Submission to the Economic Regulation Authority

Review of the Railways Access Code (2000)

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1 Executive Summary

Aurizon welcomes the opportunity to comment on the Economic Regulation Authority's (the Authority's) third review of the Railways (Access) Code 2000 (the Code). Aurizon approaches this review from the perspective of both an above-rail operator and developer and owner of below-rail network infrastructure, with experience in most Australian rail access regimes.

This review is being conducted in a very different environment compared to when the regime was first established, which now includes a competitive above-rail market. The extent to which the regime, comprising the *Railways Access Act 1998* and the Code, has been effective in facilitating this competition should be the central question or reference point for this review.

Overall, Aurizon supports the light-handed nature of this regime, which is currently the closest of any of the Australian rail access regimes to creating an environment that encourages and allows genuine commercial negotiation. However there are some improvements that can be made. The three main areas Aurizon has identified are as follows.

1.1 Optimising the regime's effectiveness in encouraging commercial negotiation and promoting competition in the above rail market

a) The scope of this review needs to be targeted at evaluating the effectiveness of the Code in meeting the Object of the Act, where the overarching goal is to promote effective competition in the above-rail market.

b) This includes constraining unnecessary 'regulatory creep', which can manifest in a number of ways, including: (a) the regulator exercising its reasonably broad discretion to extend its decisions beyond the realm of competition policy, into industry policy; and (b) unnecessary prescription and detail, which can limit the ability of participants to flexibly respond to the needs of the market.

c) Any proposed changes need to effectively target an identified problem, considering the competitive effects within the context of the regime as a whole and including an assessment of the costs and benefits of the proposed change.

d) The interdependencies between the Code and the Part 5 Instruments need to be recognised, with the latter targeted to the specific circumstances of each network, with their detail and coverage reflecting the likelihood of use and the complexity of the issues associated with their application.

e) Consideration could also be given to allowing the regulator to publish non-binding Guidelines, as required, to provide further guidance on the operation of certain provisions and the considerations that would be taken into account. This is preferred to increasing the prescriptiveness of the Code itself. The development of each Guideline should be subject to public consultation.

f) It is recommended that the evaluation of the Code is based on a clear set of principles that are consistently applied at each five yearly review. These criteria should reflect what is needed in order to maintain an effective regime that directly supports the Object of the Act, which in turn reflects the requirements of the Competition Principles Agreement

1.2 Retaining the ability to 'opt out' of the regime, while ensuring that the implications of this are identified and effectively managed

a) It is proposed that the Code be amended to provide parties that have been negotiating outside of the Code with a clear ability to bring that negotiation within the Code. Provided the access rights

sought remain unchanged, parties should be able to go straight to arbitration under the Code. The railway owner should not be able to unreasonably prevent this from occurring.

b) It is recommended that a confidential register of all access applications is maintained by the regulator. This requires an amendment to the Code to require the railway owner to provide details of all access applications submitted – both within and outside the Code – to the regulator as soon as they have been submitted.

c) It is also recommended that the Code be amended to broaden the scope of the register of access agreements maintained by the regulator to clearly include all access agreements, that is, including agreements negotiated outside of the Code. The purpose of this is to provide the regulator with the information it needs to assist it in discharging its broader obligations under the legislation, however it should not have the ability to use this information to override or interfere with commercially negotiated contracts that have already been agreed.

d) Consideration needs to be given as to what price is imputed to agreements negotiated outside of the Code for the purpose of the Overpayment Rules.

1.3 Better addressing greenfields developments

a) Aurizon continues to have fundamental concerns with the application of the regime to greenfields developments. As all parties require certainty as to the application of the regime before investment decisions are made and capital is committed, the circumstances applying to a proposed new railway should be addressed with the Government as part of the State Agreements process.

b) Aurizon does not consider that the GRV methodology is best suited to a greenfields railway.

2 Introduction

Aurizon welcomes the opportunity to comment on the Authority's third review of the Railways (Access) Code 2000 (the Code). It is considered essential to undertake periodic reviews of the effectiveness of the Code in achieving the objectives of the Western Australian rail access regime (the regime), while balancing this against the need to provide predictability and certainty to existing and future participants.

Aurizon is the largest rail freight haulage operator in Australia by tonnes hauled, operating in key freight sectors and supply chains across the country. Aurizon is focused primarily on large, heavy haul rail tasks such as the transportation of coal, iron ore, other minerals, agricultural products and general freight, as well as containerised freight. It has business operations in Queensland, New South Wales, Victoria, South Australia and Western Australia. The Aurizon Group's operations in Queensland include the Central Queensland Coal network, comprising approximately 2,670 kilometres of largely dedicated and purpose built, heavy haul rail infrastructure, which is regulated under the Queensland Competition Authority Act 1997.

Aurizon is Australia's largest haulier of iron ore outside of the West Pilbara region, having grown this business rapidly from 13.6 million tonnes (mt) in FY2012 to 29.9 mt in FY2014.

In 2014 Aurizon and Baosteel acquired Aquila Resources. The objective of this acquisition for Aurizon is to facilitate the development of rail and port infrastructure in the West Pilbara, which will unlock mine assets in the West Pilbara province including iron ore projects that are currently stranded.

Aurizon therefore brings a relatively unique perspective to this review, as a current operator of rail haulage services as well as a future developer of greenfields network infrastructure in Western Australia. Its Australian operations span a number of different rail access regimes, including its Central Queensland coal network, the Queensland Rail Network and ARTC's Hunter Valley coal network and interstate freight network and therefore has extensive experience in the practical application of third party access regulation, from both an above and below-rail perspective. In being able to see both sides of the debate, it is therefore well placed to consider what is in the best interests of the supply chain as a whole, given it is the efficiency of the entire supply chain - not just one component - that drives the competitiveness of the nation's freight and commodities in their relevant markets.

3 General Comments

This third review of the Code sees a very different operating and market environment from the one prevailing when the Code was first approved in 2000. Importantly, there is now competition in the above-rail market, which is the key objective underpinning the establishment of third party access regimes as reflected in the Object of the Railways (Access) Act 1998 (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."*

The extent to which the regime has been effective in facilitating this competition should therefore be the central question or reference point for this review.

The Code originally applied to brownfields networks and now applies to multiple networks providing services for passengers, freight and commodities. Ownership structures have also changed. For example, when the regime commenced the freight network was a vertically integrated, government-owned operation. It is therefore essential to ensure that the regime appropriately reflects the industry and market environment and will remain relevant as it continues to evolve and change.

Aurizon fully supports the negotiate-arbitrate model and the Authority's commitment to maintain the integrity of that model. Indeed, while there are improvements that can be made, in Aurizon's view this regime is the closest of any of the Australian rail access regimes to creating an environment that encourages and allows genuine commercial negotiation.

Aurizon also endorses the comparatively light-handed nature of this regime. As will be presented in this submission, it is essential that any changes to the Code appropriately target an identified problem with a view to ensuring that effective competition is promoted. This includes reducing information asymmetries, which is very closely related to the existence of monopoly power and provides the premise for third party access regulation. However, addressing information asymmetries is not necessarily addressed by direct regulatory intervention. Instead, ensuring the railway owner provides parties with access to necessary information can be integral to creating an environment that is conducive to a balanced and effective negotiation, with regulatory intervention only invoked as a last resort.

