

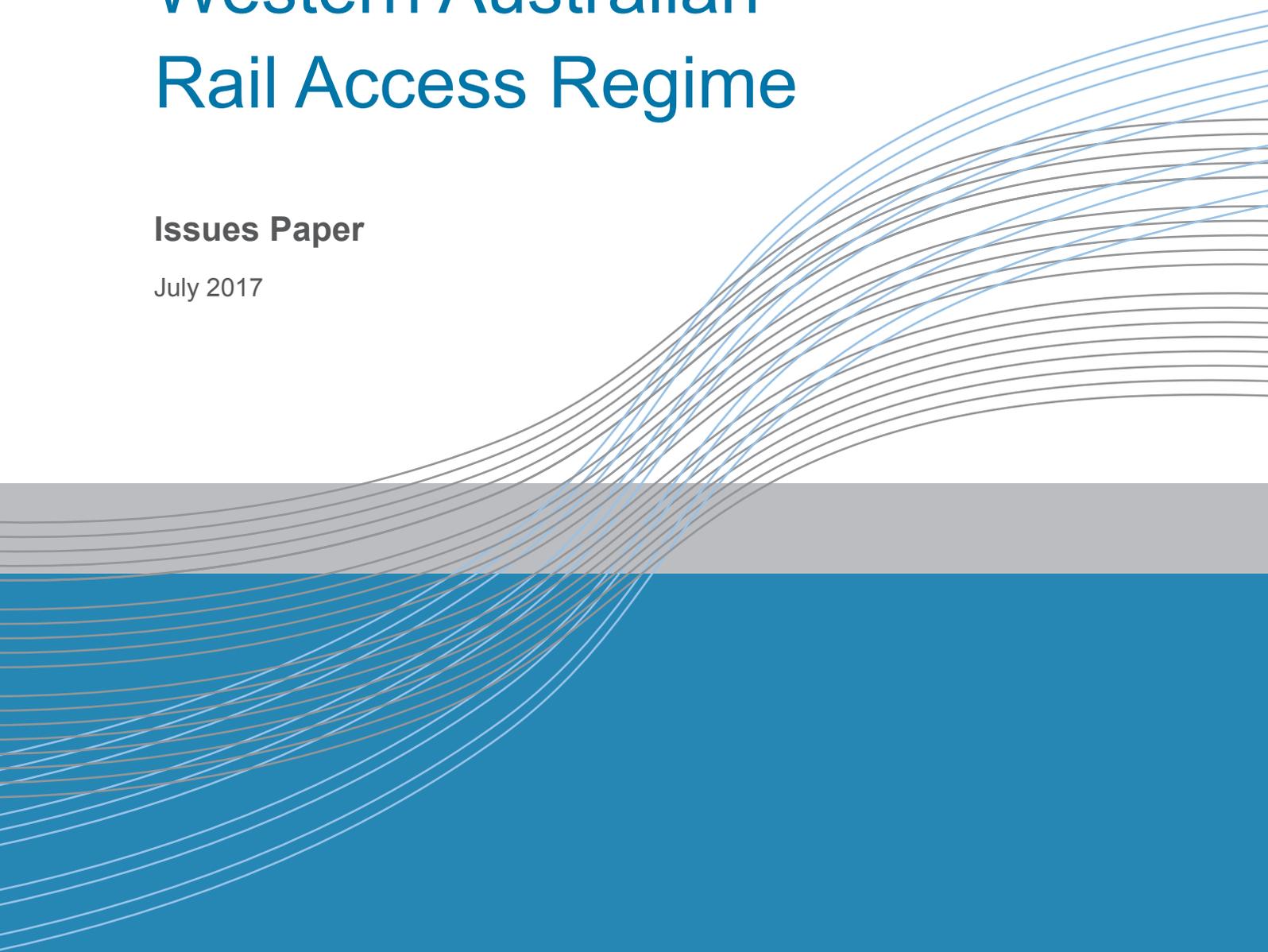


Government of **Western Australia**
Department of **Treasury**

Review of the Western Australian Rail Access Regime

Issues Paper

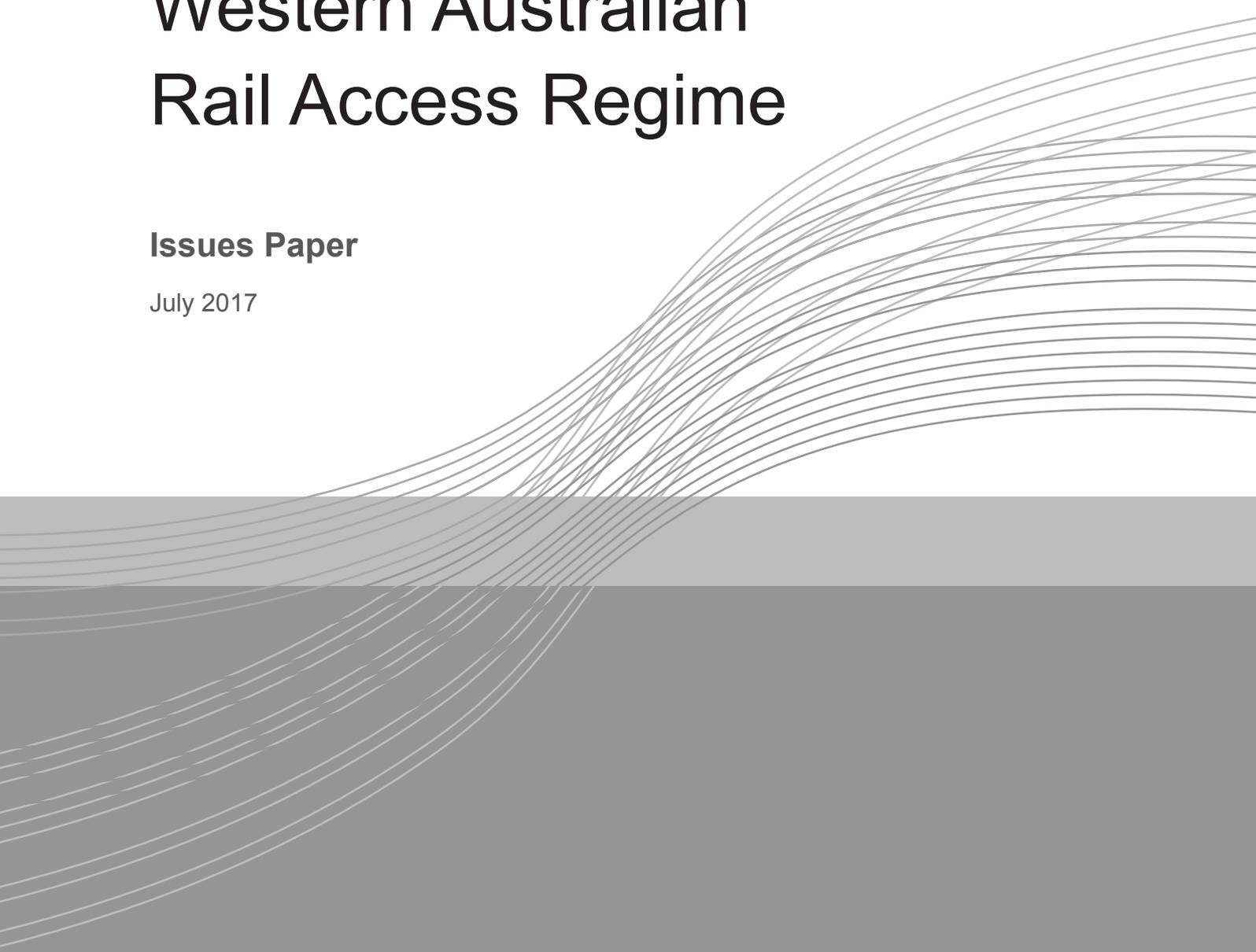
July 2017



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**Western Australian
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Abbreviations

