Briefing Note

Effectiveness of WA code in meeting CPA objectives

10 April 2005

Executive Summary

Worsley Alumina Pty Limited ('Worsley') welcomes the opportunity to respond to the Economic Regulation Authority's ('the Authority') *Issues Paper: Review of the Western Australian Railways (Access) Code 2000* ('the Issues Paper').

A number of issues have been identified in this submission. Of fundamental importance is the question of the appropriate balance between a light-handed approach to regulation, leaving as much as possible to negotiation, versus a more prescriptive approach for a vertically integrated entity.

Practically, a lack of certainty in a number of key areas has undermined confidence in the regime's effectiveness. A reasonable degree of certainty is considered of particular importance where the access provider is vertically integrated. A lack of certainty impacts the confidence of existing participants, as well as potentially deterring new entrants. If new entry is deterred, the objectives of access regimes in promoting competition will not be achieved. Further, this provides the incumbent with a natural ability and incentive to increase prices, which will seriously compromise these objectives and ultimately reduce, rather than improve, societal welfare.

Worsley is not proposing a move to an excessively prescriptive approach. However at minimum, ambiguity could be reduced by the introduction of reference tariffs for reference services, more transparency and information, and a regulator-approved standard access agreement. In this regard, lessons can be learnt from other jurisdictions where regulatory arrangements have facilitated the emergence of greater competitive tension than in WA.

Other key issues identified include:

1. there are deficiencies in the existing framework in terms of ensuring efficient and timely investment in necessary expansions. This issue is becoming more urgent in areas such as the mainline south of Perth, which is highly congested.

2. a least cost solution does not necessarily deliver the highest value for all users. A measure should be introduced to ensure investment is based on (and progressed in a manner to deliver) highest net benefit. To the extent that providing such access requires expansion, all users should contribute on an average cost basis.

3. there should be a two-pronged approach to performance measurement, being:

    (i) at a whole of regime level - the introduction of a 'scorecard' to assess the regime's overall effectiveness could be developed; and

    (ii) The key performance indicators that are included in the access agreement form an important component of that agreement. While these are subject to negotiation, most of these should be able to be standardised (and hence consistent), other than say, where different levels of service quality have been agreed. A standard suite of indicators and service quality requirements could be developed as part of the standard access agreement and reference service respectively.

4. the coverage of the Code is inadequate. It should cover all necessary infrastructure required to deliver a declared service. Accordingly, it is possible that the declaration should be able to be extended to include sidings and other infrastructure in appropriate cases based on the application of a threshold test (for example, it is acknowledged that declaration of a siding would not be appropriate in all circumstances, such as performing long term wagon storage).

5. access to prime train paths is not necessarily seen as equitable and raises concerns as to the dichotomy between contracts negotiated inside and outside the regime.

6. the principle that there be non-discrimination should be delivered through Code provisions, as well as internal WestNet policies. It is noted that Schedule 4 section 13 (4) requires consistency in the application of pricing principles however this should be strengthened to be a mandatory legislative requirement, rather than a guideline.

7. The framework for determining tariffs, which requires negotiation between an upper and lower bound, is not as effective (with the overpayment rules also

ineffective as a fallback mechanism). Reference tariffs should be introduced for reference services.

8. there should be a standard access agreement that is approved by the regulator. It is possible that different standard access agreements could be developed for different traffics.

Response to the Issues Paper

Relevant sections of the CPA

Are there other sections of the CPA which need to be considered?

It is agreed that the sections of the CPA identified by the Authority are the key sections on which this assessment should be based.

Has there been adequate time elapsed to fully assess the effectiveness of the Regime?

The regime's effectiveness has not been properly tested as no-one has applied for access under the Code. However, sufficient time has elapsed to at least identify some of the Code's major shortcomings, especially in light of experience elsewhere. Further, it is considered important to review to identify any potential deficiencies early in the life of a new regime, including evaluating the current perceptions of market participants.

Clearly, the success of any regulatory intervention will largely turn on the extent to which end customers and above rail operators have confidence in the integrity and effectiveness of the regime is extremely important. Views reflecting this confidence begin forming from its establishment, irrespective of whether or not the participant has been actively involved in negotiating a new access arrangement.

A lack of confidence will not only increase the costs to a new entrant, as noted by the Australian Logistics Council[1], but will directly impact the willingness of potential entrants to engage with the process and create the necessary amount of competitive tension. A review process such as this at least provides an important opportunity for any such concerns to be raised.

Indeed, a key concern of Worsley is that any measure (such as a lack of confidence in the regulatory arrangements) that creates a barrier to (or otherwise raises the cost of) entry must impact on the price differential over cost that will encourage third party operators into the market. In other words, the presence of any avoidable barrier to entry to the above rail market could unnecessarily increase the cost of haulage for customers.

[1] Australian Logistics Council (2003), Principles of an Effective Access Regime, p.6.

As a consequence of the relative lack of practical experience with the regime, there is merit in having some flexibility on the next scheduled review – that is once there has been some practical experience with its operation.

