Submission to the Western Australian Government

Review of the Western Australian Rail Access Regime Issues Paper (Redacted version)

FINAL – 17 November 2017

Grey highlighting = information identified as being confidential

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EXECUTIVE SUMMARY

CBH welcomes the Western Australian Government's review of the Western Australian rail access regime (**WARAR**). The purpose of the review is to identify improvements to the WARAR in order to better achieve its objective.

CBH welcomes the fact that the Government's review is intended to be broader in scope than previous reviews undertaken by the Western Australian Economic Regulation Authority (**ERA**) in 2005, 2011 and 2015.

CBH believes that a broader review is overdue. Previous WARAR reviews were restrictively narrow and led to disappointing results. Each represented a missed opportunity to address the serious problems that have emerged over the past 19 years in the design, operation, and enforcement of the WARAR.

CBH's primary submission is that the WARAR has not achieved, and is not achieving, its main objective. In the 19 years since it first commenced, the WARAR has done little to promote the efficient use of, and investment in, railway facilities and has failed to facilitate a contestable market for rail operations on a critical state asset.

CBH believes that the WARAR suffers from design flaws, has not been appropriately administered, and is poorly enforced. A number of important features mean that it can be used by railway owners to exercise their monopoly power. It is unattractive, unwieldy and inefficient as a pathway to access – a fact that has been all too apparent to access seekers and railway owners for many years.

CBH makes these submissions as one of only three proponents to have sought access under the Railways (Access) Code 2000 (**Code**). It submitted a proposal for access to the grain rail network over 45 months ago, in December 2013. The negotiation and arbitration process has been tortuous, drawn-out and expensive. And it has still not been resolved.

CBH is dissatisfied with the WARAR and the difficulties it has faced in seeking access under it. The process of obtaining access under the WARAR has had a significant negative effect on the efficiency of its operations, and has resulted in uncertainty and increased costs for CBH, its members and growers. This has directly affected the competitiveness of the WA grain industry, and its significant contribution to Australia's national economy.

The key deficiencies of the WARAR that CBH has encountered include:

(a) a failure to facilitate a streamlined path to negotiated outcomes;

(b) a flawed pricing methodology;

(c) the lack of a direct correlation between access prices and below rail performance and the absence of suitable performance requirements;

(d) a lack of transparency and information disclosure by the railway owner;

(e) ineffective enforcement mechanisms;

(f) the fact that railway owners are able to make significant confidentiality claims over information;

(g) significant challenges in relation to the choice and appointment of arbitrators; and

(h) the lack of any protection from the exercise of monopoly power by the railway owner in relation to a range of important issues under the WARAR.

CBH makes a wide range of submissions on these issues, as well as others raised by the Government, in the hope that the Government will drive reform of rail access in Western Australia at the most fundamental level. Some of the key issues addressed in the submissions deal with the need to:

(a) focus on and clarify the objective of the WARAR;

(b) address the significant deficiencies in the WARAR negotiation process, including by:

  (i) abolishing the “in” and “out” distinction under the WARAR or extending the WARAR’s negotiating protections, Part 5 instruments and right to binding arbitration to benefit access seekers who choose to negotiate outside the Code;

  (ii) introducing a reference tariff approach, where regulated prices are determined up-front;

  (iii) abolishing or reforming sections 14 and 15, which operate as obstacles that hold up access negotiations;

  (iv) imposing maximum timeframes on arbitrations;

  (v) extending the circumstances in which a "dispute" can arise under the Code to allow access seekers to commence dispute resolution earlier;

  (vi) tightening the enforcement regime; and

  (vii) requiring the status quo to be preserved under an existing access agreement between the access seeker and railway owner, where a proposal has been made for a replacement access contract;

(c) deal with the lack of transparency under the WARAR, including by strengthening the reporting obligations of railway owners (particularly in relation to performance indicators and service quality);

(d) improving the accountability of the regulator and arbitrator by introducing merits review in relation to key decisions;

(e) reform how the Code deals with capacity issues, including by clarifying the meaning of “capacity” and providing further guidance in relation to the process and timing for expansion and extension proposals;

(f) fundamentally reform the pricing model, including by introducing an indicative (or reference) tariff approach, and shifting the asset valuation methodology from gross replacement value to an “established asset base”;

(g) appropriately deal with so called marginal freight routes and avoid them being closed and “land banked” by the rail operator, and

(h) either make fundamental changes to the WARAR or move to a national rail access regime.

CBH hopes that this review will result in timely, meaningful and fundamental change to the WARAR. If that occurs, the regime may be able to achieve its objective for the benefit of rail owners and users and, ultimately, the people of Western Australia.

CBH is keen to discuss these submissions with the Government and to fully participate in subsequent stages of the review, including in relation to more detailed specific proposals.

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1. INTRODUCTION

CBH welcomes the opportunity to provide this submission to the Western Australian Government in relation to its review of the WARAR, as established by the *Railways (Access) Act 1998* (WA) (**Act**) and *Railways (Access) Code 2000* (WA) (**Code**).

The purpose of the review is set out in an "Issues Paper" published by the Western Australian Department of Treasury in July 2017 (**Issues Paper**).[1] It is to "identify improvements to the [WARAR] in order to better achieve its objective".[2]

The Issues Paper states that the Government's review is intended to be broader in scope than previous reviews undertaken by the ERA in 2005, 2011 (**2011 Code Review**) and 2015 (**2015 Code Review**).[3] While the review may lead to the implementation of recommendations made by the ERA in its previous reviews, the Government's review is "…also considering the broader context of the regime, and other potential changes to improve its effectiveness".[4] It is intended that the review will "identify elements of the regime that could be changed"[5] and "progress more substantive amendments to the [WARAR]".[6]

CBH believes that this "broader" review is overdue. The three previous Code reviews undertaken by the ERA were not only restrictively narrow in scope, but also led to disappointing results. Each represented a missed opportunity to address the serious problems that have emerged over the past 19 years in the design, operation, and enforcement of the WARAR.

CBH is, therefore, hopeful that this review will result in meaningful and fundamental change to the WARAR. If that occurs, the regime may be able to achieve its objective for the benefit of below-rail owners and users and, ultimately, the people of Western Australia.

CBH's primary submission is that the WARAR has not achieved, and is not achieving, its main objectives.

In the 19 years since it first commenced, the WARAR has done little to promote the efficient use of, and investment in, railway facilities and has failed to facilitate a contestable market for rail operations. CBH believes that it suffers from design flaws, has not been appropriately administered, and is poorly enforced.

CBH considers that a number of important features of the WARAR mean that it can be used by railway owners to exercise their monopoly power to inappropriately raise prices and decrease capacity, service offerings and service quality. It is unattractive, unwieldy and inefficient as a pathway to access – a fact that has been all too apparent to access seekers and railway owners for many years.

CBH believes that the WARAR needs to change significantly, at the most fundamental level. It encourages the Government to make that happen now.

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1 Government of Western Australia 2017, *"Review of the Western Australian Rail Access Regime: Issues Paper"* (published 21 July 2017), available at http://www.treasury.wa.gov.au/Treasury/News/Review_of_the_Western_Australian_rail_access_regime/.

2 Issues Paper, at p.1.

3 Issues Paper, at pp. 1, 2 and 40.

4 Issues Paper, at p. 2.

5 Issues Paper, at p. 2.

6 Issues Paper, at p. 40.

CBH makes this submission as one of only three proponents to have sought access under the Code. It is also the only proponent to have had input from the ERA on the determination of costs relevant to the grain freight rail network operated by Arc Infrastructure Pty Ltd (**AI**),[7] which is covered by the WARAR. This has given CBH unique insight into the many problems with the regime.

CBH submitted a proposal for access to the grain rail network over 45 months ago, in December 2013. The negotiation and arbitration process was tortuous, drawn-out, expensive[8] and replete with exasperating events, such as CBH being forced to:

- seek injunctive relief in the Supreme Court to enforce CBH's rights under the Code (which proceedings were ultimately settled with AI before trial);
- commence and participate in arbitration proceedings which took over nine months to resolve a preliminary issue [redacted] and
- enter into a number of interim, short term access agreements outside of the WARAR process (without the benefit of the protections afforded by the WARAR to "in Code" negotiations), which saw AI use its monopoly power without restraint to demand escalating price increases on a "take it or leave it" basis.[10]

CBH only reached the stage of an arbitration hearing with AI in September 2017, and is yet to receive an arbitration determination.

CBH is entirely dissatisfied with the WARAR and the difficulties it has faced in seeking access under it. The process of obtaining access under the WARAR has had a significant negative effect on the efficiency of its operations, and has resulted in uncertainty and increased costs for CBH, its members and growers. Not being able to secure long-term access on reasonable terms to a vital part of the grain supply chain has increased costs and adversely affected the competitiveness of WA grain growers (particularly their ability to transport their grain to highly competitive international markets efficiently and effectively). This has directly affected the competitiveness of the WA grain industry, and its significant contribution to Australia's national economy.

CBH's experience provides clear evidence that the WARAR has failed to achieve efficient outcomes, and to meet the main object of the Act. The key deficiencies that CBH has encountered include:

(a) a failure to facilitate a streamlined path to negotiated outcomes - in particular, the WARAR allows inappropriate threshold issues and regulatory processes[11] to effectively and unnecessarily "hold up" substantive negotiation processes;

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7 Prior to 17 July 2017, Arc Infrastructure was called Brookfield Rail Pty Ltd. For that reason, documents brought into existence prior to 17 July referred to Brookfield Rail Pty Ltd. In these submissions, references to AI are to be read as references to AI Pty Ltd, and vice versa.

8 CBH's costs pursuing sustainable access to below rail infrastructure under the WARAR have reached [redacted]. In addition, CBH has invested considerable management and operational time and resources in the process.

9 [redacted]

10 For instance, in April 2015, AI refused to allow CBH rolling-stock to operate on the AI network unless CBH agreed to an "out of Code" interim access offer under which there would be a material increase in access charges. CBH was forced to stop all train movements until it reached agreement with AI under protest.

11 This includes the need to have the ERA approve or determine floor and ceiling prices under clause 10 of Schedule 4 of the Code.

(b) a flawed pricing methodology, including a floor and ceiling price mechanism that does little to assist an access seeker to negotiate prices under the Code;

(c) the lack of a direct correlation between access prices and below rail performance and the absence of suitable minimum performance requirements;

(d) a lack of transparency and information disclosure by the railway owner, particularly in relation to pricing information and performance standards;

(e) ineffective enforcement mechanisms to enforce the performance of the obligations of the railway owner under the WARAR;

(f) the fact that railway owners are able to make significant confidentiality claims over information, the disclosure of which is vital to facilitate a transparent and consultative process and to redress the information asymmetry that exists between them and the users of rail networks;

(g) significant challenges in relation to the choice and appointment of arbitrators, which leads to inordinate delays in the commencement of arbitration proceedings; and

(h) the lack of any protection from the exercise of monopoly power by the railway owner in relation to the availability, pricing and terms of access during the period between the expiry of existing access arrangements and securing access under the WARAR.

In response to the Issues Paper, this submission explains each of these deficiencies.

About these submissions

The Government invites feedback on issues and proposals outlined in the Issues Paper and "…on any other matter related to the operation of the [WARAR]".[12] The Issues Paper discusses eight main issues.

CBH's detailed feedback on the WARAR, including the issues and proposals outlined in the Issues Paper, are set out in this submission.[13] In addition, this submission provides some background information about CBH and its experience in operating under the WARAR, as well as feedback on some other matters related to the operation of the WARAR.

It is structured in the following way:

(a) Part 1 provides an **introduction** to CBH's submissions;

(b) Part 2 provides **background information** about CBH, its supply chain and its access proposal under the Code;

(c) Part 3 discusses the **objective** of the WARAR;

(d) Part 4 discusses the "**balance of power in negotiations**" (section 3.1 of the Issues Paper);

(e) Part 5 discusses "**accountability**" (section 3.2 of the Issues Paper);

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12 Issues Paper, at p. 3.

13 This submission does not provide feedback in relation to the issues raised in the Issues Paper in relation to greenfield development (Section 3.6 of the Issues Paper) and vertically integrated rail networks in the Pilbara (Section 3.7 of the Issues Paper).

(f) Part 6 discusses "**capacity expansions and extensions**" (section 3.3 of the Issues Paper);

(g) Part 7 discusses "**pricing mechanisms**" (section 3.4 of the Issues Paper);

(h) Part 8 discusses "**marginal freight rail routes**" (section 3.5 of the Issues Paper);

(i) Part 9 discusses "**consistency with the National Access Regime**" (section 3.8 of the Issues Paper);

(j) Part 10 discusses **other issues** relating to the WARAR; and

(k) Part 11 sets out CBH's comments on **amendments from previous ERA Code reviews** that the Government has indicated that it intends to implement.

CBH is keen to discuss these submissions with the Government and to fully participate in subsequent stages of the review, including in relation to more detailed specific proposals.

Please direct any questions about these submissions to:

David Capper
General Manager - Operations
Co-operative Bulk Handling Limited

2. BACKGROUND ABOUT CBH

2.1 Background to CBH Group

CBH is a not-for-profit, non-distributing co-operative with grain producer members who reside in Western Australia (**WA**). The co-operative's commitment to maintaining a partnership with its WA grain grower members has helped build an industry that has been the backbone of the State's rural economy since the beginning of the bulk handling system in 1933. This partnership has also been the basis of CBH's strength and success.

During its life, CBH has constantly evolved, innovated and grown, with operations extending along the value chain from grain storage, handling and transport to marketing, shipping and processing. Now Australia's biggest co-operative and a leader of the nation's grain industry, CBH is controlled by approximately 4,200 WA grain growers. The co-operative exists for their benefit and the advancement of the grain industry in WA.

2.2 Background to CBH's supply chain

The nature of the operations and principal activities of CBH and its subsidiaries include:

(a) grain storage, handling and transportation services;

(b) grain trading and marketing; and

(c) engineering, constructing and investing in flour mills and other processing facilities.

CBH is the largest exporter of wheat, barley and canola in Australia. In addition to its operations in WA, it also has trading, marketing and processing operations in the eastern states of Australia and overseas.

Within WA, CBH has 197 receival points for its commodities, which are located across the wheatbelt region of WA, operations at four ports located at Kwinana, Geraldton, Albany and Esperance, and the Metro Grain Centre (**MGC**) in Forrestfield. CBH's storage and handling system currently receives around 95% of the annual WA grain harvest, and 95% of WA's grain harvest is exported. CBH's long term rolling average grain rail freight task is approximately 6.6 million tonnes per year. However, due to the seasonal variability of the grain harvest, that range has varied between 3 million and 9 million tonnes per annum. The 2016/2017 harvest was a record year, with 16.6 million tonnes received.

In April 2017, CBH published details of its grain network strategy for the future.[14] In essence, CBH aims to realise cost savings, gain efficiencies and deliver more tonnes to port when they are most needed, by focusing maintenance and capital on the core 100 sites that receive over 90% of the annual grain harvest. The strategy involves the investment into the 100 sites of $150 million per year over the next 5 years and:

- **(competitive fees)** targeting storage and handling fees of $29 per tonne or less, after rebates, by 2018;
- **(faster receivals)** achieving a 16 – 20% increase in throughput capacity, thereby helping to improve turn-around times; and
- **(more tonnes to port)** moving 2.2 million tonnes per month to port to meet customer export demand when it is needed.

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[14] CBH, "Network Strategy: Shaping the network of the future", 8 April 2017. See: https://www.cbh.com.au/other%20information/network%20strategy.

The WA grain industry is significant to Australia's national economy. This is evidenced by the fact that up to 50% of grain exported from Australia originates from WA. CBH itself exports to over 250 customers in 30 countries. An efficient and cost effective railway network is therefore essential for CBH to ensure that WA grain growers are able to remain internationally competitive.

Approximately 70% of CBH's freight task is transported by rail to CBH's port facilities or the MGC. The grain rail network is therefore a vital piece of CBH's supply chain.

2.3 CBH's recent experience in using the grain rail network

In 2010/2011, CBH made a decision to pursue enhanced "above rail" efficiencies, by investing $175 million in new rolling stock (locomotives and wagons) to be operated by a new "above rail" operator for the dedicated service of grain haulage in WA. That operator is Watco WA Rail Pty Ltd (**Watco**).

Unfortunately, the current management and operation of the WA grain rail network is making it difficult for CBH to realise any of the efficiency gains it has generated in its above rail operations. This is principally attributable to three factors:

(a) **Prices** - the railway owner's attempts to extract higher prices. Access payments to the "below rail" operator, AI, currently make up over 50% of CBH's rail supply chain costs. Comparatively, CBH estimates that WA grain growers are paying approximately 2.6 to 5 times what growers in eastern Australia pay for track access (that have higher speeds/mass).[15] Freight rates in Canada and the USA are also 30-50% lower than in WA. Due to a lack of transparency around issues such as access pricing and performance standards, there is also considerable uncertainty over how these access fees are being expended.

