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Economic Regulatory Authority
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Dear Sirs

Public Submission - Review of the Requirement to Submit Floor and Ceiling Cost Proposals

North West Infrastructure (NWI) is a joint venture company which is developing a multi-user 50 million tonnes per annum port project at Port Hedland's inner harbour. A critical component to the success of the project is the ability for emerging iron ore miners to gain third-party haulage or access arrangements from existing or new rail infrastructure owners.

NWI is responding to the Economic Regulation Authority's (Authority) invitation to make a submission on the requirements for Railway Owners to submit floor and ceiling cost proposals as outlined in the Authority's Issues Paper of May 2011.

The review by the Authority applies, or will apply to, the rail networks of WestNet Rail (WNR), The Pilbara Infrastructure Pty Ltd (TPI), Oakajee Port and Rail, and other potential networks. NWI is aware that there may be as many as 15 additions to WA's railway infrastructure in the next five year period.

In the Issues Paper, the Authority proposes to reduce the requirement for Railway Owners to submit "Floor and Ceiling Cost Proposals" in order to reduce the compliance costs for Railway Owners.

NWI's key responses to the Authority's Review are summarised below with further elaboration detailed in Appendices A and B attached to this letter.

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Key Responses to the Authority Review

- ▶ The WA Rail Access Regime is a negotiate and arbitrate model and thus public knowledge of both the level of floor and ceiling costs required by Railway Owners and the basis on which the costs are formed is critical to ensure that competition on Western Australian railway networks is effective, efficient, and fair.
- ▶ Public knowledge on floor and ceiling prices provides vital information required by resource companies to progress studies associated with the development and forward planning of mining projects.
- ▶ The absence of publicly available Authority-approved floor and ceiling costs for rail networks will only increase the asymmetric information gap between Access Seekers and Railway Owners.
- ▶ It is highly unlikely that a small reduction in the compliance costs of Railway Owners will offset the loss of public benefit caused by the suppression of independently determined and publicly available floor and ceiling costs.
- ▶ NWI questions the ability of Railway Owners to respond to requests for "Preliminary Information" and "Proposals for Access"¹ with the necessary quality of information within the timeframes² required by the Railways (Access) Code 2000 (Code).

NWI strongly recommends the retention of the requirement for Railway Owners to submit floor and ceiling cost proposals.

Should you wish to clarify any aspect of this submission, please contact Darryl Hockey on 08 9226 1776.

Yours faithfully



A T Considine
Chief Executive Officer

¹ Code Part 2 Paragraph 7 & 8

² Ibid

APPENDIX A

The Benefits of Floor and Ceiling Costs

The Objective of the WA Rail Access Regime

The WA State has chosen that certain existing and all new railways (including Oakajee Port & Rail, Aquila, NWI spur, Brockman Spur, FerrAus Spur, Karara Spur, WestNet expansions, Iron Ore Holdings, and Roy Hill Infrastructure) will be subject to an open access regime and the WA Rail Access Regime has been certified by the National Competition Council (NCC). The Regime is subject to the Rail (Access) Code 2000 (Code) and is regulated by the Economic Regulation Authority (Authority).

The Authority has identified that the objective of the WA rail access regime:

...is to establish and implement a framework in order to promote efficient, effective, fair and transparent competition on Western Australian railway networks to achieve a net public benefit to the State¹.

NWI believes that the availability of transparent, effective, efficient, and fair floor and ceiling costs for rail access and public knowledge of both the level of floor and ceiling costs and the basis on which they are formed are critical to the effectiveness of the WA Rail Access Regime.

The Benefits of Publicly Available Floor and Ceiling Costs

Floor and ceiling costs are based on a range of factors, as shown at Figure 1, and it is essential for access seekers to have full visibility of what rail access can be gained and how it will be costed.

Figure 1 – Basis of Floor and Ceiling Costs



The public availability of floor and ceiling costs, endorsed by an independent regulator, are an essential element which demonstrates that a Railway Owner complies with the Code and that access to their network can be sought in an equitable manner.

The floor and ceiling tests increase public benefits by providing a minimum restriction on commercial negotiation whilst preventing a Railway Owner from having the ability to negotiate agreements which could potentially lead to leveraging its monopoly position by the access seeker not having reference to an Authority approved floor and ceiling price.

¹ ERA Issues Paper Para 33

- ▶ The floor test means that the Railway Owner must set charges to at least cover the direct costs of providing access for an operator, or group of operators, preventing any cross-subsidies.
- ▶ The ceiling tests prevent the Railway Owner from deriving monopoly profits.

NWI believes the benefits of Authority endorsed floor and ceiling costs flow not only to potential access seekers, but also the wider community would benefit from the prevention of potential "Ramsey Pricing" or different pricing structures for the same access to rail in Western Australia.

"Ramsey" pricing sets prices that discriminate across operations. There is a range of forms of discrimination. One form would be to set access charges according to how dependent the train operator's customers are to the rail service. Another form would be to set low charges for smaller or new train operations, to facilitate their development. Thus, charges for financially marginal users may be set at marginal cost while higher charges are set for train operations that are less price-responsive (less price-elastic).²

NWI believes that the retention of the current arrangements for the submission of floor and ceiling cost proposals by Railway Owners would prevent "Ramsey Pricing" of rail access in Western Australia.

