Government of Western Australia
Department of Treasury

Review of the West Australian Rail Access Regime Issues Paper Report

Response by Roy Hill Infrastructure Pty Ltd

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1 Balance of Power in Negotiations

Issue 1 – Ability to opt Out

Proposals

Options for reform could include:

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.

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 remains unchanged.

Questions and Roy Hill's Response

1.1 What are the benefits of negotiating outside the Code?

There are significant benefits to negotiating outside the Code.

First, negotiations outside the Code may include all aspects of the operator's supply chain – for example, the operator's haulage arrangements and the shipping facilities at the port. In contrast, the Code applies only to (a) those parts of the railway network; and (b) the associated railway infrastructure which falls within the routes specified in schedule 1 of the Code. "Railway infrastructure" is defined to include the facilities necessary for the operation of the railway including the track, tunnels and bridges, stations and platforms, control and signalling systems but does not include rolling stock, maintenance facilities and office yards and depots.

The object of the *Railways (Access) Act 1998 (WA)* (**Act**) is "… to establish a rail access regime that encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations" (section 2A of the Act). In relation to the vertically integrated rail networks in the Pilbara, the Access Regime impedes the competitiveness of Australian industry and decreases the efficient use of railway facilities. The Australian Government Competition Policy Review, March 2015 (**the Harper Review**) concluded in relation to assets such as the Pilbara railways owned by The Pilbara Infrastructure Pty Ltd (**TPI**) and Roy Hill Infrastructure Pty Ltd (**Roy Hill**) " …imposing an access regime upon privately developed single-user infrastructure is more likely to produce inefficiency than efficiency, impeding the competitiveness of Australian industry. This is particularly so for vertically integrated export industries that are subject to the constraints of international competition in the final goods market."

Roy Hill has consistently submitted that it is not appropriate that the Pilbara railways owned by both FMG/TPI and Roy Hill should be governed by the Access Regime, because to the extent that the Regime applies to the vertically integrated railways in the Pilbara, it does not encourage efficient use of or investment in railway facilities. The Harper Review has now confirmed the previous submissions made by Roy Hill.

Secondly, the parties have more flexibility in negotiations conducted outside the Code. If a proponent submits a formal proposal to a railway owner in accordance with section 8 of the Code, the Code imposes obligations on both the railway owner and the access seeker in relation to:

a) what may be included in the proposal (sections 8(2), (3) (4));

b) the information to be provided by the railway owner, and the time frames within which the railway owner must respond to the proposal (section 9);

c) the financial and managerial capabilities required to be established by the proponent (sections 14 and 15); and

d) the timeframes within which the proponent must respond to requests by the railway owner for information.

Further, if the negotiations are within the Access Regime, any access agreement must address all 23 issues set out in Schedule 3, and give effect to the pricing regimes set out in Schedule 4 to the Code.

In contrast, the parties can determine how any negotiations outside the Code will be conducted, and the information and issues to be addressed in any access agreement.

1.2 Are there costs imposed on railway owners or access seekers by opting out of the Code and, if so, what are they?

No additional costs are imposed on the parties by choosing to opt out of the Code. The only risk assumed by an access seeker is that the negotiations may not be finalised, in which case the access seeker could then elect to submit a formal proposal under section 8 of the Code. The only loss suffered by the access seeker would be delay arising during the conduct of the negotiations.

1.3 Are negotiations outside the Code more likely to favour railway owners or access seekers and why?

Negotiations outside the Code will not favour either party. It is more likely that negotiations outside the Code will reach an acceptable outcome, because the parties are not bound the restrictions imposed by the Code. For example, the railway owner and an access seeker may agree that in their access agreement it is not necessary to deal with all 23 issues set out in Schedule 3. Further, an access seeker may decide not to invest in all the additional infrastructure which would be required to increase the capacity of the railway to the aggregate of the capacity required by both existing operators and the access seeker, and instead accept that in certain circumstances its rail operations may not receive the same priority as the rail operations of the existing users. Although that concession might contravene the "unfair discrimination" prohibition in section 16(2) of the Code, it is of course permissible if the negotiations occurred outside of the Code.

1.4 Would all or some of the reform options proposed above (a, b and c) improve the operation of the regime and why?

The reform options proposed above conflict with the essential requirements of the Commonwealth Principles Agreement made between the Commonwealth and the State and Territories on 11 April 1995 (**CPA**) in relation to the negotiation of access, enforceable rights to negotiate and dispute resolution. The key requirements of the CPA in this respect are:

a) access terms and conditions are to be agreed between the owner and the access seeker;

b) there is to be an enforceable right to negotiate;

c) if agreement on access cannot be reached the parties are required to appoint and fund an independent body to resolve the dispute; and

d) the dispute resolution body must take into account certain prescribed matters in resolving the dispute, set out in CPA clause 6(4)(i).

The WA Access Regime already requires that negotiations be conducted within prescribed parameters and with a number of predetermined elements of access which are prescribed by the Regime. The parties are not free to negotiate the terms and conditions of access, as required by the CPA. The reform options contained in paragraphs (a) to (c) above would only increase the prescriptive elements of the negotiation process. The WA Access Regime would thereby deviate even further from the requirements of the CPA.

Also, it is not appropriate to include a mandatory requirement that the railway owner not unfairly discriminate against an operator. This issue is dealt with in more detail in relation to "foundation customers" at question 6.4 below. Roy Hill has consistently submitted to the Authority that the concept of "unfair discrimination" requires explanation in the Code.

It is also not appropriate that the Part 5 instruments apply to all users of the railway, regardless of whether access to the railway has been negotiated within or outside of the Code. The Part 5 instruments are the costing principles, the overpayment rules, the train path policy and the train management guidelines. The railway owner and an operator may be prepared to accept railway access on a basis that is not consistent with the Part 5 instruments. For example, the overpayment rules may not apply to a particular operator, or an operator may require an opportunity to bid for additional train paths in a way which is inconsistent with the principles set out in the Train Path Policy.

1.5 Are there other options that would better address the problems associated with the opt out provisions?

Roy Hill is not aware of the particular problems referred to in relation to the "opt out provisions". Roy Hill submits that the Access Regime should be changed only to confer wider negotiation powers on the parties, so that the Regime complies more closely with the requirements of the CPA.

Issue 2 – Barriers to Negotiation

Proposals

Options for reform could include:

a) Reversing the onus to require that the railway owner must specify what, if any, extensions/expansions are required to accommodate the proposal.

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/expansion is technically and economically feasible and safe.

Questions and Roy Hill's Response

1.6 Does the requirement for the access seeker to demonstrate sufficient capacity and the feasibility of any extension/expansion create a barrier to access negotiations or imbalance in negotiating power?

No. The existing conditions precedent to a proponent making a proposal under the Access Regime are not adequate. The suggestion that the onus "to assess whether a proposal can be accommodated on a network and detailing any expansion required to accommodate the access seeker" might be placed on the railway owner fails to consider the already considerable expense and effort which is required to be incurred by a railway owner in response to a proposal.

