

Ms Aditi Varma
A/Director Economic Reform
Department of Treasury
Locked Bag 11 Cloisters Square
PERTH WA 6850

By email: regulatoryreform@treasury.wa.gov.au

Dear Ms Varma

Invitation for Submissions – Review of the Western Australian Rail Access Regime

Alcoa appreciates the opportunity to respond to the Department of Treasury's invitation for submissions the Issues Paper regarding proposed changes and potential improvements to the Western Australian Rail Access Regime.

Summary

- In Alcoa's view, due to poorly defined terminology, the Code does not prevent the railway owner from using their monopoly position and its accompanying power to 'unfairly discriminate' against the proponent.
- Alcoa supports the proposed option to make the non-discrimination requirement mandatory regardless of whether an agreement is negotiated and executed inside or outside the Code.
- In Alcoa's view, making all aspects of the Part 5 Instruments obligatory, regardless of whether access is negotiated inside or outside the Code, would be advantageous. Alcoa considers it essential that the railway owner needs to regularly (minimum of a yearly basis) report on the compliance with the Part 5 Instruments.
- Alcoa support a publicly available 'Floor and Ceiling Cost Model' that is kept up to date with all changes in the asset base, including any relevant expansions and extensions to be provided with the 'Costing Principles' to assist entities that might be interested in making a proposal.
- In Alcoa's view, to enforce the power of monitoring and controlling the regime, the Regulator must be equipped with tools to respond in a timely manner and to sanction the railway owner accordingly.
- Alcoa does not consider that an entity that is interested in making a proposal is in the position to demonstrate sufficient capacity of the railway network and the feasibility of any proposed extension/expansion. This inability to demonstrate capacity and/or feasibility is considered a barrier to access negotiations and an imbalance in negotiating power.
- Alcoa considers the Western Australian rail access regime as insufficiently transparent and endorses regular public reporting of the current service level, targeted service level, track performance, pricing and maintenance plans, as well as the number of applications by route and planned expansion/extension plans.

- Alcoa does not support the establishment of merit reviews.
- Alcoa does not support the use of an 'Approved Indicative Tariff' for a 'Reference Service' as the potential benefits are limited to a narrow set of potential proposals.
- Alcoa endorses the establishing of a DORC respectively EAB approach. However, there are many hurdles to overcome, for example the new approach should be submitted to the Regulator and like the Part 5 Instruments, should be part of public consultation to Alcoa's operations.

Issues

Please find attached an answer to the following issues: Balance of power in negotiations, Accountability, Capacity expansion and extension, and Pricing mechanism.

Alcoa has not responded to Marginal rail routes, Greenfield developments, Vertically integrated rail networks in the Pilbara, and Consistency with the National Access Regime, on the basis that these issues are not relevant.

Balance of Power in Negotiations

- 1.1 In Alcoa's view, the Code does not serve its original purpose '*...to encourage the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations*'.

Alcoa does not see reasonable grounds to negotiate a railway access with the railway owner inside the Code.

Entities that are interested in making a proposal, as well as railway owners, require certainty for a successful operation of their businesses, in terms of price, service level and time, over a defined planning horizon.

The Code does not anticipate this requirement for certainty. In addition, negotiating outside of the Code enables both parties to achieve this essential requirement to assure certainty.

- 1.2 Alcoa does not consider that negotiating an agreement outside of the Code will lead to higher costs. However, we recognise that negotiating an access agreement outside of the Code does not protect the proposing entity from paying above the ceiling price.

- 1.3 Negotiating an access agreement outside of the Code does favour the railway owner, because the non-discrimination clause (see Division 2 – Negotiations, Section 16 of the Code) cannot be enforced if an agreement is negotiated outside of the Code.

Furthermore, the lack of information regarding railway assets and rail network operations favours the railway owner and represents an imbalance of power in negotiations.

- 1.4 a Alcoa supports the proposed option to make the non-discrimination requirement mandatory regardless of whether an agreement is negotiated and executed inside or outside the Code.

Railway owners and proponents can negotiate an access agreement outside of the Code. In case of an agreement outside of the Code, the railway owner is not required to enforce the Part 5 Instruments (see Division 2 – Negotiations, Section 16.1 (b) of the Code).