(b) **Performance standards** - track performance standards have been significantly decreasing. The present performance of the grain rail network has caused grave concerns about how it is being managed and as to its sustainability. On 23 August 2017, there were 1,018 permanent speed restrictions in place for the total AI network.[16] That represented an 8% increase over the number of permanent restrictions that were in place only 2 years ago, in April 2015. At that time, there were 942 separate permanent speed and mass restrictions placed on Tier 1 and Tier 2 line sections. In addition, there is a range of temporary track restrictions in place, including heat restrictions. While there is limited transparency in relation to the basis for heat restrictions, they can have significant effects on CBH's operations and scheduling. In particular, heat restrictions may mean that, at times, CBH cannot run loaded trains in daylight hours for over half the number of months in a year. This is all despite the fact that government previously committed $164.5 million to fund required track maintenance.[17] As an example, the Beacon to Burakin line section only allows for 30 km/h operations for full trains, despite being re-sleepered as part of a 2012 government funding package.[18] These restrictions have severely hindered effective supply chain operations.

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15 CBH has used pricing information published by ARTC to make this estimate. See: http://www.artc.com.au/library/Pricing%20Schedule%20Effective%2001072014%20updated%2007072014.pdf

16 Speed restrictions in place on Wednesday, 23 August 2017, at 8:58 am. Data taken from ARC's RAMS system. See: http://www.artc.com.au/customers/operations/webrams/

17 CBH acknowledges that some of these permanent restrictions may be appropriate (for example, speed restrictions at curves or level crossings). However, CBH is concerned about the number and scale of the restrictions, and the fact that they are increasing.

18 The re-sleepering work was completed in 10 December 2013, at the latest. Since then, there has been no improvement in performance standards.

(c) **Closure of lines** – AI's attempt to close operations on certain route sections that are covered by the Code. After CBH's and AI's previous access agreement ended, and the parties began to negotiate for a replacement access agreement (as discussed below), AI closed the following routes:

(i) Narrogin to West Merredin;

(ii) Kulin to Yilliminning;

(iii) West Merredin to Kondinin; and

(iv) Perenjori to Maya.

This followed the closure of the York to Quairading and West Merredin to Trayning routes in late 2013. AI has also indicated its intention to close operations on the Toodyay West to Miling line from 31 December 2017. The closure of these routes, to which CBH requires access, has presented CBH with significant operational restrictions. Further, despite plans to close around 800 kilometres of track, AI has previously proposed a significant increase in access fees for the remaining parts of the grain rail network.[19]

2.4 Freight Rail Network Inquiry

The operation and management of the privatisation lease over the rail network held by AI was discussed in detail in the report of the Economics and Industry Standing Committee's (**Committee**) inquiry into the management of the WA freight rail network (Report No. 3 dated October 2014) (**Freight Rail Network Inquiry**). The Committee was highly critical of the way the railway network has been managed under the privatisation lease arrangements, and expressed concerns about the ongoing safety and viability of the arrangements. CBH has similarly been consistent in its view that there is a need for increased and effective statutory or regulatory oversight into the performance of AI under its lease.

The Committee also discussed the effectiveness of the Code and made a number of recommendations directly relevant to this review. In particular, the Committee stated that the Code is:

> "...inherently flawed insofar as it does not lend sufficient certainty to rail network access negotiations."[20]

CBH agrees with the Committee's assessment.

The Committee discussed the process of CBH's access proposal in some detail. It stated that whatever outcome was reached, "it is clear that there exists significant room for improvement within the process."[21] At the time, the Committee identified the following issues with the Code:

(a) **the length of the Code process** – the time taken to discharge the Code process was regarded as one obvious reason for the Code's historic dormancy, particularly

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[19] Economics and Industry Standing Committee's inquiry into the management of the WA freight rail network (Report No. 3 dated October 2014) (**Freight Rail Network Inquiry**) at paragraph 6.22.

[20] Freight Rail Network Inquiry at paragraph 6.68.

[21] Freight Rail Network Inquiry at paragraph 6.36.

as there was no clear end in sight to CBH's access proposal (which, at that time, was a mere ten months into the process);[22]

(b) **confidentiality issues** – the Committee regarded the confidentiality surrounding the process of determining floor and ceiling costs as unhelpful. It asserted that, as the ERA undertook independent cost calculations in the process of assessing the costs submitted by AI, "there is no good reason for the floor and ceiling costing process to take place under a shroud of secrecy";[23]

(c) **network upgrades** – the Code is not an adequate regulatory mechanism for access proposals requiring an upgrade to the network.[24] The Code offers no assistance whatsoever in the process of negotiating a network upgrade, a fact which calls into question the worth of having the Code at all, especially considering that rail technology is unlikely to regress over the remainder of the term of the lease. It recommended that the ERA's review of the Code in 2015 include a review of its effectiveness in third party access requiring capital upgrades;[25] and

(d) **the unhelpfulness of the floor and ceiling costs methodology** – while the Committee appreciated the theory informing the use of floor and ceiling costs to guide negotiations, this was an element of concern with the Code process, for the following reasons:

(i) The fact that the Code permits such a vast gulf between nominated floor and ceiling costs limits the usefulness of these parameters in any negotiation.[26]

(ii) Inflexibility within the floor and ceiling cost regime leaves a potential access seeker in a difficult position if the performance standards associated with the ceiling cost are significantly in excess of what is required (or, CBH would add, available). Because the Code stipulates ceiling costs to be a function of the cost to replace existing line with modern equivalent assets, this cost may well pertain to infrastructure that exceeds the requirements of the relevant freight task.[27]

(iii) The ceiling cost may be an unrealistic parameter for access agreement negotiations.[28]

The Committee stated that, plainly, the experience of CBH demonstrated that the Code "does little to actually facilitate or aid access agreement negotiations".[29] Further:

> "…it should not have taken the processing of [CBH's] access application for the ERA to realise that <u>the Code is effectively broken</u>, particularly as the floor and ceiling price mechanism lends only minimal transparency to the market for network access. Furthermore, negotiations under the Code can only begin at the conclusion of what is a lengthy process, and, as such, it seems obvious why access seekers have generally seen no point in turning to its provisions."[30] [Emphasis added]

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22 Freight Rail Network Inquiry at paragraph 6.36.

23 Freight Rail Network Inquiry at paragraph 6.36.

24 Freight Rail Network Inquiry, Finding 17.

25 Freight Rail Network Inquiry at paragraph 6.68 and Recommendation 5.

26 Freight Rail Network Inquiry at paragraph 6.37.

27 Freight Rail Network Inquiry at paragraph 6.38.

28 Freight Rail Network Inquiry at paragraph 6.38.

29 Freight Rail Network Inquiry at paragraph 6.40.

30 Freight Rail Network Inquiry at paragraph 6.41.

In the view of the Committee, the historic dormancy of the Code ought at the very least to have provided evidence of some problems inherent to it,[31] and this dormancy "owes a great deal more to its impotence than its redundancy".[32] Further, the fact that parties have not utilised the Code does not necessarily indicate the existence of a robust, contestable market for access to WA's freight rail network.[33]

CBH supported, and continues to support, the comments made by the Committee in relation to the inherent problems with the Code. They are directly relevant to whether the WARAR is achieving its objective. CBH urges the Government to take into account the comments in the Freight Rail Network Inquiry in relation to the Code, as part of the current review.

2.5 Background to CBH's access proposal

Between March 2012 and June 2014, CBH accessed the grain rail network under an interim commercial track access agreement with AI. CBH's "above rail" operator, Watco, held an operational track access agreement with AI covering the same period. In the lead up to the expiry of those agreements in June 2014, CBH engaged in extensive good faith negotiations with AI to reach an acceptable replacement agreement. Those negotiations were carried out "outside of the Code" pursuant to section 4A of the Code.

CBH therefore made the decision to seek access to the rail network under the Code. Following notices for, and correspondence about, required information and preliminary information under the Code, CBH formally submitted its proposal for access on 10 December 2013. CBH sought access to various routes and associated railway infrastructure for the purpose of transporting grain from its receival sites throughout the state to the port terminals operated by it, and sought to negotiate the provision of other additional services. CBH sought access to the routes that it used at that time, many of which CBH had used (either directly, or through third party haulage providers) since CBH was established in 1933.

CBH has faced considerable hurdles in seeking to obtain access under the Code. In the Schedule to this submission, CBH has set out a chronology of the key events that have occurred during the process. The following timeline provides a summary of these events.

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31 Freight Rail Network Inquiry at paragraph 5.36.

32 Freight Rail Network Inquiry at paragraph 6.3.

33 Freight Rail Network Inquiry, Finding 10.

Summary – Timeline of key events in WARAR access process

2013	23 October 2013	CBH requested the "required information" and "preliminary information" from AI
	10 December 2013	CBH submitted its proposal for access under section 8 of the Code.
	17 December 2013	AI responded to CBH's access proposal under section 9 of the Code, although not fully complying with the requirements of the section.
2014	6 January 2014	ERA gave public notification of the approval or determination of AI's costs under clause 10 of Schedule 4 of the Code, and invited submissions on them.
	17 January 2014	CBH commenced Supreme Court proceedings seeking an injunction to compel AI to provide pricing and costs information under sections 9(1)(c)(i) and (ii), and declarations that its proposal was a valid proposal under the Code.
	13 February 2014	CBH and AI settled the Supreme Court proceedings, under a confidential Settlement Agreement. CBH clarified its access proposal.
	27 February 2014	AI also requested CBH to provide information satisfying section 15 of the Code.
	17 March 2014	
	20 March 2014	CBH provided a preliminary submission on floor and ceiling costs to the ERA.
	26 March 2014	CBH responded to AI's request under section 15 of the Code.
	3 April 2014	CBH provided additional information for the purpose of satisfying AI's request in relation to section 15 of the Code.
	7 April 2014	CBH provided a detailed submission on floor and ceiling costs to the ERA.
	9 April 2014	AI provided notice under section 18(1) of the Code that it was not satisfied of the matters referred to in section 15.
	20 May 2014	CBH provided notice under section 18(3) of the Code that there is a dispute between AI and CBH as to whether the requirements of section 15 have been met.
	12 June 2014	CBH referred the dispute to arbitration.
	27 June 2014	CBH and AI entered into a short-term commercial track access agreement (due to expire on the earlier of 31 October 2014 and the date the parties entered into a replacement access agreement).
	30 June 2014	The ERA made its determination of floor and ceiling costs under clause 10 of Schedule 4 of the Code. The interim commercial track access agreement on foot between CBH and AI expired.

	22 – 23 September 2014	Hearings were held for the [redacted] dispute arbitration.
	24 September 2014	The ERA published a redacted version of its costs determination.
	14 October 2014	CBH and AI entered into a further short-term commercial track access agreement (to expire on the earlier of 30 April 2015 and the date the parties entered into a replacement access agreement).
2015	11 February 2015	The arbitrator made a final determination of the [redacted] dispute.
	16 March 2015	AI gave its notice of readiness to begin negotiations under section 19(1) of the Code.
	18 March 2015	CBH gave its notice of readiness to begin negotiations under section 19(3) of the Code.
	26 March 2015	Negotiations commenced under the Code.
	1 May 2015	CBH and AI entered into a further short term commercial track access agreement.
	24 June 2015	Negotiations end without an access agreement being reached.
	10 November 2015	CBH and AI entered into a further short term commercial track access agreement.
	4 December 2015	Code amended in relation to the appointment of arbitrators.
2016	17 February 2016	CBH referred the access dispute to arbitration in accordance with section 26(1) of the Code.
	18 March 2016	Arbitrator appointed.
2017	September 2017	Arbitration hearings.

Based on its experience with this protracted, bureaucratic, legalistic and frustrating process, CBH's view is that the Code process is inefficient, unwieldy and problematic. This is evidenced by the following issues CBH has endured:

(a) a significant period of time has elapsed since CBH submitted its proposal for access under the Code;

(b) CBH did not receive aspects of the required information, preliminary information and section 9(1)(c) information either at all, or in the time required by the Code.

(c) AI has claimed that CBH's access proposal is not a valid proposal, on the basis that CBH requested access to routes on which AI contended there was no capacity;

(d) AI has refused to give price and costs information required by section 9(1)(c) on the grounds of confidentiality;

(e) AI has refused to give price and costs information required by section 9(1)(c) for certain routes on which it contends there is no capacity (and for which CBH has requested access and contended that there is available capacity);

(f) CBH was forced to commence proceedings in the Supreme Court for declarations as to the validity of its proposal, and for an injunction mandating AI to provide the information required under section 9(1)(c);

(g) CBH and AI have engaged in an arbitration regarding whether the requirements of section 15 have been satisfied;

(h)

(i) on 1 May 2015, CBH was forced to park its fleet of rolling stock when AI prevented it from accessing the network after an interim access agreement expired and the parties were unable to reach agreement on a new "out of Code" interim access agreement (to apply until there is an outcome under the WARAR process);

(j) CBH's referral of its access dispute to arbitration was delayed by 9 months due to the need to amend the Code to expand the pool of arbitrators under the Code; and

(k) difficulties in appointing an arbitrator, which led to further significant delays.

CBH and AI have also entered into several interim commercial track access agreements during this time, to ensure service continuity for CBH while the Code process continued. They are identified in the detailed chronology in the Schedule to this submission.

This process has had a significant negative effect on CBH, its members and its growers. CBH has been forced to expend significant time and resources in unnecessary and unproductive processes that have not taken it any further in its ultimate goal of securing reasonable terms of access for the benefit of its members. This has adversely affected the efficiency of its operations, and has resulted in increased costs for CBH, its members and growers.

CBH believes that it would not be in this position if there was a stronger and more effective regulatory framework in place for access seekers – one that encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations.

3. THE OBJECTIVE OF THE WARAR

3.1 The Issues Paper

As noted above, the purpose of the Government's review is to "identify improvements to the [WARAR] in order to better achieve its objective".[34] The Issues Paper identifies that objective as being the "main object" set out in section 2A of the Act, which is expressed in the following terms:

> "The main object of this 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."

The Issues Paper then says that the WARAR aims to achieve that "purpose" by:

(a) encouraging "commercial negotiation";

(b) preventing the "misuse of market power" and "promoting competition"; and

(c) targeting "a specific economic problem (i.e. lack of competition in markets for significant infrastructure)" and promoting regulatory certainty".[35]

However, the Issues Paper then goes on to say that the proposed changes in it are "intended to meet these objectives with the least cost and delay practicable, and do not extend to addressing other policy problems and objectives" before progressing to outline a range of other factors that will be "taken into consideration".[36]

3.2 It is important not to lose focus on the main objective

The objective specified in section 2A is fundamentally important to the design, operation and enforcement of the WARAR. It addresses in general terms (though not precisely) the Government's obligation under clause 6(5)(a) of the Competition Principles Agreement (dated 11 April 1995) (**CPA**) for the WARAR to incorporate an objects clause that:

> "…promote[s] the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets."

Unfortunately, CBH is concerned that the discussion in the Issues Paper may lead to confusion about the WARAR objective. That is because the Issues Paper not only discusses the main object set out in section 2A of the Act, but also sets out other "aims" (which also seem to be referred to as "objectives") and other factors that will be considered.

CBH submits that it is important to clarify that the one and only objective of the WARAR is the object set out in section 2A of the Act.

While it may be desirable to seek to achieve that single objective by addressing certain issues or to identify the way in which it aims to do so (such as the prevention of the misuse of market power), it is important that those things do not cloud the main objective – encouraging the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations. Otherwise, there is a risk that proposals for change (or for no change) will be inappropriately driven by reference to subsidiary considerations and factors.

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[34] Issues Paper, at p.1.

[35] Issues Paper, at p.2.

[36] Issues Paper, at p.2.

3.3 Is the WARAR objective the right objective?

As discussed above, the WARAR objective in section 2A of the Act is concerned with encouraging efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations. However, for the following reasons, CBH submits that the object in section 2A should be amended.

Section 2A of the Act

On one reading, section 2A states that the end to be achieved (the objective) is the efficient use and investment in relation to railway facilities. The way in which that is to be achieved is through the facilitation of a contestable market for rail operations. Put another way, the thing being encouraged is "below rail" efficiency, and the way to achieve it is through the facilitation of a contestable "above rail" market.

Clause 6(5)(a) of the CPA

Clause 6(5)(a) of the CPA is drafted differently to section 2A. It is also concerned with the promotion of the economically efficient use of, operation and investment in, significant infrastructure. But that efficiency is promoted in order to facilitate "effective competition in upstream or downstream markets".

This suggests that the actual objective contemplated by clause 6(5)(a) of the CPA is effective competition in upstream or downstream markets. The achievement of efficient use, operation and investment is the mechanism for promoting competition.

Distinction between the objects in section 2A and clause 6(5)(a)

If the above reading of section 2A of the Act is correct, then it means that the WARAR objective:

(a) does not align with the requirements of clause 6(5)(a) of the CPA; and

(b) does not align with the objective of the National Access Regime set out in section 44AA(a) of the *Competition and Consumer Act 2010* (Cth) (**CCA**). That objective is expressed in essentially the same terms as clause 6(5)(a) of the CPA.