Appropriateness of Authority Precedent

This review is based, in part, on the precedent set when the Authority reduced the requirement for the Public Transport Authority (PTA) to submit floor and ceiling costs proposals. The Authority justified its actions as it believed that the PTA,

... "is unlikely over the foreseeable future to attract access seekers other than at the margin (such as the current SCT and GSR operations)"³

NWI believes that unlike the PTA network the access arrangements and prices for other railways are constantly being evaluated by many potential users including mining, agricultural, industrial, chemical and transport companies and above rail operators.

NWI understands why the PTA is an exception in that it is basically a passenger operation with no equivalent competitor. There is some utilisation of containerised and break-bulk traffic on a few sections of the network which is negligible compared to the passenger traffic train path density on the total network and those sections of line involved by other potential users.

² Bureau of Transport and Regional Economics [BTRE] 2003, Rail infrastructure pricing: principles and practice. Report 109, BTRE, Canberra ACT. Page XVIII

³ Review of the Regulatory Compliance Arrangements for the Public Transport Authority, 3 January 2008

However, all other railways are freight railways with total high density usage or having sections with high density usage. Additionally the number of potential railways to come under the WA Rail Access Regime is increasingly far outweighing the PTA precedent.

NWI therefore believes it is inappropriate for the Authority to use its decision in the case of the PTA as a precedent for removing the current arrangements for the submission of floor and ceiling cost proposals.

Existing Concerns of the WA Rail Access Regime

Transparency and Availability of Information

The transparency and availability of information for rail access in WA under the commercial negotiation approach requires an increase rather than a decrease in the availability of service provider information to allow negotiations to be appropriately conducted between the two parties.

This has been questioned, for example, during the recent certification process of the WA Rail Access Regime by the NCC where a number of major above rail stakeholders identified concerns with the level of information and quality of information available to access seekers, for example:

"During our initial investigations, CBH has major concerns with the methodology used to assess the Floor and Ceiling costs".⁴

"Firstly, Asciano is concerned that information asymmetry exists between the service provider and the access seeker. The commercial negotiation approach requires an increase in the availability of service provider information to address this asymmetry. Information is needed to allow negotiations to be appropriately conducted between the two parties. To this end information gathering powers in the Act and the Code should be strengthened and the information gathered should be made publicly available to ensure that commercial negotiations result in efficient outcomes".⁵

NWI believes that the absence of Authority approved floor and ceiling costs for rail networks will only increase the asymmetric information gap between access seekers and Railway Owners.

Preparing an Access Proposal

The absence of floor and ceiling prices makes it more difficult for an access seeker to prepare an Informed Proposal

⁴ Page 9 <http://www.ncc.gov.au/images/uploads/CERaWASu-004.pdf>

⁵ Page 3 <http://www.ncc.gov.au/images/uploads/CERaWASu-005.pdf>

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- ▶ The access seeker is unable to reference their proposal to a floor and ceiling price and if their initial calculations are reasonable thus hindering the preparation of business cases in order to prove financial viability to the Railway Owner.
 - ▶ In the scenario which includes capacity additions, or a restructure of sections of line, the Provisional Information would include the extra capacity cost for which there would be no reference price to compare with the proposed price (including capacity increase), and therefore it would be impossible to calculate the cost of the extra capacity and assess if this was reasonable.

Time limits on regulatory determinations

NWI supports the WA Government commitment⁶ to implement a binding six-month time limit for Authority approval processes for Part 5 Instruments and floor and ceiling costs, once the current review of the Code by the Authority concludes.

⁶ Western Australia's Submission to National Competition Council October 2010 (P13-14)

APPENDIX B

Response to Issue Paper Questions

RESPONSE TO AUTHORITY QUESTIONS

The Authority is seeking the views of stakeholders on a five key questions, each of which will be addressed in turn:

Question 1

Do regular floor and ceiling cost reviews potentially require duplication of effort on the part of the Railway Owner if an access proposal is received for a set of route sections for which floor and ceiling costs have not been determined?

The pricing mechanism for rail infrastructure should be done on an individual "Section of Line" basis as this is the most efficient method of recovering the cost of providing individual elements of rail infrastructure.

When a new section of line is established, the Railway Owner should develop new floor and ceiling prices applicable to the new "Section of Line" for endorsement by the Authority.

The availability of these costings would then assist the Railway Owner in responding to any request for access and assist the Authority with information for making an informed determination.

When an access proposal is received for a specific point on the rail network the Railway Owner will have to undertake a specific analysis of both its rail operations at the time and the proponent's request for access whether the sections of line either had, or did not have, floor and ceiling determinations. The availability of existing floor and ceiling determinations makes that task easier.

Question 2

Would regular reviews of floor and ceiling costs assist the Railway Owner in the event of a proposal being made, by ensuring that route section costs are instantly available?

Without regular reviews there is a risk that if a request for access is received under the Code that the Railway Owner would have insufficient time in preparing the response to the proponent. A regular review process would assist not only the Railway Owner to keep their route section costs accurate it would also ensure that Railway Owners were able to meet the access response times required under the Code and the Costing Principles.