The Code limits the 'unfair discrimination' to technical and operational aspects but does not mention economic or financial aspects.

Due to poorly defined terminology, the Code does not prevent the railway owner from using their monopoly position and its accompanying power to 'unfairly discriminate' the proponent.

The Regulator needs to be equipped with tools, to enable them to perform against their required function to assess if an access seeker is unfairly discriminated by the railway owner.

This leads to the question of whether the Regulator should be able to access the agreement and therefore confidential commercial information.

In Alcoa's view, to effectively monitor and control the regime, the Regulator must be equipped with tools to respond in a timely manner and to sanction the railway owner.

- 1.4 b The railway owner is obliged to provide certain information, called Part 5 Instruments, for approval by the Regulator. However, the railway owner only needs to comply if the access agreement is negotiated within the Code.

In Alcoa's view, making all aspects of the Part 5 Instruments obligatory, if you are negotiating access inside or outside the Code would be advantageous. Particularly, as it includes the definition of safety rules.

- 1.4 c Alcoa does not support proposal c.

- 1.5 Alcoa anticipates a robust and effective overhaul of the Code so that no entity has an interest in negotiating an access agreement outside the Code.

The Code provides a limited amount of protection for the proponent, if an access agreement with the railway owner is negotiated outside the Code. Alcoa strongly supports the idea that Part 5 Instruments must be applied and are not part of negotiations regardless of whether the agreement is negotiated under or outside the Code.

On the basis that Alcoa does not have the quality of information essential to determine the second step the capacity of a route, this submission responds to question 1.7 and then question 1.6.

- 1.7 The Code specifies in Part 2 – Proposals for access, Section 7.1 the following:

An entity that is interested in making a proposal in respect of a particular route may ask the railway owner in writing to provide it with

(a) an initial indication of - (i) the current available capacity of that route; and (ii) the price that the entity might pay for access; and (iii) the terms, conditions and obligations that the railway owner would want to be included in any access agreement;

and

(b) any update of the required information, as defined in section 6, that is reasonably available to the railway owner; and

[(c) deleted]

(d) the origin and destination of any train paths proposed by the railway owner for the route.

The railway owner is obligated to provide the above listed information regarding the railway capacity, price, terms and any update of the required information.

They are not obligated to provide crucial information regarding the condition or maintenance standard of the railway infrastructure, and any relevant restrictions on train weight or axle load; which affects the safe and efficient operation of the railway.

Considering the complex planning for a rail based logistics operation, this information is necessary to be able to judge the feasibility of an access proposal. At the same time, it is imperative to foresee potential capital requirements.

Alcoa takes the information provided to the proposing entity to demonstrate sufficient capacity and the feasibility of an extension /expansion, is not sufficient and therefore creates a barrier to access negotiation and an imbalance in negotiation power.

1.6 The available capacity of any route directly relates to three main factors:

- Axle load – Changing the axle load on a route section will affect the capacity – a higher axle load allows trains with higher tonnages. Important to note is, that the entire route section needs to be able to handle the increased load including all bridges, culverts etc. For example on the South West Mainline many of the route sections are capable of 25 tonnes axle loads, however weight restrictions on a number of bridges reduces the South West Mainline to 21 tonnes axle load.
- Length of the train – Increasing the maximum number of train wagons permitted on a route section will lead to higher capacity on a route section.
- Cycle time – Increasing the capacity on a route section can be achieved by reducing the cycle time for train operations.

Subsequently, it is important to examine the most efficient solution to increase the capacity of a route section. Recognising the lack of access to accurate and sufficient data, Alcoa does not consider that an entity that is interested in making a proposal is in the position to demonstrate sufficient capacity of the railway network and the feasibility of any proposed extension/expansion. This inability to demonstrate capacity and/or feasibility is a barrier to access negotiations and an imbalance in negotiating power.

1.8 The Code states that the proponent needs to specify any required changes to the railway infrastructure and operation (Part 2 – Proposals for access, Section 8.4):

A proposal may specify any extension or expansion, or both, of the route or the associated railway infrastructure that would be necessary to accommodate the proposed rail operations.