Term	Definition
ACCC	Australian Competition and Consumer Commission
Act	<i>Railways (Access) Act 1998</i>
CIRA	Competition and Infrastructure Reform Agreement
Code	<i>Railways (Access) Code 2000</i>
CPA	Competition Principles Agreement
DORC	Depreciated optimised replacement cost
EAB	Established asset base
EGR	Eastern Goldfields Route
ERA	Economic Regulation Authority
GRV	Gross replacement value
MEA	Modern equivalent assets
NAR	National Access Regime, established by Part IIIA of the <i>Competition and Consumer Act 2010</i>
NCC	National Competition Council
RAB	Regulated asset base
WACC	Weighted average cost of capital

Glossary

Term	Definition
Below rail access regime	A below rail access regime provides for a third party operator to gain access to a network by operating its own rolling stock on that network.
Ceiling price	This is the total costs attributable to that route and infrastructure to which access is sought. An operator must not pay more than this ceiling pricing.
Certification	An access regime may be certified as an 'effective' regime under the NAR. This assessment is conducted by the NCC, who makes recommendations to the Commonwealth Treasurer, who is the decision maker. A regime that is certified as effective is immune from declaration under the NAR.
ERA 2015 Review	The review of the Code conducted by the ERA and completed in 2015.
ERA 2011 Review	The review of the Code conducted by the ERA and completed in 2011.
Floor price	This is the incremental cost of providing access to an access seeker. An access seeker must not pay less than the floor price.
Greenfield railway	This refers to a new railway development
Haulage regime	A haulage regime provides access to a bundled below and above rail service, so that the third party has its product transported from origin to destination using the railway owner's rolling stock.
Indicative tariffs	These are tariffs for a benchmark, or reference, service approved up front by the regulator. They provide a guide to inform the determination of access charges for a particular access application.
Part 5 instruments	These instruments are required to be prepared by the railway owner and submitted to the ERA for approval. They include: train management guidelines; train path policy; costing principles; and over-payment rules. Part 5 also requires the ERA to consult on segregation arrangements, which are required by the Act.
Marginal routes	Marginal freight routes closed by railway owner Brookfield Rail since July 2014 due to limited usage.

Executive Summary

The Western Australian Government is conducting a review of the Western Australian rail access regime as established by the *Railways (Access) Act 1998* (the Act) and the *Railways (Access) Code 2000* (the Code).

The purpose of this review is to identify improvements to the regime in order to better achieve its objective. The objective has been:¹

...to encourage the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations.

The review is intended to be broader than previous reviews of the Code conducted by the Economic Regulation Authority (ERA), which have been undertaken in accordance with the Act specifically for the purpose of assessing the Code's suitability to give effect to the Competition Principles Agreement (CPA).² However, this review will address the recommendations of these previous ERA reviews, in the context of potential broader reforms.

The purpose of this paper is to seek the views of interested stakeholders on the operation of the regime and to obtain feedback on proposals for improvements.

In light of any feedback received, and drawing on the findings of previous ERA reviews, the Government will develop a more detailed set of specific proposals, including drafting of proposed amendments, for further public consultation.

Feedback on this Issues Paper is due by 17 November 2017. Information on how to provide feedback is in Appendix A.

For any enquiries about this review, please contact Aditi Varma, A/Director Economic Reform, regulatoryreform@treasury.wa.gov.au.

¹ *Railways (Access) Act 1998*, section 2A.

² *Railways (Access) Act 1998*, section 12.

1. Purpose and scope of this review

The Western Australian rail access regime, established by the *Railways (Access) Act 1998* (the Act) and the *Railways (Access) Code 2000* (the Code) has been in operation for over 15 years.

The Government is committed to ensuring the regime continues to achieve the objective of encouraging the efficient use of, and investment in, railway facilities, and to improving outcomes for access seekers and operators.

The current light-handed regime has several advantages and supports a contestable market for rail operations. There are, however, some limitations in the current structure and operation of the regime.

The Economic Regulation Authority (ERA) has reviewed the Code on three occasions (in 2005, 2011 and 2015) since its commencement. While the first review led to some changes to the Code, recommendations from the 2011 and 2015 Code reviews are yet to be addressed. The review process triggered by this Issues Paper will provide an opportunity to implement these recommendations where appropriate.

In addition to matters addressed by the ERA, this review is also considering the broader context of the regime, and other potential changes to improve its effectiveness. The aim is to identify elements of the regime that could be changed to better achieve the objective of encouraging efficient investment in, and use of, rail infrastructure.

The review also considers particular issues for rail networks in the Pilbara.

1.1 Identifying areas for improvement

The Government has identified several aspects of the Western Australian rail access regime, which, if amended, could improve the effectiveness of the regime. These issues, and potential changes, are discussed in the following chapters. All potential changes should be considered with respect to the purpose of the rail access regime, being to encourage efficient investment in and use of railway facilities. To achieve this purpose, the regime aims to:

- encourage commercial negotiation;
- prevent misuse of market power and promote competition; and
- target a specific economic problem (i.e. lack of competition in markets for significant infrastructure) and promote regulatory certainty.

The proposed changes outlined in this paper are intended to meet these objectives with the least cost and delay practicable, and do not extend to addressing other policy problems and objectives.

Other factors taken into consideration are:

- Ensuring that the Western Australian rail access regime is consistent with the principles for access regimes in the Competition Principles Agreement (CPA) and whether the regime could be certified as an 'effective' rail access regime under Part IIIA of the *Competition and Consumer Act 2010*.³
- Striking the right balance between being flexible enough to accommodate Western Australia's diverse range of rail business structures (e.g. both vertically integrated and separated railways, as well as different networks and traffics), while still being effective in facilitating access and providing parties with regulatory certainty.
- Ensuring that the benefits of any proposed changes outweigh the costs, and that the changes are proportional to the scale of the problem.

The Government welcomes feedback on the issues and proposals outlined in this Issues Paper and on any other matter related to the operation of the Western Australian rail access regime.

The main issues discussed in this Issues Paper are:

1. Balance of power in negotiations
2. Accountability
3. Capacity expansions and extensions
4. Pricing mechanisms
5. Marginal rail routes
6. Greenfield developments
7. Vertically integrated rail networks in the Pilbara
8. Consistency with the National Access Regime

³ The CPA was agreed by the Commonwealth Government and all States and Territories in 1995, with later modifications following the adoption of the Competition and Infrastructure Reform Agreement (CIRA) in 2006. Certification of an access regime as 'effective' makes it immune from declaration under Part IIIA.

2. Overview of the Western Australian rail access regime

The Western Australian rail access regime is established by the *Railways (Access) Act 1998* (the Act) and the *Railways (Access) Code 2000* (the Code).

The object of the 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.”⁴ It does this by:

- providing for the establishment of a Code governing the use of certain facilities for rail operations by persons other than their owners;
- conferring on the Economic Regulation Authority monitoring, enforcement and administrative functions for implementing the Code; and
- specifying the kind of arrangements that railway owners are to have in place.⁵

The Code must give effect to the Competition Principles Agreement (CPA) in respect of the railways to which the Code applies.⁶ The Code is to prescribe which parts of the railway network and associated railway infrastructure are to be made available for use by parties other than the railway owner. Agreements for access can be reached through negotiation with the railway owner or through a determination made by way of arbitration in the event of an access dispute.

The Code must also set out the required content of such agreements or determinations and the rights, powers and duties that apply through the negotiation and implementation processes.

2.1 Regime coverage

The regime covers the rail networks that are specified in Schedule 1 to the Code and include:

- Brookfield Rail’s freight network;
- The urban network; and
- The Pilbara Infrastructure’s (TPI) network.

⁴ *Railways (Access) Act 1998*, section 2A.

⁵ *Railways (Access) Act 1998*, Part 1.

⁶ *Railways (Access) Act 1998*, section 4(1).

Roy Hill's Pilbara railway is also covered by the Western Australian rail access regime pursuant to the *Railway (Roy Hill Infrastructure Pty Ltd) Agreement Act 2010*. Roy Hill considered a haulage undertaking under the national access regime, but decided to remain covered by the Western Australian rail access regime.

The regime does not cover the heavy haul Pilbara railways owned by BHP Billiton Iron Ore and Rio Tinto Iron Ore.

