



Your Ref:  
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Dr Loraine Abernethie  
Principal Research Officer  
Economics and Industry Standing Committee  
Legislative Assembly Committee Office  
Parliament of Western Australia

Dear Dr Abernethie

## **Submission to Inquiry into the Management of Western Australia's Freight Rail Network**

Thank you for inviting the Economic Regulation Authority to make a submission to the above inquiry. The comments in this letter address the matter of the "the regulatory arrangements in place for the network", which is one of the matters that the Committee is investigating.

As the ERA is currently in the process of making a determination pursuant to the *Railways (Access) Code 2000* (Code), in relation to the application for access by CBH to certain segments of the railway operated by Brookfield Rail, the ERA is unable to comment on matters or respond to questions specifically relating to its assessment of that application. The Authority is also a respondent in current court proceedings initiated by The Pilbara Infrastructure, and may be constrained from commenting on any matters which reflect on the application of the WA Rail Access Regime to the railway owned by that company. The ERA is, however, able to assist by explaining the regulations that it administers, which are set out in the *Railways (Access) Act 1998* (Act) and the Code.

### ERA Comments

The ERA administers regulations in respect of the railway routes listed in Schedule 1 of the Code. These routes comprise the WA urban (predominantly passenger) network, the WA non-urban freight network, and The Pilbara Infrastructure Pty Ltd (TPI) railway stretching from the eastern Pilbara to Port Hedland.

The Act and the Code establish a framework for negotiation of access to regulated railways in Western Australia. This is a "light handed" approach to infrastructure regulation when compared to other third party access regulatory frameworks which the ERA is responsible for administering, e.g. the *Electricity Networks Access Code 2004*.

The regulatory arrangements are considered "light handed" because the Code describes a negotiate-arbitrate approach. The Code does not prescribe exactly how negotiations are to be conducted or the specific terms and conditions to be included in an access agreement. The parties are free to negotiate terms, including price, outside the Code, with only limited exceptions in relation to safety, train management and train path policy. Where negotiations under the Code fail, parties can obtain a binding determination through arbitration. Section 24 of the Code describes the establishment of a panel of arbitrators for this purpose. The regulator cannot be included in this panel.

In comparison, the ERA's role in gas and electricity access regulation involves establishing a set of terms and conditions, including tariffs for a benchmark or reference service. Parties are also able to seek arbitration if there is a dispute about the service terms and conditions.

The diagram attached to this submission, "Main Steps of the Rail Access Process", outlines the role of the ERA in progressing an access proposal. The diagram shows that the ERA has specific responsibilities commencing with the processes outlined in Part 2 of the Code "Proposals for access" and concluding prior to the processes outlined in Part 3 of the Code, "Negotiations", being enlivened.

The floor and ceiling costs determined by the ERA constrain the price which is offered by the railway owner in negotiations with the proponent.

To assist in negotiations on the price of access, floor and ceiling costs are determined under Schedule 4. These costs form the lower and upper limits for the negotiation of access charges. The establishment of a regulated revenue band allows for price discrimination between access seekers.

Clause 10 of Schedule 4 of the Code requires a railway owner to determine floor and ceiling costs in accordance with its costing principles. Costing principles are approved by the ERA, pursuant to section 46 of Part 5 of the Code, and provide details on the manner in which a railway owner's floor and ceiling costs are to be formulated.

Even though floor and ceiling costs are determined by the railway owner, and approved or re-determined by the ERA, it is important to note that the ERA does not determine prices in respect of a particular proposal. Prices are negotiated between the railway owner and the proponent subsequent to the approval or determination of costs by the ERA. The ERA does not have a role in establishing specific access prices, except where requested to provide an opinion on the fairness of prices, as described in Section 21 of the Code.

The role of the ERA in relation to the determination of floor and ceiling costs is to either approve the railway owner's determination of costs, or to make its own determination of costs, as described in clause 10(3) of Schedule 4 of the Code. In deciding whether to approve railway owner's proposed floor and ceiling costs or in making its own determination of those costs, the ERA must take into account:

- a) the matters outlined in section 20(4) of the Act;
- b) the object of the Act and the Code to encourage the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations as set out in section 2A of the Act.

The matters outlined in section 20(4) of the Act are:

- a) the railway owner's legitimate business interests and investment in railway infrastructure;
- b) the railway owner's costs of providing access, including any costs of extending or expanding the railway infrastructure, but not including costs associated with losses arising from increased competition in upstream or downstream markets;
- c) the economic value to the railway owner of any additional investment that a person seeking access or the railway owner has agreed to undertake;
- d) the interests of all persons holding contracts for the use of the railway infrastructure;

- e) firm and binding contractual obligations of the railway owner and any other person already using the railway infrastructure;
- f) the operational and technical requirements necessary for the safe and reliable use of the railway infrastructure;
- g) the economically efficient use of the railway infrastructure; and
- h) the benefit to the public from having competitive markets.

The floor and ceiling costs approved or determined by the ERA represent the minimum and maximum recoverable revenue in respect of the relevant route sections. This means that the ceiling cost is the maximum revenue recoverable by the Railway owner from all operators and all other entities, including itself, on the relevant route.

The floor cost is determined by applying the concept of “incremental costs”. Incremental costs is defined in clause 1 of Schedule 4 of the Code, in relation to an operator or group of operators, as the operating costs and, where applicable, the capital costs and the overheads attributable to the performance of the railway owner’s access-related functions whether by the railway owner or an associate, that the railway owner would be able to avoid in respect of the 12 months following the proposed commencement of access if it were not to provide that access.