This distinction is more than a semantic one. The section 2A objective is fundamentally important because it expresses the thing to which the WARAR is directed and guides the interpretation of the WARAR. Moreover, it seems to CBH that there is a substantive difference between:

(a) a regime that seeks to facilitate contestability in dependent markets as a means of encouraging efficiency in the use of, and investment in, infrastructure; and

(b) a regime that seeks efficiency in the use of, and investment in, infrastructure as a means of promoting competition in dependent markets.

In the latter case, the goal is competition in dependent markets through infrastructure efficiency.

It seems to CBH that a potential explanation for this difference could be found in the use in section 2A of the Act of "by", rather than "thereby", before the words "facilitating a contestable market". It may be that the word "thereby" was intended, but not used. However, that is not what the words of section 2A state and it is the plain words that drive the meaning of that provision.

In addition, and more importantly, the current objective in section 2A may not accurately address the "specific economic problem" (to use the words of the Issues Paper) that an

access regime is often designed to address - the "essential facilities" problem. The nature of the "essential facilities" problem was summarised by the Hilmer Report[37] in the following terms:

> "Some economic activities exhibit natural monopoly characteristics, in the sense that they cannot be duplicated economically. While it is difficult to define precisely the term "natural monopoly", electricity transmission grids, telecommunication networks, rail tracks, major pipelines, ports and airports are often given as examples. Some facilities that exhibit these characteristics occupy strategic positions in an industry, and are thus "essential facilities" in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets. For example, competition in electricity generation and in the provision of rail services requires access to transmission grids and rail tracks respectively."[38]

Put another way, the problem is that:

> "In some markets the introduction of effective competition requires competitors to have access to facilities which exhibit natural monopoly characteristics, and hence cannot be duplicated economically. For example, effective competition in electricity generation and telecommunications services requires access to transmission grids and local telephone exchange networks respectively." [39]

The essence of this problem is that market failure may arise from an "enduring lack of effective competition where there is monopoly provision of infrastructure services due to natural monopoly". [40] According to the Productivity Commission, this is:

> "…likely to constitute an economic problem where access is required for third parties to compete effectively in dependent markets, and an infrastructure service provider denies access altogether or (for both vertically integrated and separated service providers) restricts output in order to charge monopoly prices… As a consequence, transactions that would enhance community wellbeing may not proceed."[41]

Accordingly, the mischief that access regulation should address is the economic problem that can exist when monopoly infrastructure service providers have the ability and incentive to exercise their market power to deny access to the use of infrastructure altogether or engage in monopoly pricing.

That is because such conduct can adversely affect the ability of businesses to participate in dependent markets, resulting in lower consumer welfare.

Change the object in section 2A to align with clause 6(5)(a)

Viewed in this way, it seems to CBH that the objective of access regulation should reflect the approach taken clause 6(5)(a) of the CPA, which is concerned with encouraging economically efficient use of, operation and investment in infrastructure as a way of promoting competition in dependent markets. It should have as its principal concern ensuring competition and efficiency in dependent markets.

For these reasons, CBH considers that it may be appropriate to amend the object in section 2A so that it is aligned with clause 6(5) of the CPA and the object of the National Access Regime in Part IIIA of the CCA. Doing so would also have the ancillary benefit of moving the WARAR objective away from the tortured language that may have had relevance when the vertically integrated Western Australian rail freight network was privatised almost 20 years ago.

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37 "National Competition Policy: Report by the Independent Committee of Inquiry", (1993) Australian Government Publishing Service, Canberra (**Hilmer Report**).

38 Hilmer Report at p.240.

39 Hilmer Report at p.239.

40 Productivity Commission 2013, *National Access Regime*, Inquiry Report no. 66, Canberra (**PC 2013 Inquiry**) at p.86.

41 PC 2013 Inquiry at p.86.

But also accommodate the need to address monopoly pricing and other conduct

Having said this, CBH also considers that promoting efficiency in connection with below rail operations is a desirable and essential goal in and of itself. Unless that efficiency is achieved, CBH and other rail operators will not be able to compete effectively in dependent markets.

In addition, monopolistic conduct such as monopoly pricing can – even in the absence of vertical integration or where the price of access is only a small component of a supply chain – distort efficiency in dependent markets. In this regard, the Chairman of the Australian Competition and Consumer Commission, Mr Rod Sims stated in a speech to the ABARES Outlook Conference in March 2016 that:

> "The argument is sometimes made that regulation to address monopolistic pricing is unnecessary, because monopolistic pricing is the simple transfer of economic rents between parties in a supply chain.
>
> However, this argument is ill-conceived. As I have just explained, what is the incentive for either the upstream or downstream markets to be innovative and control costs if any gains are simply transferred to the monopoly infrastructure provider in the middle of the supply chain?[42]

Accordingly, CBH submits that the object in section 2A should also expressly aim to eliminate the exercise of monopoly power by railway owners, including monopoly pricing.

3.4 **In making this submission, CBH notes that the current wording of section 2A is not well suited to this task, given its concern with facilitating a contestable market for rail operations rather than attacking the use of monopoly power.The WARAR objective clause does not cover all dependent markets**

As discussed above, clause 6(5)(a) of the CPA provides that an effective access regime should incorporate an objects clause that provides a clear statement that the purpose of regulating third party access is ultimately to promote "competition in upstream or downstream markets". This reflects the underlying goal of access regulation.

The Act provides that the Code is to be established to give effect to the CPA.[43] However, the main object set out in section 2A of the Act is concerned with "facilitating a contestable market for rail operations."[44] Accordingly, the only market to which it is directed is the contestable market for rail operations.

The problem with this is that section 2A is only concerned with the market for rail operations. It does not concern itself with any other upstream or downstream markets that rely on the use of the rail network, including, for example, WA grain markets. The WARAR objective is therefore considerably narrower in scope than the objective in clause 6(5)(a) of the CPA.

This issue was recognised by the National Competition Council (**NCC**) in its final recommendation of the certification of the WARAR (dated 13 December 2010) (**WARAR Final Recommendation**). In that document, the NCC noted that the objects clause does not refer to "promoting effective competition in upstream or downstream markets".[45]

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[42] " Mr Rod Sims, Australian Competition and Consumer Commission, "Ïncreasing efficiencies in supply chains", speech given at the ABARES Outlook Conference, Canberra, 2 March 2016, available at www.accc.gov.au.

[43] Act, section 4(1).

[44] Act, section 2A.

[45] WARAR Final Recommendation at 9.16.

To the extent that the regime does not specifically acknowledge the relevant upstream or downstream markets, it is not suitable to give effect to clause 6(5)(a) of the CPA. Simply referring to a market for "rail operations" is not a realistic reflection of the markets that are affected by the use of the infrastructure. Failing to properly capture other markets may lead to distorted outcomes, so that the Code is not applied in a way that will promote competition in those markets. As a result, for the reasons discussed above, there is a risk that there will be a loss in consumer welfare.

CBH submits that the WARAR should acknowledge, as part of its objective, the WA grain market, either expressly or implicitly as one of a broader range of markets to which the regime is directed. This will help to ensure that the rights and interests of WA grain growers to access the rail network are taken into account when making decisions under the Code. Without this, there is a risk that the Code will be applied in a way that is inconsistent with promoting competition in the WA grain market (as one of the largest markets that is affected by the use of the rail network). As discussed elsewhere in this submission, CBH considers that the Code is currently not achieving the objective of promoting competition in the WA grain market. The costly, inefficient and lengthy processes CBH has been forced to endure has also impacted growers, who compete in international export markets.

3.5 Inconsistency with the CPA

As noted above, section 2A "encourages the efficient use of, and investment in, railway facilities by facilitating a contestable market for rail operations".

In contrast, clause 6(5)(a) of the CPA requires an object that "promote[s] the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets". Essentially the same wording is used in the National Access Regime objective.[46]

There are, therefore, a number of differences between the two provisions, in that:

(a) the Act refers to "encouraging" efficiency, whereas the CPA refers to "promoting" efficiency;

(b) the Act refers to "efficiency" whereas the CPA refers to "economic efficiency";

(c) the CPA refers to the "operation" of infrastructure, whereas the Act does not; and

(d) the Act refers to "facilitating" a contestable market, whereas the CPA refers to "promoting effective competition".

CBH has not attempted to examine whether these represent substantive differences, but considers that the use of the different language means that there is a risk that they should be interpreted differently. Given this, the fact that the Code is supposed to give effect to the CPA in respect of the railways to which it applies, and the absence of any obvious reason for using different terminology, CBH submits that the wording of section 2A should be amended to be consistent with clause 6(5)(a) of the CPA and section 44AA(a) of the CCA.

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[46] See CCA, section 44AA(a).

4. BALANCE OF POWER IN NEGOTIATIONS

4.1 The Issues Paper (section 3.1)

The Issues Paper observes that facilitating access through a rail access regime is complex and requires the parties to address problems in a range of areas. It further observes that nobody has secured access using the WARAR. It suggests that:

> "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."[47]

The Issues Paper then explores specific issues relating to the ability to opt to negotiate outside of the Code (**Issue 1**), and whether some elements of the negotiation process could be seen as barriers to negotiation (**Issue 2**). Those elements relate to:

(a) the requirements under the Code for access seekers to demonstrate that proposed operations can be accommodated on the network and to specify details of any required extension or expansion; and

(b) the difficulty for access seekers in assessing the reasonableness of proposed access charges given information asymmetries that favour the railway owner.

The following section of this submission provides feedback on the issue of the balance of power in negotiations under the WARAR. To do this, it discusses:

(a) the nature of negotiate-arbitrate access models, issues that arise with such models when there is unequal bargaining power, and mechanisms that can be used to address unequal bargaining power in terms of negotiation process, information asymmetry and arbitration;

(b) deficiencies in the WARAR negotiation process;

(c) deficiencies in the way in which the WARAR addresses information asymmetry between below-rail operators and access seekers;

(d) deficiencies in the WARAR arbitration process;

(e) CBH's views on the questions asked in the Issues Paper in relation to Issue 1 and Issue 2; and

(f) CBH's views about how to address these issues.

The discussion in relation to Issue 2 only deals with barriers to negotiation in relation to the Code requirement that access seekers demonstrate that their proposed operations can be accommodated on a network and to specify details of any required extension or expansion. That is because that is effectively the only topic addressed by the Issues Paper in relation to Issue 2. Other barriers to entry are discussed in the following parts of this section of the submission, while indicative tariffs are discussed in Part 7 of this submission.

4.2 The negotiate-arbitrate model

The WARAR is based on a negotiate-arbitrate regulatory model. Under this model, an access seeker who elects to use the WARAR (or, more particularly, the Code) can take two steps to obtain access, being:

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[47] Issues Paper, at p.9.

(a) **negotiate** – first, the access seeker uses the processes set out in the Code to make an access proposal and then to negotiate with the railway owner; and

(b) **arbitrate** – second, if the access seeker and railway owner cannot reach agreement, then the access seeker can refer the access dispute to an independent and binding arbitration process.

The use of a negotiate-arbitrate regulatory model is generally consistent with clauses 6(4)(a) to (c) of the CPA. That is the model that was supported by the Hilmer Report and the Competition and Infrastructure Reform Agreement (dated 10 February 2006) (**CIRA**) (which aimed to reinforce the principles agreed under the CPA) as the core principle for access regulation.[48]

The model is based on the primacy of commercial negotiations between the parties, with an enforcement process to be relied on only if and when the parties cannot agree. It aims to reflect outcomes that would have come about from commercial negotiations in a competitive market, while limiting the costs of regulation. It is taken to be most appropriate for regulation in circumstances where a single service provider deals with a few large, well-resourced and well-informed access seekers.[49]

However, the negotiate-arbitrate model can be less effective in circumstances where a large service provider deals with multiple, small and less well-resourced or well-informed access seekers, or where there is an information or negotiation imbalance. For example, in the context of below-rail access, an above-rail operator may need access to below-rail infrastructure to participate in dependent markets, but the railway owner may not need the access seeker to earn revenue. There may, therefore, be an imbalance in bargaining power, weighing heavily on the side of the railway owner.

Frontier Economics addressed the issues associated with negotiate-arbitrate models and bargaining power in a report prepared for CBH in April 2015 in response to the ERA's review of the Code. It observed that:

> "Negotiate-arbitrate models for determining terms of access can deliver economically efficient outcomes when the parties to negotiation have similar bargaining strength. If one of the parties to the negotiations has a much weaker bargaining position than the other, the stronger party can extract surpluses (e.g. through an excessively high access price), which would not be consistent with economic efficiency.
>
> Typically, left unconstrained by regulation, <u>it is the infrastructure owner that enjoys a natural bargaining advantage over access seekers</u>. This is so for a number of reasons.
>
> - Firstly, the asset owner is already 'in' the market and has the option of denying access to the seeker if the terms offered are unfavourable — the access seeker cannot compel the asset owner to grant access.
>
> - Secondly, the access provider may enjoy significant market power because the sorts of infrastructure assets that are subject to access arrangements usually have natural monopoly characteristics. Namely, due to economies of scale and scope advantages, it is often cheaper for a single network to serve the market than for multiple, competing networks. This means that access seekers may have few (or no) alternatives apart from the network they are seeking to negotiate access to. If the asset owner did face competition from other networks, there would be stronger incentives for the access provider to offer terms that are consistent with economic efficiency as proponents would be able to seek access elsewhere if the terms offered by the asset owner were unfavourable.
>
> - Thirdly, even if other infrastructure did exist, due to technical constraints, other infrastructure may be very poor substitutes to the network that the customer is seeking access to. For instance, a firm that cannot feasibly relocate production (e.g. because it can only produce grain in a particular region, or

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48 Hilmer Report at pages 255-256; CIRA, clause 2.2.

49 NCC, Guide to Certification of State and Territory Access Regimes (dated November 2013, Version 5) (**Guide to Certification**) at 3.14.

because the location of its mines are fixed) may have few choices over the rail infrastructure it can use; utilisation of more distant rail networks would generally involve higher transportation costs that could make use of those alternative routes uneconomic.

- Finally, the asset owner generally has much greater information about its own network (e.g. the cost of the network, the age/health of the assets, utilisation and future capacity of the network) than would access seekers. If the terms of access depend, in part, on an understanding of the costs associated with installed and future (i.e. incremental) network capacity, the asset owner will typically have an advantage over access seekers during negotiations.

In principle there may be two types of asset owners. The first kind of owner is one who does not compete in downstream markets with the access seeker…Even if the access seeker and access provider do not compete in downstream markets, the asset owner would still have an incentive to exploit any market power and information advantages, when negotiating with access seekers, in order to extract a higher price than would be economically efficient because such a strategy would maximise its overall profits. The second type of asset owner is one that does compete directly with the access seeker in downstream markets… Such an asset owner may have strong commercial incentives to deny access to a proponent so as to exclude a potential competitor from the downstream market (e.g. by exercising its superior bargaining position during negations). This may hinder the development of downstream competition, to the detriment of end-users.

It is to avoid such outcomes that the WA rail access regime exists…"[50] [Emphasis added]

Frontier Economics' analysis is consistent with the discussion in Part 3 of this submission, which outlines the nature of the economic problem that access regimes should be designed to address. Indeed, the rationale for access regulation (to address the essential facilities problem) and the imbalance in bargaining power between below-rail owners/operators and above-rail operators can be seen as two sides of the same coin.

To effectively address these information and bargaining power imbalances, access regimes must create an environment in which the parties are able to enter into effective negotiations. This can be done by addressing the following issues.

Negotiation Process

In order for commercial negotiations to be effective in reducing the length of the regulatory process, there need to be viable mechanisms that allow negotiation to occur in a more time-effective manner than traditional regulatory processes. Formal procedures and guidelines can expedite this process, for example, by forcing negotiating parties to release more information, which could enhance the negotiation process. [51]

Information asymmetry

Most often, the access provider is in an advantageous negotiating position, because it has more complete information on the rail network and on the terms of access than the access seeker. This kind of information imbalance can result in costly and prolonged access negotiations.[52]

The access regime must address the information imbalance between the access seeker and railway owner, to enable the access seeker to conduct meaningful negotiations.[53] For example, sufficiently detailed information on the terms of access, including price, must be

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50 Frontier Economics, "Review of the Railways Access Code: A Report Prepared for CBH", April 2015, at pp 5 – 6 (available at https://www.erawa.com.au/cproot/13480/2/Frontier%20Economics%20consultant%20report%20-%20Review%20of%20the%20Railways%20Access%20Code.pdf) (**Frontier Report**).

51 Rob Albon and Chris Decker "International Insights for the Better Economic Regulation of Infrastructure", Working Paper No. 10 for the ACCC/AER Working Paper Series (dated March 2015) (**BERI Working Paper**) at page 69.

52 PC 2013 Inquiry at page 126.

53 NCC, Final Recommendation on certification of the Dalrymple Bay Coal Terminal Access Regime (dated 10 May 2011) at 5.23.

provided to an access seeker, to enable it to make an informed decision and to understand the basis on which the proposed access is to be provided.[54] This information must be made available in a transparent and timely manner.[55] For example, the access regime may prescribe terms and conditions of access upfront, such as in an approved access undertaking, as is the case for below-rail access in NSW[56] and Victoria.[57]

Binding dispute resolution

Importantly, the access regime should provide an effective means for dealing with situations in which the parties are unable to reach agreement.[58] To be effective, the parties must have confidence in the dispute resolution process. This is generally facilitated by procedures that are independent, transparent and consultative.[59]

Certainty of arbitrated outcomes is also an important component of effective negotiation. This is because the presence of an arbitration can affect the way the parties negotiate, and in turn, directly affect the terms of negotiated agreements.[60] For example, where the parties have guidance as to what an arbitrator will decide, it is likely that their negotiations will resemble what they expect the arbitrated outcome will be.[61] It is therefore critical that the arbitration process is designed to create efficient outcomes, by applying clear dispute resolution principles (consistent with those outlined in clause 6(4)(i) of the CPA).