A haulage regime differs from a rail access regime in that a haulage regime provides for bundled below and above rail services. That is, the railway owner transports the access seeker's product using its own rolling stock. This contrasts with a below-rail access regime, which facilitates access to the below-rail service only with the access seeker operating its own rolling stock on the railway owner's track.

2.2 Certification

In February 2011, the Western Australian rail access regime was certified as an 'effective' access regime by the Commonwealth Treasurer for five years. This certification has now lapsed. The Government intends to consider applying for re-certification once improvements to the regime have been made.

Certification of a state-based regime means that a service covered by the regime cannot be declared for third party access under the National Access Regime (NAR). If a state-based regime is not certified as 'effective', then it is open to a party to apply to the National Competition Council (NCC) for the service to be declared under the NAR.

For a state-based access regime to be certified as effective, the State Government must apply to the NCC. The NCC makes a recommendation to the Commonwealth Treasurer based on an assessment against the principles in the CPA, with the Treasurer then making a final decision. These principles relate to the desired elements of an access regime based on a negotiate-arbitrate model.

2.3 Main provisions of the Act

Any new railway that is connected to part of the railway network may be declared under the Act by the Minister. In deciding to add new routes to the declared services, and in establishing the initial railway network, the Minister must consider:⁷

- whether access to the route will promote competition in at least one market, other than the market for railway services;
- whether it would be uneconomical for anyone to establish another railway on the route;
- whether the route is of significance;

⁷ *Railways (Access) Act 1998*, section 5(3).

- whether access can be provided without undue risk to human health or safety;
- whether there is already effective access to the route; and
- whether access would be contrary to the public interest.

The Act describes the processes, including consultation, which must be undertaken before amendment or replacement of the Code and requires the regulator to carry out a review of the Code every five years. The purpose of these reviews is to assess the Code's suitability to give effect to the CPA for railways to which the Code applies.⁸

The Act establishes the ERA as the regulator⁹ responsible for monitoring and enforcing compliance by railway operators with the Act and the Code. The Act also requires that a railway owner must segregate its access related functions from its other functions, primarily to guard against conflict of interest in negotiations.¹⁰

2.4 Main provisions of the Code

The Code sets out the roles and procedures for applying for and negotiating access arrangements, information the railway owner must make available, the routes to which the Code applies and principles regarding the price to be paid for access.¹¹

Part 2 – Proposals for access

Part 2 of the Code specifies a step by step procedure for an access seeker to follow in seeking access from a railway owner, including: the information that the railway owner must provide to them, the content of an access proposal, the railway owner's obligations in respect of that proposal and circumstances where the approval of the regulator is required.

Part 3 – Negotiations

Part 3 sets out the requirements for both railway owners and access seekers in negotiations, including matters that must be covered in the negotiations and the maximum time period for negotiations.¹² If negotiations are not successful, an arbitrator will be appointed by the regulator to hear and determine the dispute.¹³ The determination made by the arbitrator is binding on the railway owner unless the access seeker elects not to give effect to the determination.¹⁴

⁸ *Railways (Access) Act 1998*, section 12(1) and (2).

⁹ *Railways (Access) Act 1998*, section 3(1).

¹⁰ *Railways (Access) Act 1998*, section 28 and 32.

¹¹ *Railways (Access) Code 2000*.

¹² *Railways (Access) Code 2000*, section 20.

¹³ *Railways (Access) Code 2000*, section 26.

¹⁴ *Railways (Access) Code 2000*, section 34.

The Code specifically states that the parties may choose to negotiate an agreement for access outside of the Code, in which case nothing in the Code applies to the negotiations or any subsequent agreement.¹⁵ The Code specifies the parts of the railway network and associated infrastructure to which it applies.

Part 5 Instruments

The Code requires the railway owner to submit certain regulatory instruments (the Part 5 instruments) to the ERA for approval. These are: train management guidelines; train path policy; costing principles; and over-payment rules. These instruments provide more detail and are specific to each covered railway. The regulator may ultimately determine the appropriate guidelines to apply.¹⁶

Part 5 also requires the ERA to consult on segregation arrangements before approving a proposed arrangement or variation. The Act, rather than Part 5 of the Code, requires railway owners to make arrangements to segregate access-related functions from other functions.

Pricing principles (Schedule 4)

The Code also sets out provisions relating to prices to be paid for access. Prices are to be determined through negotiation under the provisions of the Code. The price paid for access by an operator must be between the incremental and total costs, being the incremental costs resulting from an operators' use of the route (floor) and the total cost attributable to that route (ceiling). In addition, the cost of any extension or expansion of the network is to be borne by the users according to the extent that they will use the facilities compared to other users and the economic benefit they are expected to derive from its use.

The following guidelines are to be applied in the negotiation of prices.¹⁷

- There should be consistency in the application of the pricing principles to all rail operators, including the railway owner if it proposes to undertake rail operations. That is, any difference in prices for operators in the same market must only reflect differences in the cost or risks associated with providing them access.
- Prices should reflect the standard of the relevant infrastructure and the operations to be carried out, relevant market conditions and any identified preference of the proponent.
- Apportionment of costs should be fair and reasonable.
- Prices should be structured to encourage optimum use of facilities.
- Prices should allow the railway owner to recover, over the economic life of the infrastructure, the costs of any extension or expansion required to accommodate the operator.

¹⁵ *Railways (Access) Code 2000*, section 4A.

¹⁶ *Railways (Access) Code 2000*, section 43 and 46.

¹⁷ *Railways (Access) Code 2000*, Schedule 4, clause 13.

The regulator may determine the floor and ceiling costs for a route if the regulator considers it likely that the railway owner will receive a proposal for access to that route. Where the regulator has not determined costs and an access proposal has been made, the railway owner must determine floor and ceiling costs for that proposal in accordance with costing principles approved by the ERA and submit these to the ERA for approval.¹⁸

In making a floor and ceiling cost determination, the costs to be considered are:¹⁹

...those that would be incurred by a body managing the railways network and adopting efficient practices applicable to the provision of railway infrastructure, including the practice of operating a particular route in combination with other routes for the achievement of efficiencies.

The pricing principles contained in Schedule 4 of the Code require that capital costs are the equivalent annual cost for the provision of railway infrastructure, calculated using:²⁰

- the gross replacement value (GRV) of the railway infrastructure as the principal;
- the weighted average cost of capital (WACC) as the interest rate; and
- the economic life consistent with the basis for the GRV of the railway infrastructure.

¹⁸ *Railways (Access) Code 2000*, Schedule 4, clause 9 and 10

¹⁹ *Railways (Access) Code 2000*, Schedule 4, clause 4.

²⁰ *Railways (Access) Code 2000*, Schedule 4, clause 2(4).

3. Issues

This chapter identifies issues associated with the operation of the Western Australian rail access regime. In particular, it identifies areas of concern, or potential concern, which may undermine the regime's objective of encouraging the efficient use of, and investment in, railway facilities.

The Government is seeking feedback from stakeholders on the issues and proposals for change outlined below.

3.1 Balance of power in negotiations

3.1.1 Context

Facilitating access through a rail access regime is complex and may require the parties to address problems in areas such as safety and environmental standards, rolling stock standards, emergency response, and communications where information is unevenly held. A negotiation process that re-balances information asymmetries and bargaining power is essential to resolving such issues in a way that achieves rail access objectives.

The access negotiation framework in the Western Australian rail access regime incorporates the usual elements in access negotiations found in most rail access regimes, including:

- the process for applying for access;
- obligations around information provision by both parties; and
- timeframes; a duty to negotiate; specifying matters to be addressed in negotiations; and a process for arbitrating disputes.

Nevertheless, no party has yet gained access under the regime. While this may indicate that the regime is facilitating commercial agreements rather than prescribing regulatory outcomes, it raises the possibility that improving the negotiation process would better facilitate access.

3.1.2 Challenges, issues and proposals

Issue 1: Ability to opt out

The ability to opt to negotiate outside of the Code is unique to the Western Australian rail access regime; other jurisdictions' regimes do not allow opt out. Having opted out, no provisions of the Code apply. To date, most negotiations and agreements have occurred outside the Code.