A railway owner should only be obliged to respond to a proposal, and participate in negotiations with a proponent who has a real need to use the railway and who intends to enter into a binding access agreement for the use of the railway infrastructure. The Code should impose on a proponent:

a) a duty of good faith to the railway owner in making an access proposal;

b) a requirement that the proponent have a genuine intention to enter into an access agreement with the railway owner; and

c) a requirement that the proponent identify when access is required, not merely a time when from which access might possibly be required.

Roy Hill's concerns in this respect arise from the specific example which was the subject of the litigation in *TPI v Brockman Iron Pty Ltd* (Brockman) [2016] WASCA 36. In that case the Court decided that Brockman had made a valid access proposal under section 8 of the Code. The Supreme Court reached that decision despite the facts that:

"when the Proposal was made Brockman had not obtained required approvals and access rights to develop the Marillana Project including as to port infrastructure; Brockman had no finance for the multi-billion dollar project-its parent had only about $4million; Brockman had no bankable feasibility study for the project, which itself would cost about $50million and take between 3-4 years to prepare; Brockman had no port solution - it was estimated that port access would be available only by 2019; Brockman had no buyer for any iron ore which it might mine; and no final investment decision had yet been made to develop the project – such decision could take between two to four years after completion of any bankable feasibility study." (at page 49 of the judgment)

The Court recognised the futility of Brockman's proposal. At first instance Edelman J, after having confirmed the validity of Brockman's proposal, suggested:

"although I have concluded that Brockman Iron made a valid proposal within the meaning of the Code, this litigation raises real questions concerning when Brockman Iron can realistically engage in good faith negotiations for an agreement

to provide it with access to TPI's rail infrastructure. The costs associated with rail access are likely to be measured in terms of billions of dollars. The expert evidence at trial was that the funds available to Brockman Iron's ultimate parent to commit to the Marillana Project on 15 May 2013 were just over $4million. No external finance had been obtained. Brockman Iron has no bankable feasibility study. TPI's duty to negotiate under the Code is subject to matters including questions of finance. This consequence cannot be left without comment in my conclusion to these reasons.

From the perspective of Brockman Iron, although it had a legal entitlement to make a proposal, and although I have concluded that its proposal was valid, this costly litigation might have been avoided by the withdrawal of its proposal and submission of a new proposal if and when finance for the project was obtained. But the decision to conduct this litigation is not before the Court. It is sufficient to observe that Brockman's desire for negotiations could turn out to be entirely futile if it is unable to show that it has the managerial and financial ability to carry on the proposed rail operations to which TPI's duty to negotiate is subject."

Roy Hill understands that Brockman's proposal to TPI is the only formal access proposal which has been submitted to a railway owner under the WA Access Regime. Therefore, in the only proposal which has been lodged under the Regime, the Courts have suggested that the conditions precedent for the submission of a valid proposal have been inadequate – there is nothing to be gained if the legislation allows a valid proposal to be submitted, but the proposal may never lead to access, or indeed an access agreement, because the proponent cannot obtain the most basic requirements for the project (such as management, approvals, finance).

The Access Regime should not allow a proponent to make a valid proposal unless and until the basic requirements for a project have been obtained. Otherwise, there is a real possibility that the party's resources (time and money) will be wasted in both making and responding to the access proposal.

It would not be more efficient to place the onus on the railway owner to assess whether a proposal can be accommodated on the owner's railway. Only the proponent will know details of the access required – the quantity and quality of the ore proposed to be transported, the rolling stock proposed to be acquired, and the proposed entry and exit points. The railway owner should not be asked to assess any proposal until the proponent has satisfied the conditions precedent referred to above, and put forward a detailed proposal to the railway owner.

1.7 Is the requirement that the railway owner provide information to the access seeker to assist it in demonstrating these issues sufficient to address concerns with these obligations?

Yes. The Authority concluded at para 262 of the December 2015 Final Report on the Review of the Railways (Access) Code 2000 (**the 2015 Review**) that these concerns are adequately addressed by the obligations imposed on the railway owner by section 7A of the Code to provide information sufficient for a proponent to undertake a capacity assessment. Roy Hill accepts that conclusion.

1.8 If not, would all or some of the reform options outlined above (a and b) improve the operation of the regime and why?

As stated, Roy Hill considers that no reform is necessary.

1.9 If all or some of the reform options outlined above (a and b) were adopted, would it be reasonable to permit the railway owner to recover its costs from the access seeker?

If any reforms are adopted as a consequence of this Review which might impose additional costs on railway owners regulated by the WA Access Regime, those costs must be payable by the access seeker. A more detailed explanation of the reasons why competitive neutrality must be maintained between the four competing Pilbara railways is set out in the response to questions 2.1 and 8.4 below.

1.10 Are there any other barriers to access negotiation or imbalances in negotiating power in the negotiation framework in the Western Australian rail access regime?

Roy Hill considers that the only barriers to access negotiation or imbalances in negotiating power are commercial issues. A railway owner and a proponent will have a commercial imperative to negotiate an access arrangement if the arrangement will reduce the unit transport cost of the railway. If the railway owner and the proponent are not able to reach agreement, it is a strong indication that substantial inefficiencies will result from the access (see page 433 of the Harper Review).

1.11 If so, what reform options would address these concerns?

Reform options cannot address commercial issues.

2 Accountability

Issue 1 – Railway Owner accountability to comply with Regime

Proposals

Proposals to improve transparency and the railway owners accountability for compliance under the regime include:

a) Providing for more regular and consistent reporting of the railway owner's compliance with all of the Part 5 instruments.

b) Requiring 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.

c) Requiring the railway owner to publicly report on a regular basis (e.g. annually) on service quality matters, such as: track condition, percentage of track under speed restriction, percentage of train services delayed, percentage of train services cancelled, and average below rail delays.

Questions and Roy Hill's Response

2.1 Is the Western Australian rail access regime insufficiently transparent? If so, which elements of the regime would benefit from improved transparency?

The Issues Paper correctly states (at paragraph 3.2.2) that "regular reporting obligations impose a burden on railway owners in terms of costs and time to prepare reports."

Roy Hill submits that all railways in the Pilbara region should be subject to identical regulation. The existing patchwork of infrastructure regulatory regimes that regulate the iron ore railways in the Pilbara must be corrected. The WA Access Regime applies to the Roy Hill and TPI railways (although Roy Hill may elect to be regulated by the ACCC under Part 111 A, an option not afforded to TPI). However, BHP Billiton Iron Ore's Mount Newman and Goldsworthy railways and Rio Tinto's Iron Ore's Hamersley and Robe railways are only regulated to the extent of the regulation prescribed in applicable State Agreements. It follows that the imposition of any additional costs on Roy Hill and TPI by the WA Access Regime would impose an unacceptable competitive disadvantage on Roy Hill and TPI.

2.2 Would regular reporting by railway owners on their compliance with Part 5 Instruments improve the effectiveness of the Regime. Why or why not?

Regular reporting of compliance with the Part 5 Instruments is not necessary. The Authority has been vested with power to direct the railway owner to amend a Part 5 Instrument at any time and the Authority may inquire into and make recommendations to the Minister on matters relating to the operation of the Act and the Code (section 49 of the Code). Those powers are sufficient.