Aurizon suggests a number of areas for improvement in this submission, including making some of the provisions more effective for above-rail operators. The most significant of these issues are:

a) optimising the regime's effectiveness in encouraging commercial negotiation and promoting competition in the above rail market;

b) retaining the ability to 'opt out' of the regime, while ensuring that the implications of this are identified and effectively managed; and

c) better addressing greenfields developments.

These issues are addressed in turn below. This is followed by a discussion of other issues that have been identified with the regime.

4 Optimising the Code's Effectiveness

4.1 Staying within the scope of the regime

As noted above, the key purpose of this review should be to evaluate the effectiveness of the Code in meeting the Object of Act. This reflects the core objective of competition policy in Australia, which is to promote effective competition in relevant upstream and downstream markets.

While the scope of the regime encompasses the below rail network only, the Object of the Act requires the regime's effectiveness to be evaluated within the context of the promotion of effective competition in the above-rail market. This in turn recognises the network's contribution to the efficiency and productivity of the entire supply chain.

At the same time, it is essential that the regulatory regime only applies to the declared services (the below rail networks). While this may seem to state the obvious, one of the key sources of 'regulatory creep' that Aurizon has observed in other regimes (including the heavy haul regimes in Queensland and New South Wales) is regulators making decisions on matters relating to industry policy, not competition policy. For example, in the context of concerns about the increasing scope of regulation, ARTC's submission to the Hilmer Committee stated that in developing regulatory frameworks, competition policy needs to better prescribe:[1]

- *"the extent to which this is may be appropriate;*
- *limitations on the role of regulators where intervention in these broader elements of industries may be inappropriate or outweigh the costs; and*
- *recognition of the increased risks faced by relevant infrastructure facilities taking on responsibilities for broader industry efficiencies."*

There can be a fine line between regulation of the declared service to promote competition and regulation of the entire industry – the key issue is to ensure that the scope of the regulator's powers is limited to the regime's intended purpose. This includes ensuring that in exercising its discretion under the regime, the regulator's decisions are not crossing the boundaries of its responsibilities.

4.2 Changes need to target identified problems

As highlighted above, it is also considered important that changes are only made in response to a demonstrated problem, in particular, genuine consideration is given as to whether effective competition is being inhibited in the relevant markets. One of the problems Aurizon has observed in other jurisdictions are changes being implemented that either:

- are made in the absence of clear evidence of a demonstrated problem;
- may be necessary, but fail to appropriately target the identified problem;
- extend beyond the problem being addressed; and/or
- result in unintended adverse consequences, reflecting a failure to fully consider the implications of the change.

[1] Australian Rail Track Corporation Ltd (2014). National Competition Policy Review, ARTC Submission, November, p.48.

This can result in another form of 'regulatory creep', which has occurred in a number of regimes in Australia, where prescription or regulatory intervention has progressively increased without having regard to whether the benefits of the change outweigh the direct and indirect costs. An overly prescriptive regime impedes the ability of participants to flexibly respond to the needs of the market in what is a dynamic operating environment.

In its submission to the Harper review, Aurizon noted the extent to which Australia's regulatory regimes have become disproportionately complex relative to the economic issues they are attempting to solve.[2] Increasing complexity frequently appears to be chasing diminishing incremental benefits, at substantial private and public cost. The effect of this has been, in some cases, to produce a 'one size fits all' outcome, limiting the ability of businesses to be flexible and innovative in response to customer requirements, as well as creating a risk averse culture that is not necessarily aligned to changing customer needs or market conditions. In this regard, the Harper review noted:[3]

> *"The Panel agrees with the conclusion of the recent PC inquiry that the National Access Regime is likely to generate net benefits to the community, but its scope should be confined to ensure its use is limited to the exceptional cases where the benefits arising from increased competition in dependent markets are likely to outweigh the costs of regulated third party access."*

Related to this point, Aurizon also considers that in assessing the effectiveness of the Code's existing provisions and considering possible amendments, consideration is given to the competitive effects within the context of the regime as a whole. An incremental approach, or an approach that considers issues in isolation, can result in inconsistencies, duplication and uncertainty. Importantly, this includes considering whether the issues that have been identified can be resolved through commercial negotiation, which should always be preferred to regulatory intervention.

4.3 The Code and the Part 5 Instruments

Given the regime governs different networks with fundamentally different economic characteristics and competitive dynamics, this also needs to be taken into account in evaluating the Code's effectiveness in promoting competition in the relevant markets. In this regard, Aurizon supports the current framework whereby the Code addresses the key principles that are relevant to all networks, with the Part 5 Instruments prescribing more detail as to how these principles will be implemented and complied with, adapted to suit the circumstances of each network and railway owner. It is important for this balance to be maintained.

Aurizon also considers it important to retain the Code as a high level, principles-based governing document. For the reasons outlined above, it would not support any material increase in the level of prescription and detail in the Code itself. However, to the extent that there are aspects of the Code applying to all railway owners that require further clarification and detail that is not addressed in the Part 5 Instruments, consideration could be given to the development of non-binding Guidelines.

These Guidelines would be issued by the Authority as required in order to provide further guidance as to how key provisions in the Code are expected to operate, including the considerations it will take into account in making a determination under the Code. A key example of this is the application of the pricing principles contained in Division 2, Schedule 4 (discussed further below). The issuance of Guidelines that assist in operationalising key aspects of the Code - instead of making the Code itself more prescriptive - is more consistent with the light-handed nature of this regime. They should initially be issued as a Draft and subject to public consultation.

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[2] Refer: Aurizon (2014). Submission to the Competition Policy Review: Promoting Efficiency, Productivity and New Investment in the Australian Rail Freight and Export Infrastructure Sectors, June.

[3] Australian Government Competition Policy Review (2015). Final Report, March, p.431.

A consistent theme from access regime reviews is the absence of dispute resolution. This is generally consistent with the expectation that the regimes promote commercial negotiation and avoid relying on arbitration as a substitute for those negotiations. Nevertheless, the lack of dispute resolution is also a manifestation of the higher degree of uncertainty and lack of predictability of the outcome. This is most evident in the arbitration of a price between the floor and ceiling where there is limited regulatory decision precedents or practical consideration of what matters would be taken into account in determining an efficient price between a floor and ceiling limit.

In summary, this would mean that the regime would comprise:

a) The Code, which sets out the intended operation of the regime at a high level, including the key obligations that all railway owners must comply with;

b) Guidelines as issued by the Authority from time to time, which provide further guidance as to how certain provisions (such as the pricing principles) are expected to operate;

c) The Part 5 Instruments, which address the specific matters identified in the Code and are tailored to the circumstances of each network and railway owner. The detail and coverage of these instruments should reflect the likelihood that they will be used and the complexity of the issues involved in applying them.