Public Interest Test (clause 1(3))

Is the Code effective in ensuring the consideration of the public interest? What changes could be made to the Code, if any, to improve the operation of the public interest test as defined in clause 1(3) of the CPA?

In considering the public interest, emphasis should be on promoting competition in rail where it is efficient from a social perspective. As noted by Hilmer, competition should be encouraged where it promotes economic efficiency, rather than for its own sake.[2]

An appropriate environment for competition can then in turn enhance the competitiveness of upstream and downstream markets via lower prices and improved quality of service. The National Competition Council highlighted the dimensions of economic efficiency, being:

1. services are provided at the lowest cost (technical efficiency) – this requires a credible threat of entry in the market,
2. services are provided to those who value them most highly (allocative efficiency) – this requires appropriate terms and conditions, and
3. there are incentives for innovation and investment (dynamic efficiency).[3]

Efficiency losses that can arise from declaration include:

1. distortion of price signals,
2. dampened incentive for innovation, and
3. deterrence of investment.[4]

Network owners may be in a position to distort competition in upstream and downstream markets, particularly if vertically integrated. This was recognised in the development of the Part IIIA provisions of the *Trade Practices Act 1974* ('the TPA'):

---

[2] Commonwealth of Australia (1993), National Competition Policy, Report by the Independent Committee of Inquiry (Hilmer Report), Commonwealth Government Printer, Canberra.

[3] National Competition Council (2002), The National Access Regime: A Guide to Part IIIA of the Trade Practices Act 1974, p.22..

[4] Ibid., p.112

> Part IIIA recognises that owners of such facilities may be in a position to inhibit or distort competition in upstream or downstream markets. Where they are vertically integrated into competitive upstream or downstream markets, the owners of such facilities may also have additional incentives to restrict competitor access to the facilities' services in those markets or to offer terms and conditions of access which discriminate against them.[5]

The QCA proposed the basis for ensuring the public interest is satisfied as follows:

> The public interest in an efficient allocation of resources is best served by the Authority approving an Undertaking that facilitates the delivery of below-rail services at efficient prices and establishes a stable, certain regulatory framework. Such a regulatory framework would provide sufficient confidence to underpin investment in the above-rail market and that allows the market to develop in a non-distortionary manner.[6]

In ensuring this occurs, the QCA placed particular importance on clear and transparent pricing objectives, as well as the equivalence of terms and conditions (particularly between QR's above-rail business and other operators).

The Productivity Commission's review also highlighted the importance of establishing the objectives of access in promoting:

> - decisions that are well targeted to the identified problem and which minimize unintended side effects;
>
> - greater certainty for current and prospective facility owners, access seekers and other interested parties;
>
> - consistency among policymakers, the judiciary and those responsible for implementation and enforcement; and
>
> - regulatory accountability.[7]

In terms of ensuring the public interest is best satisfied, the concept of 'public benefit' itself is too nebulous to be used as a benchmark. A set of criteria should be established under the Code to enable the effectiveness of the regime to be properly assessed. In this regard, Worsley submits that the appropriate benchmark for the current review turns on the achievement of the object contained in section 2A of the Act. Worsley believes

---

5 ACCC (1997), Access Undertakings – An Overview, p.4.

6 Queensland Competition Authority (1999), op.cit.,p.50.

7 Productivity Commission (2001), op.cit., page 124.

that the following criteria laid out in the Australian Logistics Council (2003), Principles of an Effective Access Regime paper provide a means of assessing the extent to which the object of the Act has been accomplished:[8]

- creating a level playing field;
- engendering confidence in the regime;
- certainty and transparency;
- delivering efficient prices;
- allocating risk and reward efficiently;
- ensuring proper integration of the transport chain;
- avoiding excessive regulation;
- minimising cost for all parties.

Attachment 1 provides an initial assessment of the regime against these criteria.

Is the Code resulting in the efficient allocation of resources and adequate investment in the network? What changes to the Code, including to the public interest test, might be considered to an efficient allocation of resources and adequate investment in the network?

Worsley has significant concerns with network investment, in terms of its adequacy, timeliness and cost to various users. The mainline south of Perth is becoming increasingly congested and will soon be inadequate without new investment in track capacity. Users such as Worsley want to ensure there is no hindrance to a timely upgrade undertaken in a least cost manner.

There are aspects of capacity management within the control of the above-rail operator. Worsley has its own measures in place to deal with these issues (eg, rollingstock fleet management practices). However, it cannot control the adequacy (or otherwise) of the installed track capacity. Under-investment in necessary capacity can impose significant costs not only on the users, but wider society given the far-reaching implications of an uncompetitive transport chain. This risk was noted by the Australian Logistics Council:

> Indeed, one of the dangers of access regimes is that infrastructure providers may become less willing than before to provide sufficient capacity to accommodate a surge in demand. In the absence of specific arrangements, the opportunity costs to infrastructure providers of failing to provide sufficient capacity will be dwarfed by

[8] Ibid, p3.

