



Issues Paper Submission

17 November 2017

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1 Introduction

1.1 How to use this document

1. Arc Infrastructure Pty Ltd (**Arc**) welcomes the opportunity to respond to the *Review of the Western Australian Rail Access Regime, Issues Paper 2017* as published by the Western Australia Department of Treasury (**Issues Paper**).
2. Arc's submission (**Submission**) is structured to align with the Issues Paper and addresses the "challenges, issues and proposals" as set out by in section 3 of the Issues Paper. As the sole operator of Western Australia's (**WA**) dedicated 5,500km freight rail network (the **Arc Network**), Arc has unique insights into the complex issues associated with contemporary rail operations and Arc believes its Submission will assist in providing a valuable perspective in reviewing the Railways (Access) Code 2000 (**Code**).
3. The Executive Summary outlined in section 2 below addresses Arc's key concerns as they may apply to an independent railway manager. It is these concerns in particular that Arc wishes to enter further discussions with Government to ensure the practicalities and repercussions are fully understood before any amendments are made to the Code.
4. To provide context around the regulatory environment within WA and how the Arc Network sits within the WA Rail Access Regime (**WARAR**), Arc engaged economic experts HoustonKemp to provide an overarching report around the role of regulation in the rail industry (**Expert Report**). The Expert Report is provided as an annexure to this Submission (refer section 2 of Annexure A) and provides context around the regulatory environment within WA and how the Arc Network sits within the WARAR.
5. A full list of acronyms and commonly used terminology is provided in the definitions section at the back of this Submission for reference.

1.2 Information Workshops

6. In Arc's view it is critical that all Issues Paper discussions are viewed through the lens of predicted outcomes when applied to an operating, multi-commodity, open access network. To support this process, and given its unique position as a below rail provider, Arc would welcome the opportunity to host an Issues Paper Workshop for key stakeholders across interested Government departments to offer critical insight into the practical nature of the freight rail industry.
7. As current custodians of a critical WA infrastructure asset, Arc further extends an invitation to any interested or invested party to experience the Arc Network through a hosted Network Tour. For more information on Issues Paper Workshop and Network Tour opportunities, please contact us¹.

2 Executive Summary

2.1 Arc Infrastructure – A Unique Operation

8. Given the scope of various railway networks across WA that are subject to the Code, the WARAR coverage in WA is broad requiring sufficient flexibility to accommodate the requirements of each network. Arc is a multi-user, open access, commercial rail network manager in Australia that does not operate with subsidies from Government. As such, Arc offers a unique perspective when discussing matters and issues associated with the WARAR.
9. The key purpose of the WARAR is to encourage the main object of the Act being: *'to establish a rail access regime that encourages the efficient use of, and investment in, railway*

¹ Contact details are available via our website: <http://www.arcinfra.com/contact-us>

*facilities by facilitating a contestable market for rail operations*². To achieve this purpose the WARAR aims to³:

- (a) encourage commercial negotiation;
 - (b) prevent misuse of market power;
 - (c) promote competition;
 - (d) target a specific economic problem (ie. lack of competition in markets for significant infrastructure); and
 - (e) promote regulatory certainty.
10. Over the past 17 years of managing the Arc Network, all access agreements have been reached outside the Code apart from one, which is currently pending an arbitrated outcome. This is evidence of the success of the WARAR. While Arc is of the view that the WARAR provides a strong regulatory foundation for access seekers and railway owners, Arc also acknowledges that further improvements can be made.

2.2 General response to Issues Paper

11. Arc commends the Department of Treasury for the Issues Paper. The document is clear, well balanced and achieves its overarching objectives by summarizing and proposing the recommendations from the ERA Code reviews of 2010 and 2014. Arc considers the approach to facilitate discussion before implementation is the best approach, and have written this Submission with that intention in mind, to facilitate discussion amongst key stakeholders.
12. Arc welcomes the opportunity to respond to this Issues Paper and has set out to provide a high level summary of key concerns supported by a detailed analysis of the “challenges, issues and proposals” as they would apply to an independent rail network and the practicalities of these recommendations in an operating environment.

2.3 Identifying Improvements to WARAR

13. There are proposals throughout the Issues Paper that Arc believes will assist the Government in reaching its objective of conducting this review, being to: *‘identify improvements to the regime in order to better achieve its objective. The objective has been ... to encourage the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations*⁵.
14. Arc agrees with the following high level improvements to the WARAR:
- (a) the recommendation that the Government develop a policy to assist in addressing the National Competition Council 2010 determination’s concern regarding the consistency of WARAR, and its application to WA rail networks;
 - (b) the proposal that the Train Management Guidelines should apply inside and outside the Code;
 - (c) allowing the access seeker to move negotiations inside the Code when negotiations have failed outside the Code. Allowing this will bypass some of the steps which have already been achieved through negotiations;
 - (d) requesting that access providers increase public reporting where it is useful. This is directly linked to better understanding the quality of the Arc Network;
 - (e) implementing a merits review process;
 - (f) providing clarity on when an extension or expansion proposal can be made;
 - (g) improving recognition of the railway owners costs of providing access to marginal rail routes; and
 - (h) implementing most of the amendments identified in the Issues Papers from the ERA Code reviews (refer to Arc’s Submissions below for clarity on the amendments Arc

² *Railways (Access) Act 1998*, section 2A

³ Issues Paper, page 2

⁵ Issues Paper, page 1

supports), including the amendment proposing the publishing of a standard form access agreement on our website.

2.4 Arc's Key Positions

15. Owing to its unique position and operational experience, Arc makes the following specific recommendations to better enable the Code to service all rail users.

2.4.1 Indicative tariffs – costs likely to outweigh benefits

16. The Issues Paper proposes the implementation of indicative tariffs in limited circumstances, in an attempt to resolve information asymmetry issues and to further facilitate commercial negotiations.
17. The Issues Paper summarises the three circumstances where the regulator may use an approved indicative tariff to guide negotiations. None of the circumstances identified in the Issues Paper to apply to the Arc Network, and Arc considers the costs of implementation likely to outweigh the benefits.

2.4.2 Assessing the capital charge – GRV should be retained

18. As the Issues Paper clearly outlines through section 3.4 (Pricing mechanisms), the WARAR is unique in its application of a Gross Replacement Value (**GRV**) approach for determining capital charges as a component of the ceiling (or 'total costs'). Other models suggested by the Issues Paper include a Depreciated Optimised Replacement Cost (**DORC**) as used by other Australian rail access regimes and an Establishes Asset Base (**EAB**) as proposed in the ERA's 2014 Code review.
19. Arc is of the view that GRV should be retained, as this was the pricing mechanism in place in 2000 when the Government sold the rail freight business to Arc and entered the Lease.
20. A move to a depreciated approach (such as an EAB or DORC) will increase regulatory burden and compliance costs on the access provider and the regulator. Arc does not support any change that will reduce the ability to realise revenue based on the GRV approach as this would undermine the initial decision made by invest in the Lease and all subsequent investment made in the Arc Network.
21. EAB is not an appropriate model, sufficient detail on the operational and economic principles of the methodology have not been developed, and it is unclear how it would operate or what benefits would arise from its implementation.
22. The Issues Paper also offers a choice between DORC and GRV (where and if an EAB is not appropriate). Arc engaged HoustonKemp economics to provide a report on these two models and determine which is most appropriate for application on the Arc Network. The Expert Report determined that the move *'from a GRV to a DORC or EAB is highly unlikely to promote the objectives of the WARAR within the context of Arc Infrastructure's network.'*⁶

2.4.3 Interstate freight routes – no changes necessary

23. The Issues Paper proposes to bring the interstate services under regulation consistent with the ARTC Interstate Access Undertaking (IAU). Arc does not agree with this proposal because:
 - (a) the WARAR is already consistent with the IAU in many material areas;
 - (b) the CIRA, which prompted the proposal, proposes a 'model regime' to be applied, whereas Arc does not consider the IAU to be a 'model regime';
 - (c) the IAU is unsuitable for application to the interstate services because of various differences between the networks; and

⁶ Expert Report, page 23

- (d) a number of constraints such as the road transport, customer market power [REDACTED]

2.4.4 Arc Supports the State Government's Intent to seek recertification of the WARAR

24. Arc is pleased to understand that the Government intends to consider applying for re-certification once improvements to the WARAR have been made. Arc is supportive of Government's position and has included responses and recommendations with view to aiding amendment of the Code by addressing the perceived lack of consistency in the application of the WARAR.
25. Arc considers the following issues need to be addressed prior to the Government seeking amendment:
- (a) there is a lack of a policy determining which railways require regulation; and
 - (b) review should be undertaken of which railways should and should not be regulated.
26. Arc believes that a policy defining when a rail line should (or should not) be covered by the WARAR will address the NCC's concerns and subsequent decision to not recertify the Code. Government will then have the tool which will provide the rationale for the different regulatory approaches within the State and define where any new network will sit within these regulatory options.

2.4.5 Further engagement opportunities

27. Arc looks forward to supporting the Government as they process feedback received as part of this process and welcomes the opportunity to further explore improvements and proposed amendments.

3 Background

3.1 Westrail to Arc Infrastructure

28. In December 2000, the Government privatised its freight rail business, then known as "Westrail". The "above rail" business (primarily the locomotives, wagons and maintenance depots) was sold outright and the below rail business (primarily train control, track, signaling and communications infrastructure) was leased. The Lease provides Arc with the exclusive rights to negotiate and sell access to existing and potential users to the Arc Network. Although originally sold by the Government as a vertically integrated business, the above rail and below rail businesses were split in 2006 and have operated separately since.
29. Part of the Government's motivation to privatise was to find an owner who would introduce efficiencies and grow and invest in the business to an extent not possible by Government⁷. The Government was also looking for an entity that would have a vested interest in increasing the efficiency of the railway, facilitate investment and drive an increase in freight volumes for the benefit of the State.
30. Since the sale, the total tonnes moved on Arc Network has increased from 32 million tonnes per year to around 75 million tonnes every year, most of which is being exported or imported through the six State ports in the southern half of WA. Brookfield Infrastructure Partners L.P. provides Arc, and in turn, the State with the backing needed for investment in the Arc Network.
31. Today Arc employs 430 people with nearly 50% of these employees living in regional WA supporting rail operations through track and signaling maintenance activities. The network

⁷ WA, Parliamentary Debates, Legislative Assembly, 3 June 1999, RAIL FREIGHT SYSTEM BILL 1999 - SECOND READING, Page 8773/1, <http://www.parliament.wa.gov.au/Hansard/HANS35.NSF/3e8095c2de81a3b048256c6b002e9930/22bcacf6bd03a3d44482567910051fe49?OpenDocument>

and associated industries support regional communities through employment opportunities much wider than Arc's direct employment footprint.

3.2 Arc's Regulatory Environment

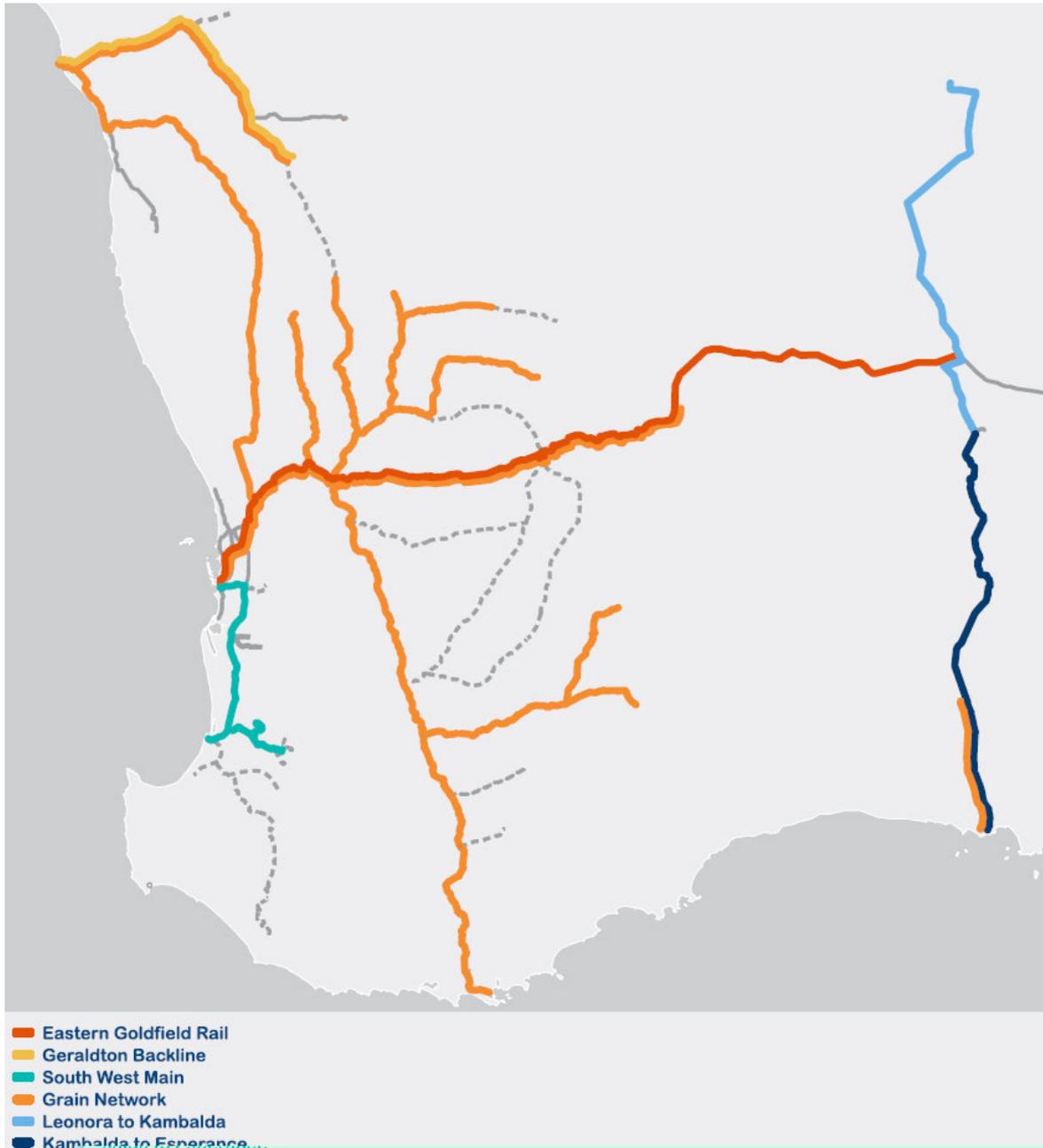
32. Arc is subject to oversight by the Public Transport Authority (**PTA**), the Office of the National Rail Safety Regulator (**ONRSR**) and the ERA. PTA are Arc's landlord and are responsible for oversight to assure Government that the objectives of the Lease are being achieved. ONRSR was created to administer and regulate the safety of the Australian railway industry under the co-regulatory framework established by the Rail Safety National Law. WA rail networks (including the Arc Network) joined the new national body in November 2015. Previous to this date the Office of Rail Safety managed within the Department of Transport oversaw Arc's licence to operate as a RIM (rail infrastructure manager).

3.3 Description of the Arc Network

3.3.1 General

33. The Arc Network comprises standard, narrow and dual gauge track and facilitates a wide variety of tasks and operations connecting to:
 - (a) the sea ports of Kwinana, Fremantle, Bunbury, Geraldton, Albany and Esperance;
 - (b) various intrastate freight terminals such as Forrestfield/Kewdale freight terminal, Kalgoorlie, Picton and Avon Yard; and
 - (c) the ARTC interstate network, providing rail connection to Adelaide, Melbourne, Sydney, Brisbane and Darwin.
34. Access to these locations is important for the State economy, and represents a critical link in the supply chain for the operations of many Arc customers. This is demonstrated by the significant contribution that rail makes to national GDP. In 2016, the value of its contribution totalled \$26 billion.⁸
35. Arc Network includes various key freight corridors, these are shown on the map below, and described in detail from paragraph 36 and below:

⁸ Australasian Railway Association, 'A National Rail Industry Plan for the Benefit of Australia', September 2017, p.20, <https://ara.net.au/sites/default/files/u647/A%20NATIONAL%20RAIL%20INDUSTRY%20PLAN%20FOR%20THE%20BENEFIT%20OF%20AUSTRALIA_0.pdf> (accessed 8 November 2017)



Key freight corridors on the Arc Network (Figure 1)

3.3.2 Eastern Goldfields Railway (EGR)

36. The EGR is the main artery of the Arc Network where it spans from Kwinana to Kalgoorlie (where it connects to ARTC network) and then extends to the east coast.
37. Many of Arc's customers use at least a portion of the EGR which encompasses both freight and passenger services. Operations on the EGR are considerably diverse. For example, the fastest train is the Prospector passenger train operating at speeds of up to 160km/h, compared to the iron ore trains operating on the same section at maximum speeds of 115km/h. The standard of the track on this section is high as the result of a number of major upgrades undertaken by Arc. Some of the upgrades undertaken under Arcs management include resleepering, rerailing and numerous turnout replacements in addition to track realignments. These upgrades result in increased operating standards for customers.

38. The portion of track from Avon Yard to Forrestfield (via the Avon Valley) is 'double track', which significantly increases the capacity of the section. 'Double track' refers to the presence of two separate rail tracks, as opposed to one.

3.3.3 Geraldton Backline

39. The section of track between Perenjori and Geraldton is known as the Geraldton Backline. This section carries a significant amount of iron ore traffic and some light use by grain services.
40. Commencing in 2010, Arc funded and completed a \$550 million upgrade which included installation of 320,000 concrete sleepers, 22,000 tonnes of rail, 700,000 tonnes of ballast, 33km of signalling and fibre optic cable, 13 radio towers, 11 new flashlight level crossings 30 new equipment rooms and associated earthworks. Some sections of the Geraldton Backline required completely new track formation and alignment, resulting in new track being built next to the original track.

3.3.4 South West Main

41. The mainline section between Kwinana and Bunbury Port is known as the South West Main. This line includes several connecting spur lines (with the most notable being towards Collie), servicing mostly alumina operations in the area. Commodities hauled on this section include alumina, caustic, lime, coal and bauxite, all of which support the production of Alumina as an output. These commodities are hauled between various mines, refineries and ports in the area. The Australind passenger service also runs regularly between Perth and Bunbury. The standard of track is high, with shorter trains operating compared to other parts of the network, but running much more frequently.

3.3.5 Leonora to Kambalda

42. The Leonora to Kambalda section is located in the Goldfields, primarily servicing the nickel industry. The nickel industry is relatively unique in that the output of nickel is not the primary product hauled on the network, as the quantity is relatively small. The production of nickel is a very complex process requiring a significant amount of inputs such as sulphur and ammonia. These are the predominant commodities hauled to support the nickel task. Many of these inputs originate on rail in the Perth metropolitan area and are delivered through intrastate freight services.

3.3.6 Kambalda to Esperance

43. The Kambalda to Esperance section is used by a number of customers to facilitate connection with the Esperance port facility. A significant amount of iron ore (originating on the EGR) is transported to Esperance, in addition to fuel and grain services. A number of upgrades have been undertaken on this section to facilitate the tasks, including lengthening the crossing loops and upgrading the communications network.

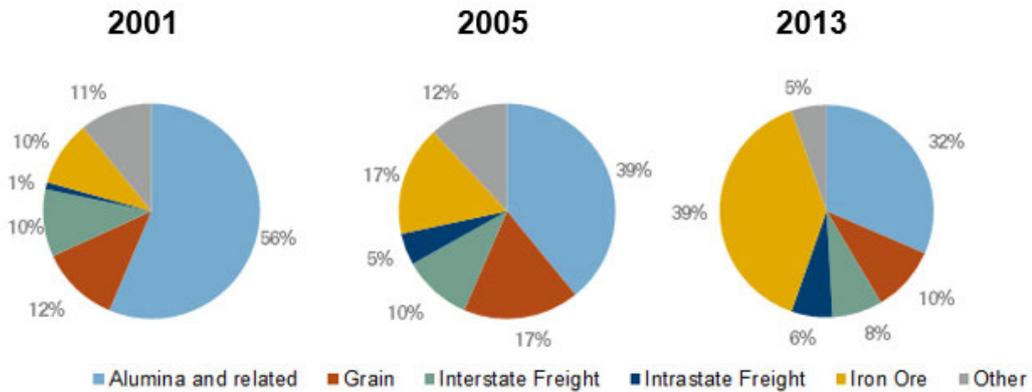
3.3.7 Grain Freight Rail Network

44. The Grain Freight Rail Network is arguably the most complex supply chain in the State. It consists of 2,400kms of rail line (or around 50% of the entire network) from 88 currently operational sites, and carries grain for WA's sole grain co-operative to five of the State's ports. Grain makes up approximately 10% of total tonnages on the Arc Network and is moved cyclically to not only facilitate the seasonal nature of the industry, but to also ensure international markets demands are met in a timely manner.

3.4 Today's Freight Task – A Diverse Commodity Mix

45. Freight transported on the Arc Network has changed constantly over time. Historically, general freight referred to as "less than containerised loads" (LCL) freight and agricultural

exports made up most of the State's freight task. With deregulation of the freight industry in 1984, LCL freight became uncommercial on rail and instead bulk commodities and containerised freight became the focus. This change in the commodity composition is shown below in Figure 2.