In addition the regular reviews of floor and ceiling costs would enable the Authority to ensure that Railway Owners were in compliance with their endorsed costing principles.

Question 3

Is there an advantage to the Access Seeker in having determined floor and ceiling costs available on the Authority's website, as opposed to discovering those via the proposal process?

Under the Code, the proponent is not provided with floor and ceiling costs until seven days after an Access Proposal is received by the Railway Owner.

- “(i) *the floor price and the ceiling price for the proposed access;*
(ii) *the costs for each route section on which those prices have been calculated; and*
(iii) *a copy of the costing principles that for the time being have effect under Section 46.*”⁷

Route section floor and ceiling costs are vital to assess not only price considerations but are also vital with regard to forward planning for individual mining, agricultural, chemical and general freight expansion. Such feasibility studies require estimation of capital charges and likely access charges for any consequential expansion of the rail network.

It is of critical importance to proponents that for planning and capacity calculation purposes that the Railway Owner's floor and ceiling costs are provided as well as complete and clear information regarding their calculation.

Independently determined floor and ceiling costs are critical for modelling below-rail and above-rail feasibility scenarios both within and potentially between sections of line without the onerous need on both parties to seek such information under an access application.

Such feasibility monitoring is done on an ongoing basis by many potential users and above-rail operators and the proposal by the Authority to cease the requirement for the Railway Owners to submit “Floor and Ceiling Cost Proposals” in order to reduce the compliance costs of Railway Owners will lead to a net reduction in public benefits.

NWI's view is that there are significant benefits to potential access seekers of having publicly available determined floor and ceiling costs for WA rail networks.

Question 4

Would the availability of “pre-determined” floor and ceiling costs on the Authority's website minimise the likelihood that a potential access seeker will seek to have the Authority instigate a floor and ceiling cost determination for a combination of route sections (under Clause 9) but rather approach the Railway Owner directly with a proposal, thereby initiating a determination under Clause 10

The absence of Authority endorsed “Floor and Ceiling costs” for rail networks will only increase the asymmetric information gap between access seekers and Railway Owners.

⁷ Code Part 2 9 (1) (c)

The Code's mechanisms are there to ensure there are fair markets but there is no obligation for the access seeker to seek application under the Code. NWI believes that the benefits of Authority approved floor and ceiling costs flow not only to potential access seekers but also the wider community benefits from the prevention of potential "Ramsey Pricing"⁸ of rail access.

The availability of "pre-determined" floor and ceiling costs which have been approved by the Authority are the only way in which a potential access seeker will have any confidence that their request for information or their proposal for rail access is formed on a reasonable basis.

If there is any lack of confidence by an Access Seeker, in their treatment by a Railway Owner, the Access Seeker would not hesitate to request the Authority to instigate a floor and ceiling cost determination for its proposed combination of route sections.

The Authority would then have to prepare a floor and ceiling calculation based on information supplied by the Railway Owner, with limited opportunity for external review.

Under the Code, for applications which require expansion, the railway owner can disagree with the proponent as to the extent and cost of the expansion. The published floor and ceiling price together with the regulated component costs and the Costing principles are a fair basis for determining the cost of expansion. Alternatively if it is agreed that expansion is not required then the Authority approved floor and ceiling price is an important issue both in the negotiations and in assisting the Authority to make a determination.

Question 5

In the absence of pre-determined route section costs, do the provisions of Clauses 9 and 10 of Schedule 4 of the Code allow sufficient time for an adequate review of proposed floor and ceiling costs to be undertaken?

NWI is significantly concerned that not all Railway Owners can demonstrate an ability to achieve the provisions of Clauses 9 and 10 of Schedule 4 of the Code.

Under the Code,⁹ the Railway Operator has 14 days to provide the Access Seeker with "Preliminary Information".

NWI's believes there is a significant risk that in the absence of "Floor and Ceiling" costs for predetermined sections of line, Railway Owners will either:

⁸ See Response to Question 3

⁹ Any business or individual seeking access to the railway system should apply in writing to the Railway Owner seeking information on the available rail track capacity, the price and terms of use, technical information (eg. track condition, curves and gradients), and other information such as timetables and existing or proposed train paths.

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- ▶ be unable to meet the timelines required by the Code, or
 - ▶ that the quality of the Railway Owners response to the Access Seeker's will be significantly compromised.

The Authority would need 30 days to make an informed determination especially in the case of a new railway. However if the Authority had not made a previous determination on floor and ceiling prices, so that it had certain information in its possession, the collection of the information and its review would unlikely be met within the 30 day time limit.

In order to improve the ability of Railway Owners to meet the provisions of Clauses 9 and 10 of Schedule 4 of the Code, NWI proposes that the Authority require Railway Owners to segment their rail route into a number of sections either:

- ▶ based on where main passing loops are located, or
- ▶ into additional route sections between load-out points and the discharge terminals

A greater number of pre-determined route section costs would make it more likely that Railway Owners will meet the provisions of Clauses 9 and 10 of Schedule 4 of the Code.