2.3 Would regular reporting by railway owners on the progress of access negotiations improve the effectiveness of the regime? Why or why not?

Regular reporting on access negotiations is not necessary. Regular reporting may adversely affect the progress of any access negotiations, and breach confidentiality obligations assumed by the railway owner and the access seeker. It is difficult to understand how reporting of the progress of access negotiations would benefit an access seeker, who might be obliged to report its negotiations with more than one railway owner.

2.4 Would regular reporting by railway owners of service quality promote more effective access negotiations? Why or why not?

Mandatory reporting obligations are already imposed on a railway owner by the Rail Safety National Law regarding the condition of the railway track. Reports must be submitted periodically to the Office of the National Rail Safety Regulator and incidents which occur on the railway must be reported. Monthly returns submitted by railway owners must include specific information, including:

a) length of track over which the railway owner has effective management control;

b) the number of kilometres travelled by trains; and

c) the number of employees engaged to undertake rail safety work.

It is not necessary or useful to impose further reporting obligations on a railway owner regarding the condition of the owner's track**.** Any further reporting obligations would impose an additional cost burden on those railways which are governed by the WA Access Regime. Roy Hill repeats its comments in its response to question 2.1 and 6.4 regarding the requirement that the access regimes which apply to all competing railways in the Pilbara must be competitively neutral.

Issue 2 – Regulator Accountability

Proposal

Including the option of merits review of regulatory decisions made under the Code is one option to increase regulatory accountability.

Questions and Roy Hill's Response

2.5 What are the advantages and disadvantages of including merits review of regulatory decisions in the Western Australian rail access regime?

A "merits based review" involves a reconsideration of the facts, law and policy as they apply to particular decision in order to determine the correct or preferable decision. The objectives of a merits based review are:

a) ensuring the fair treatment of all persons affected by the decision;

b) improving the quality and consistency of decisions; and

c) enhancing the openness and accountability of decisions made by government.

A merits review "should be available for decisions that affect the interests of a person unless there are particular reasons to exclude it" (Attorney – General's Department 2011 p 11).

"Judicial review" occurs when a court reviews a decision to verify that the decision maker used the correct legal reasoning or followed the correct legal procedures.

A merits based review may not be appropriate if a decision involves extensive inquiry processes such as public inquiries and consultations that require the participation of many people and that would be time consuming and costly to repeat on review.

There are also grounds to question whether the merits review process necessarily adds value in cases where there are likely to be divergent views about what constitutes the preferable outcome. The benefits of reviewing a decision and reaching a different but valid judgment may not outweigh the costs of undertaking the review, particularly where those costs are significant and the review process is lengthy.

2.6 What decisions made by a regulator under the regime should be subject to merits review, if it were to be introduced and why?

Roy Hill submits that the availability of a merits based review of a decision by the Authority is essential to ensure a balanced and fair regulatory system. The availability of a merits based review will assure or improve the quality of regulatory decision making. A merits based review will allow recourse to review the facts, law and policy of a decision in circumstances where the Regulator has made an error in its decision. This is necessary to satisfy potential infrastructure providers and their financiers that their legitimate business interests will be protected through recourse to a fair and equitable review process.

An administrative decision that is likely to affect the interests of a person should in the absence of a good reason be subject to review (Commonwealth Administrative Council, What Decisions should be subject to Merit Review? 1999 at para 2.4). Regulatory decisions under the WA Access Regime inevitably affect the interests of the infrastructure provider and their financiers as well as other stakeholders and so should be subject to a merits based review.

The decision of the Supreme Court of WA in the TPI/ERA case highlights why a merit's based review structure must be inserted into the Access Regime. Put simply, in the TPI/ERA case the Authority sought to prevent the review by the Supreme Court of its decisions regarding the calculation of the ceiling price on the basis that TPI had to establish "… the category of inferred error involving a decision that is so unreasonable that an inference of some other error must be drawn (bias, no evidence, irrelevant factors)" (para 149 of decision). At first instance Edelman J rejected that claim by the Regulator, and agreed with the assertions by TPI that the Regulator had erred in its calculation of the ceiling price in two ways: (a) by excluding contingencies from its calculation and (b) in its approach to the economic life of the railway. Edelman J commented that "… the combined error alleged, assuming aggregation of the two classes of alleged error and an equal annuity over a 20-year period, would be in excess of $2 billion for a 20-year access agreement".

Therefore, in the TPI/ERA case, the Authority sought to deny TPI an amount in excess of $2 billion to which the Supreme court ultimately decided that TPI was legally entitled to, on the ground that the Authority's decision, although it might be incorrect, could not be reviewed by a Court because the legislation did not permit a merits based review.

Roy Hill's view is that the TPI/ERA case highlights in the most obvious way, that the Access Regime must be amended to deprive the Authority of the ability to seek to protect its erroneous decisions on the basis that the decisions are only subject to a very limited narrow form of review.

2.7 What, if any, limits on the merits review process would be appropriate in order to ensure that the benefits of merits review outweigh the costs, e.g. time limits, limited to information available to original decision maker?

Roy Hill submits that all decisions of the Authority should be subject to a merits based review.

Roy Hill understands the argument that a merits based review may not be appropriate to decisions which have involved extensive public consultation and input by many industry participants. Although some decisions of the Authority involve a public consultation process (for example, finalisation of the Part 5 Instruments) in circumstances where the Authority has not adopted or followed submissions of the infrastructure provider, or indeed an access seeker, the decision should be subject to a merits based review if the provider or access seeker is dissatisfied with the Authority's decision. If the Courts consider that it is necessary to repeat the public consultation process, then that would not be an onerous requirement which would justify the abandonment of a merits based review structure, given how the Authority conducts its public consultation processes.

Issue 3 – Processes relating to Part 5 Instruments

Proposals

Implementing the ERA's Final Recommendation 4 from the 2011 Review may improve the process for approving Part 5 instruments and ensure they remain appropriate over time.

Final Recommendation 4
Part 5 of the Code should be amended as follows:

Section 42 should be revised to only require public consultation for variations to segregation arrangements considered by the Authority to constitute a material change.

Section 45 should include the costing principles and over-payment rules in order to ensure consistency in the public consultation process across all Part 5 instruments.

A new provision should be added to provide for the review of all Part 5 instruments every five years or as otherwise determined by the Authority.

Implementing the ERA's Final Recommendation 8 from the 2011 Review may improve the timeliness of the application of Part 5 instruments to new railways.

Final Recommendation 8

The Department of Treasury 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 six months prior to the commencement of the operations of the railway.

Questions and Roy Hill's Response

2.8 Would implementing Final Recommendation 4 of the ERA's 2011 Review assist in improving the transparency and accountability of the regulator's decisions to approve segregation arrangements and Part 5 instruments? Why or why not?

