructure (expressed in years) as the number periods...

Proposed amendment of the definition of operating costs

DTF proposes that the definition of operating costs in Schedule 4 be expanded to include the rental value of any land on which railway infrastructure is located but that is not owned directly by the railway owner or an associate (e.g. for a 'greenfields' railway development, ownership of the land may be retained by the State but the railway owner my be required to make rental payments on that land as a condition of the lease). This amendment would enable the railway owner to include any reasonable land rental costs in its costing principles as an operating cost and, subject to the approval of these principles by the Regulator, recoup (a proportion) of these costs through the access charge.

To include this mechanism in the Code, the above definition of operating costs could be amended by including the following paragraph (c) after the existing paragraphs (a) and (b):

(a) the annual rental value of any interest in land held by the new railway owner or an associate of the railway owner (other than land which is covered by the definition of capital costs in section 2), as determined by the Regulator but only to the extent in each case that the interest in land is held for the purpose of constructing, maintaining or operating railway infrastructure.

The inclusion of the above paragraph, or similar, would provide the Regulator with the discretion to determine what can be reasonably included as an operating cost and thus prevent double counting of certain land costs as both operating and capital costs.

Proposed amendments to the definition and treatment of capital costs

The definition of capital costs in Schedule 4 requires amendment to permit the railway owner to include any reasonable land-related costs (e.g. land purchase) in the calculation of the overall capital costs. Where it is necessary for the railway owner to purchase land for the purpose of constructing the railway, it is inappropriate for these costs to be excluded from the definition of capital costs. In order to include these costs in Schedule 4, DTF proposes that the current clause 2(2) be removed and clause 2(2a) be amended to include the value of any land that is purchased for the purpose of creating a cutting or embankment after the commencement of the Code. The amended clause 2(2a) could be drafted as follows:

2(5) *Railway infrastructure is to be taken, for the purposes of this clause, to include a cutting or embankment that is made after the commencement of this Code for any reason.*

A more general amendment is also required to ensure that land costs more broadly can be included as capital costs, as well as prescribing the methodology that should be used to evaluate these costs. Clauses 2(3) and 2(4) of Schedule 4 stipulate that capital costs are to be treated as an "equivalent annual cost or annuity" with part of the calculation of the cost of providing the railway infrastructure to be made by applying the GRV methodology. The GRV methodology is not appropriate for land related costs as land is generally an appreciating asset. As such, DTF proposes that the following (or similar) be inserted into section 2 of Schedule 4 as a new subclause (5):

2(5) *The following costs are regarded as capital costs but will not be subject to subclauses 2(3) and 2(4) :*

(i) costs incurred by the railway owner in relation to the acquisition of interests in land; and

(ii) additional costs, including costs incurred in connection with aboriginal heritage and native title issues and any other transaction costs incurred by the railway owner in relation to the acquisition of interests in land,

as determined by the Regulator, but only to the extent in each case that those interests in land are acquired for the purpose of constructing railway infrastructure after the commencement of this Code.

A clause to this effect will ensure that any reasonable recent (i.e. not costs incurred prior to the commencement of the Code) land costs can be included as capital costs, with provision for regulatory discretion, and that these costs are treated in a suitable manner (as determined by the Regulator). By providing the Regulator with discretion to determine the most appropriate methodology for evaluating land-related capital costs, the amendments will prevent the inappropriate use of the GRV methodology. The amendments will also ensure that the owners of 'greenfields' railway infrastructure are not unfairly penalised by permitting the inclusion of all reasonable capital and operating costs to calculate a cost-reflective access charge.

KEY PERFORMANCE INDICATORS

In 2004, the then Office of the Rail Access Regulator (the ORAR) published a KPI framework for both the Public Transport Authority and WestNet Rail, which was to be reported on annually by the ORAR. These annual reports outlined both entities performance against the KPI's and were released publicly to inform both stakeholders and the Government about the overall effectiveness and operation of the rail access regime.

The last annual report on KPI performance was released by the ERA in February 2007 (*WestNet Rail General Network Information and Key Performance Indicators for 2005-06*). In the *Final Determination and Approval of WestNet Rail's Train Management Guidelines*, released in August 2006, the ERA stated that:

"The Authority noted, in the Draft Determination, that the KPI measures would be reviewed following the implementation of recommended Code changes resulting from the review of the Code undertaken in 2005 ... The Authority continues to hold the view ... that a separate review of the KPI measures is appropriate rather than have the measures included in the TMG ... there is little merit in mandating performance measures in the proposed TMG and that it is more appropriate to undertake a separate review of the KPI's when the Code changes have been implemented."[3]

The amendments arising from the previous Code review were gazetted in June 2009. Subsequently, the ERA has determined that it does not have the legislative power to perform the function of monitoring the operational performance of the covered railways and as such has removed the obligation to report on KPI's from the compliance requirements of both WestNet Rail and the Public Transport Authority. As a result, the State currently has no means by which to monitor the effectiveness of the Act and Code.

Proposed amendment

DTF proposes that a new section 49A be inserted into the Code that would obligate the railway owner to provide certain information on KPI's to the Regulator, which the Regulator would be required to report on publicly (in compliance with the confidentiality provisions outlined in section 31 of the Act). DTF considers that this amendment is not contentious, as the practice of publicly reporting on KPI's was undertaken by the ERA until 2006.

The KPI's that the ERA will be required to collect information on must be agreed with the railway owner and cover the negotiation framework, Part 5 Instruments, safety matters and service and track quality. The KPI framework published by the ORAR in February 2004 can be used as a guide.

[3] Economic Regulation Authority *Final Determination and Approval of WestNet Rail's Train Management Guidelines*, August 2006, p. 10

It is essential that the Code provides for continued monitoring and assessment of the railway owner's compliance with the Regulator's determinations. Currently railway owners publish selected information on their websites relating to the performance of their networks, however the ERA has no way of collecting the information in a timely manner or determining the accuracy of the information. A formalised framework for reporting on KPI's is the most appropriate way to ensure this monitoring and assessment is undertaken, permitting the ERA to verify the information received and provide its own analysis and findings. Furthermore, KPI reporting would enable the ERA to assess the Modern Equivalent Asset ceiling for specific routes to ensure that railway owners comply with the standard of railway infrastructure that is to be provided.

Including a KPI section will permit both the ERA and the Government to monitor the efficiency of the Code's provisions in facilitating access and ensure that the parties are not engaging in conduct for the purpose of hindering access. This will strengthen the Code's effectiveness in relation to clause 6(4)(m) of the CPA.