One point Aurizon would make is that the reviews of other key aspects of the regime, including the Part 5 instruments, floor and ceiling costs and the WACC methodology, are currently undertaken independent of the Code review. Aurizon submits that this approach does not have regard to the interrelationships between all of these components, in particular, the interaction between the Code and the Part 5 instruments. Ideally, the Code and Part 5 Instruments should be reviewed concurrently. If separate reviews are to continue to occur, at minimum, the Part 5 Instruments should all be reviewed at the same time.

4.4 Evaluation criteria

The Code seeks to support the achievement of the Objects clause based on a negotiate-arbitrate model. Aurizon supports a light-handed regime that encourages commercially negotiated outcomes, while providing a clear fall-back if negotiations cannot be concluded in a timely way. This is consistent with the requirements of the Competition Principles Agreement, including the principle that:[4]

> *"Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access."*

Aurizon proposes that in order for this to occur it is necessary to:

a) provide sufficient certainty for participants as to how the regime will apply;

b) reduce information asymmetries, without requiring parties to disclose information that could legitimately cause commercial detriment, so that all parties can make informed decisions;

c) maintain a level playing field, that is, ensure that the network owner cannot unfairly discriminate in favour of related parties;

d) enable outcomes that achieve an optimal allocation of risk between the parties;

e) minimise transaction costs;

[4] Competition Principles Agreement (1995). clause 6(e).

f) ensure adequate accountability for compliance and performance; and

g) ensure the network owner can recover its efficient costs, including an appropriate return on capital.

It is submitted that the above factors could be used in evaluating the effectiveness of the Code. These same factors should be applied at each review, providing a consistent frame of reference for evaluating the regime's effectiveness.

Aurizon also endorses the separation of responsibilities for the development of the Code, its administration and the making of a determination under it. In particular, it is essential that a separate body makes the final recommendations following a review of the Code. This is currently the state. It is suggested that this process could be enhanced by appointing an independent review body or panel (similar to the Harper review, for example) to consider the Authority's report, make the final recommendations and ensure that they are implemented in a timely manner. This could also be facilitated by the Authority recommending specific drafting changes that clearly show how each recommendation could be implemented.

Aurizon also supports the current arrangements regarding the appointment of an independent arbitrator in the event of a dispute. It is considered important to maintain an appropriate separation of powers in relation to regulatory oversight and the hearing of disputes under the regime.

Key points

1. Overall, Aurizon supports the comparatively light-handed nature of the regime and the emphasis that has been placed on encouraging and allowing matters to be resolved through negotiation.
2. The scope of this review needs to be targeted at evaluating the effectiveness of the Code in meeting the Object of the Act, where the overarching goal is to promote effective competition in the above-rail market.
3. This includes constraining unnecessary 'regulatory creep', which can manifest in a number of ways, including: (a) the regulator exercising its reasonably broad discretion to extend its decisions beyond the realm of competition policy, into industry policy; and (b) unnecessary prescription and detail, which can limit the ability of participants to flexibly respond to the needs of the market.
4. Any proposed changes need to effectively target an identified problem, considering the competitive effects within the context of the regime as a whole and including an assessment of the costs and benefits of the proposed change.
5. The interdependencies between the Code and the Part 5 Instruments need to be recognised, with the latter targeted to the specific circumstances of each network, with their detail and coverage reflecting the likelihood of use and the complexity of the issues associated with their application.
6. Consideration could also be given to allowing the regulator to publish non-binding Guidelines, as required, to provide further guidance on the operation of certain provisions and the considerations that would be taken into account. This is preferred to increasing the prescriptiveness of the Code itself. The development of each Guideline should be subject to public consultation.
7. It is recommended that the evaluation of the Code is based on a clear set of principles that are consistently applied at each five yearly review. These criteria should reflect what is needed in order to maintain an effective regime that directly supports the Object of the Act, which in turn reflects the requirements of the *Competition Principles Agreement.*

5 The ability to ‘opt out’

As noted above, Aurizon fully supports the continuation of a negotiate-arbitrate model. The other key feature of this regime, which Aurizon also fully supports, is the ability of parties to negotiate outside of the Code, or ‘opt out’ of the regime. However, there are a number of issues that Aurizon would like to raise here as it considers that this could work more effectively.

The first issue is the situation that currently applies when a party that has been attempting to negotiate an agreement outside of the Code would like to ‘opt back in’ where it is concerned that those negotiations will not be able to be successfully concluded (which may also reflect concerns regarding the ability to do this in a reasonable timeframe).

Currently, the only way that a party can do this is to go back to the start of the process and resubmit its access application under the Code. While there may be situations where it wants to do this, it is more likely that the application it must resubmit under the Code is no different to the application it originally submitted. Apart from bringing the proposed access agreement permanently inside the Code, this action provides the access seeker with recourse to arbitration under the Code, as this will clearly be required if the parties have been unable to reach agreement to that point.

Recognising that parties may have already been in protracted negotiations in an attempt to conclude an agreement outside of the Code, having to ‘go back to the start’ will only add to these timeframes and could compromise an access seeker’s ability to respond to the needs of its customer/s. Presuming that the access rights that are sought remain unchanged, Aurizon submits that the Code should allow the parties to immediately go to arbitration under the Code.

While an access seeker may elect to opt-out of the negotiation process under the Code this may not extend to opting out of various other requirements of the Code such as the Pricing Principles. An access seeker may have sound reasons for negotiating outside of the Code, or in fact be induced to do so. However, the timeframes associated with recommencing the process under the Code if those negotiations fail may provide substantial market power to the access provider if this was to impinge upon the progress of a customer’s project.

Aurizon would stress that:

- Aurizon is only seeking the option for parties to progress straight to the arbitration phase, recognising that this may not be appropriate if the access seeker wants the opportunity to vary the access rights sought under its original application. However, the railway owner should not be able to require the access seeker to go back to the start and resubmit a new application if the details of that application remain unchanged;

- it is recognised that once negotiations are brought within the Code, the Code will then continue to apply to any agreement that is subsequently concluded within it.

The second issue is ensuring that the regulator is aware of negotiations that are occurring both within and outside of the Code. Even though it has no jurisdiction over negotiations occurring outside of the Code, it is considered reasonable for the regulator to at least be aware of all of the negotiations currently progressing under the regime and when they commenced. This can also be important to ensuring that the railway owner is not engaging in unfair discrimination, which is prohibited under the Act.

Currently, only access agreements need to be registered with the Authority (and then only agreements negotiated inside the Code, as discussed below). Aurizon therefore considers it reasonable for the railway owner to be required to submit details of all of the access applications it has received, including those submitted outside of the Code. This should be maintained confidentially by the Authority on a register.

This therefore also leads to the question of whether the regulator should also have (confidential) access to agreements negotiated outside of the Code. The main benefit of this is that it provides important information regarding the terms and conditions, in particular prices, that are being negotiated commercially. Commercially negotiated access charges for the relevant commodity and service type should provide the most important benchmark for the regulator in assessing whether a proposed access charge is reasonable - this similarly applies for an independent arbitrator. It can also be used to ensure compliance with the prohibitions on unfair discrimination.

Aurizon therefore submits that all access agreements, including those agreed outside of the Code, are provided to the Authority. Importantly, this should not provide it with any ability to overturn or interfere with commercially negotiated contracts that have already been agreed. The main purpose of this is to provide the regulator with the information it needs to assist it in discharging its broader obligations under the legislation, including ensuring, for example, that the railway owner is not systematically discriminating between arrangements negotiated within and outside of the Code.