The implementation of Final Recommendation 4 of the December 2011 Final Report on the Review of the Railways (Access) Code 2000 (**the 2011 Review**) would improve the consistency of the legislation in its application to Part 5 Instruments. Roy Hill's response to each of the separate aspects of Recommendation 4 is as follows:

(a) section 42 – public consultation should only be required for the initial approval of an owner's segregation arrangements and material variations to those arrangements. It is not clear from the Issues Paper and the ERA's 2011 Review whether it is intended to retain public consultation for the initial approval – Roy Hill submits that public consultation should be retained for the initial approval.

(b) section 45 – the ERA has adopted the practice of seeking public consultation on a railway owner's costing principles and over-payment rules, despite the omission of this requirement from the Code. Roy Hill agrees that section 45 should be amended so that the Code is consistent in relation to all Part 5 Instruments, and conforms with the practice adopted by the ERA to seek public consultation on all Part 5 Instruments prior to tie final publication.

(c) 5 yearly review – Roy Hill notes that the Code permits the ERA to require that the railway owner amend any of the Part 5 Instruments at any time (sections 43 (6), 44(5), 46(4) and 47 (5) of the Code and section 29(3) of the Act). Therefore, Roy Hill would query whether it is necessary to formalise a requirement to review all Part 5 instruments every 5 years.

2.9 Would implementing Final Recommendation 8 of the ERA's 2011 Review help to ensure that timely access will be provided to new railways? Why or why not?

Final Recommendation 8 of the 2011 Review contemplates that Treasury undertake further consultation on the issues. Roy Hill is supportive of that further consultation and would seek to be an active participant in the consultation process.

The substantive issues regarding the adoption of a model set of Part 5 Instruments require more detailed consideration. In some areas, each railway owner will require that the applicable Part 5 Instrument reflects the internal organisation structures of the owner. For example, the segregation arrangements, train path policy and train management guidelines applicable to each owner may need to be different. The appropriate arrangements for an infrastructure owner (such as Arc Infrastructure) will be different to the appropriate arrangements for a vertically integrated business (such as Roy Hill and TPI). Further, the segregation arrangements for Roy Hill and TPI will also be different because the obligations in relation to (for example) the protection of confidential information and conflicts of interest will need to reflect the internal management structures of each company.

3 Capacity Expansions and Extensions

Issue 1 – Level of Detail in the Code

Proposals

One option to improve this element of the regime is to specify in greater detail a staged process for progressing an expansion, in which the scope, cost, cost sharing and risk allocation of the project is established in greater detail at each stage. This will provide the access seeker with greater certainty about the costs of an expansion. This needs to be considered in the context of the proposals outlined above for improving the negotiation process – specifically, the proposals to place the onus on identifying an appropriate expansion on the railway owner.

Options to provide further guidance on the expansion process include:

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 developing plans, 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).

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.

Questions and Roy Hill's Response

3.1 Does the lack of detail in the Code around the process for progressing an expansion or extension create a barrier to access negotiations or an imbalance in negotiating power?

The lack of detail in the Code around the process for negotiating an expansion or extension does not create a barrier to access. The requirements of the Code are adequate and sufficiently flexible to permit the requirements of any extension or expansion to be negotiated.

The access proposal submitted by the access seeker in accordance with section 8 of the Code may specify any necessary extension or expansion (section 8(4)), but the failure to detail an expansion or extension in the proposal does not prevent the access seeker subsequently proposing an extension or expansion (section 8(5)). Roy Hill submits that the Code should impose an express obligation on an access seeker to provide sufficient detail about the extension or expansion so that the railway owner may comply with its obligation under section 9(2) to provide the access seeker with "a reasonable preliminary estimate of the costs relating to any extension or expansion" (although Roy Hill acknowledges that the railway owner is not bound by the estimate or opinion provided to comply with its obligation under section 9(2) (section 9(3)).

Roy Hill has consistently stated that all obligations imposed on the railway owner in relation to any negotiations should be subject to the condition precedent that the access seeker has first satisfied the obligations imposed on it by sections 14 and 15 of the Code – the access seeker must have showed it has the management and staff, and the financial resources, to carry on the proposed rail operations and to contribute its share of costs.

3.2 If more guidance is provided under the Code, which of the approaches outlined above (a or b) would be most appropriate?

As stated in 3.1.2.1 above, Roy Hill is of the view that no further guidance is required. However, if the Code is to be amended, the introduction of a high-level set of principles to guide the negotiation would be the least intrusive to the negotiation process. The Issues Paper acknowledges that developing an expansion concept "can be very complex, time consuming and costly, with considerable uncertainty about the outcome" (page 17 of the Issues Paper). It is not appropriate to attempt to impose any further prescriptive detail around the negotiation process given the complexity and differences which arise in any access negotiations. Roy Hill's experience in successfully negotiating a haulage arrangement with a junior miner, which involved significant capital works to connect the proponent's mine site to the Roy Hill railway and to offload product at the port, confirms the complexity and uniqueness of each negotiation.

Issue 2 – Clarity around Timing of an Expansion Proposal

Proposals

The ERA considered it should be clear that an access seeker can propose an expansion or extension at any time after a proposal is made and recommended the following:[29]

Recommendation 4
Section 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.

Implementing Recommendation 4 of the ERA's 2015 Review may provide clarification that a proposal for an extension or expansion may be made at any time after a proposal is made under section 8.

Questions and Roy Hill's Response

3.3 Does a lack of clarity in the Code about when an extension or expansion proposal can be made create a barrier to access negotiations or an imbalance in negotiating power?

This issue arises only from the interpretation of section 8(5) of the Code which would limit the period within which a proponent might propose an extension or expansion to the period during "the course of negotiations". It has been suggested that the Code should be amended so that a proposal for an extension or expansion may be made at any time.

Roy Hill submits that this amendment would be acceptable, provided that the obligations imposed on an access seeker by sections 14 and 15 of the Code were required to be satisfied when the access seeker makes its initial proposal for access under section 8 of the Code. If the access seeker may propose an extension or expansion at any time, the access seeker should be required to have first satisfied the railway owner that the access seeker has the management and staff, and the financial resources, to implement the proposed extension or expansion. Otherwise the railway owner will be required to assess a proposal which the proponent may not have the resources (either personnel or financial) to implement.

3.4 If so, would implementing Recommendation 4 of the ERA's 2015 Review provide sufficient clarity on when an extension or expansion proposal can be made?

The implementation of Recommendation 4 would provide clarity around the issue. However, Roy Hill repeats its response to question 3.3 – recommendation 4 of the ERA's 2015 Review should only be implemented if the obligations imposed on an access seeker by sections 14 and 15 of the Code are accelerated so that the required information is provided to the railway owner with the initial proposal, or when the extension or expansion is proposed.

4 Pricing Mechanisms

Issue 1 - Indicative Tariffs

Proposals

To ensure that an approved indicative tariff is useful in guiding access negotiations, without imposing undue regulatory burden, one option is for the regulator to provide such a tariff in limited circumstances. These may include where:

a) the service is priced at the total cost;

b) there are a reasonable number of services using a route and they are relatively homogenous; or

c) the railway owner is vertically integrated (noting that the current access charge implicit in existing contracts may be a relevant consideration to this assessment).