Commodity mix over time (Figure 2)

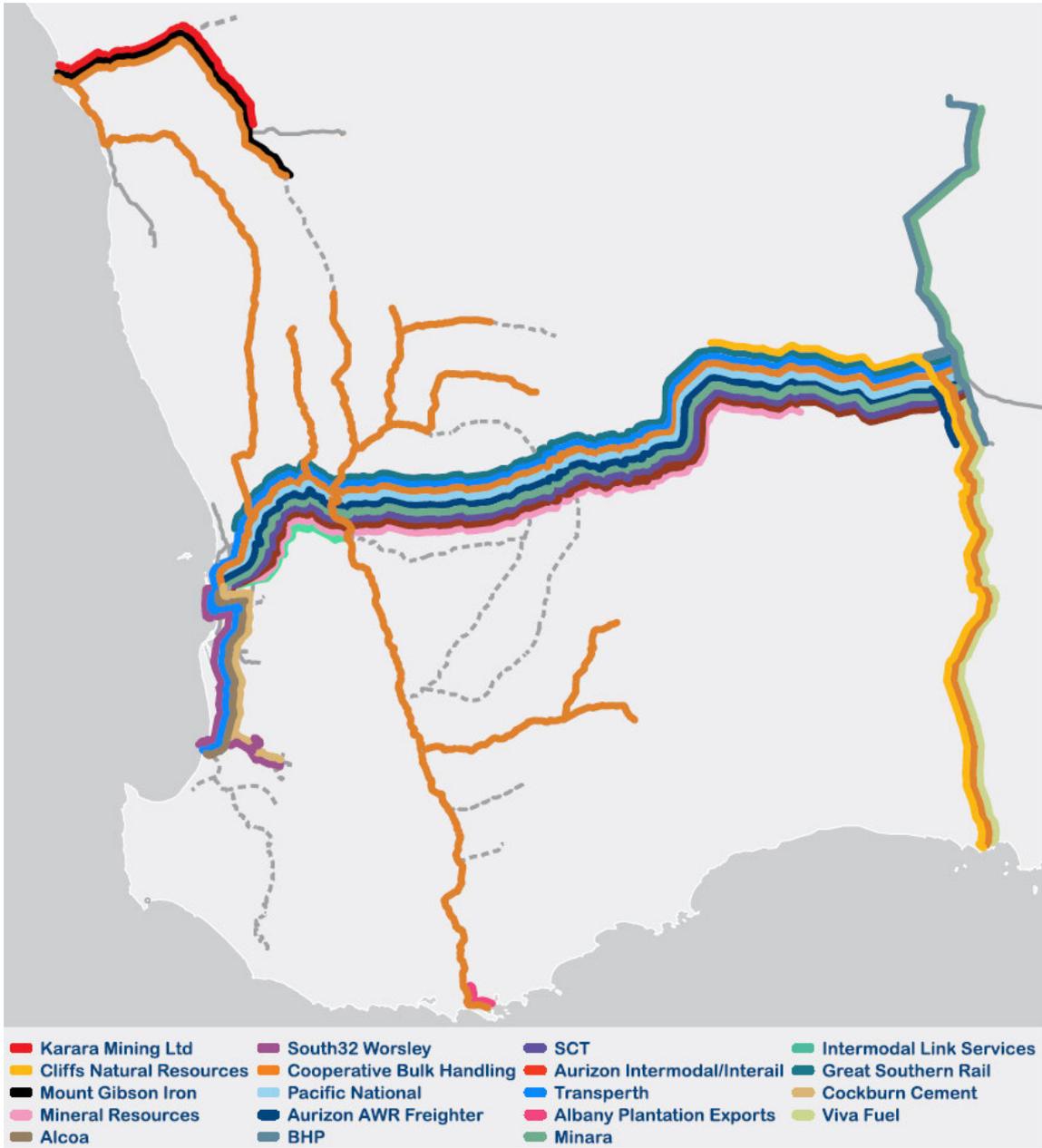
3.5 Rail Operations on the Arc Network

46. As discussed previously, Arc provides below rail services including the provision of train paths. A train path is a right to run a train between an origin and destination, usually with a matching 'return' train path, which are provided at times agreed with the customer. An access agreement sets out the terms upon which a train path will be provided by Arc to a customer.
47. Depending on the freight task, a train path may be required once a month or multiple times per day. As customers regularly wish to vary train paths (for example, due to operational delay), this is an important consideration during access agreement negotiation.
48. For inside the Code access agreements, the terms and conditions related to train paths are provided in the Train Path Policy (**TPP**). The TPP contains provisions such as permanent and temporary variations to train paths, as well as the policy for allocation train paths between customers.
49. Arc currently has access agreements with 19 customers, and facilitates five operators on Arc Network. Contracting structure is discussed in detail from paragraph 75.

3.6 Diversity in Rail Operations

50. The Arc Network provides rail services which include the haulage of iron ore, alumina, caustic, bauxite, nickel and related inputs (such as ammonia and sulphur), woodchips, interstate freight, intrastate freight, grain, coal, lime and fuel. The Arc Network also provides access for passenger services such as the TransWA Prospector, Australind and Avon Link and the Indian Pacific.

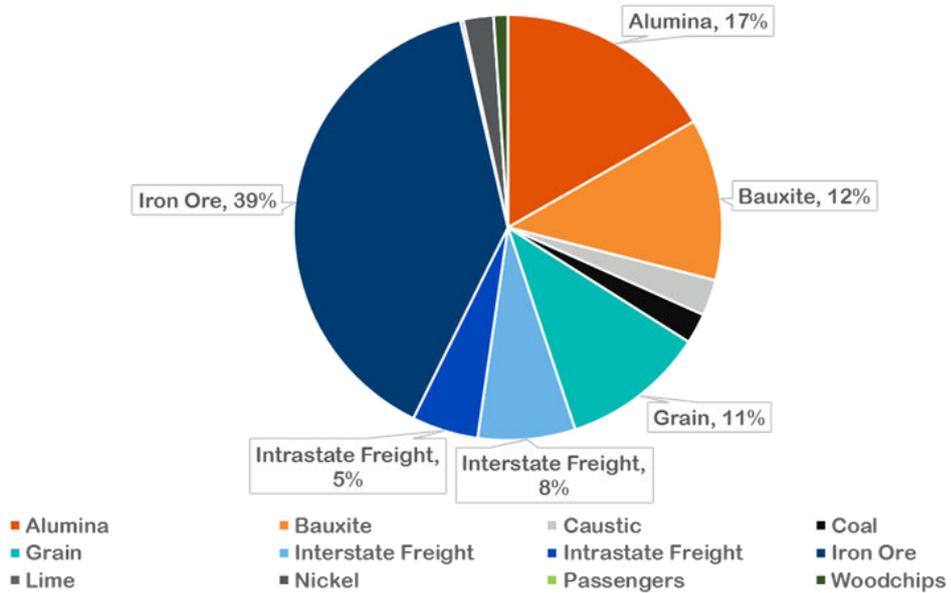
51. Figure 3 below shows Arc customers and where they operate on the Network.



Customer operations map (Figure 3)

52. Figure 4 below shows commodity makeup on the Arc Network by Net Tonnes.

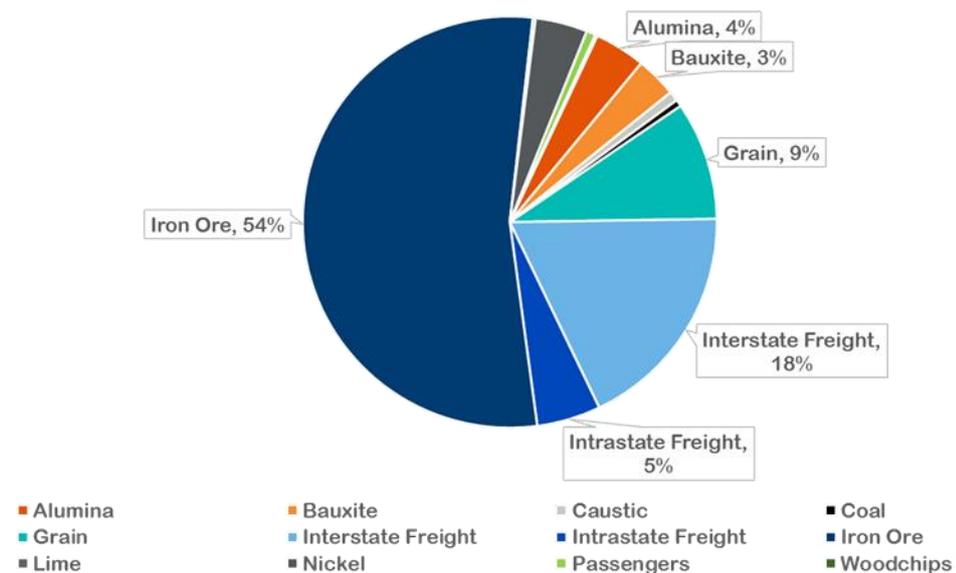
Commodity Makeup by Net Tonnes - Calendar Year 2016



Customer operations map (Figure 4)

53. Figure 5 below shows commodity makeup on the Arc Network by GTKs

Commodity Makeup by GTKs - Calendar Year 2016



Customer operations map (Figure 5)

54. Arc's customers operate trains with varying characteristics. For example, the longest haul by distance is the Minara train, operating between Kwinana and Malcolm, which travels a one way distance of 928.5 km taking 40 hours to complete a full cycle. The shortest haul is

the APEC woodchip train, operating between Mirambeena to Albany, which travels a one way is a distance of 25 km taking 1 hour for a full cycle.

55. Train length also varies significantly. For example, interstate freight trains often reach 1.8 kilometres long (travelling between Perth and the east coast) whereas the Avonlink train, which operates on the same line section, is only 54.8 metres long.
56. Customer arrangements for the loading and unloading of trains also varies. Iron ore is generally loaded into wagons using a front end loader, whereas some trains carrying dangerous goods (such as ammonia) require specialist wagons, loading infrastructure and ongoing maintenance to ensure safety.
57. It is important to understand the diversity which exists in operating an open access railway, which starkly contrasts to other networks regulated under the WARAR (generally single commodity or single user operations). This diversity means that the rail infrastructure, scheduling and terms of access need to be structured around this diversity with sufficient flexibility to ensure effective and efficient provision of access is maintained.

3.7 Diversity in Terms of Access

58. As noted above, the tasks operating on Arc Network are heterogeneous with regard to the operations. This translates to varying terms of access which are required by the Arc and its customers.
59. Even within a single commodity, there is significant diversity with regard to operations. For example, iron ore is (by net tonnes) the most common commodity transported on the Arc Network with four discrete tasks, each with bespoke commercial terms. Some of the differences include:
 - a) export location. Of the four iron ore miners exporting utilising the Arc Network, only two export through the same port;
 - b) amount of investment Arc made to provide the operational capacity, including major upgrades to Arc Network and increases in capacity required;
 - c) term of access and certainty of utilisation the contracted train paths, which is often linked to the iron ore tenements held;
 - d) loading capacity and length of a standard train;
 - e) performance standards required;
 - f) ability and rights surrounding the use of additional capacity;
 - g) relative risk of each project; and
 - h) ownership structure and funding of each entity.
60. When developing commercial terms, it is important to take all of these factors into account, along with considering which terms are a priority to the customer. Due to this diversity, there are no two customers on the Arc Network with the same terms and conditions.

3.8 Implications for Regulation

61. Regulation needs to take account of customer and operational diversity, providing room for commercial outcomes to eventuate. This is enshrined in the Competition Principles Agreement (CPA), which states:

*'Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.'*⁹

62. The CPA then goes on to state:

⁹ Clause 6(4)(a) of CPA

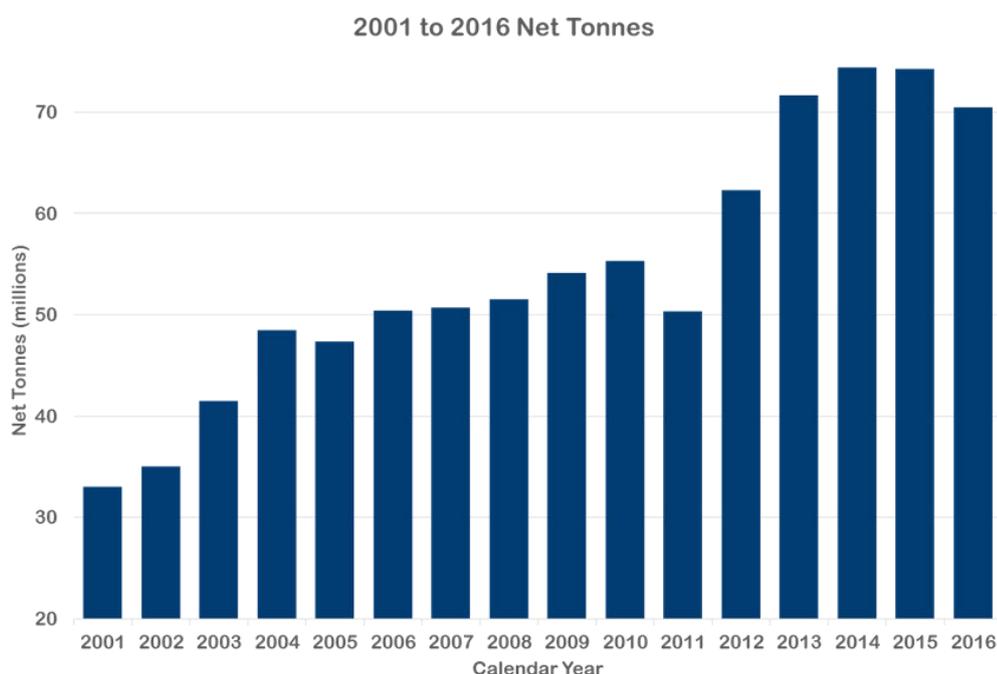
*'Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.'*¹⁰

63. It is clear from these principles that the priority indicated by the CPA is negotiation between the buyer and seller, followed by Government intervention if negotiations fail. It is at that point the Government should establish the legal right to accessing a facility.
64. Arc considers it has achieved these principles to date because no customers have operated under the Code. This should not be seen as an issue with the current regulatory framework, but rather Arc's commercial negotiations working to establish agreements with customers providing the access they seek.

3.9 Facilitating State Growth

3.9.1 Increased Tonnages

65. Since privatisation in the year 2000, tonnages on the Arc Network have increased by 113% in line with the figure 6 below:



Net tonnes since privatisation (Figure 6)

66. The freight task has changed over time, moving from a network in which alumina and related inputs made up over half of the volumes transported in 2001, to the current network which features iron ore as the dominant commodity (now 39%). This change is shown in figure 2.

3.9.2 Investment in Arc in the States Rail Freight Network

67. Over the last 7 years, Arc has invested over \$2 billion (not including government investment) directly into the Arc Network.
68. In addition to our ongoing maintenance activities, Arc have undertaken a number of significant capital expenditure projects which have delivered a modernised and upgraded the Arc Network, including:
 - a) installation of concrete sleepers on the South West Main;

¹⁰ Clause 6(4)(b) of CPA.

- b) upgrading the Kalgoorlie to Esperance line through re-railing and re-sleeping;
 - c) the \$550m Arc funded major upgrade of the Geraldton Backline;
 - d) re-sleeping from 1:4 steel/timber to 1:2 steel/timber of over 1,247 km of dedicated Grain Freight Rail Network;
 - e) the upgrade and re-railing project for the Leonora to Kambalda line;
 - f) re-railing and replacement of concrete sleepers on the railway from Perth to Kalgoorlie; and
 - g) installation of fibre optic cable data and open channel radio network over the 385km section of railway from Kalgoorlie to Esperance.
69. The strong support from Arc's shareholder and global asset management company, Brookfield Infrastructure Partners L.P., provides Arc with the backing needed for Arc to invest significantly in Arc Network.

3.9.3 Meeting the Objectives of the Act

70. Arc considers it has delivered on the objective of the Act, which is to encourage:
- 'the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations'.¹¹*
71. Key to the delivery of this objective, is a regulatory framework which is flexible enough to incentivise investment. In line with this core purpose, Arc continues to focus on:
- a) increasing tonnages transported on Arc Network;
 - b) investing directly into upgrading and modernising Arc Network; and
 - c) working with customers and stakeholders on initiatives which improve the efficiency of the rail network.
72. In its review of the management of Arc Network¹², the Auditor General stated that:
- 'the mineral and general freight carrying lines are in better condition now than when they were leased'¹³... the sale and lease of the rail freight network met many of its original objectives. The State was able to step out of the freight rail business, freeing itself from the costs of running the network, and many of the risks of owning the network'¹⁴.*

3.9.4 Facilitating a Contestable Market

73. Another key objective of the Act is to facilitate an efficient and contestable market.
74. Arc considers this objective has been met through its management of the Arc Network.
75. In particular, one of the key changes Arc introduced was to the contracting model. The traditional contracting model used historically in the rail industry saw above rail operators contract directly with the below rail infrastructure owner for access to rail capacity (train paths). Customers would contract directly with the above rail provider for rail haulage.
76. In response to customer needs, Arc developed a contracting model which provides the access right directly to the customer, not the above rail operator. This means customers can change above rail operators at their convenience, which directly meets with the object of the Act to facilitate a contestable market for rail operations.

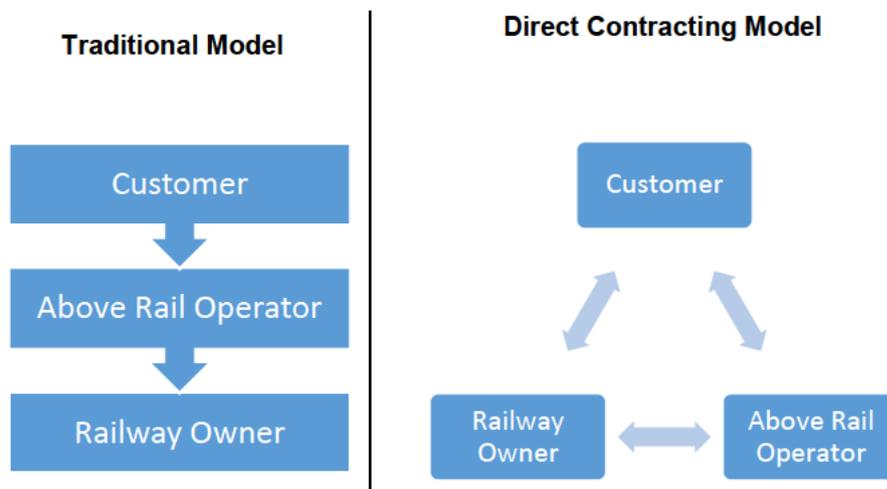
¹¹ Part 2A, Act.

¹² Western Australian Auditor General's Report, *Management of the Rail Freight Network Lease: 12 Years Down the Track*, Report No 1 (2013) <https://audit.wa.gov.au/wp-content/uploads/2013/05/report2013_01.pdf> (accessed 17 November 2017)

¹³ Ibid, p8.

¹⁴ Ibid, p8.

77. The comparison is summarised in figure 7 below:



Contracting models (Figure 7)

78. Many of our customers, particularly those which seek maximum flexibility, have entered into direct commercial agreements with Arc, which demonstrates the value of this model to customers.
79. This new model, which also enables greater ownership of access rights and transparency of services provided across the supply chain, has provided some customers with the confidence to introduce new above rail operators into the WA rail market and purchase their own locomotives and wagons, a positive development for competition that has driven further efficiencies for customers.
80. This change also reduces information asymmetry for end customers who would often receive a 'bundled' rate for above and below rail charges.

3.9.5 Facilitating Efficient Operations

81. Through direct commercial relationships, Arc has increased its focus on working with customers to optimise the performance of the freight supply chain. Increasing the productivity and utilisation of Arc Network capacity through supply chain reporting, coordinated outage planning and other initiatives delivers cost savings to our customers and greater efficiency of the entire supply chain.
82. This process delivers more tonnes on rail and optimises above rail resources, enabling both reduced costs and increased tonnages, which benefits all stakeholders. As an example, for one of Arc's customers, the increased transparency of performance across the supply chain and focus on improvement resulted in more than a 50% increase in the reliability of their rail services within 6 months. Another customer now achieves over 95% utilisation of their contracted rail capacity, delivering substantial cost savings for their business.
83. Wherever possible, Arc will seek efficient use of the Arc Network either through appropriate pricing or other contractual mechanisms (such as underutilisation provisions). Arc is incentivized to allocate capacity to the most efficient use of that capacity, and ensures this is put into practice. This benefits the rail industry, the State and Arc.

3.10 Regulation

3.10.1 Key Principles on Regulation

84. Arc notes considerable literature exists on regulation, and wishes to draw attention to two important principles:
- a) the cost burden of new regulation must be fully offset by reductions in existing regulatory burden¹⁵; and
 - b) a clear definition of the “problem” regulation is attempting to solve is critical.¹⁷
85. Arc considers these two principles extremely important, and particularly relevant in the context of the Issues Paper.

4 Response to Issues

4.1 Balance of power in negotiations

86. The Issues Paper raises two key concerns in relation to the balance of power in negotiations. Firstly, that protections afforded to parties under the Code do not apply to negotiations outside of the Code. The Issues Paper queries whether parties would benefit from certain provisions applying to negotiations outside the Code. Secondly, that certain elements of the current negotiation process set out under the Code could be seen as barriers to negotiation. There appears to be a perception that an information asymmetry exists in favour of railway owners under the Code.
87. The Issues Paper raises five questions and proposes three reforms, which may reduce barriers to negotiation by dealing with the ability to ‘opt to negotiate outside of the Code’.

4.1.1 Issue 1: ability to opt out

88. The ability to ‘opt to negotiate outside of the Code’ is unique to the WARAR.¹⁸ In Arc’s view, this is a critical feature of the Code that encourages commercial negotiation (which is a key purpose of the WARAR¹⁹) as it provides both the railway owner and the access seeker with flexibility.
89. To appreciate the value in the ability to ‘opt to negotiate outside of the Code’, it is useful to begin by addressing the Issues Paper’s first question, namely, what the benefits of negotiating outside the Code are.
90. Many access requests are relatively simple in nature, for example, increasing the length of a siding. An access seeker would generally require an indication of capacity, indicative price and an indication of applicable capital costs. Once provided with this information by the railway owner, the access seeker would then determine the viability of their project.
91. If all access requests were required to be made ‘under the Code’, then even for a relatively simple request the access seeker would have to submit a formal proposal before the railway owner could provide an initial estimate of any capital charge. Such strict adherence to

¹⁵ Australian Government, *The Australian Government Guide to Regulation*, 2014
<https://cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf>
(accessed 15 November 2017), p2

¹⁷ Ibid, p 6

¹⁸ Department of Treasury, Government of Western Australia, ‘Review of the Western Australian Rail Access Regime – Issues Paper’, July 2017 <http://www.treasury.wa.gov.au/uploadedFiles/Treasury/Publications/Review-of-the-Western-Australian-Rail-Access-Regime-July2017-f.pdf> (accessed 29 October 2017), p 9.

¹⁹ Ibid, p2.

process would make facilitating simpler access requests significantly more onerous, which is likely to hinder, not facilitate new access requests.