A further issue that is related to this is the implications of agreements negotiated outside of the Code for the management of the over-payment rules and floor and ceiling test. Revenue from agreements negotiated outside the Code are (quite rightly) included in the calculation of Total Revenue for the purpose of application of the floor and ceiling test. Over-payments are then returned to operators based on their share of that total revenue. Over-payments are limited to agreements within the Code, although it is permissible if included in agreements negotiated outside of the Code.

The question that arises is what access charges are being imputed for agreements negotiated outside of the Code. On balance, Aurizon considers it reasonable to expect that the access charges applying under agreements negotiated outside of the Code could, on average, be higher than the charges applying to agreements within the Code. If there is a revenue over-recovery, it then may conceivably arise that access holders within the Code are reimbursed an amount that is higher than what they are actually entitled to based on their actual access charge.

If these differences are material, this could put access holders of agreements negotiated outside of the Code at a competitive disadvantage. This is not simply addressed by seeking to have over-payment provisions included in agreements negotiated outside of the Code – the above consequence will still arise in apportioning the overpayment amounts.

Key points

1. It is proposed that the Code be amended to provide parties that have been negotiating outside of the Code with a clear ability to bring that negotiation within the Code. Provided the access rights sought remain unchanged, parties should be able to go straight to arbitration under the Code. The railway owner should not be able to unreasonably prevent this from occurring.
2. It is recommended that a confidential register of all access applications is maintained by the regulator. This requires an amendment to the Code to require the railway owner to provide details of all access applications submitted – both within and outside the Code – to the regulator as soon as they have been submitted.
3. It is also recommended that the Code be amended to broaden the scope of the register of access agreements maintained by the regulator to clearly include all access agreements, that is, including agreements negotiated outside of the Code. The purpose of this is to provide the regulator with the information it needs to assist it in discharging its broader obligations under the legislation, however it should not have the ability to use this information to override or interfere with commercially negotiated contracts that have already been agreed.
4. Consideration needs to be given as to what price is imputed to agreements negotiated outside of the Code for the purpose of the Overpayment Rules.

6 Application of the regime to greenfields developments

6.1 Addressing regulatory treatment via the State agreements

This regime was largely designed for brownfields networks. One of the key issues facing Australian access regimes generally, and is particularly relevant in WA, is the treatment of greenfields developments.

Uncertainty regarding the application of the regulatory regime can be a significant deterrent for new investment. This is an issue for all participants, particularly the network owner. All parties need certainty as to the regulatory arrangements that will apply before commitments are made and capital is sunk, noting that uncertainties as to if and how the regulatory regime will apply could have a material impact on the ability of the developer of a railway to raise necessary capital and the funding costs involved.

This issue largely sits outside of the Code itself. Aurizon submits that the circumstances applying to a proposed new railway should be addressed with the Government as part of the State Agreements process. Aurizon further submits that it is essential that this is confirmed before the developer commits to the project and has to go to the market to raise funds (or commit its own capital to the project). This is also necessary to address the circumstances of each project, including its risk profile.

6.2 The application of GRV

There are also issues with the application of the Gross Replacement Value (GRV) methodology to greenfields infrastructure. This includes its potential failure to account for risks incurred by the developer during the development and construction phase, which could be completely ignored in a GRV process. Aurizon therefore has concerns with the application of GRV in a greenfields context. The choice of asset valuation methodology is discussed further below.

Key points

1. Aurizon continues to have fundamental concerns with the application of the regime to greenfields developments. As all parties require certainty as to the application of the regime before investment decisions are made and capital is committed, the circumstances applying to a proposed new railway should be addressed with the Government as part of the State Agreements process.
2. Aurizon does not consider that the GRV methodology is best suited to a greenfields railway.

7 Other comments

7.1 Initial development of Part 5 Instruments

Aurizon notes previous recommendations in relation to the development of a standard set of Part 5 Instruments. This was made in response to concerns about there being no specific timeframes on the railway owner to develop them, other than “as soon as reasonably practicable”.

Aurizon concurs with these concerns. However, it considers the development of standard instruments to be problematic given the different circumstances and risk profiles of the different networks. This could reduce necessary flexibility, noting that the need for the instruments to be approved by the Authority provides protections to potential access seekers and holders. As noted above, the detail and coverage of these instruments should reflect the likelihood of use and the complexity of the issues associated with their application.

In any case, this provision is only relevant to the development of a new railway. To the extent that the network is to be covered under the regime, the instruments would need to be developed at a sufficiently early stage to give the railway owner and access seekers adequate certainty as they undertake their own evaluations and investment decision-making. Ideally, this would be prior to the commencement of the new railway’s operations.

The issue here is timely development and the solution should therefore specifically target this problem. The development of standard instruments does not directly address that problem and could have adverse consequences by reducing legitimate flexibility.

Aurizon therefore considers that this would be better addressed as part of the development approval with the State; i.e., the State has the ability to require these instruments within a certain timeframe as a condition of its approval. This could also ensure that they would be developed at a sufficiently early stage to give the railway owner and access seekers more certainty.

To the extent that an amendment is made to the Code, it is suggested that it should be drafted to ensure that the development of the Part 5 Instruments appropriately reflect the specifics of the network, with triggers for review following a request for access or the utilisation of the network by a third party, regardless of whether this arrangement is inside or outside of the Code.

Aurizon also notes that currently, the Code requires public consultation on a railway owner’s proposed Segregation Arrangements (if relevant), Train Path Policy and Train Management Guidelines, but not the Costing Principles and Overpayment Rules. Aurizon questions why the last two instruments are not subject to consultation. It considers that this should be a consistent requirement across all instruments.

Key points

1. Aurizon does not support the development of a standard set of Part 5 Instruments. It is considered that this is better addressed as part of the granting of the development approval by the State.
2. To the extent that an amendment is made to the Code, it is suggested the development of the Part 5 Instruments should reflect the specifics of the network, with triggers for review following a request for access or the utilisation of the network by a third party, regardless of whether this arrangement is inside or outside of the Code.
3. All Part 5 Instruments should be open to consultation.

7.2 Regulator's approval required in certain circumstances

The Authority has invited comment on section 10, which is the circumstances where the regulator's approval of the granting of access might be required; i.e where "it would involve the provision of access to railway infrastructure to an extent that may in effect preclude other entities from access to that infrastructure".

Aurizon agrees that the intent and meaning of that provision needs to be clarified, including the implications of the regulator not approving the proposed application.

Clearly one way this issue can be addressed is by expanding the network, provided this is commercially viable. The Authority states that it has previously determined that section 10 was not relevant where it is possible to economically expand the network, in the case of a request made by The Pilbara Infrastructure in 2013. Presumably section 10 could therefore be revised to make it clear that the requirement for regulator approval would not be invoked if it was economically efficient to expand the network (or, in other words, clarifying that one of the circumstances under which other entities may be precluded from accessing the infrastructure is where it would not be economically efficient to expand the network).