4.3 Deficiencies in the WARAR negotiation process

As discussed above, the negotiate-arbitrate model contemplates two steps at a basic, conceptual level. The actual detail of the Code is, however, considerably more complex, intricate and time-consuming.

In general terms, the Code process involves the following phases:

Phase	Description
1	The access seeker gathers relevant information from the railway owner, using the mechanisms for "required information" under Part 2A of the Code and "preliminary information" under section 7 of the Code.
2	The access seeker makes a formal **access proposal** in respect of one or more routes, and preliminary issues are addressed – including a determination by the railway owner of the prices and costs for the proposed access under clause 10(1) of Schedule 4.
3	The ERA makes a **floor price and ceiling price determination** for the route or routes to which access is sought, under clause 10(3) of Schedule 4. The ERA may initiate a public consultation process on this determination.
4	The railway owner may require the access seeker to demonstrate:

54 2009 South Australian Rail Access Regime Inquiry, Final Inquiry Report by the Essential Services Commission of SA (dated October 2009) (**ESCOSA Final Inquiry**) at 4.2.1.

55 ESCOSA Final Inquiry at 4.2.1.

56 *Transport Administration Act 1988* (NSW).

57 *Rail Management Act 1996* (Vic).

58 Guide to Certification at 5.1.

59 Guide to Certification at 5.3.

60 PC 2013 Inquiry at page 118.

61 PC 2013 Inquiry at pages 118 and 119.

Phase	Description
	• its managerial and financial **ability** (section 14); and • that its proposed rail operations are within the **capacity** of the relevant routes (section 15). Negotiations cannot commence until these matters have been satisfied.
5	The railway owner enters into **negotiations in good faith** with the access seeker, with a view to making an access agreement in respect of the relevant routes.
6	The railway owner and access seeker either **make an access agreement** in respect of the relevant routes within 90 days of the commencement of negotiations, **or an access dispute arises**. If a dispute arises, the dispute is referred to arbitration, to be conducted in accordance with the *Commercial Arbitration Act 2012* (WA).

The Code process therefore has a number of pre-cursor steps that must be resolved before negotiations commence. Those steps are technical and time-consuming, particularly if the timeframes given in the Code are not strictly adhered to (or even if they are).

Based on its experience in seeking access under the Code, CBH believes that the process is inherently flawed, and there are a number of underlying issues which prevent it from operating in a more efficient and timely manner. CBH believes that these problems mean that the WARAR does not meet its objective. It is inefficient and ineffective. It does not facilitate efficient use of, and investment in, railway facilities and does not facilitate a contestable market for rail operations. Nor does it promote competition in dependent markets more generally. Rather, the delay CBH has experienced has significantly affected its ability to secure efficient terms of access for the benefit of its members, and has put the competitiveness of its grain operations at risk.

CBH submits that the Code process needs to be reconsidered at a fundamental level, so that it operates to facilitate a more streamlined path to a negotiated outcome and produces economically efficient outcomes.

CBH has identified the following key issues with the Code process (in addition to those identified in the Issues Paper in relation to the "opt out" mechanism, as discussed below).

(a) **Timing and duration**

The Code process is too lengthy and slow, and provides many opportunities for the below-rail operator to delay progress. While some steps in the process do not have timeframes at all (e.g. the arbitration process), others that do have stipulated timeframes may not be adhered to.

As an example, the ERA is required to make a floor and ceiling price determination under clause 10(3) of Schedule 4 within 30 days after the railway owner provides the information under section 9(1)(c).[62] In CBH's case, the time required to make the determination was over 6 months – due to the fact that no costs determination had ever been made in relation to many of the routes, and because AI fundamentally changed its method of determining costs since the last costs determination in 2007. This was problematic because the ERA's determination was one of a number of pre-conditions to commencing negotiations under the WARAR. It therefore effectively "held up" the negotiation process for an extended period.

[62] Code, clause 10(3) of Schedule 4.

CBH believes there should be some scope for negotiations to commence while the determination is being made.

Even though CBH submitted an access proposal in December 2013, it was not able to start negotiations under the Code until late March 2015. That meant that AI was under no obligation to negotiate under the Code for some 15 months – a liberty that it enjoyed and exploited. In addition, AI did not provide a draft access agreement that included pricing until after the negotiations eventually commenced. This occurred in circumstances in which the Code had been invoked because the parties were unable to negotiate a long-term agreement "outside" the Code, which meant that CBH was under significant time pressure. Because of that delay, CBH needed to re-negotiate an interim access agreement several times. Being in this period of delay had a detrimental effect on CBH, its members and the efficiency of the WA grain industry. It significantly affected its ability to secure efficient terms of access for the benefit of its members, and put the competitiveness of its grain operations at risk. This was compounded by the fact there were no "transitional" provisions that provided "default" access until the process (which can include multiple arbitrations, and potentially litigation, and therefore could take months or years) was completed.

In the Frontier Report, Frontier Economics also discussed the potential for delay, as follows:

> "The problems experienced under the regime can be understood in the context of the strong bargaining position enjoyed by the railway owner. In situations where there is a risk that arbitration will lead to lower access prices, the access provider will have strong incentives to delay entry into negotiations, extend the negotiation period, or to draw the process out indefinitely. Delays of this kind are costly to access seekers. Delays affect the flow of revenues from operations that rely on access, and create uncertainty. This increases the prospects of access 'agreements' that favour the access provider.
>
> Given the incentives for asset owners to delay or hinder access, strong (and relatively short) time limits should be placed on the entire negotiation and arbitration process, with the parties given the option of initiating an arbitration process upon expiry of these timeframes, if no agreement has been reached by such time." [63]

CBH strongly supports the imposition of strong and relatively short time limits to address this fundamental issue. The prospect of entering into a process that, on the one hand, has no predictable and realistic timeframes and, on the other hand, promises delay and protracted regulatory processes, undermines confidence in the WARAR negotiation process. Above-rail operators can then have little confidence that the process will be efficient or quick. And that, in CBH's view, is a significant factor in why above-rail operators do not use the WARAR.

(b) **Technicality and lack of enforcement**

In CBH's view, there are too many steps that must be completed before a railway owner's obligation to negotiate in good faith arises. These steps effectively "stop the clock" for other parts of the process (e.g. capacity disputes, costs determinations, and section 10 approvals, which must be dealt with before the obligation to negotiate arises).

At the same time, an access seeker can only commence an arbitration to resolve disputes during negotiation after the entire negotiation period has passed (or the railway owner agrees in writing that negotiations have broken down). This has the effect of frustrating the access seeker's ability to commence dispute resolution where it has reached an impasse with the railway owner.

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[63] Frontier Report at section 2.3.3.

In CBH's view, these processes need to be streamlined, so that they are not effectively suspended each time a dispute (or another regulatory or enforcement action) arises. As discussed above, the costs determination process should not effectively "hold up" negotiations (particularly where the time required to make the determination is several months). Rather, there should be some scope for negotiations to commence while the determination is being made. Negotiation should be able to be commenced as efficiently as possible, while at the same time, disputes should be dealt with in a timely manner, as and when they arise.

This problem is compounded by the lack of enforcement provided for under the Code. The ERA's, and an access seeker's, ability to effectively enforce the Code is significantly limited by the fact the provisions of the Code can only either be enforced by an injunction obtained by the ERA or an access seeker from the Supreme Court, or through arbitration (which are both expensive and time-consuming processes). This effectively provides a railway owner with opportunities to delay and hamper the process by committing repeated "small" breaches of the Code, which have a significant cumulative impact.

The lack of enforcement is exacerbated by the view taken by the ERA in the past that it should "adopt a neutral role" in administering the WARAR, even though it has the express function (set out in the Act) [64] of monitoring and enforcing compliance by railway owners with the WARAR and is expressly given standing to seek an injunction preventing breaches of the WARAR. For that reason, the ERA has declined to take investigative or enforcement action against a railway owner in the face of concerns expressed by CBH.

And it is further inflamed by the legal, evidentiary and practical difficulties in maintaining proceedings for alleged breaches of the prohibition on hindering or preventing access under section 34A of the Act. That is particularly the case if a railway owner engages in repeated "small" breaches of the WARAR of the type described above, which serve to delay and frustrate progress towards negotiations and in arbitration proceedings.

(c) **Inappropriate threshold issues**

The Code currently operates so that the parties are unable to commence negotiations until the requirements of sections 14 and 15 have been met.[65] CBH believes there is no good reason why issues in relation to capacity and financial management/resources should hold up good faith negotiations between the parties.

This issue has caused particular problems for CBH.

CBH is frustrated that issues such as these held up the application of AI's obligation to negotiate with CBH in good faith. CBH had been willing for these issues to be discussed as part of the negotiation process, and believes that this would have led to a more efficient resolution of any disputes.

This deficiency is further addressed in the discussion of Issue 2 below.

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64 Act, section 20(1)(a).

65 Code, section 19.

(d) **Lack of pricing certainty**

There is a lack of up-front certainty regarding pricing. In particular, the spread of potential prices between the floor price and ceiling price is extreme. Further, the pricing guidelines that are to be applied under clause 13 of Schedule 4 of the Code do not provide any further guidance, apart from overarching and general obligations as to what the prices should reflect.

In CBH's case, the ceiling costs determined by the ERA were 2300% larger than the floor costs. This provided no guidance to CBH as to the price it could expect to negotiate for access, or which might be determined in an arbitration.

This makes it difficult for access seekers to have certainty or confidence in negotiated outcomes – undermining the effectiveness of the negotiate-arbitrate model. This point was supported by the Committee in the Freight Rail Network Inquiry, when it stated that:

> "the fact that the Code permits such a vast gulf between nominated floor and ceiling costs limits the usefulness of these parameters in any negotiation."[66]

In the Frontier Report, Frontier Economics also supported this point, saying that:

> "In our view, the Regulator's determined negotiating range for prices is far too wide to provide any useful guidance or starting point for negotiation between the parties over access prices.
>
> For the regime to be more effective, it would be helpful for the Regulator to take some issues "off the table" when the parties are negotiating. There are likely to be some areas of commonality between the proponent and rail owner where the interests and incentives align. In these areas an efficient negotiated settlement should be poss ble with limited regulatory involvement. However, in other areas, where the parties' interests diverge materially, significant disagreement is likely to arise.
>
> If unconstrained, such disagreements will generally tend to favour railway owners because they can exploit their strong bargaining position. Limiting the scope of the issues to be negotiated by taking certain key issues "off the table" also promotes more effective and manageable negotiations."[67]

In Frontier Economics' experience, there are two topics that tend to be most controversial in relation to pricing in access disputes. They are the permitted rate of return (i.e. WACC) and the methodology for valuing and calculating the regulatory asset base.[68] Frontier Economics argues that the Code does not deal with either of these topics effectively, concluding that:

> "The current model of floor and ceiling determinations does not offer sufficient certainty to encourage effective negotiations."[69]

This lack of certainty is a significant disincentive for access seekers considering whether to use the Code to negotiate access (and a major reason as to why so few access seekers have chosen to use the Code).

(e) Status of information disclosed by a railway owner

CBH is also concerned that the Code may permit railway owners to provide information on a "confidential" and "without prejudice" basis, so that the substance

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66 Freight Rail Network Inquiry, paragraph 6.37.

67 Frontier Report at section 2.3.2.

68 Frontier Report at section 2.3.2.

69 Frontier Report at section 2.3.2.

of the information cannot subsequently be relied on in an arbitration. In the least, the Code seems to leave the door open for railway owners to make such claims.

Such a claim has the potential to significantly undermine the efficacy of, and complicate, a subsequent arbitration, as it means that the railway owner might be able to:

(i) wholly resile from positions put to an access seeker during negotiations (or at other times in the process); and

(ii) potentially otherwise slow the arbitration down on technical points about whether an access seeker has presented a point relying on information that is subject to without prejudice privilege.

CBH submits the Code should be clarified to make it expressly clear that confidential offers and without prejudice privilege does not attach to information provided by a railway owner to an access seeker during negotiations.

4.4 Deficiencies in the way in which the WARAR addresses information asymmetry

As discussed above, railway owners usually occupy an advantageous negotiating position because they have more complete information on the rail network and on the terms of access than the access seeker. It is therefore important for an access regime to address the information balance so that the access seeker can conduct meaningful negotiations.

For the reasons discussed at length in Part 5.2 of this submission, CBH believes that the WARAR negotiation process does not address the information asymmetry between the railway owner and access seeker in an effective or efficient way. In particular, an access seeker is not able to access sufficiently detailed information regarding important issues such as pricing and performance standards. During its negotiation process under the WARAR, CBH encountered significant problems due a lack of available and sufficiently detailed information. In CBH's view, this is a significant disincentive for access seekers to use the WARAR negotiation process.

4.5 Deficiencies in the WARAR arbitration process

As discussed above, it is important that an access regime has an effective means for dealing with situations in which the parties are unable to reach agreement. The parties must have confidence in the dispute resolution process, which is generally facilitated by procedures that are independent, transparent and consultative. In addition, certainty of arbitrated outcomes is an important component of effective negotiation because the threat of an arbitration can affect the way the parties negotiate, and in turn, directly affect the terms of negotiated agreements.

As outlined above, CBH has been involved in two arbitration processes under the Code. In the course of those arbitration processes, CBH has discovered a number of deficiencies in the Code that undermine confidence in, and the efficiency and effectiveness of, arbitration under the WARAR. The deficiencies include the following.

(a) Sections 24 and 26 – panel of arbitrators

Sections 24 and 26 of the Code establish a process for the ERA to appoint an arbitrator from a panel of persons selected solely by the ERA. The ERA may only include or remove persons from the panel on the recommendation of the Chairman of the WA Chapter of the Institute of Arbitrators and Meditators Australia (now the Resolution Institute) or the Perth Centre for Energy & Resources Arbitration Ltd (**PERCERA**). The parties to the dispute have no ability to participate in the process of establishing the panel or appointing the arbitrator.

In CBH's experience, this can discourage access seekers from relying on the arbitration process under the Code. Every dispute is different, and may require arbitrators of different experiences and backgrounds. In some cases, the parties are better placed to judge this than the Resolution Institute or PERCERA, or potentially the ERA.

CBH also cannot see any reason why the ERA must act on the recommendation of the Chairman of the Resolution Institute (who need not consult with anyone, including the Resolution Institute itself). Parties to commercial disputes routinely agree on an arbitrator without the need for the intervention of a regulator or an arbitral body such as the Resolution Institute – it is not controversial to allow them to do so. CBH is also unclear as to why an organisation that has no "official" status should have such a critical role under the Code. Further, given that it is the Chairman of the Resolution Institute who is making the recommendation, there is risk that third parties could view the Chairman as being placed in a position where they have an apparent conflict of interest between making independent recommendations to the ERA, and their role as a representative of the Resolution Institute if they make a recommendation from the Resolution Institute membership.

This type of issue was discussed by the NCC in its final recommendation on the certification of the South Australian Rail Access Regime (the **SARAR**). The NCC noted that arbitrator's appointment was made by the regulator (the Essential Services Commission of South Australia) rather than the parties.[70] However, the NCC was satisfied that this was acceptable, because the parties were able to be involved in the appointment process. Before appointing an arbitrator, the regulator was required to consult with each of the parties and attempt to make an appointment that is acceptable to all parties.[71] This consultation process is not a feature of the WARAR.

In its Final Decision on the 2015 Code review, the ERA stated that:

> "The Authority has recently expanded the panel of arbitrators to include interstate arbitrators and arbitrators with a wider range of experience. The Authority has provided assurance to [AI] and CBH that it will involve them in the selection of arbitrators from the panel in the event of a dispute between them. The Authority has decided that this assurance should be provided to all parties who might come into dispute, by amendment to the Code, and has provided a recommendation to that effect.
>
> The Authority does not consider it practical to allow all stakeholders who might potentially come into dispute to be involved in appointments to the panel from which arbitrators are selected, as those potential stakeholders are not known to the Authority. The Authority considers that the panel must be a 'closed' panel."[72]

CBH appreciates the approach taken by the ERA in addressing the concerns held by it and AI in addressing the particular dispute with which they were dealing. However, CBH does not consider that is an adequate approach for dealing with disputes in the future. In saying this, CBH notes that both parties to the dispute had concerns about this issue, which is significant in itself.

CBH continues to believe that the parties should, at a minimum, be able to agree on an arbitrator, or have a right to nominate persons to the panel for the ERA to

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70 NCC's Final Recommendation on the certification of the SA Rail Access Regime dated 26 May 2011 (**SARAR Final Recommendation**) at page 35.

71 *Railways (Operations and Access) Act 1997* (SA), section 37(2).