92. Another example, related to the simpler form of access request, is the common situation where an access seeker requires a different estimation of 'capacity' to the narrow definition of 'capacity' in the Code. For instance, a prospective customer running a project viability model may only require an indication of whether there is 'some' (essentially undefined) capacity. They may not necessarily need to know the amount of capacity or even the track characteristics required to determine train paths, because projects requiring rail transport engage network operators at varying stages of project maturity.
93. Most importantly, the ability to 'negotiate outside the Code' enables railway owners to work collaboratively with access seekers to tailor an access 'package' to meet customer demand and in turn drive efficient investment. For example, in 'negotiating outside the Code', a railway owner has the flexibility to price access proposals appropriately with regard to the risk, establish different parameters for a return on capital to those set by the Costing Principles and agree unique terms required by customers.
94. There are many benefits to conducting commercial negotiations outside regulatory frameworks. This has been recognised by governments across Australia, as evidenced in clause 6(4) of the CPA. Some of the key benefits are set out below.
 - (a) Negotiation outside the Code allows significant flexibility for both parties at every stage of the negotiation process.
 - (b) The parties can analyse the full spectrum of issues, risks and terms upfront. Negotiations can be tailored to the relative complexity of each access request. Negotiating under the Code imposes constraints on some issues, such as the ability for a railway owner to take account of seasonality in a customer's use of train paths in the context of an underutilisation test (ordinarily the provisions in section 4 of the TPP make no allowance for seasonality).
 - (c) Timeframes are flexible; if for instance, an access seeker requires more time to provide information, this can be accommodated; conversely if a railway owner chooses to expedite a step in the negotiation process due to the access seeker's demands, the parties are not bound to follow the stringent requirements and timeframes of the Code.
 - (d) Extensions and expansions are more suited to access negotiations outside the Code. This is because the nature of extensions and expansions can vary widely, based on the scale and scope of the access seeker's request, which will affect the potential capital investment required. Other factors impacting extensions or expansions include the inherent risks attached to the request made (eg. market volatility of the commodity being hauled). Negotiation outside the Code is sufficiently flexible to cater for these differences.
95. Given the abovementioned benefits, in negotiations outside the Code, parties are motivated to arrive at a mutually satisfactory outcome.
96. Arc confirms the proposals for reform are:
 - (a) making the non-discrimination requirements mandatory regardless of whether an agreement is negotiated and executed inside or outside the Code;
 - (b) requiring that the Part 5 instruments (or aspects of them) apply regardless of whether or not an access agreement is executed inside or outside the Code. Under the current approach, these instruments apply only in relation to agreements negotiated within the Code; and

- (c) allowing a negotiation outside the Code that is in dispute to be brought within the Code, with the parties able to progress straight to arbitration provided the nature of the access rights sought remain unchanged.
97. Arc sets out its responses to proposals (a), (b) and (c) above respectively below.
98. The Code provides that a railway owner cannot:
- (a) unfairly discriminate between one proponent and another;²⁰ and
- (b) unfairly discriminate between the proposed rail operations of an access seeker, and the railway owner's operations, as regards allocation of train paths, management of train control and operating standards²¹.
99. In our view, changes to the current framework are not required. This aligns with the ERA's view that further definition of 'unfair discrimination' under the Code would be unnecessary.²²
100. Aside from not being required, a critical consideration in our view is, if the State were to regulate agreements negotiated outside the Code, this would undermine the objective of clauses 6(4)(a) and (b) of the CPA. The intention of clause 6(4)(a) is that parties should be free to negotiate commercially; only where parties cannot agree, then clause 6(4)(b) introduces government regulation as a backstop.²³
101. Section 46 of the CCA protects access seekers and effectively imposes obligations on railway owners to not unfairly discriminate.²⁴ Even if an agreement is negotiated outside the Code, the railway owner is effectively prohibited from engaging in conduct that would unfairly discriminate. At a practical level, the obligations set out under the TMG (which deals with operational issues such as 'real time' allocation of train paths and train control functions) already apply to all above rail operators on the Arc Network, providing further protection in ensuring the railway owner cannot unfairly discriminate between access seekers.
102. Submissions provided to the ERA during the 2014 Code Review highlighted that stakeholders hold differing views on what would be a suitable approach to clarifying the concept of discrimination in the Code.²⁵ It would be difficult to agree a list given these differing views.
103. Accordingly, it is not clear what benefits would be obtained from increasing the regulatory requirements for agreements negotiated outside the Code. What is clear, is that increasing

²⁰ Code, section 16(1)(b)

²¹ Code, section 16(2).

²² Economic Regulation Authority, 'Review of the *Railways (Access) Code 2000*', Economic Regulation Authority, 2015, paragraph 283.

²³ Council of Australian Governments, 'Competition Principles Agreement – 11 April 1995 (*As amended to 13 April 2007*)', <<https://www.coag.gov.au/about-coag/agreements/competition-principles-agreement>> (accessed 31 October 2017). Specifically, sub-clauses 4(a) and (b) provide:

'(4) A State or Territory access regime should incorporate the following principles:

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

*(b) **Where such agreement cannot be reached**, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.'* (*emphasis added*)

²⁴ Section 46 deals with misuse of market power. Specifically, sub-clause 46(1) prevents a railway owner from taking advantage of its market power to: a) eliminate or substantially damage a competitor in that or any other market; b) prevent the entry of a person into that or any other market; or c) deter or prevent a person from engaging in competitive conduct in that or any other market. The consistent use of the words 'in that or any other market' ensures the application extends beyond the railway owner's below rail market, and provides protection to the customer's ability to 'deal' within its own market.

²⁵ Above, note 3, p 34.

such requirements would significantly increase the amount of work to be done by the regulator.

104. To properly address proposal (b), the purpose of each of the Part 5 Instruments needs to be understood. This is dealt with below. Broadly, Arc's view is that, except for the TMG, this proposal undermines a key objective outlined in the Issues Paper, namely to facilitate commercial negotiation.
105. The **Train Management Guidelines (TMG)** are a statement of principles, rules and practices which will be applied to the real time management of services²⁶. The nature of this instrument is such that it would be impractical for a railway owner to apply two different methods of managing trains to the same network. All of Arc's track access agreements refer to the TMG. Accordingly, Arc supports the application of the TMG to all access agreements, whether negotiated inside or outside the Code.
106. The **Train Path Policy (TPP)** is a statement of the policy that the railway owner will apply in relation to the allocation of train paths and the provision of access to train paths which cease to be used.²⁷ The TPP applies to access agreements, which the Code defines as agreements made inside the Code. Requiring this instrument to apply to outside the Code agreements is likely to reduce the current level of flexibility afforded to railway owners and access seekers in commercial negotiations.
107. In Arc's experience, deviation from the TPP is a common key term negotiated by customers outside the Code. For example, where significant capital investment is required, customers expect and require more favourable terms reflecting their commitment to rail.
108. Given the number of agreements currently on foot with provisions differing from the TPP, imposing such an obligation would create issues, where Arc and its customers would be either in breach of the Code, or in breach of their contractual arrangements. Accordingly, the TPP should not apply to outside the Code agreements.
109. The **Costing Principles** exist to provide a framework for the determination for the incremental costs and total costs under Schedule 4 of the Code, as well as identifying the manner in which financial records are kept and presented.²⁸ The purpose of a determination of the incremental costs and total costs is to constrain the price for access that may be negotiated for the purposes of an agreement made inside the Code.
110. If the Code were amended to oblige parties to apply the Costing Principles to agreements negotiated outside the Code, this would severely restrict the parties' flexibility in negotiating the access price on a commercial basis, and undermine the objectives of the CPA (as referred to in paragraph 100 of our submissions above).
111. In light of the above reasons, the Costing Principles should only apply to agreements negotiated inside the Code.
112. The **Overpayment Rules** stipulate the mechanism used to allocate total revenue for each route section. Where the revenue a railway owner receives from all operators and other entities provided with access to a route under the Code exceeds the "total costs" of the route determined inside the Code, the railway owner must refund the excess to the relevant operators pursuant to the Overpayments Rules.
113. Like the Costing Principles, the Overpayment Rules are specifically designed to provide for agreements negotiated inside the Code. It makes no sense for them to apply to agreements negotiated outside the Code, because in negotiating agreements outside the Code, the railway owner and access seeker may agree reasonable prices outside the range of the incremental costs and total costs. This is often utilised where up front capital payments or

²⁶ Section 1.1.2 of TMG

²⁷ Section 1.1.1 of TPP

²⁸ 1.1 of Costing Principles

termination payments are agreed, which may in certain situations exceed the ceiling, particularly where the length of time to recover on capital investment is short.

114. Arc notes, that while Overpayment Rules exist to ensure access seekers are not left out of pocket, there are no 'Underpayment Rules' to ensure the same for railway owners where revenue falls short of the total costs of providing access to the route.
115. Similar considerations for why the Costing Principles should not apply to agreements negotiated outside the Code apply to the application of the Overpayment Rules. Accordingly, the Overpayment Rules should apply only to agreements negotiated inside the Code.
116. Proposal (b) assumes that both a railway owner and access seeker would have satisfied the steps required under the Code before commencing negotiations outside the Code. Put another way, given the information requirements and key steps involved in negotiating inside the Code,²⁹ before a referral to arbitration is made, the same requirements and steps would have to be applied to negotiations outside the Code. For example, the parties cannot proceed to arbitration inside the Code unless the incremental costs and total costs of providing access to the routes sought by the proponent have been approved or determined by the regulator.
117. If in negotiating outside the Code, the parties have not satisfied each step required inside the Code prior to entering into negotiations, it is not clear how the 'validity' of the access proposal would then be established inside the Code. In any event, it would be inappropriate to apply these steps to negotiations outside the Code, as this would limit flexibility.
118. If the Code were amended to permit negotiations commenced outside the Code to be brought inside the Code, a significant number of legislative amendments would need to be made to the Code to ensure that all steps necessary for an arbitration to proceed were completed. Otherwise, it is difficult to see how it would be possible for the parties to 'progress straight to arbitration'.
119. Nonetheless, in circumstances where negotiations with an access seeker commenced outside the Code, it may be possible to reduce the length of time of the 'negotiation step'³⁰ inside the Code to zero, if the following criteria were met:
 - (a) the access seeker had made a formal access request inside the Code, and had satisfied all requirements prior to the negotiation step; and
 - (b) if that formal access request mirrored the request originally made outside the Code (so there were no material differences between the 'outside the Code' access request and 'inside the Code' access request, to be determined at the railway owner's discretion).
120. Such amendments would reduce the length of the 'readiness to negotiate'³¹ and 'negotiation period'³² requirements by approximately 120 days. Further, as regards negotiation generally inside the Code, at present only the railway owner is obliged to negotiate in good faith.³³ Arc recommends that, if considering amendments to the Code around negotiation, the obligation to negotiate in good faith be made bilateral.

²⁹ Part 2 of the Code deals with the initial steps required regarding an access proposal, which involve (amongst other things) the railway owner providing initial indicative information, an access seeker specifying certain particulars in their proposal, railway owner providing floor and ceiling prices; there are also steps regarding when a duty to negotiate arises, further information a railway owner can request regarding managerial/ financial ability, etc. None of these steps apply to negotiations for access outside the Code.

³⁰ Part 3, Divisions 1 and 2 of the Code.

³¹ Code, section 19(1).

³² Code, section 20(3).

³³ Code, section 13(1).

121. The remaining 4 questions raised in the Issues Paper relating to barriers to negotiation address matters discrete from the proposals. Accordingly, these questions are dealt with separately below.
122. Firstly, the question numbered 1.2 in the Issues Paper queries whether there are costs imposed on railway owners or access seekers by opting out of the Code. Costs for access seekers and railway owners are reduced by negotiating access outside the Code rather than inside the Code, because of the increased flexibility associated with commercial negotiations and because it is unnecessary to comply with many of the regulations that apply in a negotiation inside the Code.
123. Secondly, the question numbered 1.3 in the Issues Paper asks whether negotiations outside the Code are more likely to favour railway owners or access seekers. Commercial negotiations undertaken outside the Code are not more likely to favour one party above the other. Both the access seeker and railway owner are motivated to agree mutually acceptable terms, without the compliance obligations, costs and timeframes associated with negotiating under a regulatory framework. This is particularly the case in WA, where the presence of competition from alternate forms of transport such as road and sea freight provides an incentive for railway owners to offer competitive packages to access seekers.
124. As stated in paragraph 101 above, federal competition laws protect access seekers who negotiate outside the Code, by imposing obligations on railway owners to ensure they do not abuse their market power.³⁴ Further, the access seeker always has the option of making an access proposal under the Code, if it considers that an agreement negotiated or made under the Code will be more to its benefit.
125. The complex nature of facilitating transport by rail means that access seekers are generally large, sophisticated companies, usually with considerable power in their own market, who are financially positioned to access specialist services and advice to negotiate satisfactory outcomes. Access seekers generally possess detailed knowledge of the markets they operate in, which information railway owners may not have. Although the Issues Paper points towards information asymmetry as an issue for access seekers, this issue exists for railway owners as well.
126. Thirdly, the question numbered 1.4 in the Issues Paper queries whether proposals (a), (b) and (c) (referred to above in these submissions) would improve the operation of the regime. For the reasons set out at paragraphs 100, 104, 108, 113, 117 and 118 above, the proposals would not improve the operation of the regime.
127. Finally, the question numbered 1.5 in the Issues Paper queries whether other options exist that would better address the perception that problems exist with the 'opt-out' provisions in the Code. In our view, the ability for an access seeker to elect to negotiate either inside or outside the Code as currently provided, is reasonable. It has not given rise to any significant problems and satisfies the requirements of clause 6(4) of the CPA.

4.1.2 Issue 2: Barriers to negotiation

128. As mentioned above in paragraph 86, the second concern raised is that certain elements of the current negotiation process set out under the Code, could be seen as barriers to negotiation. There appears to be a perception that an information asymmetry exists in favour of railway owners under the Code.
129. The Issues Paper proposes 2 reform options to address this concern, namely:
 - (a) reversing the onus to require that the railway owner must specify what, if any, extension or expansions are required to accommodate the proposal; and

³⁴ Above, note 24.

- (b) reversing the onus to require that the railway owner demonstrate whether a proposal can or cannot be accommodated on the rail network and whether a proposed extension or expansion is technically and economically feasible and safe.
130. Arc's response to proposals (a) and (b) are set out further below at paragraphs 141 - 155, together with responses to the questions raised in the Issues Paper, which relate to the second concern. Before responding to these proposals, it is important for context to understand the current process and practical considerations that are currently taken into account.
131. The current process for negotiation access inside the Code requires an access seeker to demonstrate their proposal is technically and economically feasible. Separate from the Code process, whether a proposal can be catered for within a route on the railway network depends on two factors - route characteristics and operational characteristics. The route characteristic will generally inform which operational characteristics are viable.
132. Route characteristics are provided to access seekers and can be publicly accessed via Arc's website. They include:
- (a) required information³⁵ (inclusive of preliminary information,³⁶ sectional run times, maps, distances, location details etc.); and
 - (b) general operating instructions (specifics about what train can operate where, and what limitations exist).
133. Operational characteristics include features such as train details (length, weight, wagon type, locomotive power mode, axle load, cargo, dangerous goods etc.) and terminal times.
134. The route characteristics are generally known and provided by the railway owner, and the operational characteristics are generally known and provided by the access seeker. Once the route characteristics and operational characteristics are known by both parties, then, from a technical perspective, it is possible to either progress or deny an access proposal (ie. ascertain whether the proposed operation can run on the network).
135. The current process requires the access seeker to provide information and the railway owner to confirm that the proposed operations can be facilitated on the network.³⁷ This objective can only be achieved by the exchange of information between the access seeker and railway owner. It is incorrect to say the onus lies with either the railway owner or the access seeker in isolation, as the onus lies on each for different elements.
136. The current process requires:
- (a) the railway owner to provide the preliminary information³⁸;
 - (b) the access seeker to provide operational information³⁹;
 - (c) the railway owner may require the access seeker to⁴⁰ prove its financial and managerial capacity⁴¹ and prove the operations are within the capacity of the route⁴²; and

³⁵Code, section 6.

³⁶Code, section 7(1).

³⁷Code, section 18.

³⁸Code, section 7.

³⁹Code, section 8.

⁴⁰Code, section 18.

⁴¹Code, section 14.

⁴²Code, section 15.

- (d) the railway owner must provide the floor and ceiling price for the proposed access, costs for each route section, and a copy of the costing principles to the access seeker⁴³,
- (together, the **Access Request Process**).
137. One of the requirements under the Code is that the access seeker has sufficient managerial ability. This indicates that the access seeker should be a sophisticated entity with knowledge and experience in managing rail operations.
138. The key issue specified in the Issues Paper is the obligation for the access seeker to prove that its operations are within the capacity of the route:
- 'It may be more efficient to place the onus on the railway owner to assess whether the proposal can be accommodated on the network.'*⁴⁴
139. This is what occurs in practice, since any access proposal requires confirmation by the railway owner. The railway owner is required to confirm that the proposed operations do not conflict with other operations existing operations, in accordance with section 18 of the Code. The onus of establishing whether a proposal can or cannot be accommodated is, to an extent, already on the railway owner.
140. Arc submits the Access Request Process could be further improved by:
- (a) adding a requirement for each party to use reasonable endeavours to consult and provide information, which the other party reasonably requires during the Access Request Process. This will ensure that any information gaps are filled; and
 - (b) increasing the time for the railway owner to provide the floor and ceiling estimates pursuant to section 9 of the Code. The current timeframe in the Code has only been met by prior preparation for access proposals Arc had advanced notice of. Arc notes, it is not an obligation under the Code for access seekers to provide advanced notice of an impending access proposal.
141. The above suggestions reflect Arc's view that the current requirements under the Code comprise reasonable obligations on access seekers, assuming that both parties (railway owners and access seekers) consult with each other. This is relevant to answering the question numbered 1.6 in the Issues Paper, namely, whether the requirement for the access seeker to demonstrate sufficient capacity and the feasibility of any extension or expansion, creates a barrier to access negotiations or an imbalance in negotiating power.
142. It would be unreasonable to expect railway owners to determine whether there is sufficient capacity without the requisite information from the access seeker. For example, if an access seeker has merely provided an estimate of tonnages, but no details on train characteristics, the railway owner will not know how many train paths are required.
143. Demonstrating the feasibility of an extension or expansion is addressed below in response to proposal (b). In the usual course, Arc would inform an access seeker whether a proposed extension or expansion is technically feasible and safe, and the price involved; and it would then be for the access seeker to determine whether that price is economically feasible. Given that Arc is competing against alternative transport modes, it has a strong incentive to price efficiently.
144. Arc does not consider information asymmetry to create a barrier to access negotiations or an imbalance in negotiating power. Information asymmetry is a commonly occurring circumstance when parties engage in a commercial transaction. There is information asymmetry for both access seekers and railway owners, since the railway owner does not know every detail about the access seeker or details of the project for which access is being sought. This asymmetry does not necessarily result in an imbalance in negotiating power in

⁴³Code, section 9.

⁴⁴Issues Paper, p11.

favour of the railway owner, or create a barrier for the access seeker in negotiations. It does, however, suggest that the market is not fully informed, which raises as a possibility, that any price negotiated (in the absence of information) may not be efficient. As explained above, the economic feasibility of an extension or expansion depends on factors largely known only to the access seeker, not the railway owner.

145. As economic feasibility depends on factors largely known only to the access seeker, and as railway owners are already obliged to provide significant information to assist access seekers with making decisions concerning the economic feasibility of their proposals, Arc considers this obligation is sufficient to address any concerns regarding obligations of the access seeker to demonstrate sufficient capacity and feasibility of any extension or expansion. This effectively addresses the question numbered 1.7 in the Issues Paper.
146. With respect to proposal (a), the Code currently places the onus on the access seeker to specify what extension or expansion is required. Works related to extension or expansions include an extremely wide range of infrastructure and cost options. For example, an additional turnout may cost around \$1 million, while a major network upgrade could cost in excess of \$500 million.
147. The railway owner is required to provide information and effectively assist the access seeker in clarifying the feasibility of any extension or expansion. As a railway owner, Arc is motivated to attract and encourage tasks on rail. Accordingly, Arc will provide financial and technical information and assistance to encourage and facilitate access requests. However it is appropriate that the onus remain with the access seeker to specify what, if any, extension or expansion is needed, as the access seeker has the detailed knowledge of its project necessary to answer this question in the first instance.
148. Notwithstanding paragraph 146 above, if Government were to amend the Code so that the onus was put on the railway owner, additional protections would need to be included. At a minimum, the following requirements listed in paragraphs 149 - 154 below would need to be implemented.
149. Firstly, access seekers should be required to provide all information reasonably required by the railway owner. If the requisite information were not provided, then the railway owner would not have to proceed with the access request.
150. Secondly, the railway owner could then elect whether the analysis is conducted in-house or by external parties (consultants). This term is required to ensure the railway owner can respond to an extension or expansion request, as Arc staff may be constrained from performing existing tasks as well as additional work relating to extension or expansion projects, or there may be a number of concurrent extension or expansion requests made. Further, the railway owner should be compensated for all work completed on an upfront basis, including a reasonable margin.
151. Finally, following the analysis referred to in paragraph 150, Arc would deliver a report addressing the following:
 - (a) whether an extension/expansion can be accommodated on the Arc Network;
 - (b) whether an extension/expansion can be technically and safely carried out;
 - (c) what high level works would be required to deliver works in line with the proposal; and
 - (d) an 'orders of magnitude', non-binding view on price,which would effectively answer the question of whether an extension or expansion is required to accommodate an access proposal.
152. In response to the question numbered 1.9 in the Issues Paper, if all or some of proposals (a) and (b) were adopted, it would not only be reasonable, but critical, for the railway owner to recover its costs from the access seeker in order to ensure the railway owner has the ability to continue to invest efficiently in rail infrastructure. It is very important to allow railway

owners to recover their costs associated with responding to an access proposal if any reforms are made, which increase the obligations placed on the railway owner.

153. With respect to proposal (b), the requirement for the railway owner to demonstrate whether a proposal can or cannot be accommodated on the network is addressed in Arc's response to proposal (a), as is the question of whether a proposed extension or expansion is technically feasible and safe.
154. Economic feasibility depends on the underlying profitability of the access seeker's project, which is unknown to the railway owner. In agreements negotiated inside the Code, the price for access should be determined by reference to the total and incremental costs to the railway owner of providing the access sought. Whether that price renders a project economically feasible will depend on the economics of the access seeker's project. Since that is unknown to the railway owner, the onus should not be on the railway owner to determine economic viability.
155. Arc also notes that the question of economic viability usually arises at a later stage in the typical lifecycle of a project's development, with questions of technical feasibility and safety considerations usually being considered earlier.
156. In light of the above, and in response to the question numbered 1.9 in the Issues Paper, Arc does not consider that proposals (a) and (b) would improve the operation of the WARAR.
157. In response to the question numbered 1.10 in the Issues Paper, which deals with whether there are any other barriers to access negotiation or imbalances in negotiation power in the negotiation framework in the WARAR, Arc considers that, while not necessarily requiring reform, Arc generally knows very little about customer operations. This can make certain operational activities, such as maintenance planning, difficult, however, these matters can usually be resolved in the course of negotiations between the parties, whether inside or outside the Code.
158. Arc notes that any potential imbalances are in many cases offset by the type and size of a customer, with some of these entities being monopolies in their own markets.

4.2 Accountability

159. The Issues Paper raises 3 key concerns in relation to accountability, namely:
 - (a) that accountability arrangements need to strike a balance between providing sufficient transparency and assurance to stakeholders, while not imposing unnecessary regulatory burden on the railway owner;
 - (b) that regulator accountability must also be considered, particularly the need to minimise risk of regulatory error; and
 - (c) that processes relating to Part 5 instruments effectively be intensified as applicable to new railway owners to ensure better accountability, via increased public consultation and review obligations.
160. Arc's responses to these three concerns are set out respectively below, together with responses to the proposals and questions raised under each concern in the Issues Paper.

4.2.1 Issue 1: Railway owner accountability to comply with regime

161. By way of context for this issue, railway owners have various regulatory obligations under the WARAR. Some key obligations include:

- (a) providing access seekers with required⁴⁵ and preliminary information⁴⁶;
 - (b) providing copies of finalised access agreements⁴⁷ and any arbitration determinations⁴⁸ to the regulator;
 - (c) obligations to keep a register of access proposals made under the Code⁴⁹; and
 - (d) adhering to particular standards of behaviour with regard to negotiating under the Code⁵⁰,
- all of which are designed to assist and protect access seekers.