> the cost that is imposed on infrastructure users and the economy, as the benefits of increased production will be lost to foreign competition.[9]

It also noted the requirement for pricing to signal efficient behaviour and how consideration needed to be given to the integration of congestion pricing with signals for new investment.

Section 10 of the Code provides for regulatory intervention in situations where granting access to one user could preclude access to another (for example, due to a capacity constraint). However, the regulator's powers are limited to approving the commencement of negotiations. That is, it is not able to given approval subject to certain conditions being met (including the nature of the pricing arrangements to be considered as part of the arrangement). This would appear to substantially weaken the potential effectiveness of this provision.

The costs of capacity constraints have been widely publicised recently in the context of the QCA's assessment of regulatory instruments in respect of the Dalrymple Bay Coal Terminal. A further example of this occurred at Port Waratah in NSW in 2004. Significant port congestion resulted in an application by Port Waratah Coal Services (PWCS) to the ACCC to implement a short-term capacity distribution system to address these issues (this involved auctioning demand reduction). PWCS estimated that if the solution was not implemented, estimated demurrage costs in the order of US$163 million would be incurred by coal producers. The ACCC granted this authorisation, concluding "that the key public benefit generated by the (short-term) system is an improvement in economic efficiency due to demurrage cost savings."[10] It was noted that since an interim solution had been implemented, the peak ship queue had reduced from 56 ships to approximately 10. Coal producers saved approximately US$47 million in demurrage from April to August 2004, with estimated savings to December 2004 totalling US$173.5 million.[11] These examples are equally relevant in the context of rail transport. To date, however, the cost of delays in expansion to the mainline network has not been quantified.

Another key area of concern relates to how the costs of subsequent capacity expansions, which may be necessary to accommodate the requirements of additional users, should be borne. The principles to be considered are identified in the Code (including the need for equitable treatment), however as pricing arrangements are part of the access agreement the extent to which expansion costs are shared is not known.

---

[9] Australian Logistics Council (2003), op.cit.,p.8.

[10] ACCC (2004), Draft Determination: Application for Authorisation Lodged by Port Waratah Coal Services", p.(ii).

[11] Ibid.

For example, an existing user may continue to pay at or near marginal cost, with any subsequent users of the track (post-expansion) required to bear the full responsibility for the costs of the upgrade. This will place these users at a competitive cost disadvantage relative to the incumbent. It could also result in claims of unfair discrimination by the rail network owner in favour of a related above-rail business.

A more equitable solution would be to apply average cost pricing to *all* users of the track where capacity to pay is not in dispute. Worsley believes that in the South-West access charges will generally be at or near the ceiling and accordingly would support applying an average cost pricing approach (with capacity consumption being explicitly signalled as part of the tariff structure) where upgrades occur to ensure WestNet's capital costs are covered (noting that there may have to be some limit on the extent to which access charges could rise following an expansion to protect against particularly expensive upgrades).

Similar concerns have arisen in the context of more routine repairs and maintenance. The issue of disruption to users was considered in the context of the Train Path Policy ('TPP') and Train Management Guidelines ('TMG'). The determination for the TPP noted responses received in the public consultation regarding the issue of compensation for unreasonable disruptions.[12] The Authority's response indicated that it had received advice that it was does not have the power to make determinations for compensation in this regard, however, it would expect that this is addressed in the access agreement. Reference was also made to Section 34 of the *Railways (Access) Act 1998* ('the Act') regarding hindering or preventing access and the consequent penalties that could apply. The final TPP provides for consultation and the provision of notice of maintenance works, however does not discuss the potential for compensation.

A significant example of this occurred within the context of electricity transmission. In 2001, a network outage in New South Wales, which affected the transfer capability between New South Wales and Queensland, was estimated to result in an increase in ancillary service costs of more than $50 million over a two week period.[13]The responsible transmission network service provider came under significant criticism. In commenting on this example in its report to the Council of Australian Governments on energy market efficiency ('the Parer Report), the Ministerial Council on Energy noted that:

---

[12] Office of the Rail Access Regulator (2002), Train Path Policy to Apply to WestNet Rail: Determination of the Western Australian Independent Rail Access Regulator.

[13] Council on Australian Governments Energy Market Review, (2002), Towards a Truly National and Efficient Energy Market, Commonwealth of Australia, p.131.

> Many submissions to the Review have identified the relative unresponsiveness of regulated transmission services to market requirements as a substantial impediment to efficient market operation and development. The principal reason for this unresponsiveness is that regulated TNSPs are not directly exposed to the market consequences of their operational and maintenance activities…Regulatory performance requirements can exacerbate this problem by focusing on minimising the cost of service rather than maximising market responsive network capability. These requirements can encourage regulated TNSPs to adopt asset management practices that could lead to the perverse outcome of scheduling routine maintenance during a peak period, rather than during an off peak period, because it would minimise labour costs…[14]

Worsley has concerns that a similar outcome where a solution is implemented at the lowest possible cost without due regard to the interference and imposition of a high cost on users, could occur in the Western Australian rail network. Under the current arrangements, no compensation would be provided.