72 ERA, *"Review of the Railways (Access) Code 2000 Final Report"*, December 2015 (**2015 Code Review**) at paras 415 and 416.

choose from. At the same time, CBH accepts that it would be reasonable to retain the right of the ERA to appoint the arbitrator where the parties cannot agree on an appointment.

The fact that the ERA has expanded the panel to include a broader range of persons does not respond to the central point made by CBH – the parties are in the first instance best placed to identify the expert and to appoint him or her and should, consistent with principle concerning the primacy of negotiations, be free to appoint him or her if they so wish.

CBH also notes that allowing the parties to determine the appropriate arbitrator would avoid the ERA's concern about allowing "all stakeholders who might potentially come into dispute to be involved in appointments to the panel from which arbitrators are selected, as those potential stakeholders are not known to the Authority". Those stakeholders would not need to be concerned with the panel in the first instance if they can resolve the matter as between themselves.

(b) The ERA as the arbitrator?

As an alternative, Frontier Economics suggested in its 2015 report that the ERA could take the role as the arbitrator under the Code, in line with other access regimes.[73]

CBH's position is that it would be appropriate for the parties to have the right to appoint their preferred arbitrator. However, the proposal by Frontier Economics may be worthy of further exploration. A range of factors would need to be addressed, including the additional resources the ERA is likely to require, given that it does not currently undertake an arbitration role under the Code.

CBH also believes that (as discussed in Part 5.3 of this submission), an arbitration (whether by the ERA or an independent arbitrator) should be subject to merits review.

(c) Time limit on arbitrator decision

CBH supports a time limit being imposed for the conclusion of an arbitration under Part 3 Division 3 of the Code. CBH experienced considerable delay in progressing its access proposal under the Code, due to the need to commence dispute resolution in relation to section 15 requirements. The first arbitration process took over nine months, from the date that CBH submitted a notice of dispute to the railway owner, to the date that a final arbitration determination was made. The delay had a detrimental effect on CBH's ability to secure efficient access to the rail network for the benefit of its members and the WA grain industry.[74]

Imposing a time limit would ensure that costs are minimised and that negotiations can be commenced more efficiently. It would also redress the railway owner's market power, by facilitating a quicker and more streamlined path to negotiation for preliminary issues.

CBH also notes that, under clause 2.6 of the CIRA (which aimed to reinforce the principles agreed under the CPA), the parties agreed to introduce requirements that regulators be bound to make regulatory decisions within six months, provided it has been given sufficient information. This has been implemented in other jurisdictions - for example:

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[73] Frontier Report at section 2.3.5.

[74] For example, consider the events of April 2015 referred to in footnote 9.

(i) In South Australia, the award must be made within six months from the date the dispute was referred to arbitration.[75]

(ii) Under Part IIIA of the CCA, the ACCC is required to make a final determination within 180 days from the time the application is received (with provision being made for certain disregarded time).[76]

(iii) In Victoria, dispute resolution is carried out by the regulator, the Essential Services Commission (**ESC**), which is given 45 days to make a dispute resolution decision.[77] The ESC can also make an "interim decision" in respect of a dispute, before making a final decision.[78] This may provide the parties with greater certainty as to the likely outcome of a dispute, while awaiting full resolution.

In the 2015 Code Review, the ERA declined to make a recommendation in relation to this issue. It apparently considered that the matter could be addressed in a preliminary conference.[79]

CBH does not accept the ERA's conclusion. The reason for asking for a deadline, which might be adjusted for appropriate "clock stopping" events, is to provide some certainty for the access seeker that it will not face undue delay in an arbitration - that there is some faint hope that it might be resolved expeditiously. It imposes a discipline on both the parties and the arbitrator, and requires the arbitrator to move quickly even though he or she might not otherwise be motivated to do so.

(d) Revising the meaning of "disputes"

In the 2011 Code Review, the ERA recommended (Recommendation 3), that section 25 of the Code should be amended so that the definition of "disputes" includes all information provision and negotiation obligations on railway owners under Parts 2 and 3 of the Code.

CBH agrees that there is a need for the Code to improve the ability of parties to enforce the information provision and negotiation obligations under Parts 2 and 3 of the Code. However, CBH does not believe that submitting these kinds of obligations to arbitration under the Code will lead to efficient or timely outcomes.

An arbitration process can be lengthy and unpredictable (even if a time limit is imposed on arbitration, in line with CBH's submissions). It would be disruptive and costly for the access seeker to have to commence arbitration proceedings every time the parties disagree about what information has been or must be provided. Further, an arbitrator may not necessarily be the most appropriate person to enforce these obligations. These are often not disputes about negotiation or factual issues, but rather compliance with statutory obligations (such as information provision obligations).

It would be more appropriate for the ERA to enforce these kinds of statutory obligations, by issuing orders, penalties or infringement notices (as discussed below).

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75 *Railways (Operations and Access) Act 1997* (SA), section 50A.

76 CCA, section 44XA.

77 *Rail Management Act 1996* (Vic), section 38ZY.

78 *Rail Management Act 1996* (Vic), section 38ZZO.

79 2015 Code Review at paras 415 and 416.

Instead of submitting these kinds of issues to arbitration, there should be a more streamlined enforcement process (led either by the access seeker or the ERA) to enforce the Part 2 and Part 3 obligations under the Code, as discussed elsewhere in these submissions.

However, in the course of the 2015 Code Review, CBH argued that there is merit to revising the meaning of "disputes", so that the parties do not have to wait out the entire negotiation period before they can refer a matter to arbitration. In the 2015 Code Review, the ERA noted that it had not accepted this submission. It considered that the Part 3 of the Code provides an "adequate list of circumstances that must exist for the proponent to be considered in dispute with the railway owner and does not need to be expanded".[80]

CBH does not agree with the ERA's conclusion and again submits that the meaning of "disputes" should be revised.

Currently, the parties are only in "dispute" if:

(i) the railway owner has refused to negotiate in good faith;

(ii) there is a dispute about section 14 and 15 requirements; or

(iii) the parties have entered into negotiations but have not reached agreement on the provisions to be contained in an access agreement before the termination day, or before the termination day, the parties have jointly made a written determination that the negotiations have broken down.

This has the effect of frustrating the access seeker's ability to commence dispute resolution where it has reached an impasse with the railway owner. For example, the access seeker may believe that it has exhausted its ability to negotiate with the railway owner on a certain issue or overall. However, the access seeker is incapable of commencing dispute resolution until the entire negotiation period has passed, or the railway owner agrees that negotiations have broken down (which the railway owner may not easily agree to if it does not want to go to arbitration). This outcome is not consistent with ensuring economically efficient outcomes, which require a timely, transparent and efficient process. It is not efficient to force an access seeker to waste time and money in waiting out a negotiation period, until it can commence effective dispute resolution.

Other jurisdictions define "dispute" more broadly and allow the access seeker to commence dispute resolution at any time the parties are unable to agree (rather than forcing the parties to wait out a specified period). For example:

(i) Under Part IIIA of the CCA, either party may notify the ACCC that an access dispute exists if a third party is unable to agree with the provider on one or more aspects of access to a declared service.[81]

(ii) Under the SARAR, a dispute arises if the proponent fails to obtain an agreement on the proposal, after making reasonable attempts to reach agreement with the operator.[82] This means the access seeker can raise a dispute at any time, if it feels it has already made a reasonable attempt to agree on particular issues. It also doesn't need the agreement of the operator to exercise these rights.

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80 2015 Code Review at para 392.

81 CCA, section 44S.

82 *Railways (Operations and Access) Act 1997* (SA), section 34(c).

(iii) Under the National Gas Law (**NGL**),[83] the access seeker is able to notify the dispute resolution body of an access dispute at any time that it is unable to agree with the service provider about one or more aspects of access.[84]

CBH believes that the scope of when a "dispute" can arise under the WARAR must be extended, to allow the access seeker to commence dispute resolution at any time. The ultimate goal of the Code should be to facilitate a more streamlined path to a negotiated outcome.

CBH notes that section 35 of the Code already provides protection for the integrity of the dispute resolution process – i.e. by providing that an arbitrator may terminate an arbitration if the referral to arbitration was vexatious, the subject matter of the dispute is trivial, misconceived or lacking in substance, or if the other party has not engaged in negotiations in good faith.

(e) Precedent value of arbitration determinations

As access arbitrations under the Code are "private", and the determinations are subject to the strict confidentiality requirements imposed by the *Commercial Arbitration Act 2012* (WA), arbitration determinations currently have no "precedent" value to other access seekers. Those restrictions essentially mean that arbitration determinations can only be disclosed with the consent of both parties.

It seems to CBH that the privacy of arbitrations can create a number of issues, including:

(i) potentially inconsistent outcomes for access seekers, even if the access seekers are seeking the same service and are otherwise in the same position as each other; and

(ii) "wasted" time and effort for access seekers, as the decisions made in one arbitration determination cannot be transferred to another. By contrast, a railway owner can develop its strategy and arguments based on its past experience in other access arbitrations.

During the course of the ERA's 2015 Code review, CBH submitted that these issues should be addressed by making arbitration determinations public (subject to appropriate protections to allow for genuinely confidential information to be "redacted"). In its draft report, the ERA stated that arbitrations should remain confidential. This appears to have been the ERA's final position.

CBH disagrees with the ERA. Arbitration decisions do more than simply resolve specific disagreements under specific circumstances. They necessarily include statements about the law, and provide useful guidance (if not binding precedent value) for other access seekers.

CBH therefore reiterates the need to consider making arbitration determinations public (subject to appropriate protections).

4.6 Issue 1: Ability to opt out

CBH's responses to the particular questions in the Issues Paper in relation to Issue 1 are as follows.

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83 *National Gas Access (Western Australia) Law* as applied as a law of Western Australia under section 7 of the *National Gas Access (WA) Act 2009* (**NGL**).

84 NGL, section 181.

(a) Question 1.1. - What are the benefits of negotiating outside the Code?

As discussed in Part 3.3 of this submission, access regulation should address the economic problem that arises when a monopoly infrastructure service provider has the ability and incentive to exercise its market power to deny access to the use of infrastructure altogether or engage in monopoly pricing, where such access is required to promote competition in dependent markets.

As discussed in Part 4.2 of this submission, the way in which the WARAR seeks to address this problem is by using a negotiate-arbitrate model. Under its version of that model, the WARAR:

(i) imposes duties on the railway owner to, among other things, negotiate in good faith with a view to making an access agreement, use all reasonable endeavours to avoid unnecessary delays and meet the requirements of an access seeker, and not unfairly discriminate between access seekers who have submitted access proposals under section 8 of the Code;[85]

(ii) provides a right for an access seeker to make an access proposal to the railway owner and which then requires the railway owner to respond to the access proposal;[86]

(iii) requires the railway owner to make certain information available to an access seeker who wishes to, or does, make an application under the Code;[87]

(iv) provides for independent and binding arbitration of access disputes under the Code;[88]

(v) requires that there be "overpayment rules" for the repayment to access users under the Code of amounts in excess of the total costs attributable to a route and its associated railway infrastructure;[89]

(vi) requires a railway owner to segregate its access related-functions (being the functions involved in arranging the provision of access under the Code) from its other functions;[90]

(vii) prohibits a railway owner from engaging in conduct aimed at hindering or preventing access by any person for the purpose of carrying on rail operations to which the Code applies, the making of access agreements under the Code, or access to which a person is entitled under an access agreement under the Code or under an access arbitration determination;[91] and

(viii) prohibits a person who has access under an access agreement under the Code from engaging in conduct aimed at hindering or preventing access by

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85 Code, sections 20, 13(1), 16(1)(a) and 16(1)(b).

86 Code, sections 8 and 9.

87 Code, sections 7 and 9.

88 Code, Part 3, Division 3.

89 Code, section 47 and Schedule 4, clause 8(4).

90 Act, sections 28 – 30. See also sections 30 – 34 in relation to: obligations to protect confidential information; avoid conflicts of interest for officers in the performance of access-related and other functions; the duty of fairness; and the maintenance of separate accounts and records relating to access-related functions.

91 Code, section 34A(1).

another person to any part of the railways network to which the Code applies.[92]

Each of these elements aims to regulate the use of a railway owner's market power in the provision of below-rail access. It is because of the existence of that market power, and a railway owner's ability and incentive to use it, that it is necessary to impose such mechanisms on a railway owner.

However, the imposition of those regulatory mechanisms under the WARAR can have disadvantages. In particular, they can increase the costs that the railway owner and access seeker incur in providing access (and operating its business) and lead to less flexibility in negotiations, in relation to both the negotiation process and the matters on which the parties are free to agree. Further, the mechanisms can lead to dissatisfaction on the part of access seekers if they are forced to use the regime in circumstances in which there is uncertainty as to the likely outcomes under it (e.g. in relation to pricing) or the way in which the negotiate-arbitrate process will operate (e.g. in relation to timing, cost and certainty).

It is, therefore, desirable to allow an access seeker to have the flexibility to choose to negotiate, and to reach substantive agreement, without adhering to such mechanisms.[93] This is consistent with the idea that, if the mechanisms are principally in place to protect the access seeker from the use of market power, then the access seeker should generally be free to choose to negotiate without them if it considers doing so to be in its best interests. Further, it is consistent with the concept of the primacy of negotiations that is inherent in the negotiate-arbitrate model.

It follows from this that the primary benefit (at least theoretically) of allowing an access seeker to negotiate outside the Code – in the sense that there is freedom to depart from the prescriptive Code process - may be that it can provide the access seeker and the railway owner greater flexibility in the manner and substance of their negotiations. This is important because of the significant deficiencies that exist in relation to the WARAR negotiation process and the uncertainty in likely outcomes under the Code as a result of the use of a floor and ceiling price methodology for pricing. In addition, there may be a benefit for an access seeker and a railway owner if they can avoid the costs associated with following a formal process.

However, there are significant and fundamental problems with the way in which the freedom to negotiate outside of (or to "opt out" of) the Code actually operates. These problems, which entirely undermine the benefits, stem from the fact that the access seeker is required to make an absolute decision to pursue access inside or outside the Code.

If the access seeker chooses to pursue access inside the Code, then it is provided with the full array of mechanisms to protect it against the misuse of market power by the railway owner. However, the access seeker must strictly adhere to the WARAR negotiation and arbitration process, as well as endure numerous deficiencies with the process, and has only little certainty as to the likely outcome.

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92 Code, section 34(2).

93 However, this must be subject to some constraints. Most importantly, an access seeker should not be entitled to negotiate with a railway owner in a way that prejudices the legitimate interests of other access seekers or users (e.g. where doing so would result in the access seeker jumping a queue to get access to limited capacity, result in a breakdown of the railway owner's segregation arrangements, or in the hindering or preventing of access).

If the access seeker chooses to pursue access outside of the Code, then it does not receive the protections afforded by the Code.[94] That means that it gains flexibility but receives little (if any) protection against the misuse of market power, so that the railway owner can deny access absolutely or engage in other monopolistic practices (e.g. monopoly pricing, imposing unreasonable requirements and delay).

This means that an access seeker faces a stark choice:

(i) (**In Code**) protection but limited flexibility and high uncertainty as to outcome; or

(ii) (**Out of Code**) flexibility but no protection and high uncertainty.

In addition, the binary nature of the election to negotiate “inside” or “outside” the Code provides the railway owner with the opportunity to preserve and exploit its market power. For example, a railway owner can represent to an access seeker that it is better to negotiate "outside the Code" (and without its protections against the use of market power) than "inside" the Code because the Code will likely lead to delay, uncertainty and unfavourable outcomes for the access seeker. It can also use the threat of withdrawing from, or refusing to participate in, any negotiations “outside the Code” if an access seeker uses the Code process. Of course, it can also refuse to negotiate outside the Code once the Code process has commenced.

Even if an access seeker does choose to negotiate “inside” the Code, the “in/out” nature of the decision, combined with the significant range of potential pricing outcomes between the floor and ceiling price, can still provide a railway owner with an opportunity to exercise its market power. For example, a railway owner can:

(i) make unattractive access offers "inside" the Code (e.g. based on the ceiling price); and

(ii) simultaneously make better offers (but which remain unfavourable to the access seeker) "outside" the Code,

as a means to persuade the access seeker to accept a deal outside the Code. Even though an offer outside the Code may be more favourable than the unattractive offer made inside the Code, there is a real risk that it will exceed the price that would apply under the Code. The “out of Code” offer may reflect the use of monopoly power to the extent that it exceeds the efficient price of access (being the price that would be charged in a workably competitive market for the provision of access).

In each of these situations the railway owner has the opportunity to use the significant deficiencies in the WARAR as a threat to the access seeker in order to enhance, or at least preserve, its ability to misuse its market power. This is the inverse of what occurs under other access regimes that do not have an ”in/out” mechanism, such as the National Access Regime under the CCA and the NGL, under which the threat of arbitration and other regulatory protections always apply to negotiations in or out of the regime so as to curb the exercise of market power.