Questions and Roy Hill's Response

4.1 Are the benefits of approved indicative tariffs likely to outweigh the costs in the following circumstances:

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

In response to questions 4.1(a), (b) and (c), Roy Hill is of the view that an approved indicative tariff would be inconsistent with the CPA. The CPA specifically required the Code to adopt the negotiated access agreement/arbitral dispute resolution approach to railway regulation. The object of regulating infrastructure to promote competition is concerned with competition in dependant markets and ensuring economic efficiency, which relies on freedom of negotiation.

Recent regulatory developments and judicial pronouncements have encouraged a less prescriptive approach to pricing. The High Court's adoption of the "private profitability" test, instead of the social benefit test and the natural monopoly test, in *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 (**the TPI v ACCC case)** (see the answer to question 4.3 below) suggests that a service cannot be declared if it can be shown that an existing or future market participant could reasonably expect to obtain a sufficient return on capital if it duplicated the facility to provide the service. A service should be regulated only if there is no one who would find it economic to develop another facility to provide that service.

The adoption of a prescribed benchmark tariff is unlikely to allow "… third party access to [be] provided … on the basis of terms and conditions agreed between the owner of the facility and the person seeking access." (CPA section 6.e.1)

4.2 Are there other circumstances where the benefits of approved indicative tariffs would be expected to outweigh the costs and, if so, why?

An approved indicative tariff is not appropriate in the case of a vertically integrated railway, where each access seeker may have assumed quite different risks in connection with the service.

Issue 2 – Assessing the Capital Charge using GRV

Proposals

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.

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.

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.

Questions and Roy Hill's Response

4.3 Would the use of an EAB approach in place of GRV, as recommended by the ERA in Recommendation 2 of its 2015 Review:

(a) provide more effective guidance to access seekers as to a reasonable access charge, given the age and condition of the assets?
(b) reduce the investment risks related to greenfield railways or major brownfields extension/expansions?

At paragraph 147 of the Final Report for ERA's 2015 Review, the Authority concluded that "the utilisation of an EAB approach will provide an increased level of prescriptiveness in relation to the economic value of assets…" Roy Hill favours the "light handed" regulatory approach encouraged by the CPA and Roy Hill's preliminary view is that the GRV approach is better suited to the requirements of the Access Regime and is consistent with the most recent judicial comments by the High Court on the correct approach to the valuation of assets. The High Court decision in the TPI V ACCC case involved an application by TPI for railways owned by BHP and Rio Tinto in the Pilbara region to be declared, which in turn involved an interpretation of the requirement that it must be uneconomic for anyone to develop another facility to provide the service. Put simply, a service cannot be declared, and therefore be subject to an application for access by a third party, unless it is uneconomic for anyone to develop another facility to provide the service. The High Court held that this should be determined on a "private profitability test". Under this test a service cannot be declared if it would be profitable for any person, including the existing railway owner, to establish a second facility to provide the service. In the case of the Pilbara railways, it has clearly been economic for another party to duplicate the service, because TPI and subsequently Roy Hill have built railways which duplicate the existing BHP and Rio Tinto railways.

The Harper Committee correctly concluded that the CPA was intended to be a regime for access to services where:

(a) it would not be economic to duplicate the facility; and
(b) access to the service is necessary to permit effective competition in a downstream or upstream market (at page 433 of the Harper Committee Review).

If it is commercially feasible to develop another facility the railway owner and the access seeker have commercial incentives to reach an access agreement where it is efficient to do so. The ceiling price for the access seeker will be the replacement cost of a new railway, and the railway owner will have an incentive to allow access if its overall costs can be reduced.

It would follow that, in the situation where a service such as a railway can be replicated by an access seeker (which applies to the Pilbara railways), the Access Regime should provide that the ceiling price is the replacement cost of the railway. This would suggest that the correct basis on which the access charge (or the price of access) should be calculated is not the current condition of the railway's owner's asset, but the cost of replacing that asset.

Further, the existing Access Regime only requires that floor and ceiling costs are determined after receipt of an access proposal. The existing Access Regime requires only that the GRV is determined at that particular time. If an EAB approach were introduced, the Authority would need to ensure that the administrative burden imposed on a railway operator was not increased by requiring a regular redetermination of costs (for example whenever an expansion or extension to the railway was completed) in the absence of an access proposal in order to be able to establish the historic cost of the railway.

The Authority must ensure that the introduction of an EAB approach does not involve significantly more regulatory complexity. The GRV approach requires only an assessment of replacement cost following receipt of an access application. In contrast, an EAB might require a level of cost transparency not currently required, and which would require continued and ongoing scrutiny by the Regulator of railway owner's costs and records.

Therefore, further information and detail about any EAB approach which is proposed to be implemented is required before Roy Hill can finalise its view about whether the GRV or EAB approach is the appropriate valuation methodology.

4.4 What are the specific consequences for existing railway owners of changing from a GRV approach to an EAB approach, particularly where they have invested on the basis of a GRV based regulatory framework?

At a practical level, the EAB approach requires information regarding the initial cost of the railway. The initial cost is the base figure from which the annual depreciation cost would be calculated. Although this information is available to Roy Hill in respect of its railway, it simply may not be possible to calculate the initial cost of an older existing railway.

The consequences of implementing an EAB approach will be least in the case of the recent greenfields developments, in that the GRV and the EAB will be closely aligned. If applied correctly the GRV and EAB should provide similar net present values. They will provide differences in the timing of cash flows, which can lead to changes in net present value, which will penalise or advantage the access provider or the access seeker. .

4.5 If an EAB valuation method is to be applied, should other elements of the pricing provisions be amended to align with the use of a depreciated asset value, including:

(a) should capital costs be assessed as the sum of depreciation and return on assets, potentially allowing some flexibility in the depreciation profile to be used?
(b) should capital investment, including extensions and expansions, be included in the EAB?
(c) should the definition of costs used to determine the incremental and total costs be better aligned with efficient costs for (at least) the period for which access is sought, given the actual age and condition of the assets?
(d) should merits review be made available for ERA decisions on costs, in line with Recommendation 3 of the ERA's 2015 Review?

The response to each of these questions in questions 4.5(a), (b), (c) and (d) is "Yes". The pricing provisions in Schedule 4 of the Code would need to be reviewed in their entirety if an EAB valuation was adopted. As stated above, although Roy Hill is in a position to ascertain the initial cost of its railway, it may not be possible to calculate the initial cost of an older existing railway. It is important that all costs be included. For example, the definition of "Operating Costs" should include all land rental payments to Government or annual payments to land owners.

Issue 3 – Uncertainty about pricing for major expansions

Proposals

Implementing an EAB may enable greater clarity and certainty around the pricing of expansions. An EAB approach allows the floor and ceiling costs to be determined based on the EAB of the route prior to the expansion, plus the forecast expansion costs (including staging costs). The incremental cost for the access application would include the capital costs associated with the expansion.

Similarly, any subsequent calculation of the floor or ceiling costs (e.g. for future access seekers or for the over-payment rules) would reflect the EAB prior to the expansion plus the expansion costs.