The cost of maintenance or expansion should take into account the impact on users. Consultation with users should occur prior to any upgrades being undertaken as to the expansion path and the measures to alleviate operational impacts (it is noted that consultation is provided for under the TPP and TMG). This should result in determining a solution that delivers the highest economic value to network participants, rather than simply the lowest cost.

Compensation should be payable to users for certain disruptions to services under the standard access agreement. For example, as Worsley can divert some traffic by road to alleviate congestion, it could be compensated for the additional costs of doing so whilst an upgrade is being undertaken. Those compensation costs should then be treated as part of the capital cost for WestNet and hence recovered under the regulatory cap.

In summary, efficient expansion is critical to the effectiveness of the regime, and the competitiveness of the dependent industries. Capacity constraints impose real costs on users, with the quantum of these costs having the potential to far outweigh the opportunity cost of not expanding. Further, disruptions due to maintenance can also impose significant costs.

The issue is not whether the reference service should be provided, but rather, at what cost. Consideration needs also to be given to whether WestNet should be under an obligation to provide the reference service even if it means that there is an obligation to

[14] Ibid. The ACCC is currently developing a revised framework for monitoring service quality, which proposes to better reflect the market impact of electricity transmission.

expand with the cost of the expansion recovered from Users on an average cost basis. Further:

- the solution should be based on the highest economic value, not necessarily the lowest cost.
- if costs arise due to unnecessary disruptions for maintenance and repairs, compensation should be payable under the terms of the access agreement.
- similarly, if measures must be taken to alleviate congestion, users should be compensated, with the cost able to be recovered by WestNet as part of the regulatory cap.

Coverage of services (clauses 6(3), 6(4)(d))

Whilst coverage is mainly defined in the Act rather than the Code, the Authority seeks views on the adequacy of the coverage of the Regime and views of potential refinement of merit. Is the coverage of service adequate? What if any additional infrastructure could be included in the coverage to improve effectiveness of the Regime?

Under the Act, coverage is based on the definition of 'railway infrastructure', with section 5 identifying the criteria to be considered when applying the Code to particular routes.

The National Competition Council emphasised that the declaration process provides for access to services rather than the facility itself.[15] The *Queensland Competition Authority Act 1997* defines coverage within the context of the types of services that are potentially declarable (rather than specific infrastructure). Section 72, based on the Part IIIA definition, states:

> (1) **"Service "** is a service provided, or to be provided, by means of a facility and includes, for example -
>
> (a) the use of a facility (including, for example, a road or railway line); and
>
> (b) the transporting of people; and
>
> (c) the handling or transporting of goods or things; and
>
> (d) a communication service or similar service.
>
> (2) However **"Service"** does not include –

[15] National Competiton Council (2002), op.cit.

(a) the supply of goods (except to the extent the supply is an integral, but subsidiary, part of the service); or

(b) the use of intellectual property or a production process (except to the extent the supply is an integral, but subsidiary, part of the service); or

(c) a service declared under a regulation to be a service to which this part does not apply.

The *Queensland Competition Authority Amendment Regulation (No.1) 1998* 'declared' rail services under section 4(2) as:

> …the use of rail transport infrastructure for providing transportation by rail if the infrastructure is used for operating railway for which Queensland Rail, or a successor, assign or subsidiary of Queensland Rail, is the railway manager.

Part 2 of QR's Access Undertaking goes on to specify the types of activities that are included in its scope:[16]

> (b) Activities that an Access Seeker may seek to undertake on the Rail Infrastructure as part of the operation of a Train Service include:
>
> (i) mainline running of a Train from its origin to destination, including:
>
> - the use of passing loops to facilitate mainline running of the Train; and
> - Train queuing and staging required to facilitate the running of a Train Service from its origin to its destination, including before and after loading and unloading of a Train;
>
> (ii) loading and unloading of a Train at facilities other than Other Rail Infrastructure;
>
> (iii) Train marshalling and shunting at the following times:
>
> - in preparation for running of the Train Service;
> - before or after loading or unloading of the Train; and
> - before or after maintenance and provisioning of the Train; and
>
> (iv) Train stowage in the following circumstances:

[16] Queensland Rail Network Access (2001), QR Access Undertaking, p.5.

- as required for crew changes, meal breaks and on Track maintenance and provisioning of the Train; and
- where an Access Holder cannot operate its Train Service in accordance with its Train Service Entitlement as a result of a breakdown or other temporary outage of the Access Holder, the loading facility or the unloading facility, and/or the unavailability of the Rail Infrastructure.

(c) Access will include, in addition to the use of the Rail Infrastructure, the benefit of other Below Rail Services essential to the use of the Rail Infrastructure such as signaling, Train Control Services and associated communications and … if the Train services require electric energy for traction, the provision of such electric energy.

The current coverage provided for under the Act is inadequate. There is a need to clearly define the nature of the declared service as well as the infrastructure necessary to deliver this.