To the extent that a determination must be made by the regulator, clause 10(4) provides it with considerable discretion as to the factors that it will take into account here – indeed it "may be informed in such a manner as he or she thinks fit". This broad discretion creates uncertainty and increases the risk of regulatory creep.

Aurizon therefore submits that there would be benefit in specifying the types of factors it would take into account here, having regard to the Objects clause. This could be the subject of a Guideline, rather than being prescribed in the Code.

Further, it is not clear over what timeframe this is being evaluated, that is, when a reference is made to "other entities" this presumably refers to future access seekers, who could emerge now or at any point in the future. It is also not clear that such entities even need to exist, or be likely to emerge in future. The considerable discretion the regulator currently has here creates uncertainty for parties as to how this would be assessed.

The natural question that also then arises is the consequence of the regulator not approving the application because it would preclude other access. Related to the issue raised above, is whether this implies that there is a more highly valued use for that capacity that is expected to emerge in the future. That is, in not enabling the capacity to be fully utilised, what alternative use is contemplated and will this better promote the objective of maximising the efficient utilisation of the network infrastructure.

Key points

1. Aurizon agrees that section 10 needs further clarification, including:
    a. making it clear that it does not apply if it would be economically efficient to expand the network; and
    b. how a decision would be made by the regulator under this section. This could be the subject of a separate Guideline published by the Authority.

7.3 Unfair discrimination

Currently, the duty to not unfairly discriminate only arises in the context of negotiations. Aurizon considers that this should be relevant under all aspects of the regime, including the application of the Part 5 Instruments. As the principle of unfair discrimination should be a general or overarching obligation applied to all railway owners, this broader obligation should be contained in the Code. The prohibition on unfair discrimination should also clearly apply regardless of whether the arrangement is inside or outside of the Code.

Circumstances may arise where two or more access seekers are competing for the same service within the rail haulage market and one party elects to negotiate under the Code and another opts out of the Code. There is the prospect that the access seeker who elects to negotiate outside is given preferential dealings by the access provider. Similarly, two customers in the same commodity market are competing for the limited available capacity and the economics of the projects are unable to support expansion of the Network. The access provider should not be permitted to discriminate between these two parties where one elects to negotiate under the Code. That is, the Code itself should not become a potential source of market power.

Further, what constitutes 'unfair discrimination' has not been defined. Aurizon considers that this needs to be clarified, while emphasising the importance of ensuring that it does not unreasonably constrain the railway owner. That is, there needs to be some onus on the (potentially) aggrieved party to have a reasonable foundation for a claim that it has suffered from unfair discrimination, recognising that there are information asymmetries in ensuring compliance.

Aurizon proposes that there are two key tests that should need to be satisfied to demonstrate that unfair discrimination has occurred, which are:

a) it has a material adverse effect on one or more access seekers; and

b) it has a substantial impact on competition in the relevant market.

As submitted in section 5 above, the information asymmetries can be addressed by ensuring that the regulator has confidential access to all access agreements to ensure that discrimination is not occurring. Aurizon also emphasises that even if the regulator considers that unfair discrimination has occurred, this should not provide it with the ability to overturn or interfere with commercially negotiated contracts that have already been agreed.

The ability for the regulator to access this information exerts more discipline on the railway owner to comply with its legislative obligations. It is expected that railway owners will be much less likely to engage in unfair discrimination in the knowledge that the regulator will have access to concluded access agreements.

Key points

1. The prohibition on unfair discrimination should clearly apply to all aspects of the regime, not just negotiations. It should also apply regardless of whether the arrangement is inside or outside of the Code.
2. In order to further clarify what might constitute unfair discrimination, it is proposed that three key tests need to be satisfied:
    a. it has a material adverse effect on one or more access seekers; and
    b. it has a substantial impact on competition in the relevant market.
3. The regulator should have confidential access to all access agreements (inside and outside the Code) to enable it to monitor compliance with this requirement. This provides it with information to enable it to assess whether the railway owner has been systematically discriminating between arrangements negotiated within and outside of the Code. However, it should not have the ability to use this information to override or interfere with commercially negotiated contracts that have already been agreed.

7.4 The scope of railway operations

Currently, the WA freight network is regulated on the assumption that it is a vertically separated model. This assumes that the scope of above-rail services is narrowly defined to encompass the actual operation of those services on the network. However, the above-rail market is broader than this, including the design and construction of rollingstock and assessing the operation of a service based on existing or expanded network capacity. While a railway owner may not operate train services, it could partially encroach in the market associated with other aspects of rail operations and therefore in direct competition with third party operators in these activities.

This becomes particularly relevant in relation to provisions such as:

a) the technical information about the network infrastructure provided by the railway owner that could affect the design of rollingstock (clause 7(3));

b) the information provided by an operator in its access application (section 8); and

c) the requirement for the operator to show that its operations are within the capacity of the route or expanded route (section 15).

The threshold question is whether the definition of the above-rail market needs to be broadened to recognise that above-rail operations comprise more than just the operation of train services. In Aurizon's view, this broader definition is required to recognise the range of factors that are relevant to above-rail competition, which is directly relevant to satisfying the Objects clause.

This then leads to the question of whether segregation arrangements need to be put in place to ensure that the railway owner does not unfairly discriminate against a third party in these activities. At minimum, it is essential that appropriate confidentiality arrangements are put in place to protect information submitted by an access seeker, including information regarding the design and construction of rollingstock. The intention of this should be to ensure that the railway owner cannot potentially use the information submitted by a third party for its own purposes, for example, in the design of a service that is directly offered to another party. This will require restrictions on the dissemination of this information within the railway owner's organisation beyond what is reasonably necessary to assess the access seeker's proposal.

Key points

1. Aurizon submits that the scope of the above-rail market needs to be appropriately defined to recognise the range of factors that participants compete on, which is not just the provision of above-rail services but also the design and construction of rollingstock (for example).
2. To the extent that the railway owner is involved in any of these services, it will be necessary to put restrictions in place to prevent it from using information submitted by third party operators for its own purposes. This would have an adverse impact on competition in that market.

7.5 Standard access agreements

Standard access agreements are a feature of a number of other rail access regimes in Australia. While the Authority has not specifically canvassed this in its Issues Paper, a question that may arise in this review is whether a standard access agreement needs to be developed. In the first instance, if such a question is raised, Aurizon reiterates the need to have regard to the underlying problem that needs to be addressed, and whether standard agreements are the best means of addressing that problem.

Standard access agreements can provide guidance to an access seeker in its negotiation of the terms and conditions of access. This is particularly beneficial in the early stages of a regime's development.

However, the WA rail access regime is now well established. Market participants now bring extensive knowledge and experience to the negotiations.

In practice, it would be very difficult to develop a standard set of access agreements encompassing the range of different commodities and service types. Most importantly, the existence of standard terms and conditions can significantly reduce flexibility in negotiations.

In Aurizon's view, the development of a standard set of agreements is not only difficult but also considered unnecessary at this stage in the regime's development, particularly having regard to the trade-off involved, which is a loss of flexibility.

Key points

1. Aurizon does not support the development of standard access agreements, which is not currently a requirement under this regime.