162. In Arc's case, additional obligations are set out under the Lease. These obligations include maintaining the railway network to particular standards, providing our landlord (the Public Transport Authority) with maintenance plans at regular intervals, and commissioning independent reviews of our compliance with the Lease on a regular basis. Together, these represent a significant burden on our business to meet ongoing compliance requirements.

163. Arc would support increased regulatory reporting that was clearly necessary to reduce or eliminate a problem or gap in the regulatory framework. However, in the abstract and without a clearly identified problem to fix, any additional reporting would only increase costs and burden a railway owner's resources. Ultimately, such costs would have to be recovered from customers. The cost burden of any new regulation should be fully offset by reductions in existing regulation.⁵¹

164. The Issues Paper sets out three proposals to address this concern:

- (a) provide for more regular and consistent reporting of the railway owner's compliance with all of the Part 5 instruments;
- (b) require the railway owner to publicly report on a regular basis on the progress of access negotiations, including for example: the number of access applications outside the Code, the number of access applications within the Code, the number of negotiations under the Code that have commenced, information on disputes or judicial challenges to any obligations under the Code, and the number of negotiations under the Code that have concluded with an access agreement; and
- (c) require the railway owner to publicly report on a regular basis (eg. annually) on service quality matters, such as: track condition, percentage of track under speed restriction, percentage of train services delayed, percentages of train services cancelled, and average below rail delays.

165. Arc's responses to proposals (a), (b) and (c) are set out respectively below.

166. With regard to proposal (a), as discussed above, any increased regulatory burden should result only from a need to solve a clearly articulated problem. Arc's Part 5 instruments, which are approved by the regulator, make ample provision to ensure compliance with the instruments. Further, the regulator has power to direct a railway operator to amend or replace any of the Part 5 Instruments. Relevant key features of each instrument are set out in paragraphs 167 - 169 below.

⁴⁵ Code, section 6. 'Required information' includes a form of the railway owner's standard access agreement, as well as detailed information listed in Schedule 2 of the Code, which relates to mapping, physical characteristics of the railway network, and physical characteristics of rolling stock on the network.

⁴⁶ Code, section 7. 'Preliminary information' is essentially an initial indication of: a) current available route capacity; b) potential access price; and c) key access agreement terms.

⁴⁷ Code, section 39(1).

⁴⁸ Code, section 39(2).

⁴⁹ Code, section 12.

⁵⁰ Code, sections 13(1) and 16(1).

⁵¹ Australian Government, 'The Australian Government Guide to Regulation'

https://cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf, p2

167. The TMG provide for a wide range of regulatory powers and obligations, including:
- (a) the ability for access seekers to request regulatory investigation into any claims⁵²;
 - (b) additional reporting obligations which come into effect if an access agreement is made under the Code⁵³; and
 - (c) the regulator's ability to audit Arc's compliance with the TMG at any time, at Arc's expense, with the scope and management of the audit being directed by the regulator.⁵⁴
168. The TPP provides for access seekers to express any concerns to the regulator that it has with the TPP, and empowers the regulator to investigate any such claims.⁵⁵ The Costing Principles and Overpayment Rules each contain a compliance and review section, similar to the TPP and TMG.⁵⁶
169. Given the existing regulatory powers present in these instruments, additional reporting obligations are unnecessary. The current powers afforded to the regulator and access seekers are sufficient to ensure compliance by railway owners with all of the Part 5 Instruments. It is unclear how increasing reporting obligations in relation to the Costing Principles and Overpayment Rules would increase transparency, given those instruments are effectively used by the regulator. This answers the question numbered 2.2 in the Issues paper, namely whether regular reporting by railway owners on their compliance with Part 5 instruments would improve the effectiveness of the regime.
170. With regard to proposal (b), Arc supports reporting on the number of access applications made under the Code and the number of notices of readiness to commence negotiations that are issued⁵⁷, in addition to the current obligation to notify and provide the regulator with finalised access agreements (which, is essentially reporting to the regulator on the number of negotiations under the Code that have concluded with an access agreement).
171. Access agreements negotiated outside the Code are conducted entirely on a commercial-in-confidence basis and are outside the scope of the Code.⁵⁸ In some circumstances, the very fact of negotiation of access by a potential customer is commercially confidential.
172. It is not clear what interest the public may have, or what benefit would be derived, from any other public reporting. Further, with regard to information on disputes or judicial challenges, these matters are highly likely to pertain to sensitive commercial information of both railway owners and access seekers, and as such should not be reported. Once a judicial challenge is finalised, it is reported publicly as a matter of course via the Court's website and established legal databases.
173. Arc repeats paragraphs 170 - 172 above in response to the question numbered 2.3 in the Issues Paper, which asks whether regular reporting by railway owners on the progress of access negotiations would improve the effectiveness of the regime.
174. With respect to proposal (c), as stated above, determining the purpose and use of this information is critical before contemplating additional reporting obligations. Without clarity, such additional obligations are merely a regulatory burden on the railway operator for no discernible benefit.
175. The measure of percentage of track under speed restriction is a relatively meaningless measure, as it does not translate to useful information for access seekers and operators.

⁵² TMG, section 5.1.3.

⁵³ TMG, section 5.1.4.

⁵⁴ TMG, section 5.1.5.

⁵⁵ TPP, section 6.1.1.

⁵⁶ Costing Principles, section 6, Overpayment Rules, section 5.

⁵⁷ Code, section 19(1).

⁵⁸ Code, section 4A(1)(b)

The measure may show different outcomes, which does not paint a true picture of track performance.

176. Arc does not see the benefit of reporting on the percentage of train services cancelled for below rail issues, for two reasons: the first, that for prospective access seekers, cancellation of services is irrelevant; secondly, that for existing access seekers, they will already be informed of any cancellations impacting their services.
177. In addition to the measures discussed above, we propose alternative service quality matters to report on in place of track condition and percentage of train services delayed, which Arc is happy to discuss the specifics of.
178. In response to the question numbered 2.4 in the Issues Paper, namely whether regular reporting by railway owners on service quality would promote more effective access negotiations, in Arc's view there is generally no discernible benefit to be gained.
179. Notwithstanding the relatively minor amendments suggested above, in response to the question numbered 2.1 in the Issues Paper, which deals with whether the WARAR is sufficiently transparent, in Arc's view it is sufficiently transparent.

4.2.2 Issue 2: Regulator accountability

180. As mentioned in paragraph 159(b), the Issues Paper is concerned to ensure that regulatory accountability is adequately considered in any reform measures. Accordingly, it proposed including the option of merits review of regulatory decisions made under the Code in order to increase regulatory accountability. The Issues Paper also asked (refer to the question numbered 2.5) what would be the advantages and disadvantages of including merits review of regulatory decisions in the WARAR.
181. A merits review process would increase regulatory accountability. Submissions made by both railway owners and access seekers in the 2014 Code Review expressed a preference for a merits review process being incorporated into the Code, yet the Regulator recommended it be implemented only if other Recommendations were implemented.
182. The Regulator's reasoning was that its decisions had limited bearing on a final price. Although the Regulator does not determine the access price, regulatory decisions made under the Code do affect the negotiation and determination of price, in particular the Regulator's determination of the incremental and total costs of providing the access sought by a proponent. Such decisions should be subject to merit review.
183. Recent decisions by the Regulator demonstrate that a merits review process may have been beneficial. For example, in the CBH Floor and Ceiling determination⁵⁹, the regulator allocated to the Dongara to Arrowsmith line section an incremental cost of zero. This was clearly incorrect. Where a customer has requested access to a line section, Arc is required to maintain that line to an operational standard, which would necessarily incur costs.
184. In light of the above, we recommend that a merits review process be implemented. The Regulator is responsible for administering the Code in its entirety, which may result in a variety of decisions being made, such as determining compliance with Part 5 Instruments.
185. A merits review process would assist in reducing some of the considerable risks faced by owners in the determination of pricing related matters. Railway owners are bound by arbitrated determinations of an access price, whereas access seekers are not⁶⁰ and can

⁵⁹ Table 5, Economic Regulatory Authority, *Determination of Costs Relevant to Co-operative Bulk Handling's Access Proposal dated 10 December 2013*, 30 June 2014 (reprinted 16 April 2016), <<https://www.erawa.com.au/cproot/13441/2/Corrigenda%20Determination%20of%20Costs%20Relevant%20to%20Co-operative%20Bulk%20Handling%E2%80%99s%20Access%20Proposal.pdf>> (accessed 15 November 2017)

⁶⁰ Code, sub-sections 34(1) and (2).

- seek other forms of transport. The current regime mitigates the risks faced by access seekers, but not railway owners.
186. Any merits review process should include a mechanism to prevent frivolous requests for review being made. It is common or leave to be required to make an application for merits review of a regulatory decision.
 187. Further, Arc proposes that railway owners be given the option to appeal or seek limited merits review of, an arbitrator's determination under the Code, given that railway owners are bound by an arbitrated decision. This would be an added layer of regulatory protection to ensure railway owners will have the confidence to continue investing in rail infrastructure.
 188. In summary therefore, merits review would be advantageous for the following reasons:
 - (a) greater regulator accountability;
 - (b) greater flexibility, through an alternative to judicial review; and
 - (c) greater ease with which impacted parties could raise concerns with regulatory decisions, reducing the risk of error and negative impact on an affected stakeholder.
 189. Despite a merits review being costly, Arc considers that the benefits of the availability of a merits review process would outweigh the costs.
 190. As to what decisions made by a regulator under the WARAR should be subject to a merits review (refer to the question numbered 2.6 in the Issues Paper), Arc recommends that any cost determinations made by the regulator and changes to the segregation arrangements be subject to merits review, given their potential for significant adverse impact to parties subject to the WARAR.
 191. If a merits review process were introduced, then, in response to the question numbered 2.7 in the Issues Paper (which asks what sort of limits on merits review may be appropriate), limiting any merits review process to reviewing information that was before the original decision maker would be appropriate, as allowing new evidence to be adduced would mean that the decision making process effectively starts again. It would also be appropriate to stipulate reasonable time frames for the process.

4.2.3 Issue 3: Processes relating to Part 5 Instruments

192. The Issues Paper set out 2 proposals to address the concern raised regarding Part 5 instruments and accountability with respect to new railway owners, namely:
 - (a) implement the ERA's Final Recommendation 4 from the 2011 Code Review to improve the approval process for Part 5 instruments and ensure they remain appropriate over time; and
 - (b) implement the ERA's Final Recommendation 8 from the 2011 Code Review to improve the timeliness in applying Part 5 instruments to new railways.
193. Final Recommendation 4 recommends 3 changes. The first change is amending Part 5 of the Code so that s 42 of the Code only requires public consultation for variations to segregation arrangements, which are considered by the Authority to constitute a material change. Arc supports this proposal, as it will provide the Regulator flexibility in dealing with minor and/or merely procedural amendments.
194. The second change is that s 45 of the Code should include the Costing Principles and Overpayment rules, in order to ensure consistency in the public consultation process across all Part 5 instruments. In our view, this amendment is unnecessary and will create further work for the regulator without any discernible benefit. Arc notes that the Costing Principles

and Overpayment Rules contain similar provisions in their 'Compliance and Review' sections, which provide that:⁶¹

- (a) stakeholders can raise concerns with the regulator at any time and the regulator is empowered to investigate those concerns;
 - (b) the regulator can amend the instruments at any time; and
 - (c) both access seekers and railway owners can ask the regulator to consider amendments at any time.
195. Public consultation is generally labour intensive and imposes costs on government and network owners. While Arc appreciates the merit of public consultation in principle, in this instance Arc does not see the cost as justified. The review and approval function carried out by the regulator of these instruments has to date been appropriate, sufficient and successful.
196. The third change is that a new provision be added to provide for review of all Part 5 instruments every 5 years, or as otherwise determined by the Authority. Arc understands the proposal to review Part 5 instruments every five years refers to a review by the regulator and relevant railway owner. Assuming this interpretation is correct, Arc agrees with the recommendation. However, as the regulator already has the power to direct a railway owner to amend or replace a Part 5 instrument at any time, including wording to the effect of 'as otherwise determined' would be superfluous.
197. Paragraphs 193 - 196 effectively set out Arc's response to the question numbered 2.8 in the Issues Paper, namely whether implementing Final Recommendation 4 of the ERA's 2011 Review would assist in improving the transparency and accountability of the regulator's decision to approve segregation arrangements and Part 5 instruments.
198. Final Recommendation 8 required the Department of Treasury to undertake further consultation in relation to the desirability of requiring a standing set of model Part 5 Instruments to be maintained by the Authority, and if desirable, that these model Part 5 instruments should apply to all new railways from a date of six months prior to the commencement of the operations of that railway.
199. Generally, Arc supports this proposal. A standing set of model Part 5 Instruments would assist in simplifying regulatory obligations for new railway owners. This also response to the question numbered 2.9 in the Issues Paper as to whether implementing Final Recommendation 8 would assist in ensuring the timely provision of access to new railways.
200. However, if a model set of instruments were to be applied to new railways, provision should be made for the railway owner and regulator to discuss and agree changes to those model instruments once the new railway is established, to ensure that they are fit for purpose. This also would appear to follow from the existing regime for Part 5 Instruments.

4.3 Capacity expansions and extensions

201. The Issues Paper raises two key concerns in relation to extensions and expansions, namely:
- (a) a lack of detail in the Code about how an expansion, if required, will proceed; and
 - (b) ambiguity in the Code about when proposals for extension or expansion can be made.
202. Arc sets out its responses to issues (a) and (b) referred to above, together with related proposals and questions respectively below.

⁶¹ Above, note 38.

4.3.1 Issue 1: Level of detail in the Code

203. Arc's submissions in this section should be read in the context of the amendments proposed to the Code in determining whether an extension or expansion is technically feasible, which is detailed in Arc's response to 'Issue 2: Barriers to negotiation' above. The amendments proposed involve implementing a process whereby the railway owner will ultimately provide a high level report setting out:
- (a) whether an extension/expansion can be accommodated;
 - (b) whether the works can be carried out from a technical and safety standpoint;
 - (c) an overview of the works required; and
 - (d) an order of magnitude, non-binding estimate of price.
204. The Issues Paper proposes two competing reform options, (a) and (b) as set out below:
- (a) Outlining a high level set of principles to guide the negotiation. These could address the roles and responsibilities of the various parties, such as who is responsible for funding the investigations and, ultimately, construction, obligations to consult and arrangements for sharing the cost of an expansion (i.e. pro-rata); and
 - (b) a more detailed process which sets out the steps to be taken in developing a project from concept, pre-feasibility and feasibility studies, and more detailed provisions around the roles and responsibilities of various parties.
205. Arc's responses to proposals (a) and (b) above are set out respectively below. Proposal (a) appears to put forward a mixture of principles and key negotiating conditions.
206. We note 'Principle' is defined by the Oxford Dictionary as:
- 'a fundamental truth or proposition that serves as the foundation for a system of belief or behaviour or a chain of reasoning.'*
207. While high level principles may be applied across all railway networks subject to the WARAR, the specifics of how responsibilities are allocated may need to be customised to suit the different railway networks. A regime similar to that found in the IAU may be appropriate for the Arc network.
208. The IAU takes a relatively 'light touch' approach to capacity increases, whilst still specifying the responsibilities relating to cost, ownership and risk allocation. A modified version of that framework may be appropriate to apply to the Arc Network. We envisage that a modified version would also take account of:
- (a) the specific risk of each project, and commensurate returns required;
 - (b) the identity of the railway owner and its respective requirements;
 - (c) imposing no obligation on the railway owner to carry out an extension/expansion if it is not deemed commercially viable (at the railway owner's discretion); and
 - (d) potential impacts on other customers.
209. Arc does not consider overly prescriptive regimes for extensions or expansions to be appropriate, as such regimes generally cater for networks with established, relatively homogenous traffic. Accordingly, in response to the question numbered 3.2 in the Issues Paper, the approach outlined in proposal (a) would be more appropriate than the approach outlined in proposal (b).
210. Proposal (b) appears to be premised on the concern raised in question numbered 3.1 in the Issues Paper. That question asks whether the lack of detail in the Code around the process

to progress an extension or expansion creates a barrier to access negotiations or an imbalance in negotiating power.

211. Conceptually, there is a difficulty with imposing too onerous or prescriptive regulatory requirements under the Code. The Minister is required, by s 4 of the Act, to establish a Code in respect of “railways to which the Code applies”. Further, by s 4(2), the Code must provide “for railway infrastructure to be available for use by persons other than the railway owner.” However, axiomatically, where an extension or expansion is proposed, the extended or expanded railway or railway infrastructure does not yet exist, and cannot fall within the compass of the Minister’s power to regulate under s 4 of the Act.
212. Nonetheless, and subject to the above observation, the proposed framework referred to in paragraphs 207 and 208 above could be used to provide additional detail on the intended process, without unfairly burdening the railway owner. But any such framework should only be provided as a guide, not as a prescriptive regime.
213. Given the issues referred to in paragraphs 211 and 212, and in accordance with the principles enshrined in clause 6(4) of the CPA, Arc recommends that parties should be free to determine the necessary parameters to facilitate any extension/ expansion on a commercial basis.
214. Finally, in considering potential imbalances to negotiating power, account needs to be taken of the financial and commercial risks to railway owners of carrying out any proposed extension or expansion. In these situations, the railway owner will be the one taking on the risk, and therefore appropriate measures should be implemented to ensure that the railway owner is protected. If such protections are construed as an imbalance to negotiating power, they are only an inevitable but necessary ingredient of a regime under which an infrastructure owner can be compelled to provide access to its asset.
215. Arc’s view with respect to proposal (b) is that a detailed approach to extensions or expansions would not be appropriate. In Arc’s experience, each project is unique and so a ‘one size fits all’ approach is unlikely to work. Arc notes that while Aurizon’s undertaking⁶² and ARTC’s Hunter Valley undertaking⁶³ include more prescriptive regimes around the process for project execution, these regimes both deal with homogenous network traffic (i.e. coal). It does not make sense to try and apply a prescriptive regime to a network such as Arc’s, which has heterogeneous traffic.
216. However, referring to paragraphs 207 and 208 above, Arc supports including a high-level process, similar to that set out in the IAU, which was designed for a network supporting heterogeneous traffic.
217. The issues Arc sees if a ‘one size fits all’ approach were to be implemented are that either:
 - (a) derogations from the process will likely be required by an access seeker or railway owner, which would undermine implementation; or
 - (b) parties would not follow the process due to a lack of flexibility vis a vis their financial, market or business needs, which may result in extension/expansions not being undertaken, limiting investment in railways.
218. Although at some stage of a projects lifecycle a detailed process may be warranted, it should not have to be specified up front in the context of the WARAR. Such a process is best determined via entry into a project agreement between a railway owner and access seekers.

⁶²Aurizon Network Pty Ltd, ‘Aurizon Network Submission Draft – 30 November 2016: The 2017 Undertaking’, http://www.aurizon.com.au/~media/aurizon/files/what%20we%20do/network/network%20downloads/ut5%20draft%20access%20undertaking-1/the%202017%20draft%20access%20undertaking_markup%20ut5%20compared%20to%20ut4.pdf (accessed 10 November 2017).

⁶³Australian Rail Track Corporation Limited, ‘Hunter Valley Coal Network Access Undertaking’, 23 June 2011.

4.3.2 Issue 2: Clarity around timing of an expansion proposal

219. With regard to the second issue identified at paragraph 201(b) above, the Issues Paper proposes that Recommendation 4 of the ERA's 2015 Code Review be implemented. That recommendation provides that s 8(5) of the Code be amended to allow for a proposal of an extension or expansion to be made at any time after the making of a proposal under section 8 of the Code, on the grounds that such an extension or expansion would be necessary to accommodate the proposed rail operations.
220. The reason for this proposal can be found in the premise of the question numbered 3.3 in the Issues Paper. The question is whether a lack of clarity in the Code about when an extension or expansion proposal can be made, creates a barrier to access negotiations or an imbalance in negotiating power.
221. The Code is sufficiently clear. It is reasonable to expect access seekers to specify in an access proposal (and no later) whether an extension or expansion is required. Alternatively, if access seekers are to remain free to request an extension/expansion during negotiations, then it should be at the railway owner's discretion as to whether or not the access proposal is varied to accommodate that request.
222. Access seekers will usually be aware of any extension or expansion required prior to submitting an access proposal, due to their ability to request preliminary information from the railway owner under s 7 of the Code, including an indication of current available capacity.
223. Where an extension or expansion is not initially proposed as part of an access proposal, some or all of the following issues may arise:
- (a) an extension or expansion could impact the proposed operations of an access proposal, therefore nullifying specific elements of the original proposal;
 - (b) an extension or expansion could change the underlying financial ability of the access seeker⁶⁴, due to increased financial exposure. If an extension or expansion is proposed after the timing currently provided for under the Code, the railway owner has no ability to reassess the financial ability of the access seeker;
 - (c) the proposal may result in an access seeker 'reclassifying' parts of its access proposal as an extension or expansion, which would undermine the regulator's assumptions in relation to a floor and ceiling costs determination;
 - (d) major expansions may alter the WACC of the railway owner, which would in turn change the total costs of providing the access sought; and
 - (e) a significant information imbalance would be created, in which the railway owner would not be aware of all the information required to progress an access proposal.
224. The process of submitting an access proposal should be treated as a 'stage gate' process. Once a stage is completed and passes to the next 'gate', the assumptions made to progress through that gate should remain in place. Allowing extension or expansion requests to be freely proposed at any time, circumvents the other steps required for a railway owner to progress an access proposal.
225. For the reasons provided above, the recommendation in its current form should not be implemented. This also answers the question numbered 3.4 in the Issues Paper, namely whether implementing Recommendation 4 would provide sufficient clarity on when an extension or expansion proposal can be made. Access seekers should specify any

⁶⁴ Section 14 of the Code provides that a railway owner is entitled to have an access seeker establish (effectively to the railway owner's satisfaction) that it has sufficient managerial and financial ability for the access task to be carried out.

extension or expansion required in the initial access proposal, and extensions or expansions raised during the negotiation phase should not be entertained.

226. If an extension or expansion proposal were permitted to be raised after the initial access proposal, it should be at the railway owner's discretion whether to allow such derogations. Ultimately, there should be a final limit after which an extension or expansion proposal cannot be raised. It would be untenable for such a proposal to be raised for the first time in the course of an arbitration concerning the terms and price of access.

4.3.3 Issue 3: Uncertainty about recognition of costs in pricing provisions

227. This issue is dealt with in the pricing mechanisms section.

4.4 Pricing Mechanisms

4.4.1 Issue 1: Indicative Tariffs

228. The Issues Paper proposes the implementation of indicative tariffs in limited circumstances, noting that their implementation could assist with resolving information asymmetry issues and facilitating negotiations. Firstly, it is unclear from the Issues Paper how potential benefits relating to information asymmetry and facilitating negotiations, outweigh the burden of implementation and associated costs.