Both parties may have an incentive to negotiate outside the Code, particularly if the Code process is considered cumbersome or too uncertain. However, negotiations outside the Code may not be balanced as none of the protections offered by the Code apply. Importantly, once negotiations outside the Code have progressed, it will generally be costly and time-consuming to begin negotiating under the Code. While there is merit in retaining the ability to opt out, it may be beneficial for certain overarching protections to apply to negotiations both inside and outside the Code, as well as reducing perceived or actual burdens and uncertainty with the Code process.

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

- 1.1 What are the benefits of negotiating outside the Code?
- 1.2 Are there costs imposed on railway owners or access seekers by opting out of the Code and, if so, what are they?
- 1.3 Are negotiations outside the Code more likely to favour railway owners or access seekers and why?
- 1.4 Would all or some of the reform options proposed above (a, b and c) improve the operation of the regime and why?
- 1.5 Are there other options that would better address the problems associated with the opt out provisions?

Issue 2: Barriers to negotiation

Some elements of the current access negotiation process could be seen as barriers to negotiation.

One such potential barrier is requiring access seekers to demonstrate that proposed operations can be accommodated on the network,²¹ and specify details of any required extension or expansion.²² The proponent must provide the railway owner with a preliminary assessment, based on reasonably available information, showing that the proposed extension or expansion:

- can be carried out in a technically and economically feasible way; and
- will be consistent with the carrying on of safe and reliable rail operations on the route.²³

The access seeker is unlikely to be best placed to: assess whether the network can accommodate its proposed operations without capacity expansion, identify details of any required expansions, or demonstrate that such expansions are feasible and safe. It would be difficult for an access seeker to be able to demonstrate these matters given it will have access to only limited information.

The ERA noted that the railway owner must provide the access seeker with information to assist it in demonstrating these issues, and that if the information provided by the railway owner is not adequate the railway owner should not be permitted to be dissatisfied with the access seeker's demonstration of these issues.²⁴

Despite this assistance to the access seeker, it may be more efficient to place the onus on the railway owner to assess whether the proposal can be accommodated on the network and, if applicable, detailing any expansion required to accommodate the access seeker and ensuring it is feasible and safe. This is the approach taken in other Australian rail access regimes.

Reversing this onus may impose additional costs on the railway owner – if so, it may be appropriate to limit this obligation to bona fide access applications, or to allow the railway owner to recover its costs from the access seeker.

It may also be difficult for an access seeker to assess the reasonableness of a proposed access charge given the asymmetry of information between a railway owner and access seeker (in the absence of an indicative tariff), which can hinder the progression of a negotiation. The issue of indicative tariffs is discussed further below.

²¹ *Rail (Access) Code 2000*, section 15(1).

²² *Rail (Access) Code 2000*, section 8(4).

²³ *Rail (Access) Code 2000*, section 15(2).

²⁴ Economic Regulation Authority (2015). *Review of the Railways (Access) Code 2000*, Final Report, December 2015, p. 33.

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.²⁵
- 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.²⁶

Questions

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

3.2 Accountability

3.2.1 Context

Accountability and transparency mechanisms are important elements of access regimes in that they promote compliance as well as supporting stakeholder confidence in the integrity of the regime.

²⁵ *Rail (Access) Code 2000*, section 8(4).

²⁶ *Rail (Access) Code 2000*, section 15.

3.2.2 Challenges, issues and proposals

Issue 1: Railway owner accountability to comply with regime

The Western Australian rail access regime is relatively light handed in that there are minimal reporting obligations on railway owners covered by the regime.

Compliance obligations for access providers under the Part 5 instruments vary somewhat between instruments and railways. Compliance obligations under Part 5 instruments typically involve the railway owner making high level commitments to fulfil their obligations, and stating that the ERA will investigate any complaints and has the power to amend instruments. Periodic independent audit is provided for some, but not all, instruments and obligations. There are also no requirements to publicly report on service quality, including track condition.

Regular reporting obligations impose a burden on railway owners in terms of cost and time to prepare reports. Conversely, they provide stakeholders (including access seekers, holders and the regulator) with information on how effectively the regime is being applied. Certain performance information, such as track condition, may also assist access seekers in negotiations.

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. It may also be appropriate for different accountability arrangements to apply to different rail networks, depending on their circumstances. For example, more stringent audit requirements may be warranted for a vertically integrated access provider.

Proposals

Proposals to improve transparency and the railway owner's 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

- 2.1 Is the Western Australian rail access regime insufficiently transparent? If so, which elements of the regime would benefit from improved transparency?
- 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?
- 2.3 Would regular reporting by railway owners on the progress of access negotiations improve the effectiveness of the regime? Why or why not?
- 2.4 Would regular reporting by railway owners of service quality promote more effective access negotiations? Why or why not?

Issue 2: Regulator accountability

Accountability also applies to the ERA as the regulator. While the requirements of the Act and Code somewhat constrain the regulator's discretion, considerable discretion remains. Regulator error can substantially affect railway owners and access seekers. Review mechanisms, such as judicial and merits review, can greatly enhance regulator accountability.

While judicial review is available, the Western Australian rail access regime does not provide for merits review. In the 2015 Review, the ERA recommended providing for access to merits review in relation to certain regulatory decisions (this was directly linked to the adoption of its recommendation in relation to the change to the asset valuation approach) (see section 3.4.2 of this Issues Paper).

Other decisions that may benefit from merits review include:

- Decisions regarding the approval or otherwise of Part 5 instruments.
- Decisions on the determination of floor/ceiling costs, whether if made in the context of a specific access negotiation or in anticipation of future demand for access on a route.
- Decisions on the weighted average cost of capital.
- Opinions provided on whether a price for access meets the requirements of Clause 13(a) of Schedule 4 of the Code, which requires consistency in the application of pricing principles to rail operations.

Introducing merits review may, however, increase the scope for delays and costs associated with regulatory processes. To help ensure the costs do not outweigh the benefits, limits could be placed on the process – such as time limits and limiting review to the information available to the original decision maker.

Proposals

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

Questions

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

Issue 3: Processes relating to Part 5 Instruments

Part 5 of the Code requires a railway owner to submit certain instruments for approval, namely: train management guidelines, train path policy, costing principles, and over-payment rules. Part 5 also requires the ERA consult publicly on the railway owner's train management guidelines, train path policy²⁷ and segregation arrangements²⁸ before it can approve these documents.

The Code requirements for approving and amending Part 5 instruments are not consistent. For example, while public consultation is not required for costing principles or overpayment rules, consultation is required for other instruments. Requiring public consultation for all instruments would increase the transparency of the regulator's process for approving these instruments, and will commensurately increase the accountability of how the regulator assesses the instruments.

Once the Part 5 instruments are approved, the Code allows the railway owner, with the approval of the regulator, to amend or replace the instruments, or the regulator to require their amendment or replacement. While there is no requirement for periodic review of the instruments, the ERA may review the instruments and direct the railway owner to amend or replace them.

To address these concerns, the ERA recommended in its 2011 Review that all Part 5 instruments be reviewed every five years.

During the ERA's 2011 Review, concerns were also raised that the Code, rather than specifying a definitive timeframe for the submission or approval of Part 5 instruments, requires they be submitted 'as soon as is practicable after the commencement of the Code'. The ERA considered that the lack of definitive timeframes for submitting Part 5 instruments by greenfield railway owners hampers a Code objective of providing timely access to prescribed railways, undermining the effectiveness of the Code.

²⁷ *Rail (Access) Code 2000*, section 45.

²⁸ *Rail (Access) Code 2000*, section 42.

To address this concern, the ERA proposed that a model set of Part 5 instruments be applied to all new railways from six months before operations begin. This would enable the railway owner to propose amendments to the model instruments sufficiently early for the ERA to approve them prior to the start of operations. The ERA envisaged the model instruments being based on the current approved instruments for TPI.

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

- 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?
- 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?

3.3 Capacity expansions and extensions

3.3.1 Context

The Western Australian rail access regime provides for the railway owner to expand or extend the network to accommodate an access seeker's application if required, at the cost of the access seeker. As discussed above, the regime places the onus on the access seeker to specify the nature of the expansion required to accommodate the access seeker and to demonstrate whether it is economically and technically feasible, and safe.