7.6 Identifying and assessing the need for an expansion

Reference is made to the previous comments regarding the treatment of greenfields developments, which could be especially relevant in the case of an extension.

Aurizon observes that under clause 8(4) an access proposal may specify any extension or expansion that would be required to accommodate the proposed rail operations. This is quite different from the situation applying elsewhere, where it is the responsibility of the railway owner to determine if this is required to accommodate the requested access rights and advise the access seeker accordingly.

In Aurizon's view, this reflects the fact that the railway owner will tend to be better placed to determine whether investment is required and if so, what type of investment would be most efficient. There could be a range of different options available to increase network capacity, with different costs, capacity outcomes and risk profiles. This could include solutions that would increase the capacity of the existing network infrastructure. The railway owner has better information and knowledge regarding its own infrastructure, including the needs of existing access holders and other potential access seekers.

Recognising the above, Aurizon is not proposing that the current provision be changed. However, while an access seeker should still be able to propose an extension or expansion if deemed necessary, it is important that an access proposal should not be able to be rejected (or not progressed) by the railway owner, because, for example:

a) the access seeker has not identified investment that may be required in order to accommodate its request for access rights; or

b) the access seeker's proposed investment is not considered the most efficient solution for the network, or is not favoured by the railway owner. In this case, instead of rejecting the access proposal the railway owner should revert with its preferred expansion solution/s.

If the railway owner does reject the access seeker's proposal, it should clearly set out the reasons for doing so. The access seeker should then be able to trigger dispute resolution if it does not agree with the railway owner's assessment.

It is also essential that the access seeker has the information that is necessary in order to make an assessment.

Consistent with the above treatment, clause 15(2) entitles the railway owner to require the proponent to provide a preliminary assessment that the proposed extension or expansion is technically and economically feasible. Again, Aurizon considers that the railway owner would typically be better placed to undertake any feasibility studies, although it is reasonable to expect the access seeker/s to fund the costs. There are two points Aurizon would make here.

a) If this is to be required, the railway owner needs to provide the necessary information to the access seeker to undertake this study properly.

b) Regardless of who undertakes the study, Aurizon considers it reasonable that the railway owner can require the access seeker to fund the costs of these investigations.

Related to the point made above, in order to promote the Objects clause it is essential to ensure that the most efficient investment solution is encouraged to accommodate demands for access. Further, this needs to be considered from the perspective of the supply chain as a whole, as the most efficient solution could be a non-network option and/or a change that would increase the utilisation of the existing network and avoid the need for more costly network investment. It is noted that the Code makes no reference to the efficiency of investment solutions – even from a below-rail only perspective. It is suggested that consideration is given to addressing this in the Code given this is in direct support of the Objects clause.

This also extends to planning. The Code currently requires the railway owner to publish identified network improvements and capital works for a five year horizon, however no onus is placed on the railway owner to fully consider a range of options and demonstrate why its proposed expansion path (to the extent it has identified one) is the most efficient. While Aurizon is not proposing the introduction of detailed obligations on the railway owner in relation to planning, an amendment could be made to place an obligation on the railway owner to at least demonstrate that its proposed expansion path is efficient, having regard to feasible alternatives.

Key points

1. An access proposal should not be able to be rejected (or not progressed) by the railway owner because:
    a. the access seeker has either not identified investment that may be required in order to accommodate its request for access rights; or
    b. the railway owner does not agree with the access seeker's proposed investment. In this case, instead of rejecting the access proposal the railway owner should revert with its preferred expansion solution/s.

    If the railway owner does reject the access seeker's proposal, it should clearly set out the reasons for doing so.

2. The ability of an access seeker to identify investment that may be required also presumes that it has been given all necessary information by the railway owner.
3. If the access seeker is to undertake the necessary feasibility studies, the railway owner should:
    a. provide the access seeker with the information necessary to undertake these studies properly; and
    b. be able to require the access seeker to fund the studies.
4. It is important that any proposed below-rail investment represents the most efficient solution from the perspective of the supply chain as a whole. This similarly applies to medium term investment planning.

7.7 Pricing: specification of floor and ceiling limits

Aurizon agrees that the obligation to only provide a floor and ceiling price is problematic. The band can be very wide, noting that in some circumstances, the GRV-based ceiling price is not realistic (this is considered separately below). Inviting public consultation on the proposed floor and ceiling prices achieves little given the significant information asymmetries involved. Ultimately, the access seeker has no certainty as to how the network owner will arrive at a price within that band, nor can it be confident that it is reasonable relative to other parties using the same, or a similar, service.

At the other end of the spectrum is the publication of benchmark prices. The Authority has specifically invited comment on this issue, questioning whether a more prescriptive regime would be better in giving effect to the Competition Principles Agreement.

While the publication of benchmark prices may have intuitive appeal, Aurizon has significant concerns with going down this path. Consistent with comments made previously in relation to standardised Part 5 Instruments and access agreements, once a benchmark tariff is published it could reduce the flexibility of both parties in the negotiation, which could undermine the effectiveness of the negotiate-arbitrate model. It would also be practically difficult to implement, given the range of commodities and service types for which a benchmark tariff (and benchmark service) would need to be defined.

However, the current arrangement needs to be improved to address the information asymmetries that currently arise with the publication of a floor and ceiling price. While the access seeker has recourse to seek a ruling from the regulator, the framework should still be designed to maximise the ability (and incentive) of parties to reach a commercially negotiated solution without regulatory intervention.

It is submitted that the solution to this problem lies between the two extremes of a floor-ceiling band and a benchmark price. This could involve expanding the requirements in clause 9(1) to include the following.

First, the network owner should fully disclose to the access seeker the costs of providing access to its proposed service, having regard to the relevant risks and the allocation of those risks.

Second, it should be required to set out the factors the railway owner has taken into account in arriving its proposed access charge. This should be based on the guidelines set out in Schedule 4, Clause 13, which consistent with the comments made about the apportionment of the costs of an expansion, are not clearly enforceable. The railway owner should clearly demonstrate how each of these principles have been applied.

Currently, the main avenue for an access seeker in ensuring these principles have been applied is to seek an opinion from the regulator on the proposed access charge. This is limited to the extent to which the railway owner has met the requirements of clause 13(a), which relates to the consistent application of pricing principles.

Aurizon also submits that the intended application of these pricing principles is unclear. It considers that this would benefit from the publication of a Guideline by the Authority, to clarify how it would seek to apply the pricing principles under a range of different circumstances. This is relevant to:

a) the railway owner's pricing proposal;

c) any opinion provided by the Authority on a proposed access charge; and

d) a determination by an arbitrator.

This would serve to provide guidance only, as continued flexibility is needed to respond to specific circumstances. However, it should also be incumbent on any party applying that Guideline (whether it be a railway owner, the Authority or an arbitrator) to clearly explain any material departure from the Guideline.