Questions and Roy Hill's Response

4.6 Does the lack of guidance on pricing of expansions create a barrier to access negotiations or an imbalance in negotiating power where major extensions or expansions are required?

The lack of guidance on pricing an expansion or extension does not create a barrier to access. At present section 9 of the Code requires an initial non-binding determination of "costs" and a reasonable pre-estimate of the costs relating to any extension or expansion, and the railway owner's opinion as to the share of those costs which are payable by the proponent. Section 6 of Schedule 4 to the Code requires that the parties must, in negotiating the price to be paid for the access, take into account:

(a) the costs to be borne by the railway owner and the proponent; and

(b) the economic benefit to the railway owner and the proponent resulting from the extension or expansion.

The Authority concluded in the 2015 Review that no recommendation to amend the Code was necessary on this issue as the costs of any extension or expansion are not subject to the Code until such time as they are constructed. After construction the regulated costs of the extended route must be reviewed if the railway owner wishes the total cost to be determined for the purpose of administering the overpayment rules in respect of the extended route.

4.7 If so, would the use of an EAB and inclusion of expansion costs in the determination of floor or ceiling costs assist the negotiation process?

As stated, Roy Hill's view is that the lack of guidance on pricing of expansions does not create a barrier to access. Indeed, the flexibility of the existing structure would assist the negotiating process because it can accommodate the very different proposals for an expansion or extension.

4.8 Does the inconsistency between how costs, including expansion costs, are assessed for the purpose of an access application, and the subsequent assessment of costs for the over-payment rules or later access applications, create a risk that railway owners will not recover these costs or may over recover costs?

The alleged inconsistency is only that the costs of an expansion or extension for the purposes of an access application are based on a negotiated outcome. For the purposes of calculations in the over-payment rules those amounts are replaced by the actual construction calculated following completion. Roy Hill is not dissatisfied with that process. The alternative proposal in support of the EAB requires the calculation of floor and ceiling costs based on the estimated costs of the expansion or extension. As the floor and ceiling prices are based on estimated amounts, there is an inevitable possibility of error in that the actual costs of the expansion could be quite different to the estimated amounts.

5 Marginal Freight Routes

[no comment]

6 Greenfields Development

Issue 1 – Uncertainty relating to Greenfield Developments

Proposals

Possible amendments include:

(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.

(c) Allowing railway owners or developers to apply to the regulator for a binding no coverage ruling for a specified period.

Questions and Roy Hill's Response

6.1 Would the proposals outlined (a, b or c) improve the operation of the regime?

Yes. Roy Hill is particularly aware of the issues which arise in the context of a Greenfields development. There are two separate issues:

(a) the Access Regime should not apply to a railway until the development is complete and has been operating at full capacity for a certain period (say 12 months). Roy Hill's experience is that access by a third party cannot be considered in the case of a vertically integrated railway with a foundation customer until the railway is operating at least at nameplate capacity. A third party should not be able to seek or obtain access to a railway at any time before the railway owner is satisfied that the railway is fully operational. The project Sponsors should be satisfied that all design and operation risk has been satisfied before a third party can seek access to the asset. This would eliminate the possibility that a third party might apply for access to the railway during the "ramp up" initial phase of the railway which might otherwise delay or disrupt the railway owner from reaching its optimal efficiency with the foundation customer as soon as practicable.

(b) the railway owner should be permitted to apply to the regulator so that the Access Regime does not apply to the railway for a particular period. For example, if the railway was damaged or destroyed, or required major maintenance the Regime should not apply for the period required to repair or reinstate the railway.

(c) the costing principles and the pricing should reflect the actual cost to the railway owner of the asset. The actual costs of the assets can only be determined finally after the railway is fully operational in the sense that it has reached nameplate capacity. Further, the permitted depreciation should reflect the actual useful life of the asset. Therefore in the case of a mine with a finite life, the depreciation costs applicable to the assets which service that mine should reflect the life of the mine and the actual cost of the asset. Depreciation or the economic life of the assets should not be required to be calculated on the basis of estimated costs of the infrastructure prior to completion, and on the basis that the assets may be used after the life of the railway owner's mine, by another party to service another mine.

(d) the costing principles should permit the recovery from the access seeker of any amounts which have been calculated incorrectly because the life of the mine has been adjusted. For example, if the ceiling and floor costs had been calculated on the basis of a mine life of 20 years, and it transpired that the life of the mine was only 15 years, then the depreciation cost to an access seeker should have been substantially greater. Roy Hill would submit that the difference should be recoverable form the access seeker.

6.2 Are there any other amendments that would improve the operation of the regime for greenfield railways?

The most significant amendment to the Code which is required to encourage Greenfields developments is that the railway owner must be able to confer priority on the foundation customer over the rights of third party access seekers. This is addressed in issue 2 below.

Issue 2 – Treatment of Foundation Customers

Proposals

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.

Questions and Roy Hill's Response

6.3 Are the costs and risks borne by foundation customers materially different to the costs and risks borne by subsequent access seekers? If so, what are the main differences?

Yes. The costs and risks borne by foundation customers are significantly greater than the costs and risks borne by subsequent access seekers. The foundation customers of the two Pilbara railways subject to the Access Regime have been related to the railway owners. Typically a Sponsor Group consisting of the equity and debt providers will initially assume all project risk, and seek to allocate that project risk amongst themselves and the project contractors. It is important to understand that :

(a) the infrastructure will be purpose built to meet the requirements of the Sponsors. The capacity of the infrastructure will be determined according to the requirements of the Sponsors;

(b) the cost of the infrastructure will be calculated to accommodate the volume of product available to the Sponsors;

(c) the investor will seek to achieve a rate of return on the investment to provide adequate risk compensation to the Sponsors;

(d) the Sponsors will expect that the operational assumptions underpinning the project will not be subject to unreasonable alteration; and

(e) the Sponsors will have invested in logistics infrastructure (mine and port) to minimise integrated supply chain risk.

The risks which have been assumed by the Sponsors of both existing Pilbara railways subject to the Access Regime, and which would be assumed by any further project sponsors will include:

(f) financial risk - the Sponsors will have contributed equity and will have assumed all financial risk related to the Project. If the Project is unable to support the debt levels contributed by financiers, the Sponsors will typically have assumed obligations to repay the debt, which will be enforceable against the Sponsors;

(g) construction risk – although the Sponsors will seek to allocate construction risk and costs risk through a fixed price D&C contract to the D&C contractor, typically the D&C contractor will not accept all construction risk. The Sponsors will be required to assume some delay risk and some cost risk (for example, force majeure);

(h) design risk – the contractor will accept construction risk in the sense that what they construct meets the design specification, but not the risk that the design will deliver the required capacity. The Sponsors will be required to assume that risk;

(i) asset performance – contractors engaged to provide mining, haulage and maintenance services will accept some performance risk (with limited liability) but the Sponsors will assume all residual risks;

(j) integrated logistics performance risk – the Sponsors will assume all risk of co-ordination of the mine, port and rail infrastructure. The Sponsors will have aligned the configuration and operational performance of the infrastructure to match the contractual requirements of offtake arrangements and mine operational performance; and

(k) supplier credit risk – the Sponsors are exposed to the basic financial risk that infrastructure suppliers perform contractual obligations. The risk can be mitigated by security (parent guarantees or performance security) but the financial risk is not typically eliminated entirely, in that the disruption costs of a contractor insolvency are not usually completely recovered.