In particular, whilst the Act defines the infrastructure to be made automatically subject to the regime, there is no capacity to declare other rail infrastructure (that is infrastructure not so defined0 irrespective of whether or not that infrastructure provides services of a character that should be declared based on the application of the standard tests. All of the necessary infrastructure should be capable of being declared as part of the declared service through the application of a threshold test (based on the Competition Principles Agreement or the Trade Practices Act, 1974). This in turn requires detailed consideration of the scope of the service to be declared.

For example, sidings are currently excluded. It is recognised that in some circumstances, the utilisation of sidings does not form part of the declared service (for example, long-term storage), and users may be required to construct their own facilities. However, there are circumstances where they do clearly form part of the declared service, such as for short-term storage of trainsbetween cycles. Declaration of these facilities should therefore be considered on a case-by-case basis, based on criteria reflecting the principles contained in the CPA.

Is there a need to change the Act and/or the Code to provide greater certainty on the processes for obtaining coverage by the Regime of new routes and/or for extensions to existing routes?

It is recommended that changes be made to the Act (and the Code) to identify the nature of the *service* to be covered, as well as the infrastructure required to deliver it. In this regard, reference is made to the QR example provided above. Declaration of some facilities (such as sidings) may need to be considered on a case-by-case basis (as outlined above).

There are fundamental concerns with the environment for investment and expansion and these have already been outlined above.

Treatment of interstate issues (clauses 6(2), 6(4)(p))

Is the Code and the wholesale agreement an effective framework for interstate access seekers? How could it be improved? Are there any inconsistencies between the ARTC Undertaking and the Regime which result in a loss of efficiency or make obtaining third Party access more difficult?

Worsley notes the desire to ensure that the access arrangements are compatible with interstate traffic with the removal of inconsistencies with the ARTC Undertaking. However, Worsley points out that heavy haul, arrangements for interstate access operate largely independently of the rail network and are far more significant than intermodal operations in the context of the rail task as a whole. As such, the compatibility regulatory arrangements with the underlying requirements of heavy haul operations should not be ignored.

In this regard, a more important issue Reference is made to comments by the Australian Logistics Council in terms of integrating the transport chain:

> …a core principle of good access regulation is to ensure that the consequences of regulation are well understood in the context of the transportation chain as a whole. However, it is rare for regulatory arrangements to address more than one leg at a time. Perhaps the most effective ways of accomplishing this outcome is to recognize the role of end customers in the process, as it will be the end customers who are best placed to make the trade-offs between the steps in the process that will minimise total transport cost, so long as all relevant information is made available to them. Indeed, recognising the primacy of the customer is absolutely fundamental to the success of a regime.[17]

Negotiation framework (clause 6(4)(a)-(c), (e), (f), (g)-(i), (m)-(o))

Is the maximum penalty for breaches of the regulatory framework ($100,000) adequate for providing railway owners with incentive to ensure full compliance?

Losses incurred from WestNet's non-conformance with the regime should be recoverable as damages by the party that suffers damage. Further, any penalties should

[17] Australain Logistics Council (2003), op.cit., p.8.

reflect the full economic value of the loss suffered by the party. A maximum penalty of $100,000 is considered insufficient disincentive for the owner to comply with the framework, particularly when considered relative to the impact that could be suffered by the affected party/parties.

Whilst there are not multiple intra-state operators visibly competing and operating in the WA market, is the threat of competition realistic enough to ensure that freight rates are efficient?

This is difficult to assess given, as noted, its limited testing in practice. Further, it is not possible to compare the pricing offered to different operators. The assessment therefore relies on the perceived integrity and effectiveness of the competitive framework and the hence the degree of confidence in the regime. This in turn is a function of having an appropriate level of detail and transparency. Too little gives rise to ambiguity, while too much can lead to the regime being overly prescriptive.

Worsley is of the view that there is insufficient detail and transparency and is not confident that all pricing outcomes, negotiated with each operator between the lower and upper bound, is efficient. This is of particular concern in terms of pricing offered to the related above-rail operator relative to other competitors in the market. It is acknowledged that consistency is required under the Code, however as noted above, penalties for non-compliance could prove insignificant relative to the loss a disadvantaged participant might suffer. The issue of pricing is discussed further below.

Are the segregation arrangements adequate and what changes might improve confidence of access seekers, whilst avoiding significant administration costs?

Worsley respects that the business was sold on an integrated basis. However, it has some significant concerns with the integrity of the current arrangements. Of fundamental concern is ensuring consistency between arrangements:

- negotiated inside and outside the Code (notwithstanding this principle is recognised by Westnet), particularly given the Authority has no role in relation to arrangements negotiated outside the Code; as well as
- between WestNet and its affiliated operator.

A lack of transparency, leading to an inability to determine whether these arrangements are consistent, undermines the confidence of the market, particularly where the network owner is vertically integrated. This can become self-fulfilling – that is, a lack of transparency can more readily lead to the perception that the network owner will take advantage of the situation (including favouring its affiliate), even if this does not occur. This in turn can prove a significant deterrent to new entrants, acting as a type of barrier to entry. If entry is seen as unpalatable, the incumbent is

more likely to naturally exploit this advantage, producing an outcome of higher, rather than lower, prices.