229. Secondly, although indicative tariffs may be useful where services are priced at total cost and the services are relatively homogeneous, these (and the other circumstances identified in the Issues Paper) do not appear to apply to the Arc Network. Arc is not vertically integrated, and the services operating on the Arc Network are heterogeneous. The threat of competition from road transport effectively constrains the prices Arc can charge to be less than total cost on single user lines.

230. The question numbered 4.2 in the Issues Paper essentially asks when the benefits of approved indicative tariffs might outweigh the costs. Question 4.1 queries whether the benefits would outweigh the costs in circumstances where:

- (a) the service is priced at the total cost;
- (b) where there is a reasonable number of services using a route and they are relatively homogenous; or
- (c) where the railway owner is vertically integrated,

which is also the premise of the reform proposal made in relation to this issue.

231. Although the circumstances set out in question 4.1 do not appear to apply to the Arc Network, question 4.2 poses a more general question around when indicative tariffs may be beneficial.

In response to question 4.1, the ACCC has noted a number of benefits associated with **not** having indicative tariffs:⁶⁵

- (a) recognition of the diversity of a network and its traffic, which allows a railway owner to reflect the characteristics of the services being provided, enabling the negotiation of a pricing level that maximises cost recovery while taking account of market conditions;

⁶⁵ Australian Competition and Consumer Commission, 'Draft Decision – Access Undertaking Interstate Rail Network Australian Rail Track Corporation', April 2008, <<https://www.accc.gov.au/system/files/ACCC%20draft%20decision%20ARTCinterstate%2029%20April%202008.pdf>> (accessed 5 November 2017), p100.

- (b) the ability for the railway owner to reflect in its charges the costs of managing and maintaining the network, reflecting the consumption of capacity and the interaction between services; and
 - (c) the ability to charge prices which reflect market demand conditions, with differentiation of prices between operations on the basis of ability to pay and market value of a train path, without unduly distorting decisions about consumption of network capacity.
233. Considering the above and in response to the reform proposal made for this issue, it would not be appropriate to implement indicative tariffs in limited circumstances.
234. Given the general application of question 4.2 in the Issues Paper, Arc engaged HoustonKemp Economists to provide a report on the potential implementation of indicative tariffs, and the economic considerations for Arc's railway network. The report is included in Annexure A, with section 3 dealing with indicative tariffs.
235. The report concludes that the benefits of implementing indicative tariffs are unlikely to outweigh the costs, for the following reasons:
- (a) the presumption of information asymmetry as between access seeker and infrastructure provider is not valid, since infrastructure providers generally do not have information on an access seeker's alternative of road transport;
 - (b) unless recovery of ceiling revenue is assured, indicative tariffs are likely to reduce an infrastructure provider's ability to recover its fixed costs, thereby discouraging efficient investment;
 - (c) the range of pricing outcomes from any negotiation is significantly narrower than implied by the simple observation of the floor and ceiling prices, because:
 - (i) an infrastructure provider is required to be consistent in the manner in which it sets access prices;
 - (ii) competition from road transport establishes the maximum price an access seeker would pay;
 - (d) the diversity in the freight task across the Arc Network means that the definition of a standard service is impracticable; and
 - (e) there would be substantial additional regulatory burden associated with their introduction.
236. Arc agrees with these conclusions and submits that benefits exist in maintaining the current approach, particularly the flexibility it affords to both railway owners and access seekers, and the fact that it facilitates commercial negotiations.
237. Further to the issues dealt with by the HoustonKemp report, an analysis of the issues associated with practical implementation of an indicative tariff regime is set out below.
238. The Arc Network is heterogeneous in terms of traffic, as described in paragraphs 45 to 60. Due to this heterogeneity, an indicative tariff regime would require a significant number of tariffs to be developed for the different types of traffic.
239. Practically, and due to the lack of homogeneity, an indicative tariff may be required for each task on the network. Coupled with over 40 route sections on the network, each with their own price floors and ceilings, this means that the exercise would require a significant amount of resources (and cost) to determine and maintain. This is likely to represent a significant regulatory burden on Arc, which is likely to outweigh any benefits.
240. As an example of the potential complexity in calculating indicative tariffs in sufficient detail, Network Rail, a public company in Britain, operates a rail network of 20,000 miles, providing below rail services for freight and passenger services. Network Rail is required by the Office of Rail and Road in Britain to post reference tariffs for all the traffic that operates on its

network. Consequently, Network Rail currently has over 20 categories of rates, which it publishes on its website. For just one of those categories – the ‘Freight Variable Usage Charge’ category, 2,136 rates were published for the 2017/18 financial year.⁶⁶ Arc considers this to be impractical, and would represent a significant regulatory burden on railway owners and the ERA.

241. The only task which could arguably be defined as ‘indicative’ on the Arc Network is the interstate freight task, which is serviced by three (soon to be two) operators.⁶⁷ However, indicative tariffs are not necessary for the interstate services for the reasons set out below.

244. Currently, the interstate freight tasks differ from each other in the following aspects: train characteristics such as gross mass, financial capability of contracting entity, market share and train paths sought. These are all relevant commercial considerations, which impact terms and price. The declaration of approved indicative tariffs effectively sets a bar in relation to pricing, which limits the ability to customise terms and conditions with access seekers.

245. The use of indicative tariffs on ARTC’s interstate network does not necessarily mean they should be used in the same way on the Arc Network, for a number of reasons, which are set out below.

246. Firstly, the composition of traffic, which was a relevant consideration for the ACCC in its approval of an indicative tariff regime for ARTC, is different on the Arc Network. The ACCC in its draft decision for the IAU noted that:

*‘A reference service should be clearly defined and represent a reasonable proportion of the services operated’.*⁶⁸

247. The ACCC then went on to say:

*‘...the types of trains that operate the indicative service account for about 60 per cent of ARTC’s revenue, and indicative services are, by far, the largest service category on ARTC’s network’.*⁶⁹

248. The interstate traffic on the Arc Network makes up less than 20% by net tonnes on the EGR, which classes the task as a minor user of the network, rather than a majority user as is the case on the ARTC network. Further, the threat of road and sea transport already acts as binding constraints on prices.

249. The setting of indicative tariffs is prone to error because of the level of detailed analysis required to set appropriate tariffs for each task. Approval of indicative tariffs would require the regulator to take into account all the factors which affect price, which include but are not limited to commodity, train length, seasonality, financial capability of the end user, interaction with other traffic, ability to pay, and competitive constraints imposed by competing forms of transport. They do not allow for sufficient differentiation of tasks.

⁶⁶ Network Rail, *Track usage price list*, <https://www.networkrail.co.uk/industry-commercial-partners/information-operating-companies/cp5-access-charges/>

⁶⁷ Aurizon Intermodal, one of our current intermodal customers will cease interstate intermodal operations by 31 December 2017. <http://www.aurizon.com.au/what-we-deliver/intermodal>. (Accessed 6 November 2017).

⁶⁸ Australian Competition & Consumer Commission, *Draft Decision, Access Undertaking – Interstate Rail Network, Australian Rail Track Corporation*, April 2008 <<https://www.accc.gov.au/system/files/ACCC%20draft%20decision%20ARTCinterstate%2029%20April%202008.pdf>> (accessed 15 November 2017), p94

⁶⁹ *Ibid*, Page 94,

250. Development and approval of indicative tariffs would involve significant initial cost. Ongoing maintenance would be required to ensure the tariffs stayed current, accurate and relevant, which would impose further significant burden on both the Regulator and railway owners.
251. The process of approving indicative tariffs is likely to give rise to commercial confidentiality issues, particularly if each tariff were developed with reference to existing commercial agreements.
252. If indicative tariffs are priced at less than the ceiling (or 'total cost'), then approved indicative tariffs are unlikely to take into account an individual access seeker's ability or willingness to pay for access. As outlined in section 3.2.2 of the HoustonKemp Report, a railway owner should be able to recover as much as it can towards its total costs of providing access.
253. Consider the following theoretical example where indicative tariffs may not result in sufficient negotiating flexibility:
- (a) Customer A is seeking a term of one year, and customer B is seeking a term of ten years, but are identical in every other aspect. The implementation of a regime featuring indicative tariffs would require the indicative rate be provided for these tasks.
 - (b) To facilitate access for either task, significant capital is required to be spent by the railway owner initially to facilitate access, plus a small amount on ongoing maintenance each year during the access term.
 - (c) From a commercial perspective, these customers should not pay the same price because there are materially different costs and risks associated with each customer's task. That is, there are higher risks associated with customer A due to the short length of the term, and limited ability for the railway owner to recover its investment.
 - (d) This example demonstrates one of the potential issues with the implementation of a regime featuring indicative tariffs.
254. For the reasons outlined above, Arc does not support the implementation of indicative tariffs.

4.4.2 Issue 2: Assessing the capital charge using GRV

255. The WARAR currently provides that the price charged for access in an agreement negotiated under the Code must fall within the range of a 'floor price' and 'ceiling price'⁷⁰. The valuation methodology used to calculate the 'floor and ceiling' includes various costs, such as the capital charge which informs the ceiling level. The ceiling, which is the railway owner's total costs attributable to the route and infrastructure to which the proponent seeks access, is the maximum revenue that a railway owner can recover.⁷¹
256. Those "total costs" are the total of all operating costs, capital costs, and overheads attributable to the railway owner's access-related functions.⁷² Since the Code's inception, the "capital costs" have been calculated on the basis of the gross replacement value (GRV) of the railway infrastructure, calculated as the lowest current cost to replace the existing assets with assets that have the capacity to provide the level of service that meets actual and reasonably project demand and which are, if appropriate, modern equivalent assets.⁷³
257. In 2010 the ERA proposed a change from the GRV approach to a DORC methodology, but the proposal was not adopted⁷⁴. More recently, the ERA proposed in Recommendation 2 of the 2014 Code Review that the Code be amended to provide for an Established Asset Base (**EAB**) valuation methodology instead of a GRV valuation methodology⁷⁵. In the issues paper published by the ERA at the start of the 2014 Code Review process, the underlying issue prompting this recommendation was identified as the NCC's concern as to how the Regime

⁷⁰ Items 7 and 8 of Schedule 4 of the Code.

⁷¹ Clause 8 of Schedule 4 of the Code.

⁷² Definition of "total costs" in clause 1 of Schedule 4 of the Code.

⁷³ Clause 2 of Schedule 4 of the Code.

⁷⁴ Paragraphs 232-234, 2010 Code Review

⁷⁵ Recommendation 2, 2014 Code Review

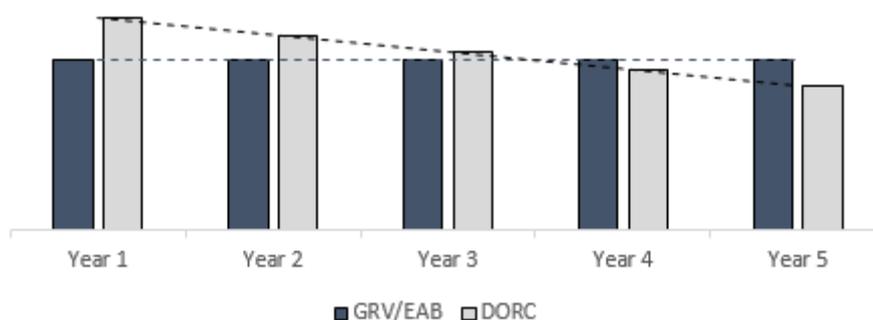
and the ARTC undertaking “interface” on the interstate route at Kalgoorlie in circumstances where the ARTC undertaking adopts a different asset valuation methodology.⁷⁶ Arc’s views on seeking certification and consistency with other access regimes are addressed below in our response to Issue 2: Certification as an effective regime.

258. By the time of the ERA’s final report in the 2014 Code Review, the justification for considering a change from a GRV to some form of EAB methodology had changed. In the 2014 Code Review, the reason given was the GRV approach resulted in asset valuations that did not necessarily relate to the asset’s current condition or the economic value a user may expect to extract from the use of the asset.⁷⁷ The ERA observed that the “capital component of costs under a DORC approach ... better reflects the value of the regulated assets”, but also recognised “the limitations of relying upon a depreciated value to reflect the condition of an asset (or the standard of a service), and that the written down value of an asset does not necessarily align with the condition of the asset.”⁷⁸

259. Perhaps reflecting the shift that occurred during the 2014 Code Review process, the Issues Paper does not identify the lack of certification as a problem relevant to this issue. The Issues Paper instead notes ‘*the current approach is arguably consistent with the Competition Principles Agreement*’⁷⁹, but identifies some aspects of the GRV methodology that might be undesirable. The first concern raised is that the:

‘... GRV annuity approach ‘backloads’ the recovery of the investment in order to maintain a constant real capital charge. This is inconsistent with investor preferences, which will often require higher charges in the earlier period in order to meet financing requirements or reduce project risks.’⁸⁰

This issue concerns the profile of the revenue ceiling when compared to alternative valuation approaches. The profile of the revenue ceiling for a GRV or EAB methodology is flat which contrasts to the declining value characteristic of a DORC methodology. This issue was examined by the Office of the Rail Access Regulator, the predecessor of the ERA, soon after the Code came into operation⁸². Figure 8 demonstrates the flat and declining ceiling profiles of GRV, DORC and EAB approaches to asset valuation:



Profile of valuation approaches (Figure 8)

261. Arc considers the flat profile desirable because it matches the expected profile of revenue from an open access network such as the Arc’s, where prices are expected to be more or less constant in real terms over an access period. If the declining profile of a DORC approach were to be adopted, revenue would likely be significantly less than the ceiling in earlier periods and constrained by the ceiling in later periods.

⁷⁶ Para 145, 2014 Code Review Issues Paper

⁷⁷ Paragraph 110, 2014 Code Review

⁷⁸ Paragraphs 112-113, 2014 Code Review

⁷⁹ Page 21, Issues Paper

⁸⁰ Page 21, Issues Paper

⁸² Office of the Rail Access Regulator, *A Brief Comparison of the WA Rail Access Code approach to calculating ceiling cost with the conventional Depreciated Optimised Replacement Cost methodology*, 18 July 2002.

262. The second issue identified by the Issues Paper concerns the fluctuation of construction costs:

*'The GRV may fluctuate given current construction costs because the GRV is reassessed each time the costs are reviewed under the Code. This will affect the future capital charge and create a 'windfall' gain or loss for the investor. Many investors will not be prepared to accept this risk and would prefer to lock the asset value in through a regulated asset base (RAB).'*⁸³

263. Although fluctuations in the GRV due to construction costs could result in a windfall gain of loss for investors if prices are set at the ceiling, this is not the case for Arc's network. This, however, is not the case for the Arc Network, with revenue from operation of the Arc Network being significantly less than the ceiling. Given this, the second issue is deemed to not be relevant to the Arc Network.

264. The third issue raised relates to staging costs in an expansion, are not relevant for the Arc Network and has therefore not provided any commentary on it.

265. The Issues Paper sets out the following proposal:

- (a) One option is to amend the Code in line with Recommendation 2 of the ERA's 2015 Review, to provide for an EAB valuation instead of GRV. As an EAB approach is similar to a DORC-based approach, this would be more consistent with other rail access regimes.

If an EAB method is applied, other amendments to the Code may be required in order to overcome the issues identified above in relation to greenfield investments and major expansions, as well as to achieve consistency with other rail access regimes.

An alternative option is to amend the Code to provide railway owners with the option of choosing whether a GRV or DORC-based asset valuation approach will apply to their railway.

However, given railway owners have invested based on the GRV approach continuing, it is important that railway owners are not made materially worse off as a result of any change. This could require appropriate transitional provisions.

266. The Issues Paper further sets out two alternative proposals, which include:

- (a) implementation of an EAB methodology; and
- (b) giving railway owners the option to select either a DORC or GRV valuation methodology.

267. Arc does not consider the change to an EAB approach to be appropriate, given:

- (a) the issues or concerns identified with the GRV framework do not arise for the Arc Network, and the GRV framework meets the requirements of the CPA^{84 85};
- (b) the Lease was sold on the basis the GRV framework existing, and changes to that framework that would constrict revenue would undermine the original, and all subsequent, investment decisions made under that framework;
- (c) sufficient detail on the operational and economic principles of the proposed EAB methodology have not been developed, and it is unclear how it would operate or what benefits would arise from its implementation;
- (d) the regulatory burden and compliance costs of implementing and operating an EAB/DORC framework are likely to be greater than the perceived benefits.;

⁸³ Page 21, Issues Paper

⁸⁴ 9.32 of NCC Report

⁸⁵ Page 21, Issues Paper

- (e) to transition to an EAB would likely warrant amendments which are unlikely to offset the perceived benefits; and
- (f) an EAB is inconsistent with the CPA and does not meet the object of the Act or the principles in the Issues Paper.

4.4.2.1 Description of an Established Asset Base methodology

268. Both GRV and DORC methodologies are reasonably well understood and established methodologies. An EAB, however, is not well understood, and to Arc's knowledge, has not been utilised or tested in any other regime. Neither the Issues Paper nor the 2014 Code Review provide sufficient detail of the proposed EAB approach for full and proper consideration of all the implications of the proposed change.
269. It is Arc's understanding that what is being proposed in the Issues Paper is an alternative method of determining the capital costs component of the total costs for the purposes of determining the ceiling. It appears that part, if not the whole, of the motivation for moving away from a GRV approach is to adopt an approach to asset valuation that includes depreciation. It is Arc's understanding that the EAB valuation methodology would operate as follows:⁸⁶
- (a) the initial value of the asset base would need to be established;
 - (b) when access is sought under the Code, the EAB would be established by the railway owner on the basis of an opening value, capital additions and depreciation for each class of assets;
 - (c) all determinations of efficient capital cost (including capital additions) and operating costs made by the railway owner would be subject to approval or determination by the ERA;
 - (d) capital costs for each asset class would then be established via an annuity calculation using the remaining economic life and the WACC, in the same way as currently described in clause 2 of Schedule 4 to the Code (using an EAB instead of GRV); and
 - (e) negotiations would proceed on the basis of total costs, and applying only to assets which exist at the time. The costs of any required extensions or expansions would be dealt with separately, much the same way as they currently are.
270. The ERA suggested that the above approach would preserve the negotiate-arbitrate process in the Code, while minimising the prescriptiveness of the regime and the number of legislative amendments.⁸⁷ Considering these principles of the EAB valuation methodology, Arc considers it is very similar to, and could be construed as a variation of the GRV which two notable departures. Those departures are the inclusion of a depreciated network value and that negotiations would proceed at the ceiling price⁸⁸. The EAB inherits various other characteristics of the GRV, such as the same annuity style calculation which determines the ceiling price⁸⁹, which results in a flat ceiling profile over time (in contrast to the typical DORC approach to asset valuation).
271. The EAB methodology was initially proposed in the 2014 Code Review, and for the purposes of this Submission and in the absence of further information, we refer to information contained in the 2014 Code Review to analyse and assess the EAB methodology.

4.4.2.2 Change is not required

⁸⁶ 2014 Code Review, [138].

⁸⁷ 2014 Code Review, [139].

⁸⁸ Para 138, 2014 Code Review.

⁸⁹ Footnote 22, 2014 Code Review

272. Arc does not consider change from a GRV is required because it has previously been certified as being consistent with the CPA by the NCC⁹⁰. This certification did identify some potential issues regarding the application of a GRV framework to greenfield networks, which do not apply for the Arc Network. Arc understands these concerns were related to the investment return preferences of the railway owner⁹¹, rather than the concerns of access seekers.
273. It is Arc's understanding the key reason for the implementation of an EAB is to reduce the gulf between the floor and the ceiling with the purpose of reducing the "scope for negotiation"⁹². Arc notes the scope of negotiation is, in practice, constrained by the threat of road transport in Western Australia, which provides a commercial ceiling on the price Arc can charge significantly below the revenue ceiling using the GRV approach.
274. In the case of the grain industry for example, rail transport generally hauls just over half the annual harvest, with road transport hauling the remainder. Road and rail in many cases compete for the same grain, in Arc's view there is a competitive market for the transport of grain. This example is particularly relevant, because the example usually given of the parts of the railway network where the asset condition is less than the "modern equivalent asset" standard are the grain lines⁹³. However, changing to an EAB valuation methodology not necessary to constrain the scope of negotiation in this case, because the market for transport of grain is already competitive.

4.4.2.3 Confusion exists as to what an EAB is

275. As information on the operation and implementation of an EAB is very limited, Arc cannot comprehensively assess the EAB methodology. Arc's assessment in this submission is based on currently available information, which Arc considers to be insufficient to properly consider the implications of implementation.
276. Minimal details are currently known about the EAB methodology, and a comprehensive review has not been undertaken, nor are there any details of an implementation plan. This is evident when considering how an EAB might be implemented in the current framework, for example:
- (a) the current revenue ceiling calculation utilises the 'PMT' function in Microsoft Excel⁹⁴. The 'PMT' function does not work when calculated based on depreciated values, and therefore is unsuitable to use in an EAB methodology; and
 - (b) footnote 22 in the 2014 Code Review is a critical assumption required for the determination of a ceiling limit. Arc notes there are multiple possible interpretations of this footnote which result in materially different outcomes for the revenue ceiling.
277. These are just two examples of the confusion which exists due to the lack of development of the proposal.
278. Further to the above, various statements in the Issues Paper and the 2014 Code Review appear to contradict each other. For example, the Issues Paper notes:
- 'As an EAB approach is similar to a DORC-based approach, this would be more consistent with other rail access regimes.'*
279. However, the proposed EAB is different from the DORC based approach for the following reasons in several important respects:

⁹⁰ 9.32 of NCC Report

⁹¹ 9.26 of NCC Report

⁹² Para 129, 2014 Code Review

⁹³ See, e.g., 2010 Code Review, [184]

⁹⁴ 2.6 of Costing Principles

(a) One of the key differences between the two approaches is the profile of the ceiling over time. This feature is an important consideration and should be matched to the expected profiles of revenue over the term.

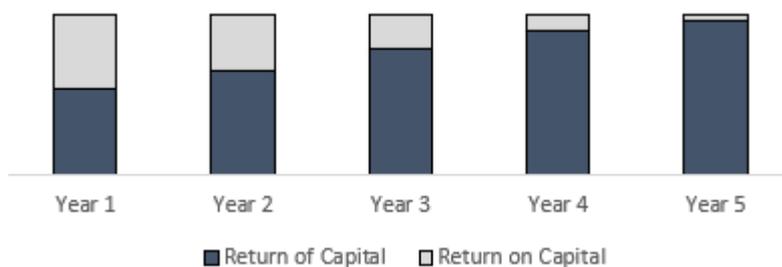
(i) **DORC Ceiling:** Access regimes using a DORC-based approach feature a revenue ceiling which declines over time, due to the explicit 'return of and return on' capital assumption. Specifically, this declining revenue ceiling is the return on capital reducing over time because the underlying asset base is being depreciated. This is shown in figure 9 below:

DORC Ceiling



DORC ceiling profile (Figure 9)

(ii) **EAB Ceiling:** The EAB proposed by the ERA explicitly includes an annuity style (or flat) ceiling over time⁹⁵. This ceiling is calculated in a similar way to a home loan, in which the 'equity' or 'return of capital' portion increases over time, and the 'interest' or 'return on capital' portion decreases over time. This is shown in figure 10 below:



EAB ceiling profile (Figure 10)

280. The methodologies also differ in considering how frequently the underlying asset base is required to be calculated:

(a) A feature of many DORC regimes is the 'lock in and roll forward' approach, which requires ongoing revaluation, generally once a year or at other relatively short intervals, and which usually involve approval or determination by a regulator. This is a heavier handed approach than the GRV methodology where asset valuation is calculated on an 'as needed' basis only when an access proposal is made under the Code.