Where the foundation customer is a part of the Sponsor Group, which has been the case in both the Pilbara railways, the foundation customer of the railway has assumed these risks. A subsequent access seeker will not have assumed these risks.

Typically, a foundation customer will offset operational risk by ensuring that the railway has some excess capacity. The excess capacity may be needed so that any shortfall arising for any reason (for example from unscheduled maintenance or a force majeure event such as a cyclone) can be redeemed quite quickly. An access seeker cannot increase the operational risk profile of the railway by using some of the foundation customer's excess capacity. The quantity of infrastructure contributed by the access seeker must be sufficient so that the foundation user maintains the same level of excess capacity to ensure that its operational risk profile is not adversely affected.

6.4 Should the Code permit different treatment of foundation customers of a greenfield railway development to subsequent customers to reflect differences in cost and risk?

Yes. At present, section 16 of the Code prohibits "unfair discrimination" between one proponent and another. The Code does not clarify the meaning of "unfair discrimination". Roy Hill has previously suggested to the Authority (in its submission as part of the 2015 Review of the Access Regime by the Authority) that the reasons which give rise to permissible discrimination should be prescribed in the Code, and should be construed in light of the commercial risks that the railway owner has assumed in developing the assets. Roy Hill has referred to the definition of "discriminate" in regulation 23 of the Gas Transmission Regulations 1994 (WA) (now repealed) for a well constructed and well drafted approach to the issue of permissible discrimination. This would be consistent with the requirements of the CPA, which states that it should be construed in light of the commercial risk that the railway owner incurred in developing the assets (CPA section 6. f.2.1). Discrimination, or different treatment, should be permitted according to:

(a) the operator's contribution to capital costs and risks;

(b) the operator's contribution to operations and maintenance costs;

(c) credit risk;

(d) the financial security offered by the access seeker;

(e) supply chain disruption risk; and

(f) the extent of any cross subsidy between existing operators and new operators.

6.5 Are there particular issues that need to be addressed when the foundation customer is related to the railway owner? If so, how should these be best managed (e.g. arm's length pricing)?

Roy Hill notes that the CPA allows for:

"Multi part pricing and price discrimination when it aids efficiency [but does] not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operations is higher."

As stated in 6.4, the CPA is to be construed according to the commercial risk that the railway owner has incurred in developing the assets.

Pricing is a reflection of risk. Accordingly, it would be wrong to suggest that the price of access to all operators should be the same.

Roy Hill submits that the access arrangements for operators should reflect the risk allocations set out in 6.3 and 6.4 above. The foundation customer may receive priority over other contracted tonnage for the foundation tonnage which formed the basis of the investment decision. The foundation customer is entitled to a "most favoured nation" clause in the foundation access agreements, so that the foundation customer has certainty that any subsequent access seekers can be provided with no better terms than those initially agreed by Sponsors.

Roy Hill notes that its request to embed a priority to its foundation customers in its Part 5 Instruments (in particular the Train Path Policy and the Train Management Guidelines) was not accepted by the Authority. This is inconsistent with the view that the contractual arrangements with operators should reflect the risk assumed by the parties.

7 Vertically Integrated Rail Networks in the Pilbara

Issue 1 – Delays in access

Issue 2 – Recouping Cost for Owners

Proposals for Issues 1 and 2

The proposals in this section aim to address both delays in access and the need for railway owners to recoup costs.

Improving the existing below rail access regime will better facilitate access to covered railways in the Pilbara, both for existing and for future railway developments. A more effective regime should help junior miners obtain access to covered rail lines in shorter timeframes and at lower costs.

A regime which places greater obligations on railway owners, however, will increase the cost of access to railway owners. Railway owners may also bear extra costs because of compliance and monitoring requirements relating to specific and detailed technology standards used in vertically integrated iron ore lines. However, these risks can be managed by ensuring that the railway owner can recover all of the efficient costs of access as part of the negotiation/regulatory process.

Another option to manage some risks and costs for railway owners is to introduce a haulage regime to augment the Western Australian rail access regime. A haulage regime offers third parties access to a bundled below and above rail service. Under a haulage regime, a railway owner transports the third party's iron ore in its own rolling stock (in contrast to a below rail access regime in which the third party operates rolling stock on the railway owner's network).

Importantly a haulage regime for vertically integrated Pilbara railways could reduce the costs associated with providing rail services. While not eliminating all coordination costs, providing haulage services to third parties would not impose the same operational constraints and loss of flexibility as providing access to a third party rail operator.

In addition, under a haulage regime, there is less need to negotiate detailed terms and conditions relating to the same range of interface and train scheduling issues noted above. This reduces matters for negotiation and potential dispute, and also somewhat limits the scope for misuse of market power by the railway owner on non-price matters.

A haulage regime is therefore likely to reduce the cost of access to the railway owner, while still providing access to third parties and promoting competition in related markets.

However, a haulage regime does effectively extend economic regulation into a potentially contestable market (the above rail market), which may limit the railway owner's incentive to innovate and improve the efficiency of above rail operations. The contestability of the above rail market would depend on the particular circumstances of the rail network in question.

Given there is no precedent for a haulage regime in Australia, there is some uncertainty as to the outcomes and the type of haulage arrangements that would satisfy the National Competition Council's (NCC) certification process.

A haulage regime will not be developed as part of this review. However, because of its relevance and potential to augment an improved Western Australian rail access regime public feedback is valuable. The Government has previously worked with industry through the Pilbara Rail Access Interdepartmental Committee (PRAIC) on the development of haulage legislation to regulate access to the Pilbara iron ore railways. However, the draft legislative regime, being developed by the PRAIC, was very detailed and never entered parliament. A light-handed approach to haulage would be more consistent with the Western Australian rail access regime. Some of the principles and feedback developed during the PRAIC process could inform the design of a future haulage regime.

The main elements of a haulage regime would be substantially the same as the existing Western Australian rail access regime (i.e. a negotiate-arbitrate model). However, there would need to be some modifications to reflect the different nature of a haulage regime. For example, pricing would need to reflect a combined above and below rail service. Also, some of the Part 5 instruments, such as policies around train management, could be replaced or may no longer be required, and while costing principles and segregation arrangements will still be required they may need to be modified.

Determining which regime should apply to a particular railway, could be at the Government's discretion or, alternatively, the railway owner may be allowed to nominate the regime under which it wishes to operate.

Questions and Roy Hill's Response

7.1 What, if any, benefits are there to promoting more effective arrangements for new mines to access railways in the Pilbara region? What costs would be imposed as a result?

It is important that any assessment include an analysis of the additional costs and risks associated with third party access:

(a) operational and maintenance costs and risks – additional operational and maintenance costs will be incurred. These costs can be quantified and recovered from the third-party access seeker. However, third party access will increase the complexity and cost involved in managing the expansion or increased utilisation of the network. The railway owner will be exposed to additional risk in scheduling, safety, reliability and maintenance of the network.