The TPP and TMG are to apply equally to arrangements negotiated inside and outside the Code as part of WestNet policy. However, this should not be left to WestNet policy to ensure, but rather should be a requirement under the Code to give it legislative force. Presumably, non-compliance with these policies would flow through to the Key Performance Indicators which should be contained in each access agreement.

The importance of a level playing field was highlighted by the Australian Logistics Council.[18] It highlighted that distortions can occur via the delivery of more or less favourable pricing arrangements to different operators. It is practically difficult for an operator to know, or actually demonstrate, that they are potentially being treated unfairly. Public consultation undertaken in the development of the Segregation Arrangements suggested that fairness needs to be regularly demonstrated by the public release of prices for major hauls by associate companies for key routes, as well as key performance indicators. Under section 21 of the Code, the Authority can be sought for an opinion on price sought, however:

> An opinion given under this section is for the information of the applicant and does not have any effect for the purposes of the Act or this Code.

Distortions can also occur in the allocation of prime train paths, the reservation of capacity or imposing undesirable entry barriers (such as unnecessarily onerous compliance requirements). Again, it very difficult for an outside operator (or end customers) to confirm that "key terms and conditions" offered to an associate company is "broadly comparable" to those offered to others (as indicated in part 6 of WestNet's Segregation Arrangements).

Worsley has particular concerns regarding the allocation of cyclical train paths, particularly where other users of the network have an agreement outside of the Code. Worsley is concerned that a preparedness to enter an agreement outside of the Code could secure preferential treatment in terms of access to prime train paths (especially where the agreement is entered into with an affiliate of the access provider).

This issue also comes back to investment in expansions. For example, an incumbent may secure access to existing train paths at marginal costs, whereas subsequent users (for whom expanded capacity is required) may be required to pay the full costs of expansion. As noted above, an average cost principle should apply to all users in terms of covering the costs of expansions.

---

[18] Ibid., p.4.

Third party access is more likely to be provided where there is clear incentive to do so. There is seen to be a natural disincentive in WA given the integration of the below- and above-rail businesses. The regulatory environment needs to be 'strong enough' to deal with this integration.

Is the negotiation framework effective? What if any reforms to the negotiation framework would enhance the ability to meet the CPA objectives? What options are there to try to ensure railway owners use all reasonable endeavours to accommodate the requirements of access seekers?

It is difficult to comment on the effectiveness of negotiation within this regime given that there are no examples of access agreements that have been concluded. However, there is naturally unequal bargaining power between access seekers and access providers by virtue of the structural arrangements, as well as the information asymmetry. An example of where deficiencies have been identified in allowing a 'by negotiation' framework is embedded generation in electricity. This has led to calls for the development of a Code of Conduct, which is currently being coordinated by IPART.

In this case, the negotiation framework could be assisted by replacing the upper and lower bound for tariff negotiations with reference tariffs (discussed below), as well as a standard access agreement approved by the regulator.

Is there merit in introducing a capacity register?

Worsley would support the development of a capacity register.

Should a shorter time limit be placed on the railway owner to respond to existing business access requests?

The timeframes as currently outlined appear reasonable.

Dispute resolution (clauses 6(4)(a)-(c), (g)-(l), (o))

Are the dispute resolution provisions in the Code appropriate and effective?Are any refinements required?Should the settlement of access disputes be subject to time limits, which would be subject to interim determinations by the Regulator?Should "class" arbitrations (involving more than one access seeker) be introduced, where the Regulator could, if appropriate, disseminate information in one dispute to the parties in another?Should access seekers be given the right to seek damages and other remedies in the case of a breach of an access agreement by the railway owner which causes significant damage or loss?

A regulator should not be involved in negotiations. However, dispute resolution processes may need to be instigated sooner rather than later. At the same time, dispute

resolution can be very costly and time-consuming. The first step could be mediation (introduced at the discretion of the regulator in consultation with the parties involved), which should ideally involve an appropriately qualified person from the Authority. If arbitration is required, it should involve someone who has an appropriate understanding of the industry rather than the current arrangements which are reliant upon parties with experience in conducting arbitrations who are unlikely to have the requisite specific experience and expertise in resolving rail access disputes.

Clear timeframes should be specified for disputes. As noted above, access seekers should be able to seek damages in the event of loss due to a breach of the access agreement by the owners. Currently penalties for breaches are considered inadequate. The quantum of any damages paid should relate to the actual value of the loss suffered as a result of the breach.

Appropriate terms and conditions (clause 6(4)(a)-(c), (e), (f), (i), (k), (n))

Is the hybrid model the most appropriate model for use in the Regime?

It is acknowledged that one of the most significant challenges in designing a regulatory regime is achieving an appropriate balance between allowing parties to negotiate versus having a more prescriptive approach. Certainly, the 'by negotiation' approach is encouraged under the CPA.