Both proposed options (a) and (b) recommend reversing the onus from the proponent to the railway owner.

(a) The railway owner to specify if any upgrades to the railway infrastructure are required to accommodate the proposal.

(b) The railway owner to review the proposal and demonstrate if it can be accommodated on the railway network and it meets technical, economic, and safety compliance.

Alcoa supports the implementation of both proposed options. The current asymmetry in information relating to operational requirements and infrastructure, disadvantage an entity that is interested in making a proposal, and disadvantage the proponent in negotiations with the railway owner.

Alcoa acknowledges that the proposed changes will require modification to current timelines for access proposals and will require a set of principles defining an 'efficient solution of an extension/expansion'.

1.9 According to the Code Part 2- Proposal for access, Section 9.2 (b) the railway owner is required to provide the proponent with a cost estimate. Therefore, the Code already obliges the railway owner to assess the extension/expansion.

The proposal is merely changing the onus to the party who is in the best position to carry out the work. The railway owner already has:

- full understanding of what types of process are to be undertaken,
- the allocation of responsibility,
- oversight of potential cost sharing,
- risk minimisation for the delivery of an expansion and extension project, and
- this reduces or avoids any kind of duplication of work.

Alcoa does not support the proposal to permit the railway owner to recover its costs from the access seeker.

1.10 Alcoa has identified further the following barriers to access negotiations:

- The process and steps involved (even before negotiation begins) are onerous and slow to execute, and have no timeframes. Negotiations can only begin after a long process of information exchange when requirements have been met to the satisfaction of the railway owner.
- Arbitration can only be entered into after the negotiation time period has expired (or by agreement that negotiations are at a stalemate). There should be scope to have negotiations able to commence in parallel with the cost determinations being made.
- Disputes and arbitration need to be resolved in a more timely manner. Arbitration and/or injunction to Supreme Court are the only avenues currently available for the access seeker to enforce the Code, which can be both time and cost prohibitive.

1.11 Alcoa has identified the following options to address other barriers to access negotiation in the Western Australian rail access regime:

- Overall, Alcoa has the view, that the Code is ineffective in assisting negotiations. Reforms should include sufficiently detailed, transparent, and current information relating to access and its price. Furthermore, the required information and the format for a standard access agreement should be pre-approved and published by the Regulator as new Part 5 Instruments. This would increase the efficiency and improve the transparency of the process.
- Negotiations need to be efficient, timely and cost effective; with the option of interim access so that the railway owner does not have the power to arbitrarily restrict the operations of the access seeker who is already operating on the railway and is now seeking access under the Code.
- Dispute definition needs to be elaborated and expanded upon in the Code, and be available at any time, not just after negotiations. Stricter timeframes should be added to the Code with penalties for non-compliance.
- A publicly available 'Floor and Ceiling Cost Model' that is kept up to date with all changes in the asset base, including any relevant expansions and extensions to be provided with the 'Costing Principles' to assist entities that might be interested in making a proposal.

Accountability

2.1 The Code does not oblige the railway owner to publish, publicly or confidentially, information on a regular basis on how they comply with the regime, especially in terms of maintenance standards and the capacity of the railway.

It is one of the core responsibilities of the Regulator to review how a railway owner complies with the Code and enforce compliance if required.

Alcoa considers the Western Australian rail access regime as insufficiently transparent and endorses the regular public reporting in an accessible way of the current service level, targeted service level, track performance, pricing and maintenance plans, as well as the number of applications by route and planned expansion/extension plans.

2.2 The railway owner only needs to comply with the Part 5 Instruments if the access agreement is under the Code. Currently, no access has been negotiated under the Code.

Alcoa has the view, that the asymmetry in accessing information, respectively the lack of transparency of information, is a hurdle in negotiating access agreements. This does not

support the purpose of the Code and disadvantages the position of the entity that is interested in making a proposal.

Regular reporting on the compliance with the Part 5 Instruments would improve the effectiveness of the regime by reducing the asymmetry in information.