3.3.2 Challenges, issues and proposals

Issue 1: Level of detail in the Code

The Code does not provide detail about how an expansion, if required, will proceed. Developing an expansion concept can be very complex, time consuming and costly, with considerable uncertainty about the outcome. Other rail access regimes (such as Aurizon Network's Access Undertaking and Australian Rail Track Corporation's (ARTC) Hunter Valley Access Undertaking) include considerably more detail around the process for developing and progressing an expansion from concept to construction. This includes specifying obligations on the parties in terms of who is responsible for developing the concept, preparing pre-feasibility and feasibility studies and specifying responsibility for funding the various stages and the expansion itself. Uncertainty around capacity expansions can be a major barrier to successful negotiations.

This lack of detail around the process for expansions can also increase uncertainty about the price of an expansion, which increases the risk for the access seeker who must ultimately pay.

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

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

Issue 2: Clarity around timing of an expansion proposal

Another possible barrier to negotiating an agreement requiring an expansion identified in the ERA's 2015 Review was that the Code is ambiguous about when proposals for extension or expansion can be made. The ERA noted that the validity of an access proposal had been challenged in the courts on the basis that an expansion was not specified at the time the proposal was submitted. However, highlighting the confusion, concerns were also expressed that the Code does not permit an extension or expansion proposal to be made until negotiations have formally commenced.

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

- 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?
- 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?

²⁹ Economic Regulation Authority (2015). Review of the Railways (Access) Code 2000, Final Report, December 2015, p. 27.

Issue 3: Uncertainty about recognition of costs in pricing provisions

For brownfields investments, there is uncertainty about the extent to which the costs associated with expansions or extensions are recognised in the pricing provisions. This issue is addressed in section 3.4.

3.4 Pricing mechanisms

3.4.1 Context

The Western Australian rail access regime provides for the railway owner and the access seeker to negotiate on an access price within a floor or ceiling limit. While there are no benchmark or reference tariffs approved by the regulator, if the regulator considers an access proposal is likely to be made for a particular route it may determine relevant floor and ceiling costs.

Uniquely, the Western Australian rail access regime requires that a GRV method is used to determine capital charges. The GRV method defines capital costs as an annuity for providing railway infrastructure by applying the GRV as principal, the weighted average cost of capital (WACC) as the interest rate, and the economic life of the infrastructure as the term. GRV is defined as the lowest current costs to replace existing assets to provide the required capacity and are, if appropriate, modern equivalent assets (MEA).

Most other Australian rail access regimes use a depreciated optimised replacement cost (DORC) method for calculating asset values, which forms the basis of cost and pricing calculations. The DORC approach aims to determine the capital value for the asset at a point in time and over time incorporating depreciation of, and efficient investment in, the asset base. The DORC value is used as the basis for a building block calculation of allowable revenue, which includes recovery of operating costs, as well as return on and of capital.

3.4.2 Challenges, issues and proposals

Issue 1: Indicative tariffs

By providing for regulatory approval of costs related to incremental and total (floor and ceiling) costs, the regime provides a very wide range of possible prices within which the parties may negotiate. This may disadvantage the access seeker in negotiations as there is an information asymmetry between the railway owner and the access seeker, with the former being better informed about the actual cost of providing the service. This asymmetry is somewhat offset by the access seeker having more information about the expected revenue and return on investment from using that service.

One way to address this potential information asymmetry, and better facilitate negotiations, is to allow regulatory approval of an indicative tariff for a reference service. The final access charge may vary from the indicative charge to better reflect the particular access proposal, and the associated cost and risk differences.

There may, however, be disadvantages to an approved indicative tariff. For example, where the value of the service to the access seeker is below the total cost the regulator will not necessarily be well placed to assess the most appropriate level of the indicative tariff. Unless there are multiple access seekers requiring access for similar services, it may be more efficient for the tariff to be agreed through negotiation with recourse to arbitration if required.

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:

- the service is priced at the total cost;
- there are a reasonable number of services using a route and they are relatively homogenous; or
- 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

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

Issue 2: Assessing the capital charge using GRV

The GRV annuity approach should result in an even capital charge over the life of the asset (assuming no asset appreciation over time and pricing at the ceiling). In contrast, a DORC asset value will tend to cause a higher capital charge early in the life of the asset, and a lower capital charge later in the asset's life. While DORC values are often assessed on the basis of straight line depreciation, the DORC approach can provide flexibility for alternate depreciation profiles to be used if circumstances warrant. The capital component of costs under a DORC approach may better reflect the value of the assets given changes in their age and condition over time.

The GRV asset value method requires that efficient operating and maintenance costs be assessed as if the assets are new. Under the DORC approach, efficient costs are assessed based on the actual requirements for maintaining the assets, given their current age and condition.

Given the Western Australian regime has previously been certified as effective under the NAR, the current approach is arguably consistent with the Competition Principles Agreement (CPA). However, there are some aspects of this approach which could raise concerns, particularly for major expansions or greenfield investments, for a number of reasons:

- 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.
- 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).
- The GRV approach does not recognise staging costs³⁰ in an expansion. These are a legitimate inclusion in the RAB value, provided they have been prudently and efficiently incurred.

Therefore the GRV approach increases the risk and uncertainty about the overall recovery of an investment in a major expansion or a greenfield railway. It is also less flexible than a DORC based RAB at matching the timing of cash flows to investor’s requirements.

In addition, the GRV approach creates issues for older rail infrastructure because the GRV does not necessarily relate to the asset’s current condition or the economic value a user may expect to extract the asset.³¹

The ERA’s 2015 review extensively canvassed the advantages and disadvantages of a GRV approach noting that the Western Australian regime is the only Australian rail access regime to use the GRV approach.

Where the GRV is based on MEA assets, the Code provides that the assessment of operating costs will be based on the assumption of MEA assets – that is, the assets are assumed to be in an ‘as new’ condition. This means that the efficient operating cost used for assessing floor and ceiling costs may bear little resemblance to the efficient costs the access provider incurs given the age and condition of the assets. This is inconsistent with how costs are assessed under most other regulatory regimes.

³⁰ Staging costs reflect the additional costs incurred in staging asset augmentations over a period of time, rather than constructing that same capacity in a single stage.

³¹ Economic Regulation Authority (2015). Review of the Railways (Access) Code 2000, Final Report, December 2015, p. 13-19.

Alternatively, if a depreciated asset value is used as the basis for assessing the capital costs, it may be necessary to amend the definition of costs used to determine the incremental and total costs to better align these with efficient costs for (at least) the period for which access is sought, given the actual age and condition of the assets.

In the ERA's 2015 review, the ERA discussed implementing an Established Asset Base (EAB) approach, which is based on depreciated asset values and is similar to the widely used DORC approach in that it adjusts the asset value to reflect the extent of depreciation that has occurred. The ERA acknowledged that an EAB valuation reduces the scope for negotiation and that a negotiate-arbitrate approach utilising an EAB capital valuation would be more prescriptive.³²

In its 2015 Review, the ERA also acknowledged that the majority of stakeholders have expressed a high degree of uncertainty in relation to the likely outcome of negotiations. Accordingly, the ERA recommended that Schedule 4 of the Code be amended to prescribe a capital valuation method which would explicitly account for depreciation of the asset:

Recommendation 2

Clause 2 of Schedule 4 be amended to provide for an Established Asset Base (EAB) valuation in place of the Gross Replacement Value (GRV) approach currently prescribed in that clause.

Other parts of the Code be amended to accommodate an EAB basis for valuation.

Further amendments to the Code would be necessary to address the concerns associated with greenfield investment or major expansions, and to align the pricing methodology in the Western Australian rail access regime with that used in other Australian rail access regimes. These could include:

- Providing for capital charges to be assessed as the sum of the return on and return of capital, with flexibility in how depreciation is calculated, rather than assessing capital costs as an annuity. This would allow better matching of the timing of cash flows to investors' requirements.
- Including the costs associated with required extensions and expansions of the infrastructure in the EAB would recognise the staging costs inherent in an expansion, and ensure that these costs are considered in subsequent applications for access.