An overly prescriptive regime can be administratively burdensome, and more importantly, it can stifle commercial negotiation and delay investment, act as a disincentive to new entrants and stifle innovation.[19] On the other hand, if regulation is too light-handed and there is a lack of appropriate transparency and detail, ambiguity will prove problematic and costly for existing participants, and serve as a strong disincentive to potential new entrants.

In this regime, there is a natural (and a perceived) imbalance in the relative bargaining power of the access provider and access seekers particularly given the former is vertically integrated. In Worsley's view, improved transparency and information provision would improve confidence. As noted by the Australian Logistics Council, information needs to provide sufficient certainty so that participants can operate understanding the consequence of their own actions, as well as the actions of others.[20] Worsley believes that when considering where this regime should sit on the regulatory

[19] Australian Logistics Council (2003), op.cit., p.9.

[20] Ibid., p.6.

spectrum between light-handedness and prescription, it needs to move more from the former towards the latter.

In this hybrid model, is there merit in introducing reference tariffs, which are firm prices for a defined services and route that the railway owners would offer access seekers? Would reference tariffs negate the effectiveness of the negotiate-arbitrate model?

The requirement to negotiate within upper and lower bounds does not work. The perception is that tariffs will be set at the upper bound, depending on the user's capacity to pay, rather than being based on the economic value of the service.

If negotiation doesn't produce the most effective outcome, the overpayment rules become the fallback. However, these rules are also seen to be ineffective and need to be tightened considerably. For example, to make them 'work', it must go down to a route section by route section basis and this is sub-optimal.

A better solution would therefore be to introduce reference tariffs for reference services (as applies in jurisdictions such as Queensland). The inclusion of reference tariffs would significantly increase transparency and hence engender market confidence (as argued above, this is seen as particularly critical in the case of a vertically integrated provider). It would also provide a more transparent means of differentiating between services, as well as the cost components underpinning each service and each participant's contribution to them. For example, reference tariffs can facilitate the introduction of more cost reflective tariffs incorporating causal versus allocative elements. In endorsing this approach in Queensland, the QCA noted:

> The QCA envisages that reference tariffs for coal traffic will provide increased pricing transparency that will facilitate negotiation by provided a benchmark against which third-party operators can assess the reasonableness of QR's proposed access charges…The Authority considers that the key consideration in the development of further reference tariffs is whether the benefit to the competitiveness of the above-rail market from increased pricing transparency for a relatively homogeneous set of train services justifies the intrusion into QR's operational autonomy.
>
> The potential benefits of this increased price transparency include the time and effort required to negotiate access to relevant services being substantially reduced through the availability of reference tariffs. It is conceivable that, in the absence of reference tariffs, the transaction costs associated with negotiating access charges

> (including costs arising from delay) could be so high that a distortion is introduced into the above-rail market.[21]

This would not negate the effectiveness of a negotiate-arbitrate model. It would, however, narrow its scope which would also ensure that such processes were more focussed.

Is there merit in introducing a statutory obligation on railway owners to periodically publish greater information about access (Access Information) to allow potential access seekers to develop business cases for freight operations?

As noted above, the existing provision of information is considered inadequate to provide participants with an appropriate level of certainty. Worsley notes that the Information Packs produced by QR under its regulatory arrangements provide a more appropriate level of information disclosure for access seekers.

In addition, it is important that the standard access agreement (if one is developed) provide detailed information as to the utilisation of track capacity – especially for cyclical traffics. In practice, such transparency is a key tool to provide confidence in the competitive neutrality of the capacity allocation process.

Do the railway owners standard access agreements provide a fair and reasonable contract template?

Worsley is not aware of the standard terms and conditions. However, Worsley is concerned that the absence of a regulator endorsed standard agreement, developed in a consultative environment, is an impediment to third party access. Worsley also considers that it is important that rail access agreements are able to be assigned to facilitate Worsley entering access agreements as holder of the right and then assigning the agreement to its above rail operator.

Does WA's GRV annuity approach for setting the upper bound (ceiling) access revenue alter the prospect of access seekers entering an access agreement with the railway owner?

Worsley favours the move towards a DORC approach as this is consistent with most other regimes. However, it also respects that this method was applied at the time of sale. If the GRV is retained, the lease should specify requirements regarding the condition of the infrastructure at the end of the lease term.

[21] Queensland Competition Authority (1999), op.cit.,p.217.

Further, Government contributions should be considered in the context of establishing ceiling prices. This was proposed in a submission by ARG as part of the review of the Victorian Rail Access Regime, as noted by the Authority in the Issues Paper.

Do the railway owner's Overpayment Rules provide a fair and equitable approach to address any breaches of ceiling costs/revenues?

As noted above, the current overpayment rules do not operate effectively and need to be revisited. In any event, reference tariffs provide a better vehicle for regulating access charges, especially for traffics which are expected to be at or near the ceiling.

Are the Key Performance Indicators sufficiently meaningful? Can these be made more useful and relevant?

The current framework is too high level for individual access agreements and the key issue should be to develop an appropriate suite of KPIs for individual contracts (noting that the precise KPIs may differ with traffic type).