Alcoa considers it essential that the railway owner needs to regularly (annual minimum) report on the compliance with the Part 5 Instruments.

Alcoa believes that the Regulator has a core responsibility to monitor and review the accuracy of the reporting on the compliance with the Part 5 Instruments and enforce compliance by railway owners.

- 2.3 Alcoa cannot see value in publishing the progress of access negotiation to improve the effectiveness of the regime.

Alcoa notes that the proposed timeframes in the Code are not supporting efficient and fair negotiations, and proposes that all timeframes should be revised and clearly set out in the Code.

- 2.4 Under the Code, the railway owner only needs to provide to an entity that is interested in making a proposal, any update of the required information as preliminary information.

The required information comprises information regarding the route section information such as length, curves and gradients, passing loops etc., but does not include relevant information on a railway such as the current service level, targeted service level, track performance, pricing, maintenance plans and any planned expansions/extensions.

It is essential for an entity that is interested in making a proposal to have access to up to date and readily available information, without having to formally apply to the railway owner. The availability of the information is important in the evaluation phase of an entity's business case to prepare a proposal for rail access. Therefore, Alcoa suggests that the railway owner is required to publish all asset information on a regular basis.

Alcoa has a direct access agreement with Arc Infrastructure outside of the Code, which includes defined performance indicators such as quality of rail infrastructure. Alcoa proposes that the following be incorporated into the Code:

'The railway owner is required to maintain a route section to an agreed standard and to deliver a defined service level. The access price is calculated as a function of the standard achieved in which the agreed price is paid if the agreed standard and the defined service level is met.'

- 2.5 The possibility of merits review was discussed in the ERA Determination. The ERA has highlighted the following:

*'... the Regulator does not determine precise tariffs, but only broad cost parameters relating to price boundaries for negotiation. These broad negotiation boundaries have a limited bearing on a final negotiation price...'*¹

Alcoa agrees with the statement of the Regulator. Therefore, Alcoa does not support the introduction of merits reviews for all Regulator determinations. Alcoa believes that the use of merits review would not be effective in improving the efficiency of negotiations under the Code and would increase the internal processes for all stakeholders.

Alcoa is in favour of a light-handed regime and does not promote any kind of changes to the regulation. However, the Code does not appropriately equip the Regulator with the corresponding tools to perform their duties as a neutral regulator to promote and ensure a fair and competitive environment with the best outcome for the Western Australian consumers.

¹ <https://www.erawa.com.au/about-us> (Reviewed 6/11/2017)

- 2.6 Alcoa does not support the establishment of merit reviews.
- 2.7 Alcoa only can identify one determination of the Regulator, which could be subject to a merit review namely the annual determination of the Weighted Average Costs of Capital (WACC) for railway owners. The justification is the annual reset of WACC, which affects the annual access prices of long-term access agreements.
- 2.8 With reference to the proposed change in Section 42, Alcoa would require more detailed information on the definition of 'material change' by the Regulator.
- For the Section 45 recommendation, Alcoa supports implementing the ERA's Final Recommendation 4 from the 2011 Review to have all Part 5 Instruments open to consultation.
- Currently, only two of the four Part 5 Instruments require a public consultation, namely the Train Management Guidelines and Statement of Policy. Costing Principles and Over-payment Rules are not part of mandatory public consultation and they are essential instruments for the negotiation of an access agreement.
- Alcoa supports review of all Part 5 Instruments at the maximum of every five years or a lessor period if directed by the Regulator.
- 2.9 The question is aimed at new railways. No response is made as Alcoa is not interested in any greenfield developments.