Key points

1. Aurizon agrees that limiting the railway owner to the publication of floor and ceiling prices is not providing enough information to an access seeker regarding the determination of its proposed access charge.
2. Aurizon does not agree that this problem should be addressed by the publication of benchmark prices. Instead, it submits that as part of the information it provides to the access seeker, the railway owner must:
    a. fully disclose the costs of providing access to its proposed service, having regard to the relevant risks and the allocation of those risks; and
    b. set out the factors it has taken into account in arriving at its proposed access charge, having regard to the pricing principles in the Code.
3. Aurizon considers that further guidance on the application of the Code's pricing principles could be provided by the publication of a pricing Guideline by the Authority. Parties should then be transparent in demonstrating their compliance with, or any material departures from, the application of that Guideline.

7.8 Pricing: expansions

One area that has received particular focus in the Queensland rail access regime is the pricing of expansions, in particular, the allocation of costs between existing access holders and the access seeker/s that may have triggered the expansion. This can be particularly contentious when the expansion is to shared network infrastructure and the new and existing users will ultimately be accessing the same (or similar) service.

In this case it can practically be difficult to force a distinction between new and existing – or expanding and non-expanding – users, noting that any such distinction becomes irrelevant in the longer term. It can also result in price differentiation between users that operate in the same or similar market based on time of entry and could deter new entry altogether.

This is currently given limited treatment in the Code. Schedule 4, clause 7A(2)(b) suggests that costs may be apportioned to the extent that an entity will use the facilities, having regard to the 'economic benefit' it may derive. In the first instance, the investment could give existing users a future option to expand (or run additional services on an ad hoc basis). It could also improve service quality, reduce maintenance expenditure and/or defer upgrades to the network that would have otherwise been required to maintain existing service standards.

Again, Aurizon is not proposing the introduction of a prescriptive approach to the pricing of expansions, which could reduce the railway owner's flexibility in responding to the circumstances of a particular project. However, further clarity on this important issue could be provided.

First, this could benefit from a clearer set of allocation principles, including what might be taken into account in assessing whether or not a user – including an existing user – might derive an 'economic benefit' from an expansion. Second, the guidelines in Schedule 4 clause 7A(2)(b) are not clearly enforceable. At minimum, the railway owner should be required to demonstrate to access seekers how it has applied these principles in setting its proposed access charges.

It is recommended that any such clarification of the pricing of expansions is addressed in a pricing Guideline. This could be as part of, or separate to, the Guideline proposed above to address the application of the pricing principles.

Key points

1. Further clarity could be provided as to the approach that will be used to price expansions, having regard to the principles identified in the Code. This could be done via the publication of a non-binding Guideline by the Authority.

7.9 Regulator's opinion on proposed access charge

The ability for an access seeker to obtain an opinion from the regulator on a proposed access charge is an important fall-back. As noted above, this opinion is limited to whether the railway owner has consistently applied the 'pricing principles'.

There are a number of points that Aurizon would like to make here.

First, clause 13(a) in Schedule 4 refers to "consistency in the application of pricing principles", which then appears to be limited to the extent to which any differential pricing only reflects differences in the cost or risk associated with the provision of the service. It does not clearly relate to other matters, such as consistency with the standard of the infrastructure, the allocation of costs or whether the proposed structure of prices will optimise the use of the network infrastructure.

Aurizon sees benefit in limiting the scope of the regulator's opinion, both in terms of ensuring a timely response, as well as preventing the situation where this opinion is consistently relied upon by any party in a negotiation, which could reduce the incentives for parties to engage in genuine negotiation. However, as noted above, Aurizon questions how participants and stakeholders can have confidence that these other principles are being applied, as well as how they are being applied.

Aurizon has therefore proposed that the application of these principles needs to be clearly set out by the railway owner in its response to the access seeker (refer section 7.7). In the absence of this, there may need to be a mechanism where the regulator can periodically review the railway owner's compliance with these principles, which could be based on examination of a cross-section of access agreements that is it provided with under section 39.

As noted above, more certainty as to the application of the pricing principles could be obtained by the publication of a pricing Guideline by the Authority.

Second, the scope of a regulator's opinion on compliance with Schedule 4, clause 13(a), can be expected to primarily focus on the costs of providing that service. While this is clearly relevant, the regulator should be able to take into account other relevant factors, in particular, prices that have been commercially negotiated for similar services.

Indeed, Aurizon submits that the most relevant reference point for the regulator's assessment is prices that have been commercially negotiated at arms-length, which would include agreements struck outside of the Code (provided it relates to the relevant commodity and service type). It is therefore questioned whether the regulator should have (confidential) access to these other access agreements to enable it to discharge its responsibilities on a fully informed basis.

Finally, where a regulator's opinion is sought on the price of access, this would benefit from timeframes being specified to ensure this does not compromise the timely progression of the negotiations.

Key points

1. The ability to seek the regulator's opinion on a proposed access charge is important but should not become a surrogate for commercial negotiation. To enable this the railway owner should be required to demonstrate compliance with the pricing principles, potentially with reference to a published non-binding pricing Guideline. The regulator also needs to be able to periodically assess compliance based on the access agreements that have been executed.
2. The regulator's ability to assess the reasonableness of a proposed access charge is best informed by prices that have been negotiated at arms-length, which would include agreements negotiated outside of the Code. It should be able to have confidential access to these agreements so it has this information.
3. Timeframes could be placed around the provision of the regulator's opinion.

7.10 The application of GRV

An issue that has consistently been raised by a number of parties is the Authority's use of the Gross Replacement Value (GRV) methodology to value the asset base. This was examined in the previous review of the Code, where the Authority determined that it would not uphold a recommendation to apply a building blocks approach and would therefore retain the GRV method. This was based on a number of considerations, including a concern that it would be seen as a move away from the negotiate-arbitrate model.

The Authority is again seeking feedback on the appropriateness of its asset valuation methodology. It is requesting that this be considered within the wider context of the overall prescriptiveness of the regime, including the application of benchmark prices, which as stated above, is not supported by Aurizon.

Aurizon submits that having regard to the Objects clause, the primary consideration here is whether the application of GRV results in a price that reflects the efficient costs of providing the service. The GRV methodology seeks to establish the value of the assets based on the lowest costs of replacing the assets with a modern equivalent, having regard to the current cost environment.

First, as has already been identified, the application of a modern equivalent asset (MEA) standard can result in a significant misalignment between the assumed standard of the infrastructure and its actual standard, which has implications for maintenance and performance. While the Authority has previously cited this as being primarily relevant to the grain lines[5], this remains a legitimate risk for all installed infrastructure as assets age.

That is, with continued advances in technology it is reasonable to expect that even if existing assets are at or close to their modern equivalent at a point in time, it is highly likely that there will be difference between these existing assets and their modern equivalent in the future. This gap can only widen, depending on the rate of technological change. This is a fundamental problem with the GRV methodology, particularly for infrastructure that has a long economic life.

Second, under the GRV approach, the value of the asset base will continue to change through time with changes in technology and construction costs. This could be materially different from the costs actually incurred by the railway owner and could be above or below that cost, resulting in windfall gains and losses through time.

[5] Economic Regulation Authority (2011). Review of the Railways (Access) Code 2000, Final Report, December.

GRV also doesn't readily lend itself to assets whose economic life could be materially shorter than their physical lives. The principle underpinning GRV, on the other hand, is that the asset has a potentially infinite life with constant replacement. Further, as the (former) Office of the Rail Access Regulator previously recognised, some rail assets cannot be maintained in a 'state of perpetuity' (such as formation works) and must be replaced at the end of their life.[6] GRV also smooths Major Periodic Maintenance expenditure through time, rather than recognising these costs when they are incurred.