⁹⁵ Footnote 22, 2014 Code Review

- (b) An EAB inherits a similar approach to that of a GRV, as the asset base is only valued initially⁹⁶ and then as required following an access request⁹⁷.
 - (c) The 2014 Code Review stated that ongoing revaluation, which Arc understands to refer to the 'lock in and roll forward' approach, is not required as it "*would result in an unnecessary increase in prescriptiveness*"⁹⁸. This is at odds with a DORC approach.
 - (d) Further, Arc notes the ERA refers to a 'rolled forward' approach⁹⁹, but does not specify whether this is a feature of the EAB regime, or merely the discussion of a concept which doesn't necessarily apply to any of the proposals. Arc assumes paragraph 128 of the 2014 Code Review refers to the introduction of a depreciated approach, rather than specifically to the EAB.
281. For the reasons outlined above, Arc considers the proposed EAB approach is not consistent with a DORC framework. Arc therefore considers the Issues Paper may have interpreted the EAB proposed in the 2014 Code Review differently to Arc. This potentially means there may be multiple interpretations of the EAB valuation methodology.
282. The lack of information surrounding the EAB approach may relate to the circumstances under which it came into existence. Arc notes the EAB was recommended in the 2014 Code Review final report but not in the ERA's draft report. This meant that public submissions were not made on the proposal and therefore did not feed into the final report.
283. The EAB methodology is untested and unproven as a valuation methodology. The Regime is not a suitable 'testing ground' for untested valuation methodologies, due to the importance and significance of the networks it covers.

4.4.2.4 The purpose of the ceiling is unclear

284. One aspect which is not clear in the proposed EAB methodology is the setting of access prices within the floor and ceiling range. Based on the 2014 Code Review, there are conflicting statements. For example, in paragraph 138 it is stated:
- 'Negotiations may proceed on the basis of total costs, and applying to assets which exist on the ground at the time'*¹⁰⁰.
285. Arc understands this statement to propose negotiations may proceed at the ceiling (as the definition of 'total costs' under the Code means the total of all the operating costs, capital costs and overheads¹⁰¹). But it is unclear whether the word 'proceed' means 'start at' or 'be set at'.
286. Subsequently in paragraph 139, it is stated that an EAB would "*enable the negotiate-arbitrate process to be preserved*"¹⁰². Arc does not understand how the EAB would preserve the negotiate-arbitrate process if it is explicit that prices would start at or be set at the ceiling. This statement also prompts a questions, relating to the purpose of the floor, given the ceiling is used as the pricing or negotiating starting point. Arc considers that the proposal would not preserve the negotiate-arbitrate process, and would cause a material shift away from a light handed regulatory approach to a heavy handed, prescriptive regulatory approach. Arc does not support such a shift.
287. Further, it is not clear what is meant by the statement "*applying to assets which exist on the ground at the time*". If an EAB is effectively a depreciated GRV, which includes an 'Modern Equivalent Asset' assumption (which it could inherit from the GRV), then it explicitly does

⁹⁶ Para 138, 2014 Code Review

⁹⁷ Para 137, 2014 Code Review

⁹⁸ Para 137, 2014 Code Review

⁹⁹ Para 128, 2014 Code Review

¹⁰⁰ Para 138, 2014 Code Review.

¹⁰¹ Item 1 of Schedule 4 of the Code

¹⁰² Para 139, 2014 Code Review

not relate to the 'assets' on the ground, but assets which are Modern Equivalent Assets, which are defined in the Costing Principles as:

*'being an optimised network that is re-configured using current modern technology serving the current load with some allowances for reasonably projected demand growth up to three years into the future. The MEA excludes any unused or underutilised assets and allows for potential cost savings that may have resulted from technological improvement.'*¹⁰³

288. For the reasons outlined above, Arc submits that for an EAB framework to even be considered for implementation it needs to be properly defined, interrogated and its merits need to be proven.

4.4.2.5 Undermining of investment decision

289. The Arc Network was leased from the Government in 2000. The price paid by Arc to enable it to lease the Network was based on an underlying assumption that revenue earned from access seekers over the term of the Lease would be in a manner consistent with the regulatory arrangements existing during that time. The arrangements which existed at the time, and to date, are broadly that of a 'floor and ceiling' regime which uses a GRV valuation methodology to value the capital component. This means the 'test' to determine the maximum revenue earned each year is calculated by reference to the GRV, being the annuitized cost of a new, modern equivalent assets.
290. Arc made its initial investment and all subsequent investments in the Arc Network on its ability to earn revenue within this valuation methodology (being GRV) over the term of the Lease. A change to another valuation methodology will change the ability and circumstances under which Arc can earn revenue from its investments. Valuation methodologies such as DORC or EAB can fundamentally change the way revenue is earned. For example, changing and potentially shifting the ability to earn revenue during specific periods (some of which may have passed) means the revenue could be forgone.
291. If a DORC or EAB existed from the day the Lease was signed, that would likely have affected the price Arc was willing to pay for the Lease, or even if the Lease was a viable purchase at all. Arc may also have made different decisions on capital invested during the Lease term if the ability to earn a return on those investments was restricted. Arc considers the changes proposed represent a material and unreasonable increase in sovereign risk.
292. It is also important to remember, even with the passage of time, a considerable sum of money was paid to the State in exchange for the ability to earn revenues from the freight rail market over the Lease term. The structure and form of the Lease sale was considered with the intention of maximising the amount received by the State for the Lease¹⁰⁴. The Government went to some length to seek certification of the Regime at the time, but ultimately did not receive certification¹⁰⁵. The regulatory framework existing at the time was one of the key considerations in determining the Lease value.
293. The proposal to materially change the regulatory framework would send a message to the market, and may affect any future attempts by the Government to privatise State assets, likely leading to the realisation of lower sale prices.
294. The role private enterprise plays in operating and managing State assets is considered by Arc to be critical. Privatisation can lead to significant benefits, such as:

¹⁰³ Page 24, Costing Principles

¹⁰⁴ WA, Parliamentary Debates, Legislative Assembly, 3 June 1999, RAIL FREIGHT SYSTEM BILL 1999 - SECOND READING, Page 8772/1,

<http://www.parliament.wa.gov.au/Hansard/HANS35.NSF/3e8095c2de81a3b048256c6b002e9930/a75fa606f51af547482567910051fe57?OpenDocument>

¹⁰⁵ Richard Court, *Western Australia's Rail Access Regime*, October 2000, <<http://ncc.gov.au/images/uploads/CERaWaWL-001.pdf>> (accessed 15 November 2017)

- (a) increased operational efficiency (discussed in paragraphs 65 to 83);
 - (b) ensuring assets are run on a commercially viable basis “*with a level of commercial and investment acumen and innovation that is available only in the private sector*”¹⁰⁶, reducing or eliminating the need for ongoing funding by the State; and
 - (c) making significant financial contributions to the State when required, such as the capital payment for the lease which assisted to “*retire state debt*”¹⁰⁷.
295. Arc strongly opposes any potential change to the regulatory framework which could undermine its initial and subsequent decisions.

4.4.2.6 Increase to compliance costs

296. Compliance costs under the GRV pricing framework are relatively minimal, with costs incurred by Arc primarily following the submission of an access request. This occurs only sporadically, and importantly, these costs are aligned with the demand of regulated rail services. The move to an asset valuation methodology with depreciation explicitly accounted for would materially increase compliance costs, introducing a ‘regulatory maintenance’ cost in addition to the cost burden surrounding an access request.
297. To calculate ceiling costs in a regime featuring depreciation (such as an EAB or a DORC) every single asset existing on the 5,500km of the Arc Network will require a remaining and total technical life to be determined to accurately calculate depreciation. To put this into context, Arc currently has data on approximately 8 million rail assets (such as rail spans, sleepers, turnouts, culverts etc) of which only a fraction have an ‘installation date’ (which informs the remaining life). Arc expects the work required to populate its database with the requisite information to establish remaining asset life would be an extremely time consuming and costly exercise. For the ‘rail’ category for example, each piece of rail would require a physical inspection to ascertain when it was installed (by reference to date markings on each individual rail span).
298. Once the data is assembled through track inspections it would require approval from the ERA (presumably engaging its own consultants to check Arc’s data, who may also need to inspect the track). If a ‘lock in the roll forward’ approach was implemented this asset register would require ongoing maintenance, audits and periodic reassessments in addition to the initial determination of the depreciated asset value.
299. The inclusion of a depreciated asset valuation approach would be very costly, with this additional cost needing to be recouped through access charges. It is not apparent that the benefits of a depreciated approach would outweigh the costs of implementation and maintenance.

4.4.2.7 Transition arrangements would undermine benefits of new regime

300. In the case of a depreciated regime being implemented into the Regime, Arc considers reasonable transition arrangements require consideration, with some options potentially undermining some of the perceived benefits of the regime.

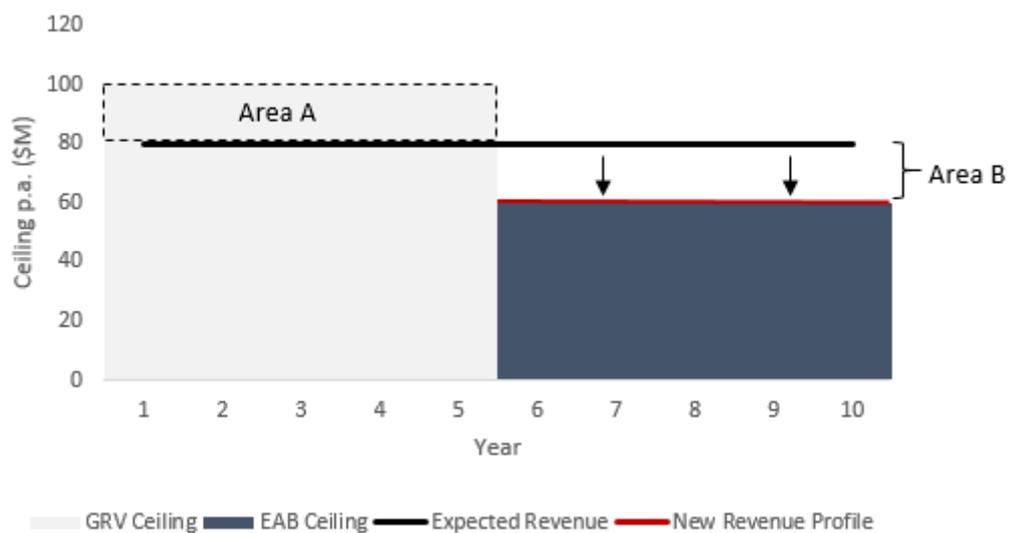
¹⁰⁶ WA, Parliamentary Debates, Legislative Assembly, 3 June 1999, RAIL FREIGHT SYSTEM BILL 1999 - SECOND READING, Page 8772/1,

<http://www.parliament.wa.gov.au/Hansard/HANS35.NSF/3e8095c2de81a3b048256c6b002e9930/a75fa606f51af547482567910051fe57?OpenDocument>

¹⁰⁷ WA, Parliamentary Debates, Legislative Assembly, 3 June 1999, RAIL FREIGHT SYSTEM BILL 1999 - SECOND READING, Page 8773/1,

<http://www.parliament.wa.gov.au/Hansard/HANS35.NSF/3e8095c2de81a3b048256c6b002e9930/22bcfaf6bd03a3d44482567910051fe49?OpenDocument>

301. Firstly, the change to an EAB would necessitate the implementation of a merits review process¹⁰⁸. This would undermine benefits of reduced negotiation time due to the narrower floor and ceiling range would be offset by the time taken during a merits review process¹⁰⁹.
302. Secondly, equitable transitional arrangements would be required to provide for a fair revenue ceiling over time when considering the revised capital charge. Under recovery of historical revenue ceilings should be capitalised for use in future periods due to the potential constriction of future revenues. The key principle is that over the long term revenues will not be higher than the long term ceiling. This principle could be implemented by capitalising previous under recoveries by rolling them forward into future periods. Such a change would be necessary for a move to a depreciated regime, as it is the only way the interests of a railway owners with regard to the expenditure incurred over time could be adequately addressed due to a change in valuation methodology.
303. Consider the following example, which shows how such a mechanism could work:
- A network is built and is operated for 5 years under a GRV regime. The network for this time had an annual revenue ceiling of \$100m and an annual revenue of \$80m. This meant that for each year the network recovered \$20m less than the ceiling, denoted in figure 11 as Area A.
 - In year 6 the regime is changed to an EAB regime, which accounted for the depreciation of the asset. This change reduces the revenue ceiling to \$60m from years 6 to 10. This would mean the expected revenue, shown by the black line, is constrained by the new ceiling, shown by the red line.
 - This is an unreasonable outcome for the railway owner due to no recognition of historical under recoveries with future revenue constraints. This is particularly evident in this example where over the term the aggregate ceiling is \$800m with expected revenue also totalling \$800m (in aggregate). The railway owner would not have, over the term, earned more than the ceiling in aggregate, but revenue is constrained in the later years resulting in \$700m being recovered.
 - To address this issue a mechanism could be introduced which provides for capitalisation of previous under recoveries, which would be available to offset against the reduced ceiling in year 6 and on. These capitalised losses should be able to be rolled forward into future periods for use.



Capitalisation of under recoveries (Figure 11)

¹⁰⁸ Para 140, 2014 Code Review.

¹⁰⁹ Para 140, 2014 Code Review.

304. If previous under recoveries were not capitalised, and therefore potentially not able to be recovered, it would introduce a constraint inconsistent with the legitimate business interests of the railway owner. The amount of revenue capitalised could either be based on the new regime existing for the entirety of the term, or a capitalisation of previous under recoveries based on the original valuation methodology (consistent with example above).
305. Although the approach to capitalise previous under recoveries of the ceiling does solve one of the transitional issues, Arc considers such a regime would be difficult to apply and may undermine some of the perceived benefits of changing regimes, such as reducing the gulf between the floor and ceiling.
306. In addition to the capitalised under recovery, changes in any new valuation methodology should take account of the economic life of assets (being the period in which revenue can be generated from the asset) instead of the technical life of assets (being the lifespan of the asset) by referencing the remaining lease term. Without this change Arc will not be able to earn a return on assets installed with a technical life longer than the remaining lease life.

4.4.2.8 An EAB does not meet the object of the Act, the CPA or the Issues Paper

307. The ERA proposed that negotiations will proceed on the basis of the ‘total costs’¹¹⁰, which Arc interprets to mean the ceiling (by reference to the Code, in which ‘total costs’ means the total of all ‘*operating costs; capital costs; and the overheads...*’¹¹¹). This means that an EAB methodology, by design, constrains the negotiating range, and therefore the ability to negotiate. This was noted by the ERA when it proposed the EAB:

‘The Authority acknowledges that an Established Asset Base approach reduces the scope for negotiation’¹¹²

308. This statement conflicts with:
- (a) one of the stated aims of the Issues Paper, which is to ‘*encourage commercial negotiation*’¹¹³; and
 - (b) clause 6(4)(a) of the CPA, which specifies ‘*Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.*’
309. An EAB leaves no room for the agreement of terms and conditions between the owner of the facility and the person seeking access.
310. Further, due to the investment risks present under an EAB for railway owners Arc considers the EAB regime does not meet the object of the Act which is to ‘*encourage efficient use of, and investment in, railway facilities*’¹¹⁴ (emphasis added).
311. If negotiations were to proceed on the basis of ‘total costs’, there would be a very narrow range of potential outcomes. A ‘total cost’ determined by reference to depreciated capital costs in the manner proposed represents the minimum amount of revenue reasonably required by a railway owner to cover its fixed and variable costs. This also presents an issue in some circumstances where increased flexibility is a benefit to the negotiation process, and is particularly evident when considering customers requiring terms to provide flexibility such as seasonality which could limit the capacity to pay in some years, and result in charges being too high in others.

¹¹⁰ Para 138, 2014 Code Review

¹¹¹ Item 1 of Schedule 4 of the Code

¹¹² Para 129, 2014 Code Review

¹¹³ Page 2, Issues Paper

¹¹⁴ 2A of Act

312. For example, the transport of the grain task is very seasonal, with the ability of the grain market to pay being inextricably linked to the size of the harvest, over which its participants have very little control. The grain task would therefore benefit from a flexible arrangement, where in some seasons access charges are higher, and in others, access charges are lower. An EAB does not provide a sufficiently flexible framework for this to occur.

4.4.2.9 Analysis of the 'GRV or DORC approach'

313. The Issues Paper in its proposal suggests an option for railway owners to choose which valuation methodology should apply to their respective network. Arc notes this aligns with statements made in the NCC report:

*'Prescribing the costing methodology in the Code is not the preferred approach. The Council considers that it is advantageous for the regulator to have the discretion to determine the appropriate methodology on a case by case basis, particularly given the recent, and likely future, application of the Code to greenfield developments.'*¹¹⁵

314. Arc engaged HoustonKemp to provide a report on whether a GRV or DORC valuation methodology would be most appropriate for the Arc Network. In its report HoustonKemp concluded:

'In our opinion, the potential move from a GRV to a DORC or EAB-based approach to determining the price ceiling is highly unlikely to promote the objectives of the Western Australian rail access regime in the context of the Arc Infrastructure's rail network. This is because:

- *such a change would represent a significant departure from the function of the ceiling test, which is to establish the threshold above which prices can be said to represent the exercise of market power;*
- *A DORC approach:*
 - *would result in a higher price ceiling during the life cycle of the asset; and*
 - *could reduce railway owners' ability to cost recover, particularly when the asset is at or near its end of its economic life.*
- *the application of a DORC or EAB-based approach would add significantly to the administrative burden of the regime.*

315. Arc agrees with the findings of the HoustonKemp report and considers the correct asset valuation methodology to apply to the Arc network is a GRV approach.

4.4.2.10 Arc's Position

316. For the reasons above, the EAB methodology is not appropriate for Arc's Network. If changes are to be made, railway owners should have a choice of whether a GRV or DORC methodology should apply to their network. For the Arc Network, the appropriate methodology is a GRV approach.

¹¹⁵ 9.27 of NCC Report

4.5 Marginal freight routes

317. The Issues Paper refers to marginal routes, which it states specifically, means the 'Tier 3 lines', a term originating from the SGNR,¹¹⁶ which includes the line sections shown in figure 12 set out below:¹¹⁷



Tier 3 network (Figure 12)

318. The SGNR analysed the viability of investments in the rail network in the context of marginal freight lines and made the following finding:¹¹⁸

¹¹⁶ Sd+D Consult, 'Report prepared for Freight and Logistics Council of WA on behalf of the Strategic Grain and Network Committee', December 2009 (SGNR), <<http://walga.asn.au/getattachment/Policy-Advice-and-Advocacy/Infrastructure/Urban-and-Regional-Transport/Grain-Freight/Strategic-Grain-Freight-Network-Review.pdf.aspx?lang=en-AU>> (accessed 5 November 2017)

¹¹⁷ Ibid, Figure 13.

¹¹⁸ Page 8, Finding 3, SGNR.

Finding 3: *There is a good business case for long-term retention of Tier 1 lines and for investment to renew key assets required for continued efficient operation, e.g. re-sleepering. The business case for investing in Tier 2 lines varies from case to case, and for some it will be more economic to upgrade nearby local road networks. There is no sound business case for upgrading Tier 3 lines, as transport of grain will be cheaper by road regardless of rail upgrading; these will soon cease to operate.*

319. The Strategic Grain Network Committee, which developed the SGNR, comprised representatives from Arc, Co-operative Bulk Handling Limited, Government and various other industry representatives.¹¹⁹ The outcome reported in the SGNR reflected industry consensus to direct funding to roads in some instances rather than Tier 3 lines, because the cost of transport by road was less than the investment required to continue to operate those lines.
320. Arc takes this opportunity to clarify the circumstances surrounding the closure of the Tier 3 lines, which the Issues Paper states were shut due to limited usage.¹²⁰ The Tier 3 lines were shut because they were not economic, and there was no sound business case to continue to maintain them when compared to competing cost of transport by road, as noted in paragraph 318 above. The tier 3 the lines could have stayed open if a customer was willing to fund the required maintenance cost.
321. Following the SGNR, CBH subsequently made a request under the Code for access, which included access to several Tier 3 lines. Depending on the outcome of a pending arbitration between Arc and CBH, it is possible that some of the Tier 3 lines could become operational again.