On top of this, the Code also provides incentives for a railway owner to pursue agreements outside the Code. For example, the current over-payment rules encourage the railway owner to keep access seekers outside the Code. While the ceiling price test takes into account payments that are made by third parties who have obtained access outside the Code, there is no provision for over-payments to

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[94] Code, section 4A.

be returned to out-of-Code operators. Railway owners may therefore be tempted to keep users outside the provisions of the Code, under the terms of access agreements made outside the Code. This was recommended to be expressly prohibited under the Code, in the Freight Rail Network Inquiry.[95]

Against this, it might be argued that the Code nevertheless restrains a railway owner from using its market power in negotiations "outside" the Code because an access seeker is always free to make an access proposal under the Code should the "out of Code" negotiations fail. That is, a railway owner might moderate its behaviour in "out of Code" negotiations because it knows that the terms of access could ultimately be determined by an independent arbitrator if the access seeker decides to later proceed under the Code. The issue with such an argument is that it depends on whether the Code is viewed as a credible threat by both the access seeker and the railway owner.

In CBH's view, the deficiencies in the negotiation process, continuing information asymmetry and issues with the arbitration process outlined in this submission mean that the WARAR is not viewed as a credible threat. It is simply not an efficient and effective way of securing access in the face of railway owners that have the ability and incentive to misuse their market power. The threat of a later "in Code" access application simply does not, in CBH's experience, effectively restrain the misuse of market power. Rather, the prospect of enduring the Code process is used by railway owners as the threat against the access seeker – it is better to do a sub-optimal deal quickly outside the Code than face the prospect of a lengthy, drawn-out, expensive process with no certainty as to the potential outcome (if there is one at all).

In addition, the argument has a significant practical difficulty. It is that access seekers often need to secure rail access agreements reasonably quickly (e.g. as an element of a project, to secure finance, or to ensure that their business operations can continue). That creates time pressure, a factor that is well known to railway operators. Faced with that timing pressure, it is simply not a viable option for the access seeker to negotiate outside the Code, with the hope of a quicker result, and to later enter into an unpredictable and open-ended Code negotiate-arbitrate process. Further, the duplication of the negotiation process is likely to result in a duplication of negotiating costs as well as delay costs. In such circumstances, both the access seeker and railway owner will know that the access seeker will not view the threat of arbitration under the Code as a practical credible threat and is likely to accept a sub-optimal deal.

For these reasons, access seekers have a significant incentive to avoid negotiating under the Code. Evidence for this can be found in the fact that the WARAR has only been used by 3 access seekers in its 19 year history.[96]

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95 Freight Rail Network Inquiry, Recommendation 6.

96 An alternative explanation as to why the WARAR has not been used could be that railway owners have been so reasonable in their dealings with access seekers that few have felt the need to seek access under the Code. This could be the case because the WARAR is such an effective constraint on the behaviour of monopolist railway owners that they have overcome their natural incentive to use their market power to maximise profit (or they have simply overcome that incentive even though the WARAR is deficient). CBH submits that this explanation is inconsistent with its experience and is entirely implausible in the face of the deficiencies with the Code as outlined in this submission. The more likely explanation is that access seekers choose the quicker option to secure a deal, accepting that the railway owner is charging too much and giving too little or because they have no other realistic option.

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

In CBH's view, negotiations outside the Code impose additional costs on access seekers. In general terms, they are costs that are:

(i) incurred because access seekers are required to pay access charges that incorporate monopoly rent, which (as explained above) can be extracted by the railway owner because the WARAR does not provide a railway owner with a credible threat of regulation;

(ii) incurred because access seekers are required to comply with unreasonable access terms and conditions that are imposed through the exercise of market power by the railway owner because (as explained above) the WARAR does not provide a railway owner with a credible threat of regulation; and

(iii) wasted in "out of Code" negotiations where those negotiations are unsuccessful, including:

(A) management and operational time, legal costs, and consulting costs incurred in the "out of Code" negotiations; and

(B) costs resulting from delay in securing an enforceable right of access.

The risk of costs associated with "out of Code" negotiations is materially heightened when railway owners provide information (such as access offers) during the negotiations on the basis that they are "without-prejudice" and "confidential", so that they cannot be used under the Code, particularly in an arbitration.

(c) Question 1.3 - Are negotiations outside the Code more likely to favour railway owners or access seekers and why?

For the reasons set out in Parts 4.2 and 4.6(a) of this submission, CBH considers that negotiations outside the Code are more likely to favour railway owners.

As Karara Mining Ltd (**Karara**) described to the Committee as part of the Freight Rail Network Inquiry, there is essentially "a monopolistic provider of those services [which] puts the balance of the negotiation power too much on one side and not enough on the company that is trying to get access to that infrastructure".[97]

(d) Question 1.4 - Would all or some of the reform options proposed above (a, b and c) [in the Issues Paper] improve the operation of the regime and why?

CBH believes that all of the protections provided by the Code should be available to access seekers who choose to negotiate "outside the Code". Otherwise, for the reasons outlined above, the railway owner has both the ability and incentive to exercise its market power in "out of Code" negotiations without any effective constraint.

Consistent with this, CBH supports the reform option (option "a") of making non-discrimination requirements apply to access negotiations in relation to railways covered by the Code, regardless of whether those negotiations are conducted inside or outside of the Code. Similarly, CBH supports reform option "b", which

[97] Freight Rail Network Inquiry at paragraph 6.56.

would require the Part 5 instruments to apply regardless of whether or not an access agreement is executed inside or outside of the Code.

CBH also strongly supports reform option "c", under which the parties to a negotiation outside of the Code who have an access dispute (including in the sense of being unable to agree on any aspect of access to a service) can progress straight to arbitration under the Code. However, the proviso proposed in relation to "the nature of the access rights sought" remaining "unchanged" should be changed to a proviso that the "service being sought" remaining unchanged. This will ensure that the parties have the flexibility to amend their position on the particular terms and conditions that apply to the service, in response to developments in an arbitration (rather than fixing them to detailed positions that they might wish to concede and to avoid inefficient arguments about whether a position on detailed rights has been changed). In addition, CBH submits that, once an access proposal is made, the access seeker should be able to bring evidence of any offer made by the railway owner before the arbitrator (including offers purportedly made "outside the Code" and any "confidential" offers).

(e) Question 1.5 - Are there other options that would better address the problems associated with the opt out provisions?

In CBH's view, there is another option for dealing with the problems created by the binary nature of the "opt out" provisions. It is a solution that would remove the opportunity for railway owners to exercise their market power as described above and increase the efficiency of negotiate-arbitrate process.

That option is to altogether remove the distinction between "outside the Code" and "inside the Code" negotiations so that:

(i) any access seeker has an automatic right to negotiate access, unimpeded by sections 14 and 15 requirements and any questions as to the validity or form of its proposal; and

(ii) if the access seeker cannot reach agreement, then it has an automatic right to invoke the arbitration process.

This would align the WARAR process with the way in which access has been regulated in other markets, including the NGL, the National Access Regime (in Part IIIA of the CCA) and the SARAR. For example, under the SARAR, there is no distinction between operators outside the regime, and operators inside the regime. There is one pathway for access seekers to seek access, and this applies in relation to all operators and railway services that the Act is declared to apply to.[98]

Any concerns about commercial flexibility can then be addressed in other ways - for example, by allowing the parties to negotiate away from the Part 5 instruments (with those instruments merely acting as a safety net, with some limited exceptions such as the over-payment rules).

In essence, this option would repeal section 4A of the Code and remove the formality imposed by the Code in relation to the making of applications, financial capability and capacity. The emphasis would be on flexibility and promoting commercial negotiations, with the right to quickly move to arbitration if there is a dispute between the parties. An example of such a model can be found in section 2.4A of the *Electricity Networks Access Code 2004* (WA), which provides that subject to that Code and the requirements of certain other instruments (such as an

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98 *Railways (Operations and Access) Act 1997* (SA), section 7.

applications and queuing policy, ring-fencing rules and technical rules), the parties have freedom about what they contract for.

4.7 Issue 2: Elements of the negotiation process that are barriers to negotiation

The discussion in the Issues Paper in relation to Issue 2 is mainly concerned with the requirements under the Code for access seekers to demonstrate that proposed operations can be accommodated on the network and to specify details of any required extension or expansion.[99] These requirements are principally set out in section 15 of the Code.

CBH submits that the requirements of section 15 are a significant barrier to being able to negotiate for access. Its responses to the particular questions in the Issues Paper in relation to Issue 2 are as follows.

(a) Question 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?

As currently drafted, the Code operates so that an access seeker is unable to require a railway owner to commence negotiations for an access agreement until the requirements of section 15 have been met.[100]

Section 15 provides, in effect, for the railway owner to require an access seeker to prove that the access seeker "can be accommodated" on the route to which it wants access.[101] If it cannot, then it is necessary for the access seeker to prove that an "extension or expansion" could, if undertaken by the railway owner, accommodate the access.[102] In addition, the railway owner is also entitled to require the proponent to provide a "preliminary assessment…showing that the proposed extension or expansion:

(a) can be carried out in a technically and economically feasible way; and

(b) will be consistent with the carrying on of safe and reliable rail operations on the route."[103]

In response, the railway owner is entitled to give notice to the access seeker that the requirements of section 15 have been met or that the "railway owner is not satisfied as to all of the matters mentioned…" in the section.[104] It is not required to give reasons. If the access seekers considers that a negative notice is not justified, then its ultimate recourse is to commence an arbitration.[105]

In CBH's view, this capacity mechanism suffers from a number of serious deficiencies. As a result, it operates as a significant barrier to access negotiations and further skews the balance of negotiating power in favour of railway owners. The deficiencies are that:

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99 As noted above, the Issues Paper also discusses the difficulty for access seekers in assessing the reasonableness of proposed access charges given information asymmetries that favour the railway owner. That topic is discussed elsewhere in this submission.

100 Code, sections 13(2) and 19.

101 Code, section 15(1)(c).

102 Code, section 15(1)(d).

103 Code, section 15(2).

104 Code, sections 18(1) and 19(2).

105 Code, section 18(3).

(i) it inefficiently and inappropriately imposes the onus on the access seeker to satisfy the railway owner that the railway owner can accommodate the access seeker on the railway owner's network (either with the network as currently configured or with an extension or expansion that the access seeker proposes); and

(ii) the requirement that section 15 capacity issues be resolved before the railway owner has an obligation to commence access negotiations (i.e. by operating as a threshold requirement) has the potential to materially delay commercial discussions between railway owners and access seekers.

Each of these points are addressed below.

Onus on the access seeker

In CBH's view, an access seeker is not, except in rare cases, likely to have sufficient information or expertise in relation to a rail network (including, for example, knowledge of the underlying capacity of a route, or of other user's requirements) to make a judgment as to whether its operations can be accommodated. Put differently, the access seeker is not the best placed of the parties to make such a judgment. Rather, it is the railway owner who is best placed to assess the capacity of the rail network.

It is manifestly inefficient and absurd to force an access seeker to prove the capacity of a railway network, especially where it has access to limited information and limited expertise. In general, the timeliness of decision-making can be improved by ensuring that the informational burden is placed on those best able to bear it.[106]

Capacity as a threshold issue before negotiations can commence

This issue has caused particular problems for CBH. Due to a dispute about whether the section 15 capacity requirements had been met by CBH, AI and CBH engaged in an arbitration under the Code. The issue took over nine months to resolve, and was one of the main reasons why CBH was unable to proceed to negotiations sooner.

CBH is frustrated that issues such as these held up the application of AI's obligation to negotiate with CBH in good faith. CBH had been willing for any capacity issues to be discussed as part of the negotiation process, and believes that that would have led to a more efficient resolution of any capacity disputes.

(b) Question 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?

In CBH's experience, the information provided by the railway owner is not sufficient to address the concerns with the capacity mechanism. This is for the following reasons:

(i) For the reasons discussed at length in Part 5.2 of this submission, CBH believes that the WARAR negotiation process does not address the information asymmetry between the railway owner and access seeker in an effective nor efficient way. This includes the information that a railway

[106] BERI Working Paper at page 100.

owner is required to provide under sections 7A and 7 of the Code, which must be taken into account for the purposes of section 15.

(ii) While sections 7A and 7 of the Code contemplate that a railway owner will provide certain information, that is of little use if the railway owner either does not provide the information or provides poor quality information. As discussed in Part 5.2 of this Submission, prior to making its access proposal under the Code, CBH sought an initial indication from AI of the then current capacity of a range of routes, and an initial indication of the price that CBH might pay for access, under section 7(1) of the Code. AI responded by asserting that some of those routes had, or would have, no capacity and refused to provide an initial indication of the access price for those routes. In the absence of meaningful information, CBH was left in an unworkable position.

(iii) Imposing a "requirement" to provide information is in itself a "toothless tiger" if there are difficulties in enforcing the requirement. As discussed in Part 4.3(b) of this submission, CBH has real concerns about enforcement of the WARAR, which extends to non-compliance with requirements to provide information.

(iv) In CBH's view, the extent of the information asymmetry between a railway owner and access seeker is so great that the provision of information of the type contemplated is highly unlikely to ever overcome it. Indeed, even if sections 7A and 7 were to be amended to increase the information to be provided, it would be extremely difficult to define the type, extent and amount of information that would need to be provided to satisfactorily address the asymmetry. That is particularly so if the railway owner is hostile to the use of the WARAR process.

(v) Even if sufficient information was to be provided so as to overcome the information asymmetry, that would not address the problem that exists because of the status of section 15 as a threshold issue for the commencement of negotiations. If the railway owner is hostile to the access seeker, then it would still have the opportunity to not be satisfied with the requirements of section 15. This then delays the crystallisation of its obligation to negotiate.

(c) Question 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?

The options referred to in this question are:

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

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.

As discussed above, the negotiate-arbitrate access regulatory model emphasises the primacy of commercial negotiations between the parties. CBH submits that this means that an access regime should provide the parties with the freedom to reach agreement by commercial negotiation first and foremost, without the requirement for an access seeker to satisfy (in the access provider's opinion) preconditions on matters that can be readily addressed in the negotiations themselves (particularly when they are matters that would be addressed in negotiations in a competitive

market, rather than through formal preconditions to discussions). An access regime should not give an access provider any opportunities to delay its obligation to negotiate with an access seeker, and should not allow it to prevent the commencement of independent arbitration.

The ERA has previously indicated that there should be opportunities after commencement of negotiations for the railway owner to raise matters of the type covered by section 15. In its decision under section 10 of the Code in relation to Brockman Iron Pty Ltd's access proposal to The Pilbara Infrastructure Pty Ltd (**TPI**) (dated 14 August 2013) (**TPI Section 10 Decision**), the ERA stated that:

> "The Authority is of the view that the scheme of the rail access regime does not require a proponent to undertake feasibility studies or include evidence of its financial standing in its access proposal. Rather, it is clear from Part 3 of the Code that there are opportunities, after commencement of negotiations, for the railway owner to require a proponent to provide information with respect to its financial resources to carry on the proposed rail operations and how its proposal for access can be accommodated on the route."[107]

While the specific process set out in section 15 must occur before negotiations can commence, CBH agrees that matters concerning the capacity of a route, any extension or expansion of a route, and the financial standing and resources of an access seeker, can be—and properly should be—addressed as part of negotiations, rather than as a pre-cursor to them.

Further, other rail access regimes do not allow these issues to delay good faith negotiations. For example under the SARAR, the operator is required to negotiate in good faith with an access proponent on whether its requirements as set out in the access proposal could reasonably be met, and if so, the terms and conditions for the provision of access.[108] This means that issues of capacity are treated as part of the negotiation process. Further, under Part IIIA of the CCA, there is no requirement for the parties to resolve issues relating to capacity or financial management before negotiations commence.

This issue is also tied to the need for the Code to facilitate a more streamlined path to negotiation under the Code, as discussed above.

CBH believes there is no good reason as to why issues in relation to capacity should hold up good faith negotiations between the parties. Section 15 should not be treated as a threshold issue that must be satisfied before the parties can commence negotiations. Rather, it is an issue that should form part of negotiations between the parties.

Accordingly, CBH submits that the first and best reform option should be to remove section 15 as a threshold issue and to leave matters of capacity to commercial negotiations. The obligation to negotiate should then commence from the moment that an access proposal is received.

If, despite CBH's submission, section 15 is to remain in place as a threshold issue, then CBH further submits that it inappropriately places the onus on the access seeker to show that its proposed operations can be accommodated on a route. Placing the onus on the railway owner is more consistent with the approach taken in other jurisdictions. Generally, it is the railway owner who has responsibility for

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107 The Pilbara Infrastructure Pty Ltd, Decision in accordance with the requirements of Section 10 of the *Railways (Access) Code 2000* dated 14 August 2013, page 7.