³² Economic Regulation Authority (2015). Review of the Railways (Access) Code 2000, Final Report, December 2015, p. 16.

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

- 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?
- 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?
- 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,?

Issue 3: Uncertainty about pricing for major expansions

As discussed in section 3.3.2, there is some uncertainty about how the pricing provisions apply where there are significant expansions or extensions. Under the Code, the incremental and total costs are to be assessed for the network as it exists prior to any expansion, with the costs of the expansion to be paid for by the access seeker. While this approach may work satisfactorily for small expansions or extensions, when applied to major expansions this approach creates a number of areas of uncertainty:

- Major expansions or extensions can change the nature of the costs that will be incurred in operating and maintaining the network, which is not recognised in the assessment of floor and ceiling costs.
- Post expansion, the assessment of ceiling costs is based on the gross replacement value of the network, which does not recognise the additional staging costs incurred in expanding an existing network.

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

- 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?
- 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?
- 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?

3.5 Marginal freight rail routes

3.5.1 Context

Schedule 1 of the Code specifies routes to which the Code applies. This includes a number of marginal freight routes – defined during the Strategic Grain Network Review process (2009) as ‘Tier 3’ rail lines (see Figure 3.1) – which have been closed by the infrastructure manager (Brookfield Rail) since July 2014 due to limited usage. Sections of these lines are still listed in Schedule 1 of the Code; therefore they remain covered routes for the purposes of the access regime and subject to the provisions of the Code.

In 2014, the Final Report of the Parliamentary Inquiry into the management of Western Australia’s freight network discussed some of the limitations of the regulatory regime for the freight rail network. In particular, it noted the limited role of the regulator in price setting, concerns about timeliness and a lack of transparency in the access application/price setting process.³³

Figure 3.1 Map of Grain Rail Network³⁴



³³ Parliament of Western Australia (2014). The Management of Western Australia’s Freight Rail Network, report no. 3, Economics and Industry Standing Committee.

³⁴ Report prepared for Freight and Logistics Council of Western Australia on behalf of the Strategic Grain Network Committee, December 2009.

3.5.2 Challenges, issues and proposals

Issue: Coverage of marginal routes

The infrastructure manager has assessed that continuing to provide access to and use of these marginal routes is uneconomic, however the regime is silent on whether they should remain within the scope of the regime.

It is questionable whether the marginal routes would continue to meet the requirements for a route to be regulated under the Code. These requirements are based on the access criteria in the CPA (and are consistent with the NAR in Part IIIA of the *Competition and Consumer Act 2010*) and relate to whether access would promote competition in related markets, whether it is economical to duplicate and whether the route is of significance. The low volumes hauled on these routes and current competition from road transport argues against these routes continuing to satisfy the access criteria.

Notwithstanding this, while the routes remain within the regime, it is unclear to what extent the infrastructure manager is obliged to continue to fund their maintenance to a standard to enable them to be available for use by access seekers and, if the routes do remain suitable for use, the appropriate access charge. In considering this issue, it is important to account for the legitimate business interests of the infrastructure manager and acknowledge that the pricing principles require an access seeker to pay at least the incremental cost of providing access. This would ordinarily include the cost of re-establishing, or rehabilitating dysfunctional routes.

It is also unclear whether the access pricing issue can be properly addressed within the regime. Funding of uneconomic lines to ensure they remain suitable for use is a broader public policy issue rather than specifically an access issue.

There is no mechanism in the Western Australian rail access regime to trigger a reassessment of the coverage of routes. Such a mechanism would make the issue of viability more transparent, as would amendments to the Code providing clearer guidance on coverage and how to price routes that need rehabilitation. It could also prevent inefficient investment in rail infrastructure where it was found that certain lines no longer satisfy the access criteria.

Proposals

To clarify the status and obligations relating to the marginal routes, the following proposals may be considered:

- a. Removing marginal freight lines from coverage under the code.
- b. Providing greater guidance on the provision of access for these routes. This might include specifying:
 - 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

- the treatment of any payments by the Government to support the ongoing provision of these routes for pricing purposes.
- c. Including a mechanism under the Code allowing for a review of coverage for routes. This 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.

Questions

- 5.1 What are the benefits, if any, of the access regime obliging a railway owner or manager to negotiate for access to routes that they have assessed are uneconomic to provide? What are the costs to the railway owner or manager of imposing such obligations?
- 5.2 Are the issues associated with the negotiation of access to marginal routes different from the issues associated with access to other routes? If so, what additional guidance (including on setting access prices) should be included in the Code in relation to negotiating access to marginal routes?
- 5.3 Is there a benefit to including a review mechanism for coverage of routes in the regime? Should this be an automatic periodic review every five or ten years, or triggered by a particular process?

3.6 Greenfield development

3.6.1 Context

The Western Australian rail access regime focuses on established railways and does not address issues specific to greenfield railways. This is broadly similar to other rail access regimes, with the exception of the NAR, which provides for binding no coverage rulings for a set period for greenfield infrastructure. This means that there is little guidance regarding how the regulator might take particular circumstances of greenfield developments into account in applying the regime.

Recently the Western Australian regime has been applied to two greenfield developments – the Pilbara Infrastructure (TPI) railway, owned by Fortescue Metals Group (FMG), and the Roy Hill railway development.

3.6.2 Challenges, issues and proposals

Issue 1: Uncertainty relating to greenfield developments

Greenfield railway developments face particular issues compared to established networks. In particular, greenfield railways face greater uncertainty about future costs and risks. The nature of the applicable regulatory regime can also be a source of risk, even if specified and agreed to up-front (for example, as is the case with the Roy Hill project in the Pilbara).

Particular concerns include that some obligations will apply on the commencement of the rail line, which may not be relevant or feasible. For example, the obligation to have in place elements of segregation arrangements (such as functional separation within the business) may not be necessary or feasible in the early stages of a new railway development. Similarly, it may be difficult to develop costing principles in the early stages because costs are not known with much certainty (compared to an established railway).

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

- 6.1 Would the proposals outlined above (a, b or c) improve the operation of the regime?
- 6.2 Are there any other amendments that would improve the operation of the regime for greenfield railways?

Issue 2: Treatment of foundation customers

Foundation customers, who typically underpin greenfield railway developments, often take on different costs and risks compared to subsequent customers of the established railway. The terms of their access agreements may reflect this additional risk, for example, through rebates in access charges or priority access to expansion capacity.

A concern is that the treatment of foundation customers compared to others is unclear under the Code; in particular, how these arrangements with foundations customers interact with obligations under the Code regarding non-discriminatory access, capacity allocation and reporting of revenue for the purpose of total cost calculations. Another issue arises around how to view foundation contracts when the customer is related to the infrastructure provider (as is often the case for greenfield railways servicing the mining industry).

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

- 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?
- 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?
- 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)?

Issue 3: GRV asset valuation approach

The particular issues for greenfield railways posed by the Code's required GRV asset valuation approach are addressed in section 3.4.2 above.