Should users have some right to seek Authority involvement in contracts which have been established 'outside the Code'? How might this be achieved, what risks might this create and what are the implications of these risks?

There are fundamental difficulties with agreements being outside of the Code. Worsley remains concerned about the capacity for agreements negotiated outside of the Code to deliver favourable outcomes to the affiliated operator, especially since agreements negotiated outside of the Code that provide favourable terms are only likely to be offered to the affiliated operator.

Institutional Arrangements

Does the Regime encourage investment and are the information flows, that provide the signals for where investment in the system is required, efficient? What reforms to the Code could improve investment incentive efficiency?

Issues with investment incentives have been discussed at length above.

Is there merit in introducing a greater role for the Authority? (for example as the conciliator in train path issues, review fairness of track downtime schedules and evaluating progress towards MEA).

It would be dangerous for the Authority to become involved in access negotiations. The Authority could take on mediation role subject to consulting the parties as to whether there is merit in it performing that role in the particular instance.

Access agreements should also limit the extent to which WestNet is able to interfere with delivery of contracted paths and provide a means for resolving disputes about path allocations (including ensuring access holders have a means of securing all necessary information to independently assess the competitive neutrality of path allocations).

Would the benefits of having the Authority making and processing access applications, outweigh the costs of such a system?

The pros and cons of a more prescriptive approach have already been discussed. At minimum, Worsley would welcome the introduction of reference tariffs, improved information flows and a regulator-approved standard access contract. However, Worsley is loathe to see the regulator become involved in commercial negotiations.

Should the railway owner be subject to licensing and what benefits would this bring? If licensing was to be established how might it best be implemented?

Worsley has no comment on this issue.

Conclusion

Worsley has identified a number of issues with the current regime. While there is considerable merit in encouraging commercial negotiation, more certainty is needed in a number of key areas to ensure those negotiations have the maximum chance of succedss.

Measures to increase transparency and certainty will increase participants' confidence in the regime. This is not only important for new entrants but also end customers who will assess whether they are likely to be disadvantaged in securing haulage services form a new entrant. Ambiguity will deter new entrants and frustrate the objectives of the access regime in promoting competition.

Issues identified include:

1. Deficiencies in the existing framework in terms of encouraging efficient and timely investment in necessary expansions. There are also concerns in how the costs are to be borne by users (an average cost approach is recommended). This is becoming more urgent in areas such as the mainline south of Perth, which is highly congested.

2. Further, a least cost solution does not necessarily deliver the highest value for all users. A measure should be introduced to ensure investment is based on (and progressed in a manner to deliver) highest net benefit. To the extent

that providing such access requires expansion, all users should contribute on an average cost basis.

3. There should be a two-pronged approach to performance measurement, being:

   (i) at a whole of regime level - the introduction of a 'scorecard' to assess the regime's overall effectiveness could be developed; and

   (ii) The key performance indicators that are included in the access agreement form an important component of that agreement. While these are subject to negotiation, most of these should be able to be standardised (and hence consistent), other than say, where different levels of service quality have been agreed. A standard suite of indicators and service quality requirements could be developed as part of the standard access agreement and reference service respectively.

4. The coverage of the Code is inadequate. It should cover all necessary infrastructure required to deliver a declared service. Accordingly, it is possible that the declaration should be able to be extended to include sidings and other infrastructure in appropriate cases based on the application of a threshold test (for example, it is acknowledged that declaration of a siding would not be appropriate in all circumstances, such for performing wagon maintenance).

5. Access to prime train paths is not necessarily seen as equitable and raises concerns as to the dichotomy between contracts negotiated inside and outside the regime.

6. The Code needs to strengthen the actual and perceived separation of WestNet Rail's ('WestNet') below-rail business from the above-rail. The principle that there be non-discrimination should not be delivered through internal WestNet policies but rather through Code provisions.

7. The framework for determining tariffs, which requires negotiation between an upper and lower bound, is not as effective (with the overpayment rules also ineffective as a fallback mechanism). Reference tariffs should be introduced for reference services.

8. There should be a standard access agreement that is approved by the regulator. It is possible that different standard access agreements could be developed for different traffics.

Attachment 1

Scorecard for Public Interest Considerations

Criterion	Performance
1. Creating a level playing field.	Regime achieves a base level of performance here. More needs to be done to create a properly functioning above rail market.
2. Engendering confidence in the regime	Customers and above rail operators do not have a sufficient level of confidence in the regime
3. Certainty and transparency.	Greater levels of transparency should be provided.
4. Delivering efficient prices.	No – reference tariffs need to be developed for services at or near the ceiling. More efficient pricing structures should also be developed.
5. Allocating risk and reward efficiently.	Absence of a standard access agreement affects the likelihood of achieving this objective. Once property rights are properly established, commercial negotiation can help deliver this.
6. Ensuring proper integration of the transport chain.	Limited consideration given to this issue in the regime – although there is invariably a limit to what can be achieved in isolation.
7. Avoiding excessive regulation	No.
8. Minimising cost for all parties	Lower costs could be achieved through reference tariffs and standard access agreements.