108 *Railways (Operations and Access) Act 1997* (SA), section 32(1).

carrying out a capacity analysis/capacity allocation, and to assess whether there is sufficient capacity to meet the access seeker's request. For example:

(i) Under Pacific National's access arrangement for the South Dynon Terminal, it is required to carry out capacity allocation of available capacity, in accordance with the capacity allocation protocol (found at Annexure B of the access arrangement). This sets out the procedure that Pacific National must follow on receipt of an access application in assessing whether there is sufficient capacity to meet the access seeker's request.[109]

(ii) Under the Australian Rail Track Corporation's (**ARTC**) Interstate Access Undertaking (dated 15 July 2008) (**ARTC IAU**), ARTC is required to undertake a "Capacity Analysis" as part of preparing an Indicative Access Proposal for the access seeker. The Capacity Analysis identifies whether there is sufficient available capacity to meet the requirements of the applicant, and if not, the extent to which additional capacity is required. It also sets out how capacity is to be allocated in the case of multiple applicants.[110]

CBH believes there is also merit in clarifying section 15 (if it is to be retained) to address the relevant criteria for raising a capacity argument. Otherwise, railway owners are too easily able to use capacity issues as a reason to avoid negotiations, or to attempt to hinder access by the access seeker. For example, the railway owner should be under a more robust obligation to:

(i) assess the capacity of the route, in line with specified criteria;

(ii) determine whether the access seeker's requirements can be accommodated on the route (also in line with specified criteria); and

(iii) provide a written and detailed explanation as to why a particular request for access cannot be accommodated (including likely prospects for future access).

As such, CBH would support the introduction of options “a” and “b”, appropriately modified to address the comments above.

(d) Question 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?

As matter of general principle, CBH considers that a railway owner should be entitled to recover the costs it efficiently incurs in providing access to an access seeker. Accordingly, CBH considers that it would be reasonable to permit the railway owner to recover its efficient costs in many circumstances.

However, CBH does not consider that the railway owner should be permitted to recover costs that it incurs due to it allowing the condition of infrastructure to fall below the standards required by applicable legal or contractual obligations (such as a lease) and best industry engineering and operating practice when it has received access fees sufficient to properly maintain the line. In this regard, CBH believes that its experience in relation to the Miling track on the AI network may serve as an example. Over time, AI has allowed the condition of that track to deteriorate so

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109 Pacific National's access arrangement for the South Dynon Terminal Access Arrangement (approved in June 2012), Annexure A, clause 5 and Annexure B.

110 ARTC IAU, Part 5.

that it is now below the standard required for above rail operations, but now insists upon carrying out expensive remediation works to bring the track back to an appropriate standard at CBH's cost (as CBH is the only user of the track). CBH does not believe that AI should be able to recover the costs of that expansion, noting that AI should not have allowed the track to deteriorate in the first place and has been paid sufficient revenue to maintain the line.

Another example would be found in relation to AI's position in respect of the Moora line, where significant restrictions on performance are in place. To return the line to a 19 TAL line without the operational restrictions that hamper CBH's above rail activities, AI requires CBH to pay for remediation works or suffer increasing restrictions. AI is required to keep the line open under the terms of the privatisation lease with the Government (as it is not permitted to surrender it), but has not maintained the level of operation that existed at the commencement of the lease. If the treatment of the Miling line is any guide AI will seek to recover the cost of the work from CBH, as the most consistent operator on the line, (in effect requiring CBH to pay twice) to enable AI to fulfil its lease obligations.

Further, CBH considers that there is a separate question as to whether the costs should be charged to the specific access seeker or rolled into the costs that it recovers from all users. For example, it would not seem appropriate to recover such costs from a single access seeker if they are incurred in connection with an expansion or extension that:

(i) is not access seeker-specific (such as a core network expansion the benefit of which is capable of being used by other users);

(ii) although triggered by the access seeker's access proposal, would exceed the access seeker's reasonable requirements (e.g. where the railway owner considers that, due to economies of scale, it is more efficient to undertake a substantial rather than minor expansion); or

(iii) is necessary by reason of the railway owner permitting the condition of the infrastructure to fall below the standards required by applicable legal or contractual obligations (such as a lease) and best industry engineering and operating practice.

In addition, it is imperative that the costs the railway owner is permitted to recover be expressly limited to those that would satisfy the test in clause 4 of Schedule 4 of the Code. That is:

> "...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."

(e) Question 1.10 - Are there any other barriers to access negotiation or imbalances in negotiating power in the negotiation framework in the WARAR?

Refer to the discussion above in Part 4 of this submission.

(f) Question 1.11 - If so, what reform options would address these concerns?

Refer to Part 4.8 of this submission.

4.8 How these issues can be addressed

CBH believes that the processes under the WARAR need to be restructured so that they facilitate a more streamlined path to a negotiated outcome. Doing so will promote efficient use of, and investment in, railway facilities and facilitate a contestable market for rail operations (and other dependent markets).

These issues can be addressed together with the following submissions made by CBH:

(a) there should be a reference tariff approach in place, where regulated prices are determined up-front (or at a minimum, floor and ceiling costs determinations should be regularly made and published on the ERA's website);

(b) the section 14 and 15 requirements should not be threshold issues that hold up the negotiation process;

(c) there should be a timeframe imposed on arbitration;

(d) the scope of when a "dispute" can arise under the Code must be extended to allow the access seeker to commence dispute resolution at any time;

(e) there must be a tighter enforcement regime so that the parties do not have to commence Supreme Court proceedings or arbitration to enforce Part 2 or Part 3 obligations; and

(f) there should be a provision that requires the status quo to be preserved under an existing access agreement between the access seeker and railway owner, where an access proposal process is underway between those parties for a replacement access agreement.

These are all issues which will improve the ability of the WARAR to facilitate a more efficient path to a negotiated outcome.

There is also merit in considering a similar approach taken in the NSW and Victorian rail access regimes, and in the gas access regime in WA, regarding the publication of an access arrangement/undertaking. This significantly increases the efficiency of the entire access process, because cost determinations, indicative prices and template access agreements are in place up-front and are already approved by the regulator. This saves time and resources for each access seeker having to negotiate these issues with the access provider from scratch, and the regulator having to make approvals and determinations for each proposal.

5. ACCOUNTABILITY

5.1 The Issues Paper (section 3.2)

The Issues Paper observes that "[a]ccountability 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". It then goes on to explore three specific issues:

(a) (**Issue 1**) whether the WARAR is sufficiently transparent, and whether regular reporting by railway owners on compliance with Part 5 instruments, the progress of access negotiations and service quality would promote more effective access negotiations;

(b) (**Issue 2**) whether the WARAR is effective in relation to the accountability of the regulator and, particularly, as to the possibility of providing merits review from decisions of the regulator; and

(c) (**Issue 3**) whether to implement previous ERA recommendations in relation to the variation and review of Part 5 instruments.

The following section of this submission provides feedback on these issues.

5.2 Issue 1: Railway owner accountability to comply with the regime

CBH considers that the WARAR suffers from a significant transparency problem. The regime does not adequately address the information asymmetry between railway owners and access seekers. This means that railway owners continue to have the ability and incentive to exercise their market power.

In the following sections of this submission, CBH addresses its concerns in relation to the transparency of the WARAR by responding to questions 2.1 to 2.4 of the Issues Paper.

(a) Question 2.1: Is the WARAR insufficiently transparent? If so, which elements of the regime would benefit from improved transparency?

WARAR is insufficiently transparent

As discussed in Part 4 of this submission, the negotiate-arbitrate model emphasises the primacy of commercial negotiations between the parties. However, the very nature of the essential facilities problem means that there is likely to be an imbalance in negotiating power. This may stem (at least partly) from an information asymmetry between the monopoly asset owner and an access seeker.

It is, therefore, important for an access regime to overcome the information imbalance. This encompasses a requirement for the monopoly service provider to:

(i) sufficiently address information imbalances between the parties, to enable the access seeker to conduct meaningful negotiations; and

(ii) provide sufficiently detailed information to the access seeker on the terms of access, including price, to ensure that an access seeker can understand the basis on which access is to be offered and make an informed decision, with that information made available in a transparent and timely manner.

CBH believes that the WARAR negotiation process does not address these things in an effective nor efficient way. It does not adequately promote the transparency of information nor adequately address information asymmetries between the railway owner and access seeker during negotiation processes. In particular, an access

seeker is not able to access sufficiently detailed information regarding important issues such as pricing and performance standards. In CBH's view, this is a significant disincentive for access seekers to use the WARAR negotiation process.

Previous experience under the Code

During its negotiation process under the WARAR, CBH encountered significant problems due to a lack of available and sufficiently detailed information. This was the case despite extensive research and analysis, including work undertaken by its external legal and economic advisers. For example, CBH had substantial difficulties in understanding the price the AI might seek for access, understanding whether (and why) AI considered that capacity was or was not available, and preparing for effective negotiations due to the formidable information asymmetries it faced. CBH also had to respond to information requests from AI for information that AI already possessed or was in the best position to develop.

CBH is not the only proponent to have struggled with the lack of information disclosure and transparency under the WARAR. For example, CBH understands that Karara is presently party to an access agreement negotiated directly with AI "outside the Code", but had originally looked to the Code for support in gaining access to the freight rail network operated by AI. After seeking the advice of the ERA and independent legal advice, Karara is reported to have formed the view that the regulatory framework could not provide sufficient certainty for achieving its desired outcome within an acceptable timeframe. It concluded that engaging the Code would be a "waste of time".[111]

Karara gave evidence to the Committee in the Freight Rail Network Inquiry which demonstrated the public interest in ensuring greater transparency and availability of pricing information under the Code. Karara identified (amongst other things) the lack of existing pricing information as a key impediment to relying on the provisions of the Code. Karara stated that because there was "no real mechanism to get a floor and ceiling price and there was no information on existing floor and ceiling prices, [the Code] was completely ineffective and of no use".[112] Karara informed the Committee that there was "not enough transparency on all [the] inputs into how a tariff would be calculated".[113] The Code was contrasted with the greater transparency found under the regulatory framework for rail access in the Queensland market (which provides for a register of previous deals and transparency on previous access terms). Karara suggested that the Queensland framework functioned to facilitate better negotiations. Similarly, Karara noted that there is a greater level of transparency within the mining industry generally as to applicable mining rates, given that there is a range of service providers and the ability to access the cost models used by contract miners. However, in the WA freight rail market, Karara noted that "there is only one realistic provider of the service, and getting real insights into what their true costs are is much more difficult".[114]

Ultimately, Karara elected to negotiate for access "outside the Code". However, it described to the Committee the difficulties it faced in negotiating with a monopoly service provider in an unregulated market, where there was essentially "a monopolistic provider of those services [which] puts the balance of the negotiation power too much on one side and not enough on the company that is trying to get

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111 Freight Rail Network Inquiry at paragraph 6.50.

112 Freight Rail Network Inquiry at paragraph 6.51.

113 Freight Rail Network Inquiry at paragraph 6.55.

114 Freight Rail Network Inquiry at paragraph 6.53.

access to that infrastructure".[115] Overall, Karara submitted that the lack of regulation "jeopardised the deal", and that "there could have been a better deal… if there was a stronger regulatory framework".[116]

Elements that would benefit from improved transparency

While there are numerous issues in relation to the transparency of the WARAR, the discussion below explains some of the main elements of the WARAR that are insufficiently transparent and which would benefit from improved transparency. They relate to:

(i) pricing information;

(ii) performance indicators and service quality;

(iii) provision of prices for routes to which the railway owner contends there is no capacity; and

(iv) requirement to provide a draft access agreement.

Pricing information

In CBH's view, the Code does not provide for sufficient information to be made available to an access seeker regarding access prices and the methodology on which these prices are based.

As part of the preliminary information under section 7, the railway owner is only required to provide an initial indication of the "price that the entity might pay for access". This is provided without any information on how this price was derived, or the principles or costs on which it was based.

This was insufficient for it to understand whether this price was reasonable, how it related to the pricing guidelines under the Code, and how the prices were attributable to each route requested by CBH. From a commercial and practical perspective, it is difficult to prepare a proposal for access without knowing the access charges for each route, and the costs on which they are based.

Further, under section 9, the railway owner is only required to provide the floor price and ceiling price for the proposed access, the costs for each route section on which those prices have been calculated, and a copy of the costing principles.

This level of information was not sufficient for CBH to properly understand the basis on which the proposed access is to be provided on a route-by-route basis. CBH also had no indication of how these prices had been derived, how they related to the pricing guidelines under the Code, or how they related to the level of service that CBH would be getting. CBH was forced to seek injunctive relief in order to have full disclosure of the costs required for each route under section 9(1)(c) of the Code.

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115 Freight Rail Network Inquiry at paragraph 6.56.

116 Freight Rail Network Inquiry at paragraph 6.61.

Accordingly, CBH submits that sections 7(1) and 9(1) should be clarified to remove any argument to the effect that the railway owner is not required to provide prospective prices for each route. It is not sufficient for the railway owner to merely provide a global floor and ceiling price for all routes. Rather, prices must be provided on a route-by-route basis.

Pricing disclosure requirements in other jurisdictions are far more detailed and require greater transparency of pricing outcomes. Methods that have been adopted in other jurisdictions include the preparation of an access arrangement, which is approved by an independent regulator. The access arrangement often requires the railway owner to publish indicative access charges that an access seeker can expect to pay for each service. The access arrangement may also be accompanied by "access arrangement information", which sets out, in a clear and focused way, detailed information up-front in relation to how prices have been derived and how they relate to pricing principles. For example:

(i) In South Australia, the operator is required to provide a detailed "information brochure" to any applicant on request, containing a statement of the terms and conditions on which the operator is prepared to make the infrastructure available for use. This is given before a proposal has been made. The brochure must refer to any relevant pricing principles and show how the terms and conditions relate to, or compare with, relevant pricing principles.[117] It must provide:

(A) indicative floor and ceiling prices for all significant railway services, being services it provides that are, or are highly likely to be, subject to access interest;

(B) accompanying statements explaining how the floor and ceiling prices relate to each aspect of the pricing principles, including the value of the real rate of return used and the latest regulatory asset values used, by railway segment;

(C) the prices for any other items for which a charge would be made (e.g. for particular services or items of plant);

(D) any price penalties that may apply (e.g. delays or disruptions caused to other services);

(E) the basis for charging any direct costs arising from the applicant's operations (e.g. due to damage caused); and

(F) any other prices that would be charged.[118]

This provides for far greater information disclosure than that provided for under the Code, which only requires indicative floor and ceiling prices under section 7(1), and limited price and costs information under section 9 (without any such accompanying statements).

(ii) Under the ARTC IAU, ARTC is required to publish indicative access charges, which are approved by the ACCC as part of its approval of the undertaking. The indicative charges comprise a variable tariff and flagfall tariff for each

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117 *Railways (Operations and Access) Act 1997* (SA), section 28.

118 South Australian Rail Access Regime, Information Kit dated March 2010, section 4.3.

segment.[119] The undertaking also sets out the pricing principles that govern the setting of access charges and the structure of charges.[120] The access seeker can request ARTC to provide further details on the incremental cost for each segment to which access is being sought, and the "Economic Cost" determined in accordance with the undertaking.[121] This is provided before an access application is even made.

(iii) In Victoria, the *Rail Management Act 1996* (Vic) requires a railway owner to submit an access arrangement for approval by the ESC. Under the access arrangement, the railway owner must set out, up-front, details of each "reference service" which it proposes to provide, including the price, or methodology for the calculation of the price, to be charged in respect of the provision of each reference service.[122] These are then subject to approval by the ESC. The access arrangement also includes "access arrangement information", being information that is reasonably required to understand the derivation of the elements of the access arrangement so as to form an opinion as to whether the access arrangement complies with the regime.[123]

CBH believes that the Code should require the railway owner to provide more detailed and transparent pricing information at a preliminary stage, before negotiations commence. This information should be provided without confidentiality claims being made by the railway owner, including in relation to multi-user routes.

In addition, there is merit in following the approach taken in other jurisdictions to the publication of indicative access charges (which may be subject to regulatory scrutiny), and statements explaining how the charges have been derived. This would enable the access seeker to understand the charges it may be expected to pay for access before commencing negotiations, and to have confidence that those charges are consistent with the pricing principles. There should also be greater regulatory scrutiny of that information (i.e. having indicative prices subject to up-front regulatory approval) to ensure the railway owner is held accountable for its compliance with the pricing principles.

In the ERA's Final Decision on the Review of the Requirements for Railway Owners to submit Floor and Ceiling Costs (dated August 2011) (the **Cost Requirement Review**), the ERA made a decision to reduce the cost re-determinations imposed on a railway owner. CBH believes that this decision has placed users and access seekers at a disadvantage in dealing with the monopoly railway owner. The continued availability of transparent floor and ceiling costs (and publication of those costs) is critical to ensure ongoing transparency of costs and to address information asymmetries held by the monopoly owner. CBH does not agree with the ERA's view that the costing model provides "sufficient technical information for potential access seekers."[124] At the absolute minimum, CBH believes that the requirements to periodically re-determine the floor and ceiling costs applicable to the grain rail network should be re-instated on a more regular basis (i.e. annually), and the ERA should publish these reviews on its website in the interests of transparency for access seekers and users.

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119 ARTC IAU, section 4.6; ARTC's Hunter Valley Access Undertaking (dated 23 June 2011 and as varied from time to time) (**HVAU**), section 4.14.

120 ARTC IAU, Part 4.

121 ARTC IAU, section 3.3(a)(ix).

122 *Rail Management Act 1996* (Vic), section 38X(1)(a)(iv).

123 *Rail Management Act 1996* (Vic), section 38W(2).