The ceiling cost is derived from the total costs attributable to the section of a route and use of the infrastructure. “Total costs” is defined in clause 1 of Schedule 4 of the Code as the total of all operating costs, capital costs and overhead costs attributable to the performance of the railway owner’s access-related functions, whether by the railway owner or an associate.

The capital cost components of the floor and ceiling costs and the approach to estimating these costs are not based on actual costs or on the existing network specification but rather are based on the hypothetical Gross Replacement Value (GRV) of the railway infrastructure. GRV is calculated as the lowest current cost to replace existing assets with assets that –

- a) have the capacity to provide the level of service that meets the actual and reasonably projected demand; and
- b) are, if appropriate, modern equivalent assets.

Further, clause 4 of Schedule 4 provides that the costs referred to in Schedule 4, including the capital costs included in the floor and ceiling costs, are intended to be those that would be incurred by a body managing the railway network and adopting efficient practices applicable to the provision of railway infrastructure, including the practice of operating a particular route in combination with other routes for the achievement of efficiencies.

Another purpose of determining ceiling costs, in addition to assisting the establishment of an access price in negotiations, is to create an upper limit for allowable revenue. The railway owner’s over-payment rules (a Part 5 instrument) outline the process for refunding to operators any revenues collected in excess of ceiling costs.

In addition to approving floor and ceiling costs, the ERA is required by the Act to approve/determine railway owners’ segregation arrangements, which set out the controls and procedures for segregating a railway owner’s below-rail access-related functions from any above rail operations.

A “below rail” operator is someone who owns and operates a railway. An “above rail” operator is someone who operates rolling stock on a railway. Segregation arrangements ensure that,

where a company is both a below rail and above rail operator, third parties seeking access to the rail network are not disadvantaged.

The ERA is also responsible for approving the “Part 5” instruments defined in Part 5 of the Code. These determine the rules for the safe running of trains on a railway network, ensure that rail capacity is allocated fairly to all users, and, as previously mentioned, establish a basis for the railway owner to set upper and lower cost recovery bounds (known as floor and ceiling costs) for each route section.

These instruments are described in Part 5 of the Code as: the Train Path Policy, the Train Management Guidelines, the Costing Principles and the Over-payment Rules.

To date there have been three proposals made for third party access pursuant to the Code. These proposals were lodged by:

- a) Portland Cement in 2001 in respect of the WestNet Rail route into the Port of Esperance. This proposal was overtaken by commercial negotiations outside the Code.
- b) Brockman Mining in 2013 in respect of The Pilbara Infrastructure route into Port Hedland. The ERA made a determination of costs relevant to this proposal in September 2013.
- c) Co-operative Bulk Handling in 2013 in respect of all routes hitherto used for grain haulage. The current deadline for the making of a determination of costs relevant to this proposal is 30 June 2014.

### Code Reviews

The Authority is required by section 12 of the Act to carry out a review of the Code every five years. Accordingly, the Authority has undertaken reviews, and provided these to the Treasurer, as required by section 12(6) of the Act. The Authority has published its Code review reports on its website, most recently in 2004 and 2010. Amendments to the Code which were enacted in 2009, followed on from the 2004 report. The Authority does not consider that any of the eight recommendations contained in the 2010 Code Review report reflect any significant issues with the application of the Code to the Brookfield Rail-owned infrastructure.

The Authority has two additional points of concern which have not previously been raised in Code Review reports. Neither of these points reflect in particular on the application of the Code to the Brookfield Rail infrastructure, but more generally to all rail infrastructure owners.

- 1 A railway owner can assert a claim under section 10 of the Code that, in its opinion, provision of access to an access seeker would preclude other entities from access to that infrastructure. If a railway owner makes such a claim in respect of a proposal, then negotiations on that proposal may not proceed without the approval of the regulator. The railway owner can assert such a claim even if the route in question is clearly able to be expanded. The requirement that the regulator undertake consultation on this matter for 30 days prevents the regulator from immediately assessing any such claim on its merits and, if appropriate, approving negotiations to proceed. Section 10 therefore provides an opportunity for the railway owner, in certain circumstances, to unnecessarily delay the access process.

- 2 The confidentiality provisions of section 50 of the Code allow railway owners to require confidentiality over material which may be required by a proponent or stakeholder to adequately assess or contribute to a regulatory decision. The claim of confidentiality may be used by a railway owner to prevent the provision of relevant material to proponents, even under the protection of a confidentiality agreement, and may prevent the regulator from publishing material which is in the public interest.

In addition to these general points, the Authority is currently considering the ability of the owner of the freight network to place routes in care and maintenance, and out of service, whilst not being required to remove these routes from Schedule 1 of the Code. As this matter is being considered in conjunction with a determination currently under way, the Authority is not able to provide further public comment on this issue, other than to note that it presents some difficulty to the Authority.

This submission is not confidential or closed. The Authority has been requested by the committee to make this submission. I do not request to appear before the committee in support of this submission; however, I am prepared to appear before the committee if called upon to do so.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Lyndon Rowe', with a stylized 'L' and 'R'.

LYNDON ROWE  
**CHAIRMAN**

7/5/14.

## MAIN STEPS OF THE RAIL ACCESS PROCESS