3.7 Vertically integrated rail networks in the Pilbara

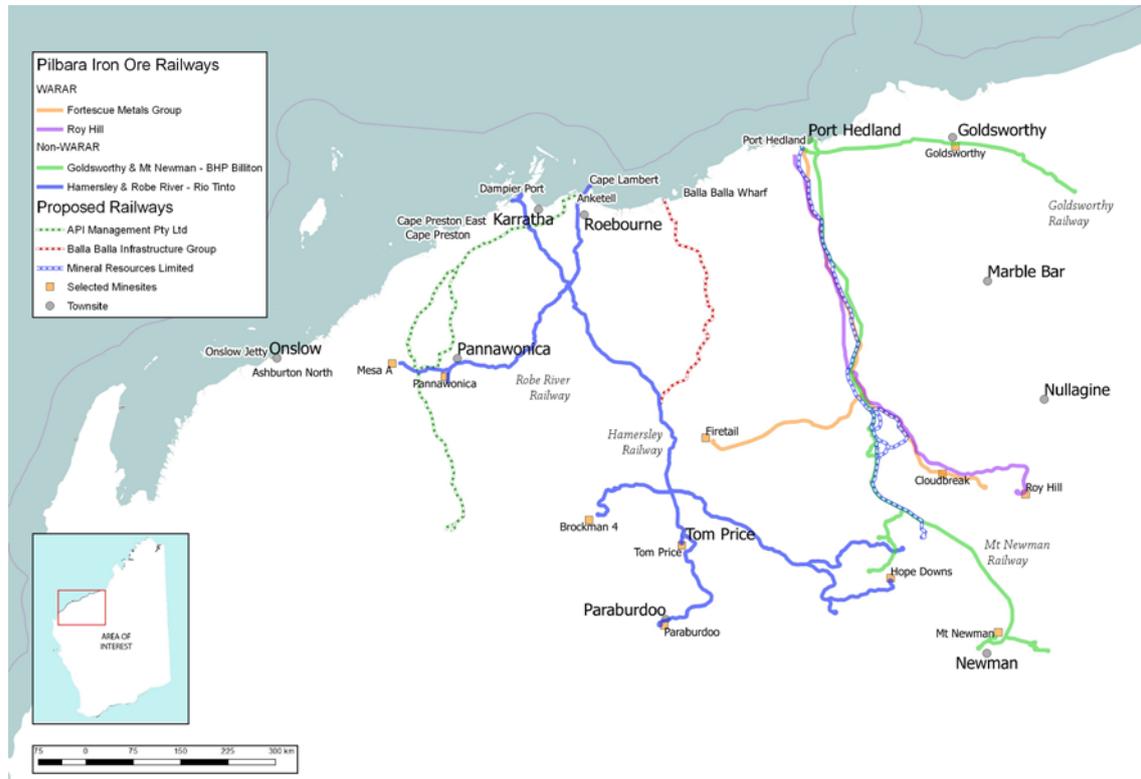
3.7.1 Context

The approach to third party access for heavy haul iron ore railways in the Pilbara region is mixed, with different arrangements applying to each railway. The Western Australian rail access regime covers TPI railways and currently covers the Roy Hill railway.³⁵ In contrast, the railways owned by BHP Billiton Iron Ore and Rio Tinto Iron Ore are not subject to the Western Australian rail access regime (see Figure 3.2 for a map of rail networks in the Pilbara); attempts to have these railways declared under the NAR have resulted in a protracted legal dispute and, ultimately, have not been successful.³⁶

³⁵ Under the *Railway (Roy Hill Infrastructure Pty Ltd) Agreement Act 2010*, Roy Hill Pty Ltd has the option to develop a haulage undertaking, to be submitted to the Australian Competition and Consumer Commission (ACCC) for approval, at which point the Western Australian rail access regime would cease to apply.

³⁶ FMG applied for the declaration of four Pilbara railways lines owned by BHP Billiton Iron Ore and Rio Tinto Iron Ore in 2008 – the Hamersley railway; Goldsworthy railway; Robe River railways; and Mt Newman railway. This matter has since been through an extensive legal appeals process, including appeals to the Australian Competition Tribunal, the Full Court of the Federal Court and further appeals to the High Court. Following the re-making of the decision by the ACT in 2013, only the Goldsworthy railway is covered under the NAR.

Figure 3.2 Map of existing and planned rail lines in the Pilbara



The main benefits of facilitating effective third party access in the Pilbara region are:

- Enabling further development of the iron ore industry in the region, particularly by ‘junior’ miners who would otherwise not be able to transport their product to ports for export.
- Preventing unnecessary duplication of rail infrastructure, which may lead to inefficient economic outcomes.

Costs of access for a railway owner are similar to those noted earlier, namely costs of negotiating access and the potential loss of efficiency and flexibility in running their railway not captured by pricing arrangements.

3.7.2 Challenges, issues and proposals

Issue 1: Delays in access

The different approaches to facilitating third party access to rail infrastructure in the Pilbara may create uncertainty for rail owners and access seekers, leading to delays and increased costs. In turn, this might deter investment in mining exploration and development.

Issue 2: Recouping cost for owners

Integrated railway owners may bear additional costs and risks because of compliance and monitoring requirements relating to specific and detailed technology standards used in vertically integrated lines. As mentioned above, railway owners may also incur costs due to loss of efficiency and flexibility arising from third parties accessing rail lines.

It might be challenging for rail owners to ensure some of the costs associated with integrated operations are reflected in the pricing framework. Potentially leading to an over or under investment in rail development.

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

- 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?
- 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?
- 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?
- 7.4 What, if any, implications would the haulage regime options have for the other issues raised in this paper?
- 7.5 Under what circumstance should a haulage option be available to owners of vertically integrated rail networks?

3.8 Consistency with National Access Regime

3.8.1 Context

The Western Australian rail access regime can be regarded as being broadly consistent with the NAR on the basis that it has previously been certified as an ‘effective’ access regime. To be certified, the regime must be consistent with the principles in the CPA, on which all rail access regimes in Australia are based.

However, in its detailed application, there are important differences between the Western Australian rail access regime, and the access framework that applies on the adjoining interstate rail network.³⁷ Further, the NCC raised several concerns in assessing certification of the Western Australian rail access regime in 2011, which needs to be recognised.³⁸

For interstate freight routes within Western Australia, the issue of consistency across access regimes is particularly important as it will be more efficient for a single access regime to apply across interstate freight routes. Beyond the interstate freight routes, there remains an issue of consistency across access regimes given the costs of haulage operators and stakeholders operating under several different regimes across Australia. This is not currently an issue for the Pilbara railways which have no connection with interstate freight routes or interstate haulage operators.

³⁷ ARTC Interstate Access Undertaking

³⁸ National Competition Council (2010). “Application for certification of the Western Australian rail access regime – Final Recommendation”, 13 December 2010, p. 7.

3.8.2 Challenges, issues and proposals

Issue 1: Interstate freight routes

On the issue of interstate freight routes, the ERA recommended in its 2015 Review implementing the requirement of the Competition and Infrastructure Reform Agreement (CIRA)³⁹ that a simpler and consistent national system of rail access regulation is implemented for nationally significant routes, using the ARTC Access Undertaking as a model. The ERA's recommendation was that:

Recommendation 1

The Government consider options to bring interstate services offered by Brookfield Rail on the interstate route under regulations consistent with the ARTC undertaking, in line with the 2006 Competition and Infrastructure Reform Agreement.

The ERA considered that the ideal outcome would be for Brookfield Rail to submit an undertaking to the Australian Competition and Consumer Commission (ACCC) for administration of the interstate services under the NAR. Its preferred option was therefore to amend the Code to remove its application to interstate services (noting this option would not affect the regulation of intra-state services on the Eastern Goldfields Route (EGR)). This would enable the regulation of interstate services on the EGR to be made consistent with the ARTC undertaking. The ERA acknowledged that this is the prerogative of the railway owner, and further noted that the Government may consider making the removal of the interstate route or interstate services from the Code contingent on Brookfield Rail offering an undertaking under the NAR.⁴⁰

Removing access to the interstate route or interstate services from the Code's application would allow for a consistent access framework to be applied for those interstate services. However, this does not fully address the issue of inconsistent rail access regimes, but rather moves it to a different interface point:

- If interstate services are regulated under a nationally consistent access regime while intrastate services (on the same route) are regulated under the Western Australian rail access regime, the railway owner – Brookfield Rail – will be required to provide access to different services on the same route under different access frameworks. This may create a risk of the railway owner being subject to conflicting obligations in terms of negotiating and providing access to different services on the same route.

³⁹ In 2006, the Government was a signatory to the CIRA, which was signed by all Australian Governments.

⁴⁰ Economic Regulation Authority (2015). Review of the Railways (Access) Code 2000, Final Report, December 2015, p. 9-13

- Alternately, if all services on the interstate route are regulated under a nationally consistent access regime, with the remaining network subject to the Western Australian rail access regime, there will be a range of intrastate services that will need to negotiate access under two different frameworks. This will also create risks for the railway owner of being subject to conflicting obligations in terms of negotiating and providing access to services on adjoining routes.