Capacity Expansions and Extensions

- 3.1 Alcoa considers that the lack of detail in the Code with respect to the process, responsibilities, timing, cost sharing and recovery of an expansion project creates a barrier for negotiation and an imbalance in negotiating power between the parties.
- The delivery of expansion and extension projects is a core competency for a railway owner who routinely deals with such projects. The railway owner has a full understanding of what types of process are to be undertaken, the allocation of responsibilities, and possible cost sharing options to minimise the risks and costs to it as a result of the delivery of an expansion and extension project.
- The delivery of expansion and extension projects is not a core competence of an access seeker, such as Alcoa, who is therefore in a weaker position with regard to the negotiating power between the railway owner and the access seeker.
- 3.2 Alcoa is in favour of the high level set of principles as set out in proposal (a) to guide the negotiations.
- 3.3 Certainty for a proponent is essential when an extension or expansion proposal can be made. This lack of clarity creates an barrier to access negotiation.
- 3.4 Implementing Recommendation 4 of the ERA's 2015 Review appears to clarify that a proposal for an extension or expansion may be made at any time after a proposal is made under Section 8. Alcoa notes that amendments might also be required to Section 9 Railway owner's obligation on receipt of proposal to improve certainty for all stakeholders.

Pricing Mechanisms

- 4.1 Alcoa does not support the use of an 'Approved Indicative Tariff' for a 'Reference Service' as potential benefits are limited to a narrow set of potential proposals. It is not clear how required costs of capacity expansions/extensions would be incorporated in the tariffs.

There is a risk that the 'Approved Indicative Tariff' may become a default position in a negotiation or an arbitration, which would disadvantage the proponent in negotiations.

- 4.2 Alcoa cannot identify other circumstances where the potential benefits of 'Approved Indicative Tariffs' would be expected to outweigh either the costs and or the disadvantages they would impose on an access seeker in negotiations.

It is likely that an 'Approved Indicative Tariff' would be contentious with either, or both, the railway owner and proponents, and the tariff itself would be subject to a merits review process.

- 4.3 a Alcoa believes that using the EAB approach in place of GRV would only provide effective guidance to proponents with regards to access charges, if the required information on which an EAB is based, are publicly available. This information must include up to date age and condition of railway assets detailed to an appropriate level of granularity and the information how it was collected.

In regard to the initial determination of the asset value, Alcoa has concerns that, if the railway owner determines the asset value and depreciation, the railway owner could use this to their advantage. Of further concern is that there is no change proposed to the current level of transparency regarding the value of the assets for proponents.

Alcoa believes that the calculation of the asset value and the setting of depreciation rate needs to be transparent and determined by the Regulator, including a public consultation process to provide impartiality and to reduce the uncertainty around the basis for the calculations.

Unfortunately, the ERA Determination does not provide advice regarding the EBA approach and the defined formula to be utilised for calculating the value there, as well as the utilised inputs. While in the ERA states in paragraph 138 the following:

"The EAB would be established by the railway owner on the basis of an opening value, capital additions and depreciation. Depreciation would be calculated for each class of assets using the remaining economic life."

the ERA states in paragraph 141:

"The Authority considers that establishing an opening depreciated value for all routes on the SW freight network is best established by the WA Government as owners/managers of the lease arrangement, because the lease contains the confidential provisions requiring performance and track standard reporting."

In general, Alcoa endorses establishment of a DORC respectively EAB approach. The new approach should be submitted to the Regulator and similar to the Part 5 Instruments, part of public consultation.

- 4.3 b Alcoa notes that value of the asset at day one is the same for both EAB and GRV. Under EAB the asset life can be adjusted over time by the depreciation rate applied. This would reduce the investment risk for extension or expansions for the entity that is interested in making a proposal.

However, the EAB, as well as GRV, are heavily impacted by the WACC and the cost of capital may be different for the railway owner for long-term investments when compared to cost of finance for an extension or expansion.

- 4.5 Alcoa believes that if an EAB valuation method is to be applied, that parts a) and b) of Question 4.5 should be adopted.

The Issues Paper does not discuss issues regarding the condition of the assets. Furthermore, the Code does not specify any standards for route sections or urges the railway owner to maintain the assets to a defined standard.

In Alcoa's view, the Code does address the needs of the proponents on the basis business needs operational certainty and reliability in regards to price, time, and service level. This is one of the main reasons why no access agreement has been negotiated under the Code and this needs to be considered in the determination principles of the Floor and Ceiling Costs.

If clarification is required on any of our comments, please do not hesitate to contact the undersigned.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Adrian Jones', written over a light blue horizontal line.

Adrian Jones

Senior Manager, Transport & Logistics