4.5.1 Issue: Coverage of marginal freight routes

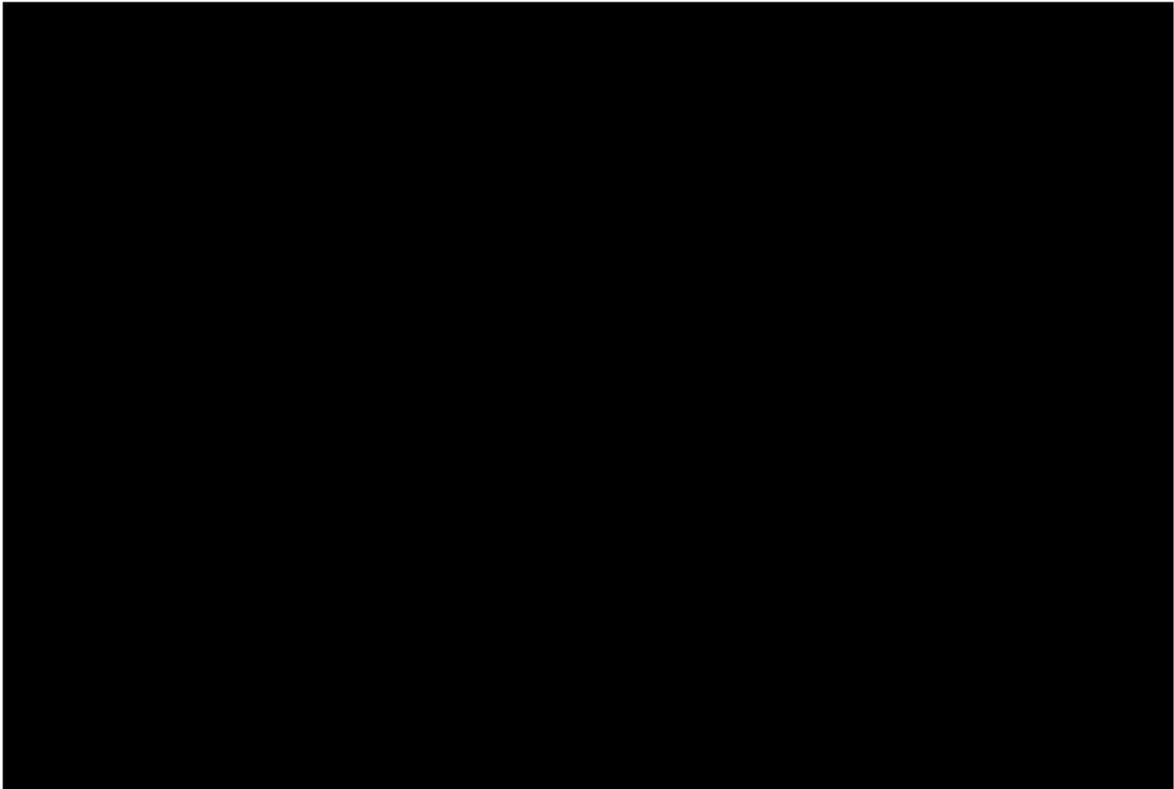
322. The Issues Paper raises the concern that it is questionable whether marginal routes would continue to meet the requirements for a route to be regulated under the Code, and that certain issues associated with marginal routes (such as access pricing and obligations of Arc to fund maintenance) may or may not be appropriately dealt with under the WARAR.
323. Tier 3 lines are not the only uneconomic routes currently managed by Arc and regulated under the Code. Other uneconomic lines are:
- (a) the line between Picton and Lambert;
 - (b) the spur between Mullewa and Pindar;
 - (c) the line between Beacon and Bonnie Rock; and
 - (d) the line between Mundijong and Jarrahdale.
324. To address the concerns mentioned in paragraph 322, the Issues Paper sets out 3 proposals, namely to:
- (a) remove marginal freight lines from coverage under the Code;
 - (b) provide greater guidance on the provision of access for these routes, which may include specifying:
 - (i) particular matters to have regard to in setting access prices (such as costs to be included in incremental cost and guidance on contributions above incremental cost); and
 - (ii) the treatment of any payments by the Government to support the ongoing provision of these routes for pricing purposes; and

¹¹⁹ Page 24, SGNR.

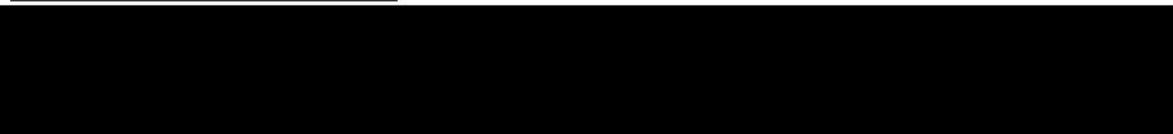
¹²⁰ Page 25, Issues Paper.

- (c) include a mechanism under the Code allowing for a review of coverage for routes, which would require specifying a regular review period or specific process for applying for removal or addition of a route and clarifying the decision-making process, including matters to take into account and who is the decision maker.
325. Arc's responses to the above proposals and associated questions are set out below.
326. In response to proposal (a), if marginal freight routes ceased to be regulated under the WARAR (by removal from the Code), then, as matters currently stand, it would be possible for the marginal freight routes to fall under the NAR. It would be open for a proponent seeking access to one or more of those routes to ask for them to be 'declared' under Part IIIA of the CCA, if they are not subject to an "effective" State access regime.
327. Although it may be supposed, given the outcome in the SGNR, that it is unlikely that the Commonwealth Minister would 'declare' the marginal freight routes, unless or until such an assessment were to be made, the outcome is unclear.
328. Whether or not the lines meet the declaration criteria may depend on the proposed operations on the line sections, which cannot be known unless and until the access request is made.
329. Additionally, changes in access regulation over time do not provide for a consistent answer on whether marginal freight lines should be regulated. An example of this are the recent changes to the NAR which varied the declaration criteria.¹²¹
330. Due to a combination of varying legal, macroeconomic and local factors, there is no clear answer as to whether the marginal freight routes ought, or ought not, be regulated.
331. However, for different parts of the railway network to be subject to different regulatory regimes would be a burdensome and impractical outcome, which may undermine Arc's ability to facilitate efficient investment in the network. Further, it would increase railway owner's compliance costs, as well as complexity for access seekers attempting to seek train paths that involve routes subject to two different regulatory regimes for no perceptible benefit.
332. For the reasons set out above in response to proposal (a), Arc's response to proposal (c) is that including a mechanism under the Code allowing for a review of coverage of routes opens up a railway owner to being subject to different regulatory regimes. This would create a burdensome and impractical outcome, which is why our response to the question numbered 5.3 in the Issues Paper, which deals with whether there is a benefit to including a review mechanism for coverage of routes in the regime, is effectively 'no'.
333. In light of the above, the marginal freight lines should remain under the WARAR, with some potential changes designed to protect the legitimate business interests of railway owners. These are outlined in our response to proposal (b), set out below.
334. With regard to proposal (b), greater guidance and protections for railway owners is needed when providing access to marginal freight routes, particularly lines which require significant capital works to reopen before access can be provided.

¹²¹ Competition and Consumer Amendment (Competition Policy Review) Bill 2017

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340. Question 5.1 in the Issues Paper queries what the benefits may be of the WARAR obliging a railway owner to negotiate access to routes, which they have assessed as being uneconomic, and the associated costs of imposing such obligations. While this question is generally dealt with in our response to proposal (a) above, it must be noted that it is only uneconomic to provide access to a route where the total costs of providing access will not be met by the revenue earned from providing access. Whether or not it is economic to provide access will therefore depend on the price a proponent is willing to pay, which, usually, will be constrained by the competing cost of transport by road.
341. Railway owners will always incur costs in complying with regulatory regimes providing for access to any routes, whether economic or uneconomic. However, save for clear cases such as the Tier 3 lines, it may not be possible to determine whether or not it is economic to provide access before an access proposal is made, because railway owners do not have knowledge of the costs of a proponent's alternative modes of transport.
342. Therefore, accepting that some level of regulation is inevitable, as noted in our response to proposal (a), the lowest cost approach should be implemented. For the marginal freight routes Arc manages, this is regulation under the WARAR.

4.6 Greenfield development

343. The Arc Network, being a State owned asset originally established over 100 years ago, is not a greenfields railway. Generally however, Arc believes that greenfields networks face unique risks, and an onerous regulatory regime could potentially reduce investments in greenfield networks.
344. The Issues paper raises 2 concerns regarding greenfields developments:
- 

- (a) that some obligations will apply on the commencement of the rail line, which may not be relevant or feasible; and
- (b) that the treatment of foundation customers who typically underpin greenfield railway developments, relative to 'normal' customers, is unclear.

4.6.1 Issue 1: Uncertainty relating to greenfield developments

345. The Issues Paper propose three reform options to address uncertainty relating to greenfield developments, namely:
- (a) acknowledging that some flexibility in imposing Code obligations may be warranted having regard to the particular circumstances of the railway. This may apply to the timing of certain obligations as well as the content (such as the ability to apply accelerated depreciation to mitigate asset stranding risk or the flexibility to adjust access prices once costs are known with greater certainty). This may be achieved by including a process for the railway owner to seek 'derogations' from the Code;
 - (b) providing for a defined 'access holiday' for greenfield railway developments (for example, specifying that access obligations will commence after a certain defined period from commencement of operations) to provide greater certainty and minimise regulatory risk for such developments; and
 - (c) allowing railway owners or developers to apply to the regulator for a binding no coverage ruling for a specified period.
346. With regard to proposal (a), Arc considers that additional flexibility would generally be beneficial to the development of greenfield railways. As for proposal (b), the granting of access holidays would be beneficial for greenfield railway owners, to assist them in sorting out any 'teething' issues. It may be impractical to expect greenfield railway owners to allow access requests from the railway's first day of becoming operational. As access requests take some time, we suggest it would be reasonable to afford greenfield railway owners an 'access holiday' of at least 6 months, during which time the railway owners would not be subject to dealing with access proposals.
347. In Arc's view, it would be sensible for the specifics of an 'access holiday' to include anything relating to a request for access, including for example, the obligation to provide the required information.
348. Additionally, it may be worth considering when an 'access holiday' might be extended upon request from the greenfields railway owner, in the event of, for example unexpected defects in newly installed infrastructure.
349. With regard to proposal (c), enabling the regulator to apply a binding no coverage ruling for a period following a formal request from a railway owner, would provide additional flexibility. There is no reason to restrict no such coverage rulings to greenfields developments. They may be useful for example, in the last 6 months of Arc's Lease, where the Arc Network will remain subject to access requests under the Code, but where Arc may find it impracticable to negotiate new access arrangements in light of the intensive work required pre-handover of the asset back to the State.
350. The responses to the above proposals also answer question 6.1 in the Issues Paper as to whether the proposals would improve the operation of the regime. In short, yes - the additional flexibility proposed would improve the operation of the regime, especially where it would address practical issues likely to be encountered by railway owners.

4.6.2 Issue 2: Treatment of foundation customers

351. The Issues Paper proposed the following reform option:

'Possible amendments to the Code include acknowledging that foundation customers and subsequent customers are separate classes of users, and that different treatment of foundation and subsequent customers may be required in order to reflect risks borne by foundation customers. This acknowledgement would be relevant for Code obligations such as non-discriminatory access, consistent application of pricing principles, capacity allocation and reporting of revenues.'

352. Given that foundation customers typically underpin network expansions, Arc considers it critical that their interests should be protected under the regulatory regime. Although Arc's railway network is technically a brownfields investment, we nevertheless consider Karara Mining to be the foundation customer for the Tilley to Geraldton section of the network due to the substantial upgrade undertaken to provide access.
353. A foundation customer should be defined by each railway owner, regardless of whether the customer applies for access inside or outside the Code. 'Foundation customer' status should afford railway owners scope to negotiate more favourable terms for that customer, in exchange for the customer's significant commitment to the railway owner's network.
354. Foundation customers generally bear materially different costs and risks. They may for instance, bear significantly greater access costs, to reflect the fact that infrastructure has been built for their needs, as opposed to other customers accessing pre-existing infrastructure, who then bear a share of the operating cost of that infrastructure. Depending on arrangements, significant risk can either sit with the foundation customer, the railway owner or both. Any amendments made should be flexible enough to consider and protect the interests of both parties.-This answers question 6.3 of the Issues Paper as to whether the costs and risks borne by foundation customers materially differ to those borne by subsequent customers.
355. There is a correlation between the success of a foundation customer's project and the railway owners' investment. If a foundation customer's project succeeds they can continue to pay access charges to the railway owner. If it fails, they cannot. For this reason, additional rights should be afforded to foundation customers – and this also responds to question 6.4 in the Issues Paper, regarding whether the Code should permit different treatment of foundation customers. However, these rights need to be balanced in consideration of other customers, to ensure that other customer's rights to access the network are not undermined.
356. Accordingly, discretion should lie with the railway owner to determine which customers are afforded foundation customer status, given the investments made by the railway owner, as well as the railway owner needing to ensure that its legal obligations with respect to other customers are met.
357. The reasoning provided above supports the proposal made in the Issues Paper, which suggests that the Code be amended to reflect the risks borne by foundation customers and effectively, that different treatment of foundation customers and subsequent customers under the Code may be justified.
358. Suggested examples of terms to make available to foundation customers include changes to the Part 5 instruments, for instance affording foundation customers under the TMG priority in some cases over non-foundation customers, and giving them a first right of refusal.

4.6.3 Issue 3: GRV asset valuation approach

359. This issue is dealt with above in response to section 4.4.2.

4.7 Consistency with National Access Regime

360. This section deals with a number of issues arising from the certification process administered by the National Competition Council in 2011 regarding the WARAR (**NCC Report**). The Issues Paper raises two key concerns arising from the NCC Report as to why

the WARAR was not recertified, namely 'Interstate Issues'¹²⁵ and the issue of consistency across access regimes in WA.¹²⁶

361. It appeared reasonably clear from the NCC Report that the 'determining' issue, which resulted in the NCC refusing to certify the WARAR was the issue of consistency across access regimes (**Consistency Issue**).¹²⁷ The Consistency Issue pertains to the second limb of the objects outlined in Part IIIA of the CCA, to 'provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.'
362. For clarity, the NCC considered certification of the WARAR for all other matters, including the treatment of interstate issues.¹²⁸ The Consistency Issue should be dealt with appropriately – please refer to Arc's submissions set out in relation to Issue 2 below.

4.7.1 Issue 1: Interstate freight routes

363. The Issues Paper makes two proposals in relation to interstate freight routes, namely:
- (a) implementing Recommendation 1 of the 2014 Code Review, which recommends bringing the 'interstate services' under regulations consistent with the IAU; and
 - (b) other proposals made above that would align the WARAR more closely with the NAR, namely moving to EAB pricing and ensuring suitable coverage of marginal freight routes.
364. Arc sets out its responses to proposals (a) and (b) respectively below, followed by responses to the questions related to these proposals, as they address discrete matters.
365. Arc notes that the wording of Recommendation 1 of the 2014 Code Review is that the regulations should be consistent with the IAU, not that the ARTC regime should be extended to cover the interstate services.
366. Arc considers that if any changes are required, they should be made under the WARAR. It should be noted that, under the Lease, the Government has promised Arc that the railway infrastructure would be subject only to the WARAR¹²⁹.
367. The interstate freight route refers to the line sections connecting Perth to Brisbane. Arc operates the line between Perth and Kalgoorlie. ARTC operates the line beyond Kalgoorlie to Brisbane, which line is the subject of a different regulatory regime, the IAU.
368. The traffic on the interstate freight route line sections operated by Arc is heterogeneous. It includes interstate services, iron ore, grain, nickel and related inputs, passenger services, general intrastate freight, fuel and other types of traffic. Analysis of the traffic composition is included in paragraphs 33 to 57.
369. The 'interstate services' referred to in the Issues Paper, which were also referred to in Recommendation 1 of the 2014 Code Review, are three Arc customers, who traverse the entire line section from Kalgoorlie to Perth delivering general freight from interstate. These customers are Pacific National, Aurizon Intermodal¹³⁰ and SCT Logistics.
370. These customers' operations have similar characteristics such as freight category, axle load, and train length. However, they differ in other aspects, such as average train weight, credit risk and end customers.

¹²⁵ Page 33, Issues Paper.

¹²⁶ Page 33, Issues Paper

¹²⁷ NCC Report

¹²⁸ 6.18 of NCC Report.

¹²⁹ Lease, clause 4.9(a) – this refers to Arc taking on the network leases subject **only** to (amongst other things) the 'Access Regime' (the Act and the Code).

¹³⁰ Aurizon Intermodal has announced it will be winding down operations, and selling its assets to Pacific National: <http://www.theaustralian.com.au/business/companies/aurizon-swings-to-loss-plans-buyback/news-story/cabe97dcca1e76933036cbd528ef2ff4>

371. The WARAR is broadly consistent with the IAU. The ACCC considers that at a high level, the frameworks of the IAU and the NSW access undertaking are similar due to both having a negotiate/arbitrate model coupled with floor/ceiling based pricing.¹³¹ While the WARAR differs from the IAU in some provisions, such as indicative tariffs and limitations to capital spend, it shares the same common features of being a negotiate/arbitrate model coupled with floor/ceiling based pricing. These similarities reduce any potential changes required to ensure the WARAR is consistent with the IAU.
372. One key difference between the two regimes is the route taken to regulation. The ARTC network is regulated through a voluntary undertaking. In contrast, the regulation applying to the Arc Network was not proposed or negotiated by Arc.
373. In 2006, the State of Western Australia was a signatory to the CIRA agreement¹³², which includes the following terms:

'3.1. The Parties agree to implement a simpler and consistent national system of rail access regulation, using the Australian Rail Track Corporation access undertaking to the Australian Competition and Consumer Commission as a model, to apply to the following agreed nationally significant railways:

*a. Interstate rail track from Perth to Brisbane, currently managed by the Australian Rail Track Corporation and other parties, **subject to the outcome of commercial negotiations**; and*

*b. Major intra-state freight corridors **on an agreed case by case basis depending on the costs and benefits of inclusion under a national regime.***

*3.2. The Parties agree to develop an agreed approach to the application of the Australian Rail Track Corporation access undertaking model including pricing and access mechanisms that will be appropriate **if vertically integrated operators retain control of relevant sections of track.***

3.3. The Parties agree that state based rail access regimes governing other significant export related rail infrastructure facilities will be submitted for certification as required by clause 2.9.

3.4. This agreement does not require any change to passenger priority policies.' (emphasis added)

374. The most relevant provision for this issue is clause 3.1(a), which contemplates a nationally consistent access regime, using the IAU as a 'model undertaking'. In our view, item 3.1(a) should not be implemented for Arc's railway network for the following reasons:
- (a) In 2009, the COAG Business Regulation and Competition Working Group examined the issue and determined that until the benefits can be proved to outweigh the costs, the ARTC model should not be applied in Western Australia¹³³. To Arcs knowledge no such analysis was undertaken.
- (b) There is no accepted 'model undertaking'. The ACCC, when considering the 2008 IAU, noted that it was not assessing whether the IAU is a 'model undertaking'¹³⁴. The ACCC

¹³¹ Australian Competition & Consumer Commission, *Final Decision, Australian Rail Track Corporation, Access Undertaking – Interstate Rail Network*, July 2008 <<https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20the%20ARTC%20Interstate%20Rail%20Access%20undertaking.pdf>> (accessed 15 November 2017), D2: Scope and Administration, p27

¹³² Council of Australian Governments, '*Competition and Infrastructure Reform Agreement*', February 2006 <<http://www.dtf.vic.gov.au/files/72968d97-5e41-4f12-87ae-a1cd00a8c0a8/Competition-Infrastructure-Reform-Agreement.pdf>> (accessed 15 November 2017)

¹³³COAG Reform Council, '2009 COAG Reform Council Report – Report to the Council of Australian Governments on Implementation of the National Reform Agenda', March 2009.

¹³⁴Australian Competition & Consumer Commission, *Final Decision, Australian Rail Track Corporation, Access Undertaking – Interstate Rail Network*, July 2008 <<https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20the%20ARTC%20Interstate%20Rail%20Access%20undertaking.pdf>> (accessed 15 November 2017), D2: Scope and Administration, p27

further stated that a 'model undertaking' should be developed by government¹³⁵ (as opposed to ARTC submitting an undertaking, then approved by ACCC).

- (c) The NCC also suggested in the NCC Report that a 'model approach' to access regulation is required, and that this approach should be provided to the different jurisdictions for consideration and consultation.¹³⁶
- (d) This means, that the IAU was formed **without consideration of its suitability as a model for national rail access**. Therefore, before considering applying the IAU, or parts of it, to the interstate services on the Arc Network, a 'model undertaking' should be developed. All stakeholders, including Arc should be engaged in the development of any 'model undertaking'. Such engagement has not occurred at all stages of development of the IAU. For example, in the most recent five yearly IAU review, Arc was not engaged to provide feedback.¹³⁷
- (e) ARTC itself has two separate undertakings, each of which is designed to cater for the specific needs of different parts of its network. This highlights the needs for different terms and conditions for networks with different traffic. The traffic on the Arc Network is materially different to ARTC's network.
- (f) A 'model undertaking' should be enduring and not subject to material change over time. By contrast, the current IAU expiry is impending. Additionally, the IAU in force at the time the CIRA agreement was signed is not the same IAU that is in force now. It is unclear which, if any, version of the IAU might be considered to be a 'model undertaking'.
- (g) The IAU was not negotiated by Arc, and the terms and conditions in the IAU do not reflect terms Arc would negotiate or agree. It would be commercially impracticable to apply the IAU to the Arc Network, especially given the relatively substantial funding from Government that ARTC receives to facilitate the provision of access to its network.
- (h) Although the IAU satisfies the legislative requirement for an undertaking to include a return on investment commensurate with the commercial and regulatory risks involved for ARTC¹³⁸, no analysis has been undertaken on whether these principles would be satisfied if the IAU were applied to Arc's railway network. Arc's decision to invest in the Lease was predicated on the regime that existed at the time.
- (i) The IAU allows prices to be set at below the incremental cost of providing access due to indicative tariffs (where prices for a reference service cannot be increased to recover costs). To Arc's knowledge, the indicative tariffs in the IAU are set without regard to the floor and ceiling. There is a significant risk to Arc of under recovering capital expenditure under a model resembling the IAU. As noted by the ACCC in relation to ARTC:

*'in circumstances where ARTC is constrained by market forces to pricing below the levels necessary to recover the full economic cost of providing services, the Commission has concerns regarding the sustainability of the network infrastructure'*¹³⁹.
- (j) Preferencing of trains under the IAU is inconsistent with the TMG. Arc's other traffic and the associated commercial and contractual arrangements for access to the network need to be considered.
- (k) The IAU does not account for important differences between ARTC and Arc. ARTC is a wholly government owned corporation, whereas Arc is a private commercial entity, with

¹³⁵ Ibid, p vi

¹³⁶ 6.14 of NCC Report

¹³⁷ Attachment B – List of contacted entities in 2014 review of the IAU

<https://www.accc.gov.au/system/files/ARTC%20Interstate%20Access%20Undertaking%20-%20Clause%202%204%28e%29%20Review%20-%20ACCC%20letter%20%28public%20version%29.pdf>

¹³⁸ CCA, section 44ZZCA(a)(ii).

¹³⁹ Australian Competition and Consumer Commission 2001b, 'Draft Decision – Australian Rail Track Corporation Access Undertaking November'.

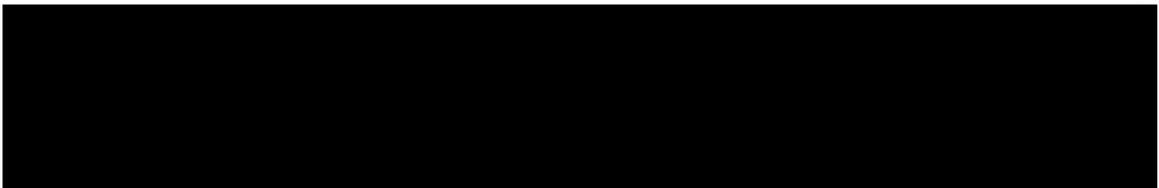
significantly different commercial imperatives. For instance, it may be possible for ARTC not to operate as a going concern, whereas Arc must operate as a going concern.

- (l) ARTC receives significant government funding enabling it to operate at otherwise unsustainable revenue levels. By way of example, for the recent Adelaide to Tarcoola upgrade government contributed \$252m.¹⁴⁰ \$975.3m of funding was granted to ARTC for the Auslink project.¹⁴¹ \$15m was granted for the extension of loops in 2015.¹⁴²
- (m) The implementation of clause 3.1(a) of the CIRA is subject to the outcome of commercial negotiations. No such commercial negotiations have occurred.
- (n) While the CIRA may be considered a binding contract between state governments, Arc note that the provisions of clause 3.1 are all drafted to be conditional. In Arc's view, this was done so as to ensure that Arc would not be put in a position where it would be in breach of legal (including contractual) obligations in order to give effect to this clause. At this stage, in light of our existing contractual obligations, it is highly likely that we would be placed in such a position, with no clear path as to how issues around breach of contract, liability etc. would be resolved.