Further, permitting or requiring, Brookfield Rail to offer an undertaking to the ACCC under the NAR will not, in itself, create consistent access regulation for interstate services. Under the NAR, an access undertaking is proposed by an infrastructure owner, and the ACCC is required to assess whether it meets the criteria specified in the NAR. While the ACCC would be expected to consider the issue of consistency with the ARTC Access Undertaking for the adjoining network, it is uncertain that the ACCC would, or even could, require that Brookfield Rail adopt an access undertaking for its network that is modelled on the ARTC Access Undertaking.

Brookfield Rail currently manages the interstate interface issue through a wholesaling arrangement. In the circumstances where such a market based agreement is in place, there is an issue as to whether further change is required.

In regard to the Pilbara railway, the ERA recognised that consistency with the ARTC undertaking is not an important criterion.

Proposals

A proposal to better achieve consistency with the NAR is implementing Recommendation 1 of the ERA's 2015 Review, which would bring interstate services offered by Brookfield Rail on the interstate route under regulations consistent with the ARTC undertaking.

In addition, other proposals in this Issues Paper that would better align the Western Australian regime with the NAR, namely moving to EAB pricing and ensuring suitable coverage of marginal routes, would help narrow any gap in treatment.

Questions

- 8.1 What are the benefits of providing a consistent access regulation framework for interstate services over their entire route? Does the current wholesaling agreement provide these benefits? Why or why not?
- 8.2 What would be the consequences of introducing inconsistency in the application of access regulation frameworks by removing the application of the Code to either:
 - a. interstate services, meaning that Brookfield Rail would be required to provide access to different services on the same route under different access frameworks; or
 - b. the interstate route, meaning that Brookfield Rail would be required to provide access to intrastate services using this route under two different access frameworks.
- 8.3 If Recommendation 1 of the ERA's 2015 Code Review were implemented, would making the removal of the interstate route or interstate services from the Code contingent on Brookfield Rail offering an undertaking under the NAR be an effective approach to introducing a consistent access framework for interstate services? What other mechanisms (such as in the context of a continuation of current wholesaling arrangements) could the Government consider to create a consistent regulatory framework for interstate services?

Issue 2: Certification as an effective regime

The Commonwealth's certification of the Western Australian rail access regime expired in February 2016. Rail lines subject to the Western Australian rail access regime are now also subject to the NAR. As such, an access seeker currently has the choice of pursuing access either through the Western Australian rail access regime or the NAR, this was also the case from 2001 until the Western Australian rail access regime was certified in 2011. Having two regulatory pathways, while creating choice for access seekers, may create uncertainty for rail owners and might deter new rail investments.

When the Western Australian rail access regime was first certified, the NCC recommended that the regime not be certified, because it 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. In certifying the regime the Commonwealth Minister recommended that the Western Australian rail access regime be applied to all new railways and certified the regime for five years in line with the ERA review process timeframes.

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

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

4. Amendments from ERA Code reviews that the Government intends to implement

The Economic Regulation Authority (ERA) made several recommendations in the 2011 and 2015 reviews of the *Rail (Access) Code 2000* (the Code) that will improve and streamline how the Western Australian rail access regime operates. The Government intends to progress implementing these recommendations without repeating the consultation already conducted by the ERA. The table below sets out the ERA recommendations the Government is proposing to implement and does not include those discussed earlier in this Issues Paper. Most of the recommendations in question appear to be relatively non-contentious; however the Government still welcomes pertinent comments on any of these recommendations.

ERA Code Review 2015
<p>Recommendation 5</p> <p>Section 10 of the Code be removed.</p>
<p>Recommendation 6</p> <p>Sections 14 and 15 of the Code be amended to indicate a timeframe of seven days for the provision by the proponent of the information required by the railway owner.</p> <p>Section 18 be amended such that the railway owner cannot be dissatisfied with a proponent's response, if the preliminary information provided under section 7A is not adequate to enable the proponent to respond to the railway owner's satisfaction.</p>
<p>Recommendation 7</p> <p>The term "days" in the Act and the Code be defined to mean "business days".</p> <p>All timeframes in the Code be adjusted accordingly.</p> <p>In particular, the timeframes prescribed in Part 2 of the Code ("Proposals for access") be amended to:</p> <p>Section 7(2) – 10 days</p> <p>Section 9(1) – 5 days</p> <p>Section 9(2) – 20 days</p> <p>Section 9(3a)(3)(a)(i)(I) – 20 days</p> <p>Section 9(3a)(3)(a)(i)(II) – 30 days</p> <p>Section 9(3a)(3)(a)(ii) – 15 days</p> <p>Section 9(3a)(3)(b) – 5 days</p> <p>Section 10(3) – 20 days</p>
<p>Recommendation 8</p> <p>The prescribed time limit set out in section 7C(2)(b) for the amendment or replacement of required information (information described in section 7A) be reduced from two years to one year.</p>

Recommendation 9

That Schedule 2 of the Code be amended to clarify the meaning of “available capacity” and the information which must be provided under item 4(o) of that Schedule, such that it is consistent with the meaning of “capacity” as defined in section 3 of the Code.

Recommendation 10

The Code be amended to include provisions, in place of section 26(2), enabling the following:

The parties in dispute to agree upon an arbitrator(s), and this agreement is to occur within ten business days of the Regulator being notified that the proponent is in dispute with the railway owner.

The proponent must notify the Regulator of the agreement of such an arbitrator(s).

If the Regulator is not notified within ten working days that an agreement has been reached, the Regulator is to appoint one or more persons whose names are on a panel established under section 24 to act as arbitrators to hear and determine the dispute.

The Regulator must consult with the parties in dispute prior to the appointment of an arbitrator from the panel.

ERA Code Review 2011

Final Recommendation 1

Part 2A of the Code should be amended by adding a further requirement that the information required to be provided by a railway owner as described under sections 6(a) and 6(b) of the Code should be published on the railway owner's website. If a railway owner does not have a website, but information relating to the railway is maintained on the website of an associated company, then the required information as described under sections 6(a) and 6(b) should be published on that company's website.

Final Recommendation 2

Section 7 of the Code should be amended by adding a new sub-section noting that any capacity information provided by the railway owner must be compiled on a reasonable basis consistent with the railway owner's obligation under section 16(2) not to unfairly discriminate between the proposed rail operations of a proponent and the rail operations of the railway owner.

Final Recommendation 5

Sections 52(1), 52(2), 52(3), 52(4) and 53 of the Code should be deleted as these transitional provisions are no longer relevant.

Final Recommendation 6

Schedule 1 should be amended as follows:

Item 52 should be amended by replacing the words “... the railway constructed pursuant to the TPI Railway and Port Agreement” with “... the railway constructed pursuant to the TPI Railway and Port Agreement and defined as ‘Railway’ in that Agreement”.

Schedule 4 should be amended as follows:

Item 50A of Schedule 1 should be added to clause 3(1)(a)(i) of Schedule 4.

Clause 3(1)(a)(ii) should be amended by replacing the words “in the other items in that schedule” with “in items 1 to 48 in that Schedule”.

Clause 3(2) should be amended to ensure that the public consultation arrangements set out in sections 3(3) to 3(5) of Schedule 4 apply to the initial WACC determination for any new railway which comes under the Code.

Appendix A: How to provide feedback

This Issues Paper is intended to facilitate discussions regarding proposed changes and potential improvements to the Western Australian Rail Access Regime and to assist stakeholders to participate in the review process. The Western Australian Government welcomes feedback from interested individuals and organisations.

The purpose of the review is to identify reforms that would better enable the regime to achieve its objective. The review is intended to be broader than the ERA's previous reviews of the Code. Specifically, the review intends to progress more substantive improvements to the Western Australian rail access regime.

The Government welcomes comments from stakeholders who want to address any of the questions set out in this Issues Paper. Comments may range from a short response on a particular question to a more substantial submission covering multiple issues.

Material that is in confidence must be clearly marked '**IN CONFIDENCE**'.

Stakeholders should provide comments in Microsoft Word (.docx) files, or Word documents saved as PDF (.pdf) files.

The closing date for feedback is 17 November 2017.

Feedback can be provided

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

by post: Aditi Varma,
A/Director Economic Reform
Department of Treasury
Locked Bag 11 Cloisters Square
Perth, Western Australia, 6850