(b) access seeker credit risk – the railway owner will seek to minimise this supplier credit risk by the use of security. However, the third-party access seeker will be required to commit to the network expansion and the capital required in connection with the railway to meet the needs of the access seeker.

(c) expansion option value loss – where access is grant to a third party, available capacity may be used, which might reduce the owner's flexibility in managing expansion profiles and the owner's ability to accommodate any price volatility;

(d) supply chain disruption risk – the risk of disruption to the owner's complete supply chain (mine, rail, port) is increased, as the owner will not have complete control of the railway. Any shortages in one area (for example stockpiles at the port) may not be corrected as easily and simply when a third party has access rights to the railway.

The true cost of third party access is therefore greater than the direct infrastructure capital and maintenance costs, and are not easily quantifiable and therefore recoverable from the access seeker. The risks would not have been included in the initial risk assessment by the Sponsors.

7.2 Would an improved Western Australian rail access regime (i.e. a below rail regime) effectively facilitate access for access seekers to vertically integrated rail networks? What are the advantages and risks? What costs and risks for the owners of vertically integrated rail lines can be easily recouped through the Western Australian rail access regime pricing mechanisms, and what cannot?

The reasons why junior miners have not used the Access Regime to gain access to established railways in the Pilbara are not any perceived deficiencies in the WA Rail Access Regime. The Regime is not the cause of the lack of access granted to third parties. External factors such as the cost of developing the infrastructure at a mine and at the port of Port Hedland to permit the export of product, and the availability of finance for those projects, is the reason. Brockman Iron applied for access to the TPI/FMG railway. The mine proposed by Brockman Iron has not been developed. If FMG/TPI and Brockman had successfully negotiated the terms and conditions of access, the mine proposed by Brockman would nevertheless not have been developed. The lack of development is due to the external factors, not the terms and conditions of the Regime.

Roy Hill was able to successfully negotiate the terms of a haulage agreement with an independent third party junior miner in 2015. Similarly, the developments contemplated by that arrangement have not proceeded. The failure of those developments to proceed is due entirely to external factors, not any deficiencies in the Access Regime.

7.3 Could a haulage regime, comprising bundled above and below rail access help to facilitate access for new mines to railways in the region? What are the benefits of such a haulage regime for rail owners and access seekers?

Roy Hill has previously submitted to the WA State Government in negotiations for its State Agreement, that the Access Regime produces inefficient outcomes for a new railway in the Pilbara constructed for the purposes of transporting iron ore from an inland mine to a port. Roy Hill has submitted that the most efficient service having regard to the requirements of the railway owner and the third party access seeker for the carriage of iron ore was a haulage service. Roy Hill proposed that the Authority would be permitted to approve the most efficient asset valuation methodology, and tariff setting approach in each application and take into account the interests of the railway owner or prospective investor.

The benefit to the railway owner of a haulage service is that the owner maintains control of the operation and maintenance of the railway. From the railway owner's perspective, the coordination risks, which contemplate more than one party operating rolling stock on the same railway at any one time, are eliminated. From the access seeker's perspective, a haulage service may reduce the initial capital investment, if it results in a reduction in the cost of the rolling stock which needs to be acquired to provide the service.

7.4 What, if any, implications would the haulage regime options have for the other issues raised in this paper?

A haulage regime involves the regulation of the provision of a haulage service by an operator, coupled with access to the railway infrastructure. Although the existing Access Regime addresses the issues which arise in the context of access to infrastructure, it does not address the issues which arise in the context of regulating the provision of a service whatsoever. The Regime would have to be expanded to cover the regulation of the provision of service by a third party. Roy Hill suggests that the complexity of a haulage regime is perhaps greater than as contemplated in the Issues Paper, which refers to pricing (which would need to reflect a combined above and below ground service), and the Part 5 instruments (which may need to be modified or not needed at all). The regulation of a service (such as a haulage service) involves issues such as service performance and service quality, all of which would need to addressed.

Roy Hill notes that the development of a haulage regime is not part of this review.

7.5 Under what circumstance should a haulage option be available to owners of vertically integrated rail networks?

A haulage regime should always be available as an alternative to a railway owner. In paragraph 7.2 Roy Hill suggested that it is likely that the provision of a railway haulage service would be preferable to rail access.

8 Consistency with National Access Regime

Issue 1 - Interstate Freight Routes

[Not applicable to Roy Hill]

Issue 2 – Certification as an effective regime

Proposals

The Government intends to consider applying for the Western Australian rail access regime to be certified as an effective regime after any changes to the regime have been made. Any changes arising from this review process should account for the possibility of certification.

A consistent regulatory approach to rail access for new rail lines will strengthen the case for recertification of the Western Australian rail access regime.

Questions and Roy Hill's Response

8.4 Is the possibility of access seekers using either the Western Australian rail access regime or the NAR to access rail lines an issue for rail owners in Western Australia? What are the costs, if any of the duplication of regimes? Could this deter new investments?

There are two aspects to this issue. First, only one regulatory regime should govern access to the Roy Hill railway. It should not be necessary for a railway owner to comply with two separate overlapping regulatory regimes. Roy Hill's experience is that third party access is an important issue for Sponsors and investors, because it affects the risk profile of the project. If a regulatory regime conferred on a third party an absolute right to access, which could adversely affect the supply chain of the railway owner, the investor or financier will include that risk in assessing the risk profile of the investment.

Secondly, it is a significant deterrent to investment in railways in Western Australia that at present two regulatory regimes govern third party access to the Roy Hill railway, and that different regulatory regimes govern other railways in the Pilbara region (see the response to question 2.1 above). At any time, Roy Hill or the owners of the competing railways could be placed at a competitive disadvantage if the regulatory regime governing the railways were changed. Compliance costs could be increased or decreased to influence the costs applicable to different railways. Stakeholders (sponsors, financiers and contractors) are entitled to certainty in relation to the regulation of their railway.

8.5 How important is consistency in approach to access regulation for new rail developers? What are the benefits?

Section 2A of the Act states that the objective of the Act is "to encourage the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations". That objective cannot be achieved if different regulatory regimes apply to competing railways. Consistency of approach is crucial. One regulatory regime should apply to all competing railways in the Pilbara region. This absolute need for the consistency of regulation applies to the four Pilbara railways because they operate in the same upstream and downstream markets. The Pilbara railways are totally within the State of Western Australia. Accordingly the Access Regimes which apply to railways in other jurisdictions (which at present are not involved in the same upstream and downstream markets) need not be absolutely consistent with the WA State Access Regime. However, if a railway operator proposed to commence operations (which competed with Roy Hill) in another Australian jurisdiction, the regulatory access regime which applied to that new entrant must be the same or a similar regulatory regime as that which applies to Roy Hill.

Amendments from the ERA Code Reviews that the Government intends to Implement

ERA Code Review 2015 – Roy Hill supports the implementation of each of the Recommendations proposed to be implemented.

ERA Code Review 2011 - Roy Hill supports the implementation of each of the Recommendations proposed to be implemented.