375. The NCC Report found the treatment of interstate issues to be consistent with the CPA¹⁴³. Arc considers that change is not required unless and until the benefits of installing a varied regime are shown, with such view supported by the COAG Business Regulation and Competition Working Group¹⁴⁴.

376. If the desired outcome is consistency, it is difficult, if not impossible to achieve complete consistency due to the interface issues already existing as a result of two separate network owners. There will always be an element of inconsistency. This issue was created by different approaches between governments.

377. In any event, Arc is already constrained in its ability to set access charges due to:



- (b) strong competition from road and sea transport; and
- (c) Arc's interstate services customers already have significant market power, and have previously been approved to collectively bargain with Arc through an ACCC authorisation.¹⁴⁵

378. For all the reasons above, Arc does not support Recommendation 1 being implemented. Further, with regard to question 8.3 raised in the Issues Paper, which queries whether making removal of the interstate route or services from the Code contingent on Arc offering an undertaking under the NAR be effective in introducing a consistent access framework for

¹⁴⁰ Australian Rail Track Corporation, *10,000 tonnes of rail delivered for Adelaide-Tarcoola upgrade*, March 2017, <<https://www.artc.com.au/2017/03/14/10000-tonnes-of-rail-delivered-for-adelaide-tarcoola-upgrade/>> (accessed 15 November 2017)

¹⁴¹ https://www.anao.gov.au/sites/q/files/net3416/f/ANAO_Report_2007-2008_22.pdf

¹⁴² Australian Rail Track Corporation, *\$15m rail upgrade for SA, Vic and WA freight*, November 2015, <<https://www.artc.com.au/2015/11/02/15m-rail-upgrade-for-sa-vic-wa-freight/>> (accessed 15 November 2017)

¹⁴³ s6 of NCC Report

¹⁴⁴ COAG Reform Council, '2009 COAG Reform Council Report – Report to the Council of Australian Governments on Implementation of the National Reform Agenda', March 2009.

¹⁴⁵ Australian Competition & Consumer Commission, *Aurizon Operations Limited & SCT Logistics- application for authorisation A91512 Interim authorisation decision*, September 2015, <<https://www.accc.gov.au/system/files/public-registers/documents/D15%2B133883.pdf>> (accessed 15 November 2017)

interstate services, it is Arc's prerogative alone whether to make an undertaking to the ACCC. Arc considers that regulation of the interstate services under the current WARAR is the most appropriate and effective regime for ensuring consistency.

379. With regard to proposal (b), Arc understands the National Access Regime (**NAR**) provides three separate pathways to facilitate access for access seekers¹⁴⁶:
- (a) through declaration of the service;
 - (b) through an access undertaking; or
 - (c) through a state or territory regime.
380. Given that three separate pathways exist, it is not clear to which of these pathways a move to EAB pricing and ensuring coverage of marginal freight routes would be aligned. Further, the phrase 'EAB pricing' referred to in the proposal doesn't make sense, as the 'EAB' proposed in the 2014 Code Review was not a 'pricing' regime, but rather an adjustment to the mechanism used to determine the total costs of providing access.¹⁴⁷
381. In order to properly address this question, Arc needs:
- (a) clarity on which of the three pathways under the NAR is being referred to; and
 - (b) full and specific details of the proposed EAB framework, and whether there are any additional changes involved to the regulatory regime (such as indicative tariffs).
382. Question 8.1 in the Issues Paper queries what the benefits are of providing a consistent access regulation framework for interstate services over their entire route, and whether the current Wholesale Agreement provides these benefits.
383. Consistency would be beneficial to the interstate services, but such benefit must be weighed against potentially negative consequences. The implementation of an entirely consistent framework for interstate services would introduce internal inconsistency under the WARAR, in that interstate services would be treated differently in some respects to intrastate services. A change would resolve one inconsistency at the expense of creating another.
384. Arc considers that the WARAR is already broadly consistent with the IAU, for the reasons stated in paragraph 371.

¹⁴⁶ Australian Competition & Consumer Commission, *Arbitrations: A guide to resolution of access disputes under Part IIIA of the Trade Practices Act 1974*, April 2006, <<https://www.accc.gov.au/system/files/Arbitrations%20-%20a%20summary%20guide%20to%20resolution%20of%20access%20disputes%20under%20Part%20IIIA%20of%20the%20TPA.pdf>> (accessed 15 November 2017)

¹⁴⁷ Para 134 of 2014 Code Review

387. Question 8.2 of the Issues Paper deals with what would be the consequences of introducing inconsistency in the application of access frameworks by removing the application of the Code to either:
- (a) interstate services, meaning that Arc would be required to provide access to different services on the same route under different access frameworks; or
 - (b) the interstate route, meaning that Arc would be required to provide access to intrastate services using this route under two different access frameworks.
388. The Issues Paper specifies that the reason for removal of the interstate services is the pursuit of a consistent framework.¹⁴⁸ We do not consider this to be an issue for the reasons set out in our response to question 8.1.
389. In addition, Arc opposes this proposal for the reasons set out below.
- (a) One of the terms of the Lease is that the lease is subject to the WARAR, and no other regime.¹⁴⁹
 - (b) A significant regulatory burden would be imposed on Arc if two regimes were to apply to the same network, or the same parts of the network.
390. The question highlights a further issue with the proposals made, namely that by introducing consistency in one respect, inconsistency is introduced in another. Given the NCC's concern with inconsistency in the WARAR, introducing further inconsistencies, especially in addition to the NCC's concern about the application of different rules to other networks by State agreement, may reduce the chances of obtaining recertification of the WARAR.
391. In response to question 8.2(b), Arc notes that the Act only contemplates changes to the interstate services, rather than the line sections the interstate services operate on¹⁵⁰.
392. Arc is opposed to the proposals outlined in questions 8.2(a) and 8.2(b).

4.7.2 Issue 2: Certification as an effective regime

393. Arc supports the Government's intention to consider applying for the WARAR to be certified as an effective regime, following any changes to be made to the WARAR. This was the proposal made in the Issues Paper in relation to certification. Arc believes the WARAR to be the appropriate regime for networks in WA, particularly considering the diversity of existing networks, and the unique nature of each of those networks.
394. It is important to have a clear understanding of what the fundamental issues are with the WARAR, which may restrict future certification.
395. In December 2010 the NCC recommended the Commonwealth minister not certify the WARAR as effective.¹⁵¹ The specific issues identified in the NCC Report relate to the satisfaction of the second limb of the objects of Part IIIA of the CCA (s 44AA), namely '*to provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry*'.
396. The NCC Report identified a number of reasons why the second limb of the object was not met:

¹⁴⁸ Page 34, Issues Paper

¹⁴⁹ Above, note 129.

¹⁵⁰ Act, section 4(3) provides: 'Provision may be made in the Code to exclude its application to interstate services, and for that purpose, to define what is an interstate service.'

¹⁵¹ s1.2 of NCC Report

'The Council has been unable to discern an underlying policy that determines whether a railway is regulated, what is regulated (access to below rail services or haulage), by which regulator (ERA or ACCC) and what approach to key elements of regulation is adopted (for example whether a GRV or DORC approach to asset valuation is applied).'¹⁵²

While the CPA principles do not necessarily require all Western Australian railways to be subject to the Regime, the second limb of the objects of Part IIIA does necessitate that there be consistency in the approach to access regulation where it is applied through a state access regime. The current situation, and in particular the recent decision to regulate access to the proposed RHI railway via haulage and an access undertaking to the ACCC, brings to the fore an apparent lack of consistency in access regulation in Western Australia. While an historical legacy explains why the Pilbara railways owned and operated by BHPBIO and Rio Tinto are not subject to the Regime, the recent decision regarding access regulation of the proposed RHI railway suggests that while the WA Rail Access Regime exists there is no consistency in or certainty to its application. Looking forward there is nothing to suggest that the opportunity and ability to structure rail access regulation outside of the Regime, or potentially structure arrangements such that there is no access regulation, will not continue.'¹⁵³

397. Summarising these issues, the Issues Paper identified the reason for the lack of certification as being that the regime:

'... did not provide for a consistent approach to third party access to railways. This concern was based on the different regulatory approaches to rail access taken in iron ore State Agreements.'¹⁵⁴

398. Arc considers the following issues need to be addressed prior to the WA Government seeking recertification:

- (a) a lack of a policy determining which railways require regulation; and
- (b) a review of which railways should and should not be regulated.

399. Based on the scope of changes proposed by the Issues Paper, Arc does not consider that concerns raised in the NCC Report have been adequately addressed.

400. In any case, Arc notes the underlying assumptions of the NCC report need to be retested, as the comments made in s10.20 regarding the Roy Hill undertaking have not eventuated. Roy Hill stated in 2014 it was still considering its options regarding the potential route to regulation¹⁵⁵.

401. Arc is also cognisant of potential changes to the regulatory process stemming from the Competition Policy Review¹⁵⁷, particularly potential changes to the scope or constitution of the ACCC and NCC.

402. The Issues Paper raised 2 questions (numbered 8.4 and 8.5 respectively) regarding recertification:

- (a) whether the possibility of access seekers using either the WARAR or the NAR to access rail lines would be an issue for rail owners in WA; what would the costs, if any, of the duplication of regimes be and whether this could deter new investments; and
- (b) how important is consistency in approach to access regulation for new rail developers and what would be the benefits.

¹⁵² s10.19 of NCC Report

¹⁵³ s10.20 of NCC Report

¹⁵⁴ Page 36 of Issues Paper

¹⁵⁵ 2.13 <http://competitionpolicyreview.gov.au/files/2014/12/RoyHill.pdf>

¹⁵⁷ Recommendation 50, Ian Harper, Peter Anderson, Su McCluskey, Michael O'Brian, *Competition Policy Review*, March 2015, <http://competitionpolicyreview.gov.au/files/2015/03/Competition-policy-review-report_online.pdf> (accessed 15 November 2017)

403. In response to question 8.4, on 11 February 2016 the certification to the WARAR expired, opening another path for access seekers through the 'declaration' provisions in Part IIIA of the CCA. This additional path to access, and the existing route through the WARAR has the effect of duplicating regulatory oversight applicable to all networks already under the WARAR, resulting in several issues for network owners, which are set out below.
404. **Issue 1:** The ability for access seekers to run parallel access proposals, one under the WARAR and one under the NAR. If an access seeker were to submit parallel access proposals, this would place significant pressure on railway operators to appropriately address each, particularly considering the tight timeframes required by the Code. This presents a significant issue even when taking into account the limited protections the Code offers in section 27, which in some cases requires the appointment of a common arbitrator. Further, it is not clear how this requirement would be binding in the context of another regime. Even considering the protections offered under the Code pursuant to section 27, it is open to access seekers to run parallel processes. If this were to occur, it would:
- (a) impose a significant burden on the railway operator;
 - (b) reduce efficiency, which would undermine the object of the Act to '*...encourage the efficient use of, and investment in, railway facilities...*' (emphasis added); and
 - (c) allow the access seeker to shop for the best outcome, with the railway owner being unfairly bound to both.
405. **Issue 2:** Compliance with two regimes can be costly and time consuming. In general, regulatory compliance is a costly exercise with this cost increasing with additional prescription. Although this is a cost of doing business as the owner of a regulated asset, it is unreasonable for a regulated asset to be subject to two different regulatory regimes each ostensibly with the same purpose.
406. The current compliance costs for the WARAR are difficult to quantify. But, as an example, the costs related to the preparation of documentation for access seekers has previously been estimated as costing \$250,000.¹⁵⁸ This is a significant cost, and represents only one of the obligations network owners have under the WARAR.
407. Our recent experience with the CBH access request has shown that responding to these requests can incur significant expense. Compliance under the NAR would also impose significant costs, which has been recognised by the Productivity Commission.¹⁵⁹ BHP Billiton have noted that responding to the various FMG applications for declaration of its railway network cost '*in the order of hundreds of millions of dollars.*'¹⁶⁰
408. **Issue 3:** Deterrence of new investment - Arc considers the possibility of being subject to regulatory duplication is likely to reduce the willingness of existing and potential new network owners to invest, particularly given the significant increase in costs that would be involved.
409. Arc also notes regimes were not developed to apply concurrently. When regimes do apply concurrently it can result in untenable, illogical outcomes which ultimately defeat the purpose of regulation.
410. In order to address these issues, Arc recommends the government seek recertification of the WARAR as soon as possible, to protect railway owners against the imposition of unreasonable compliance costs and to ensure access seekers are prohibited from initiating parallel processes and 'regime shop' for an outcome.

¹⁵⁸ Roy Hill Infrastructure, *Submission to Competition Policy Review*, November 2014,

<<http://competitionpolicyreview.gov.au/files/2014/12/RoyHill.pdf>> (accessed 15 November 2017), s2.16(a)

¹⁵⁹ Productivity Commission, *National Access Regime – Productivity Commission Inquiry Report*, October 2013, <<https://www.pc.gov.au/inquiries/completed/access-regime/report/access-regime.pdf>> (accessed 15 November 2017), p215

¹⁶⁰ BHP Billiton, *Submission to the Competition Policy Review*, June 2014,

<http://competitionpolicyreview.gov.au/files/2014/06/BHP_Billiton.pdf> (accessed 15 November 2017) s6.16

411. With regard to question 8.5, while Arc believes that consistency at a high level is important, imposing identical processes on railway owners across WA is neither required by State or Federal legislation, nor would it serve to achieve the objective of efficient use and investment in railways.
412. Arc considers obtaining identical regulation between the various regimes to be unachievable, by virtue of the differences already existing in the regulation of other networks. This would fail to take account of the differences between each network, and more importantly, the differences between the tasks which those networks are comprised of.
413. To ensure consistency and recertification by NCC, all new rail developers should be regulated under the WARAR. If the State implements our proposals, this would provide sufficient flexibility for new developers to facilitate efficient investment in rail.

5 ERA Code Review 2014

Recommendation 5

414. Arc agrees with implementing this recommendation and propose section 11 be removed, as it refers to section 10.

Recommendation 6

415. Arc agrees with the proposed update to section 14, as a seven day timeframe is reasonable.
416. Arc does not agree with the seven day time frame being sufficient for section 15 and reiterate the submission made to the regulator in the 2014 Code Review, namely that a timeframe of 90 days is sufficient. Arc notes that this position was echoed by various other entities. Arc also recommend allowing this timeframe to be extended on request.
417. Following email correspondence with the Department of Treasury, Arc understands the reference to 'section 7a' should refer to 'section 7'. This reference was also present in the 2014 Code Review final report. Arc has responded assuming 'section 7' is the correct reference.
418. Arc does not agree with the changes proposed for section 18, for the reasons set out below.
419. The changes proposed limit the ability of the railway owner to express dissatisfaction with an access proposal due to the railway owner having to provide information under section 7. This position assumes that the information provided under section 7 is sufficient for the purposes of the proponent showing it has the financial and managerial ability, in addition to showing its proposed operations are within the capacity of the route.
420. The information provided under section 7 may not be sufficient to demonstrate these items, particularly whether the proposed operations are within the capacity of the route. In many cases, additional information will be required to assess this properly. For example, the information provided under section 7 requires railway owners to provide the 'indicative maximum train lengths', noting these train lengths do not necessarily relate to the access seekers proposed operations. Simply because one operator may be able to run a long train does not mean that every operator can; this can be due to limitations of (for example) rollingstock, availability of crossing loops or the type of locomotive power. The key issue is that some of the information provided under s7 is presented as indicative only, and for railway owners to properly assess this information, it needs to be tailored to each operation.
421. In light of our comments above, Arc considers that the proposed changes to section 18:
 - (a) will allow non-compliant access proposals to progress, which will cause additional cost and reduce efficiency;
 - (b) do not address the underlying issue, which is the relevance of the information provided under s7 to a specific operation; and

- (c) remove the ability of the railway owner to halt non-compliant access proposals, noting that the railway operator, not the access seeker, will be the more qualified entity to assess these proposals.

Recommendation 7

422. Arc has interpreted all references to section 9(3a)(3) of the Code as referring to section 9(3a) of the Code. This was an error in the Issues Paper stemming from the 2014 Code Review, which was confirmed by email correspondence with the Department of Treasury.
423. Arc generally agrees with this recommendation except in the following instances:
- (a) The timeframe in section 7(2) should be longer, as 10 business days is insufficient (we understand the 10 days is a translation from 'standard days' to 'business days').
 - (b) The timeframe in section 9(1) should be longer, as 5 business days is insufficient time to prepare and update floor and ceiling costs. This requires an update of network metadata and the analysis of unit rates, as a key input to the floor and ceilings needs to be reviewed and potentially updated. It is stated in section 2.3 of the Costing Principles that an 'independent consultants report' is used, which is almost certain to take longer than 5 business days. Arc proposes this be amended to 20 business days.
 - (c) If recommendation 5 is implemented (which we support), the reference contained in s 9(3a)(a)(ii) to s 10 (removed under recommendation 5) will be redundant. Section 9(3a)(a)(ii) will either need to be removed or varied to account for recommendation 5.
 - (d) Similarly, if recommendation 5 is implemented, the update to the timeframe in section 10(3) will also be redundant.

Recommendation 8

424. Arc agrees with amending the timeframe from two years to one year.
425. Consistent with our view on Recommendation 6, we submit that the required information should be reviewed for usefulness, as there is some information included in the dataset which is unlikely to be used by access seekers.

Recommendation 9

426. Recommendation 9 suggests amending the Code to clarify the meaning of 'available capacity', with a view to making it consistent with the current definition of 'capacity' under the Code. Arc's position on Recommendation 9 is to be considered in the context of the term 'available capacity' set out in Schedule 2 of the Code, and its use in determining whether access is available.
427. When providing an indication of available capacity for access requests, Arc has specified whether there is capacity (in binary terms), and whether the capacity sought by an access seeker can be accommodated. Arc has not specified the total number of remaining train paths at this stage, because we consider available capacity to be a flexible concept.
428. There are a number of interdependencies, which determine the amount of capacity available, such as the number of trains, average speed, the relative stability of services and the heterogeneity of traffic¹⁶¹. On the Arc Network all of these factors are highly variable, which means that a single definition or 'number' related to capacity would not be accurate. In Arc's view, the most important question for an access seeker relating to capacity, is whether or not their operation can be accommodated, which we attempt to answer categorically.
429. Arc considers that:

¹⁶¹ International Union of Railways, *Capacity*, June 2004, <<http://banportalen.banverket.se/Banportalen/upload/1753/HandbokUIC406.pdf>> (accessed 15 November 2017)

- (a) in accordance with rules of statutory interpretation, 'available capacity' simply means the 'capacity' (already defined under the Code) that is available. It is not clear what is missing in terms of a definition;
- (b) notwithstanding (a), the definition of 'capacity' under the Code is flawed and should be amended so it doesn't refer to a 'number' of rail operations consistent with the arguments made in paragraph 428.

Recommendation 10

- 430. Arc agrees with this recommendation and would add that the following change be included in the event of a dispute under section 26(1), namely that all parties (including the railway owner) are to be informed by the regulator.

6 ERA Code Review 2011

Final Recommendation 1

- 431. Arc agrees to publish on its website that the required information specified by sections 6(a) and 6(b) in Part 2A of the Code. Arc considers the information to be published is indicative only, and the standard form access agreement (required under section 6(a) in Part 2A of the Code) will contain standard 'boilerplate' terms, with other terms related to a specific access request left undefined and subject to negotiation.
- 432. Arc notes most of this information required under section 6(b) in Part 2A of the Code is already published on its website.

Final Recommendation 2

- 433. Arc agrees this recommendation should be implemented.

Final Recommendation 5

- 434. Arc agrees this recommendation should be implemented and suggest s 52(5) be reviewed for deletion.

7 Definitions

The following words have these meanings in this submission:

Act means the Railways (Access) Act 1998.

Arc means Act Infrastructure Pty Ltd.

Arc Network means Arc's 5,500km rail freight network leased to it under the Lease

ARTC means Australian Rail Track Corporation Limited

CCA means *Competition and Consumer Act 2010* (Cth).

CIRA Competition and Infrastructure Reform Agreement.

Code means the *Railways (Access) Code 2000* (WA).

Consistency Issue has the meaning given in paragraph 361

Costing Principles means the costing principles approved by the Regulator in respect of approved Part 5 instruments pertaining to Arc's Network.

DORC means depreciated optimised replacement cost.

EAB means established asset base.

EGR means the eastern goldfields railway.

ERA means the Economic Regulation Authority.

Expert Report means the Houston Kemp expert report prepared for Arc dated 16 November 2017 and attached to this Submission as Annexure A.

Government means the State Government of Western Australia.

GRV means gross replacement value.

Healthy Train means a train operating within 15 minutes of its scheduled times.

IAU means the document published by the Australian Rail Track Corporation Limited titled 'Access Undertaking' dated 15 July 2008.

Issues Paper means the document referenced as: Government of Western Australia, Department of Treasury, 'Review of the Western Australian Rail Access Regime Issues Paper', July 2017, <http://www.treasury.wa.gov.au/uploadedFiles/Treasury/Publications/Review-of-the-Western-Australian-Rail-Access-Regime-July2017.pdf> (accessed 5 November 2017)

LCL has the meaning given in paragraph 45.

Lease means, as the context requires, the:

(a) Rail Freight Corridor Land Use Agreement (StandardGauge) and Railway Infrastructure Lease dated 17 December 2000; or

(b) Rail Freight Corridor Land Use Agreement (NarrowGauge) and Railway Infrastructure Lease dated 17 December 2000.

NAR means the National Access Regime established under Part IIIA of the CCA.

NCC means National Competition Council.

NCC Report means the Final Recommendation from the NCC dated 13 December 2010 (<http://ncc.gov.au/images/uploads/CERaWAFR-001.pdf>)

ONRSR has the meaning given in paragraph 32.

Part 5 Instruments means, as the context requires, any one of, or all of, the TMG, TPP, Costing Principles and Overpayment Rules.

Preliminary Information has the meaning in the Code.

PTA has the meaning given in paragraph 32.

Required Information has the meaning in the Code.

Submission has the meaning given in paragraph 1.

State means the state of Western Australia.

TMG means the document titled 'Train Management Guidelines' approved by the Regulator in respect of approved Part 5 instruments pertaining to Arc's Network.

TPP means the document titled 'Train Path Policy' approved by the Regulator in respect of approved Part 5 instruments pertaining to Arc's Network.

WARAR means the Western Australian rail access regime, which comprises the:

(a) Act;

(b) Code;

(c) Rail Safety National Law (WA) Act 2015 (WA);

(d) Rail Safety National Law (WA) Regulations 2015 (WA); and

(e) Rail Safety National Law (WA) (Alcohol and Drug Testing) Regulations 2015 (WA).

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Annexure A – HoustonKemp report