The main alternative to GRV is the Depreciated Optimised Replacement Cost (DORC) methodology, which is applied in all other rail access regimes in Australia. Aurizon observes that in practice, once the DORC value is established the valuation approach effectively becomes Depreciated Actual Cost (DAC), because:

a) it is very unlikely that a regulator would subsequently optimise that asset base, except under very limited circumstances; and

b) subsequent capital expenditure is likely to be rolled in at actual cost, provided these costs are efficient.

The application of DORC has its own issues, including in the cost, complexity and subjectivity of the initial valuation. While the 'lock in and roll forward' approach provides all parties with certainty and will be closer to the costs originally incurred by the railway owner, it is also likely to see the gradual departure of the ceiling price from the current replacement cost of the asset.

There are therefore pros and cons of each method and the selection of the most appropriate approach could vary depending on the circumstances. For example, as noted above, GRV is not considered the most appropriate method to apply to a greenfields development. Instead, an Optimised Replacement Cost (ORC) approach is likely to better approximate the efficient costs incurred by the railway owner, having regard to the specific circumstances and risk prolife of that development.

Aurizon does not support a change to the valuation methodology to established networks that are already governed under the regime. This could have a significant and adverse effect on the legitimate business interests of the railway owners, who have made investment decisions based on the regulatory treatment applying at the relevant time, which includes the asset valuation methodology. However, there may need to be some recognition of its practical limitations, including where there are material differences between the actual and implied infrastructure standard. Given this directly impacts issues such as service quality and maintenance, it may be better addressed in that context.

Aurizon submits that the regime should have flexibility to accommodate either methodology when a network is first declared for access. For example, as noted above, it does not consider that GRV is appropriate for greenfields developments and that ORC should be available as an option here.

Recognising that the different approaches have their strengths and weaknesses, railway owners should be able to initially propose the methodology that it considers is better suited to the circumstances of the network. It is recognised that the suite of options needs to be limited. Aurizon submits that this should either be GRV or DORC/ORC. The regulator would still need to approve the proposed methodology based on economic efficiency considerations. Once approved, the key issue is consistency – neither the Authority nor the railway owner should be subsequently able to apply a different approach at a future point in time.

[6] Office of the Rail Access Regulator (2002). A Brief Comparison of the WA Rail Access Code approach to calculating ceiling cost with the conventional Depreciated Optimised Replacement Cost methodology, July.

There will be 'winners and losers' from any change in approach and this could vary between route sections. If the Authority does want to consider a change in approach, Aurizon therefore submits that this should be subject to a comprehensive investigation, identifying the impacts for the railway owner and users. The final decision is then made based on a full understanding of the consequences of the change.

Key points

1. Aurizon recognises the issues associated with the application of GRV, including the material deviation that can arise between the actual and implied infrastructure standard. It also does not consider that GRV is best suited to greenfields developments.
2. It is also acknowledged that the more widely applied DORC methodology has its own strengths and weaknesses, although ORC is considered the better approach to value new assets.
3. Aurizon recognises that for the established networks that already operate within the scope of the regime, a change in methodology could compromise their legitimate business interests.
4. Aurizon therefore recommends that if and when a new railway enters the regime, it should be able to propose the use of either GRV or DORC (or ORC for a new network). Once approved, neither the Authority nor the railway owner should be able to change the valuation approach.
5. Consideration may still need to be given to the practical limitations of GRV to the established networks, although that should not give rise to a change in methodology. Given this directly impacts issues such as service quality and maintenance, it may be better addressed in that context.
6. If the Authority does want to consider a change in approach, this should be subject to a comprehensive investigation, identifying all of the impacts for the railway owner and users.

7.11 Information provision

The provision of adequate information to access seekers and holders is imperative to the effectiveness of the negotiate-arbitrate framework by reducing information asymmetries.

Consistent with most other rail access regimes in Australia, Aurizon considers it reasonable to require the railway owner to publish information that should to be made available to access seekers on its website. Further, any updates need to be made as soon as is reasonably practicable. Most other regimes have moved forward from limiting information provision to hard copy formats, noting that if required, the provision of information can still be limited to legitimate cases by making the information available via a secure portal (for example).

As part of that information provision, improvements could also be made to the transparency of the infrastructure standard and service levels. In particular, the railway owner should clearly disclose any obligations in relation to the standard of infrastructure and/or service levels that it has under the terms of its lease with the State.

Key points

1. The railway owner should be required to maintain up to date information via its website.
2. It is also important for the railway owner to be fully transparent in relation to the infrastructure standard and service levels, including any obligations contained under its lease agreement with the State.

7.12 Confidentiality

Where appropriate, the sharing of information should be encouraged as it reduces information asymmetries and contributes to the development of participants' knowledge base. It is therefore important that confidentiality claims are limited to legitimate circumstances and greater weight is given to information that is not marked confidential.

Aurizon also seeks clarification of section 39, which deals with the registration of agreements and determinations. First, it is assumed that in making the register available (clause 39(5)), the regulator is only disclosing the particulars set out in clause 39(4), that is, it is not making the actual agreements and determinations available.

To the extent that this is the case, Aurizon considers it important that agreements remain confidential. However, it questions why determinations should not be made available, noting that there may be aspects that need to be redacted if reference is made to commercially sensitive information.

Reference is also made to the point previously made, regarding the regulator having access to all executed agreements (on a confidential basis), including those executed outside of the Code. This provides it with important information regarding the price and non-price terms that are being agreed on a commercial, arms-length basis.

There may be benefit in revising the wording in section 39 to clarify the intent here.

Key points

1. Aurizon considers that while access agreements should remain confidential, determinations could be made available, provided any commercially sensitive information is redacted.
2. In this regard, it also seeks confirmation that in making the register of access agreements available, this does not include the details of the access agreements.
3. As previously submitted, Aurizon also considers that the Authority should have access to all agreements negotiated inside and outside of the Code, to assist it in discharging its responsibilities. However, it should not have the ability to use this information to override or interfere with commercially negotiated contracts that have already been agreed.

7.13 Negotiation process and disputes

The negotiation process is time consuming and in favour of the railway manager, with a number of triggers for dispute by the railway manager, which could also serve to stall the process. Aurizon submits that a dispute should only be able to be triggered once all of the information has been provided by the access seeker.

Key points

1. A dispute should only be able to be triggered once all of the information has been provided by the access seeker.

7.14 Arbitration

No timeframes for the arbitration process have been specified. Aurizon considers that there would be benefit in putting timeframes on the arbitration to provide parties with more certainty, although it does not consider that it is appropriate to impose a 'blanket' timeframe under the Code because the relevant timeframes will vary depending on the nature and complexity of the issue. Instead, Aurizon considers that there would be benefit in determining these timeframes at the start of each arbitration so that they can be set to reflect the circumstances of each dispute.

Key points

1. Timeframes should be specified for an arbitration. This should be set at the start of that process, based on the circumstances of the particular dispute.