124 Cost Requirement Review at paragraph 73.

Performance indicators and service quality

As discussed in Part 10.1 of this submission, CBH considers that the Code does not adequately deal with issues relating to service quality or performance indicators. This is left to negotiation between the parties.

CBH believes that greater transparency and disclosure of performance indicators and service standards is warranted to ensure that:

(i) access seekers are informed about the quality of services provided; and

(ii) railway owners are held accountable for service standards.

A related issue is whether the Code should impose minimum service standards on railway owners. This is discussed further in Part 10.1 of this submission.

CBH makes this submission in the context of the deteriorating performance standards on the grain rail network. While access fees requested by AI have been significantly increasing, performance standards have been decreasing. As noted above, on 23 August 2017, there were 1,018 permanent speed restrictions in place for the total AI network.[125] This represents an 8% increase over the number of permanent restrictions that were in place only 2 years ago, in April 2015 – at that time there were 942 separate permanent speed and mass restrictions placed on Tier 1 and Tier 2 line sections.

Further, CBH has experienced ongoing issues in relation to the closure of the Tier 3 lines, which has meant that CBH has had to look to other supply chain solutions to transport its grain to port. CBH has been increasingly frustrated by these restrictions, as they have significantly affected the efficiency and competitiveness of its grain operations. Without adequate transparency around AI's performance, CBH is concerned that AI has had no incentive to ensure a minimum standard of service on the grain rail network.

Further, CBH does not know what it is paying for in relation to the minimum standard performance, speed or weight on the network. It also does not know what standard it should be getting for the access fees paid by it. As an example, AI previously proposed to further increase access fees - despite the restrictions and closures outlined above - without a corresponding increase in the performance standards delivered by it[126] and without any accountability for its performance or non-performance.

CBH acknowledges that, due to the intervention of the Freight Rail Network Inquiry, it obtained a copy of the privatisation leases of the railway network, including the initial lease performance standards. However, this does not explain how or why speed and weight restrictions are imposed, and the WARAR does not include a performance standard regime. Without transparency around these issues, there was no way for CBH to effectively have this discussion with AI during negotiations.

CBH believes that the WARAR should require greater transparency of performance standards, by requiring the railway owner to provide information up-front on

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125 Speed restrictions in place on Wednesday, 23 August 2017, at 8:58am. Data taken from ARC's RAMS system. See: http://www.artc.com.au/customers/operations/webrams/

126 On the basis that, if AI is providing access to less track but charging more for it, it is reasonable to expect an increase in the quality (e.g. performance) of the service AI provides on the remaining track. CBH submits that, if the ability of a firm to charge more and provide less is a sign of the existence of market power, then actually charging more while providing less is a clear exercise of market power.

performance indicators (including details on how indicative prices relate to the level of service quality to be provided), and to undertake periodic reporting and measurement of performance indicators. The information that is already provided in relation to performance as part of the Part 5 instruments, or the standard access agreement provided by the railway owner, is not sufficient to address the significant information asymmetries between the railway owner and access seeker. Further, the railway owner's access agreement is not subject to the approval of the ERA – meaning there is no regulatory scrutiny over any performance issues that may be provided in that agreement.

Examples should be taken from other jurisdictions, such as the following:

(i) In South Australia, the railway owner is required to provide a person with a proper interest in making an access proposal with an indication of the likely price on which the operator would be prepared to provide the service.[127] The likely price must be based on indicative information provided by the applicant to the operator about its possible usage of the railway infrastructure. However, in the absence of this information, the likely price must be accompanied by a set of assumptions on which the likely price is based, including the level of service quality that is to be provided at the likely price.[128]

(ii) In ARTC's IAU, ARTC is required to measure and report on certain performance indicators at quarterly and annual intervals.[129] These include indicators relating to reliability, network availability, transit time, temporary speed restrictions and track condition. It also undertakes annual reporting of its unit costs for costs areas including infrastructure maintenance, train control and operations.[130]

Provision of prices for routes to which the railway owner contends there is no capacity

Prior to making its access proposal under the Code, CBH sought an initial indication from AI of the then current capacity of a range of routes, and an initial indication of the price that CBH might pay for access, under section 7(1) of the Code. AI responded by asserting that some of those routes had, or would have, no capacity and refused to provide an initial indication of the access price for those routes. AI took a similar approach to the provision of information when it purported to comply with its obligations under section 9(1) of the Code in response to CBH's access proposal.

CBH submits that sections 7(1) and 9(1) of the Code should be clarified to remove any doubt that the prospective prices must be provided for every requested route, and not only those for which the railway owner claims there is capacity.

Section 9(1)(c) states that the railway owner must provide the floor price and ceiling price for the "proposed access", meaning the access set out in the proposal. Whether there is capacity on these routes is a question to be determined (at this time) under the section 15 process. The railway owner should not be permitted to refuse to provide the information in section 7(1) and 9(1) on the basis that it asserts there is no capacity on certain routes.

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127 *Railways (Operations and Access) Act 1997* (SA), section 29(1)(c)(i).

128 South Australian Rail Access Regime, Information Kit dated March 2010, section 4A.1.

129 ARTC IAU, section 8.2.

130 ARTC IAU, Table 2 of Schedule G.

Requirement to provide a draft access agreement

CBH was forced to commence commercial negotiations under the Code, even though it had not seen a draft access agreement that included pricing on a route-by-route basis from AI. Without that information, CBH had no information on AI's position prior to commencing negotiations. That has made it difficult for CBH to effectively prepare for negotiations. It also provided AI with a significant negotiating advantage.

Section 9(3a) of the Code provides that the railway owner must give the proponent a draft access agreement following the determination of floor and ceiling costs under Schedule 4. CBH submits that the scope of this obligation should be clarified to ensure that the draft access agreement is complete and includes a proposed tariff (encompassing all components), based on the determination of floor and ceiling costs. The proposed pricing should also be provided on a route-by-route basis.

CBH notes that the draft access agreement referred to in section 9(3a) of the Code is not the same as the "form of the railway owner's standard access agreement" referred to in section 6 of the Code, or the "terms, conditions and obligations that the railway owner would want to be included in any access agreement" referred to in section 7(1)(a)(iii) of the Code. Rather, the draft access agreement should be a draft of the complete access agreement that the railway owner proposes prior to entering into negotiations. It must provide for, in detail, each of the matters specified in Schedule 3 to the Code, including the "prices and charges" that are to apply.[131]

The proposition that a draft access agreement should be a complete document, which includes prices on a route-by-route basis, is supported by the natural and ordinary meaning of the word "agreement", and the scheme established by the Code as a whole. It is also supported by the fact that the railway owner is not required to provide the draft agreement until after the ERA makes a floor and ceiling costs determination. If it was not required to include prices and charges, then there would have been no need to make provision of the agreement contingent on the ERA's floor and ceiling cost determination.

(b) Question 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?

The Part 5 instruments play an important role in the WARAR regulatory scheme. That is because they, among others things, provide an additional layer of policy and regulatory detail in relation to the application of the WARAR to particular railways and affect the day-to-day operation of particular railways. As such, the instruments have the potential to significantly shape how the WARAR operates in a practical sense.

It is therefore imperative that the Part 5 instruments operate effectively and efficiently, that railway owners comply with them and are held accountable for any failure to comply. In addition, it is important that access seekers have confidence as to these things. Otherwise, confidence in the effectiveness of the WARAR can be seriously undermined, which can then deter access seekers from using the regime (as is currently the case).

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131 Code, section 17(1)(a).

In CBH's view, an important way to satisfy these issues, as well as to assist in addressing the information asymmetry problems discussed above, is to ensure that there is transparency as to the effectiveness of, and the extent of compliance with, the Part 5 instruments. In particular, it is necessary to require all railway owners to regularly report on these matters on a regular and consistent basis.

Unfortunately, the WARAR is, as noted in the Issues Paper, "relatively light handed in that there are minimal reporting obligations on railway owners covered by the regime".[132] In CBH's view, this is a material issue that undermines the effectiveness of the regime.

To address this issue, CBH considers that it is necessary to require all railway owners covered by the WARAR to regularly report on their compliance with Part 5 instruments. Further, efforts should be taken to harmonise and align compliance obligations across railways, and to provide for reporting to occur in a manner that facilitates comparisons over time and between railways (and parts of railways). Finally, railway owners should be specifically required to report on service quality, including track condition.

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

CBH considers that there is merit in this proposal and supports the imposition of requirements on the railway owner to publicly report on a regular basis on the progress of access negotiations, including for example:

(i) the number of access applications outside the Code;

(ii) the number of access applications within the Code;

(iii) the number of negotiations under the Code that have commenced;

(iv) information on disputes or judicial challenges to any obligations under the Code; and

(v) the number of negotiations under the Code that have concluded with an access agreement.[133]

However, CBH considers that there is merit in also requiring a railway owner to regularly update and publish the register it is required to maintain under section 8 of the Code, as well as reporting on the:

(i) number of requests for information made under section 7A of the Code, and whether and how quickly those requests were satisfied;

(ii) number of requests for preliminary information made under section 7 of the Code, and whether and how quickly those requests were satisfied; and

(iii) number of requests for information made under section 48 of the Code, and whether and how quickly those requests were satisfied.

In CBH's view, imposing these requirements will improve the transparency of the railway owner's performance of some of its important obligations under the Code.

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132 Issues Paper, at p. 13.

133 Issues Paper, at p. 13.

This will assist interested parties to assess the effectiveness of the WARAR and, over time, policy makers in understanding whether it is necessary to make changes to the regime.

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

As discussed above, CBH believes that greater transparency and disclosure of performance (or service quality) indicators and service standards is warranted to ensure that:

(i) access seekers are informed about the quality of services provided; and

(ii) railway owners are held accountable for service standards.

CBH also considers (as discussed in Part 10.1 of this submission) that the Code should impose minimum service standards on railway owners.

It is an essential part of having effective performance standards that they be publically available and that the railway owner report against them on a regular basis. If these things do not occur, then access seekers will have no way of knowing the standards at which the railway owner is required to operate in exchange for its access fees, or of understanding whether the railway operator is operating the rail network efficiently and supplying services at a satisfactory level.

Regular public reporting against performance (or service quality) standards may also play an important role in promoting public scrutiny in relation to how well the railway owner is operating its network. In CBH's view, there is a public interest in the level of performance because of the importance of railways as "essential facilities" and due to the fact that some operators, such as AI, have received public and private moneys to facilitate higher levels of performance (or service quality). If a failure to perform at acceptable standards is detected, or the results indicate the possibility of regulatory gaming by the railway owner (e.g. by taking capital contributions from users or extracting higher access charges), then the Government will have an opportunity to address these issues by, for example, imposing more rigorous regulatory policy responses.

5.3 Issue 2: Regulator accountability

The Issues Paper discusses the accountability of the ERA under the WARAR. In CBH's view, the lack of accountability for the way in which the ERA applies and enforces the WARAR has led access seekers to have little confidence in the effectiveness of the regime.

CBH welcomes the discussion in the Issues Paper about whether merits review should be available in relation to ERA decisions. The following Parts of this submission respond to the particular questions set out in the Issues Paper (Questions 2.5 to 2.7)

(a) Question 2.5: What are the advantages and disadvantages of including merits review of regulatory decisions in the WARAR?

While the Code does not currently contain a merits review mechanism, CBH considers that it may be appropriate for merits review of arbitration determinations to be available to an access seeker, particularly given the recommendations made in other parts of this submission. It is helpful in considering the issue of merits review to consider the requirements of clause 6(5)(c) of the CPA. That provision outlines the requirements of merits review, where merits review of decisions is provided for in an access regime (although it does not require an access regime to provide for merits review).

In addition, the NCC has stated that a decision on whether or not to include merits review in an access regime may be informed by issues including:

(i) the likely complexity and extent of regulatory intervention;

(ii) the potential impact of regulation on property rights and values;

(iii) the risk of "gaming" of processes by participants; and

(iv) the need to balance potential delays to access against the need to protect the rights of affected parties.[134]

In addition to these issues, CBH considers that there is an additional material factor in relation to confidence in the quality of the regulatory decisions.

Quality of regulatory decisions

If persons affected by regulatory decisions have confidence in the quality of those decisions, then they are less likely to wish to challenge the merits of those decisions (setting aside the risk of "gaming"). Conversely, affected persons are more likely to challenge the merits of decisions where they lack confidence in the quality of the decisions.

In this respect, "quality" encompasses the soundness of the decision itself. For example, a decision should be relevant, based on evidence, consider all relevant considerations, not consider irrelevant considerations, and be logical, coherent, comprehensive, accurate, impartial, fair and lawful. In addition, "quality encompasses confidence that the decision maker has the appropriate resources, experience and expertise to make relevant decisions, is accountable for doing so and clearly demonstrate objectively the merits of their decision.

In CBH's view, it follows from this that the need for merits review from regulatory decisions made under the WARAR is affected by the confidence that railway owners and above-rail operators have in the decisions of arbitrators and the ERA.

For reasons that have been set out elsewhere in these submissions, access seekers have little confidence in the quality of regulatory decisions made under the WARAR. In particular, that is due to the lack of accountability for, and transparency in, the way in which the ERA applies and enforces the WARAR.

Accordingly, CBH considers that it is necessary to introduce a merits review mechanism into the WARAR. The need for such a mechanism could be reviewed in the future if, for example, there were to be changes in the way in which the ERA applies and enforces the WARAR and the ERA was more appropriately resourced.

Likely complexity and extent of regulatory intervention

CBH considers that the types of decisions from which review should be able to be sought under a merits review mechanism will usually be complex and involved. They will in many cases go to the core of railway owner's business and the commercial and operational viability of access for an above-rail operator.

At the same time, such decisions would be no more complex and involved than those which are customarily handled by administrative tribunals under other access regimes.

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[134] Guide to Certification at 6.13.

The potential impact of regulation on property rights and values

As indicated above, decisions made under the WARAR have the potential to have a material impact on the interests of railway owners and above-rail operators. Just as importantly, the decisions have the potential to seriously affect efficiency in major markets and industries in Western Australia and the public interest in Western Australia (e.g. in relation to regional development).

In CBH's view, this factor underscores the importance of providing for merits review of decisions, particularly where there is a lack of confidence in the quality of regulatory decisions.

The risk of "gaming" of processes by participants

In CBH's view, the risk of "gaming" by railway owners is an important factor. In contrast to access seekers, they have both the ability and incentive to use merits review processes to delay and frustrate access processes, as well as to obtain higher returns from a review body that may have less expertise and resourcing than the original decision maker.

Such concerns were behind the Federal Parliament's recent decision to effectively abolish merits review for decisions made under the national energy laws (other than decisions in relation to the disclosure of confidential or protected information).[135] This followed a review by the Council of Australian Government's Energy Council Senior Committee of Officials following applications for review of 12 of 20 of the Australian Energy Regulator's post 2013 electricity and gas decisions and two of the ERA's gas decisions. The affected network businesses sought a total of $7.3 billion in additional revenue. The Committee found, among other things, that merits review was "leading to higher prices for consumers".[136]

While this risk is of significant concern, CBH believes that the potential benefits outweigh the risk, given its concerns in relation to the quality of regulatory decision making under the WARAR. To address the risk, CBH considers that the merits review mechanism will need to be carefully designed with industry input and provide for periodic review.

The need to balance potential delays to access against the need to protect the rights of affected parties

The introduction of a merits review mechanism carries the risk of delays in obtaining access. However, CBH considers that those decisions are of such importance that there is, in general terms, a compelling case in favour of introducing such a regime.

However, any regime will need to be designed to ensure that any delays are minimised by restricting as much as possible the time it takes to engage in administrative review. This will involve carefully defining the permissible grounds of review, restricting the evidence to be considered, and imposing strict deadlines.

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135 *Competition and Consumer Amendment (Abolition of Merits Review) Act 2017* (Cth).

136 Explanatory Memorandum to the *Competition and Consumer Amendment (Abolition of Merits Review) Bill 2017* (Cth), paras 1.2 to 1.15.

(b) Question 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?

CBH believes it may be advantageous for the parties to be able to invoke merits review in a relation to an arbitration that is concerned with pricing issues or performance standard issues. The arbitrator is given limited guidance in determining access disputes, apart from compliance with the Part 5 instruments and the general overarching principles in clauses 6(4)(i), (j) and (l) of the CPA. There is significant room for flexibility in interpreting and applying these principles, particularly in relation to pricing, where there is a very wide gap between the floor price and ceiling price that is presented to the arbitrator. Merits review would assist in giving the access seeker sufficient oversight over the price setting process - in circumstances where there is limited regulatory intervention, but significant consequences of an unfavourable decision.

In addition, CBH considers that the material regulatory decisions made under the WARAR should be subject to merits review, including decisions:

- to amend the Code to prescribe routes under section 4(2)(b) of the Act,[137]
- under section 29 of the Act in connection with segregation arrangements,
- under section 7B exempting a railway oner from publishing Schedule 2 information,
- if not repealed, under section 10 of the Act in relation to whether the provision of access may preclude others from access,
- under Part 5 of the Code, in connection with the approval of Part 5 instruments,
- under clause 3 of Schedule 4 of the Code, in connection with the determination of the weighted average cost of capital,
- under clauses 9, 10 and 12 of Schedule 4 of the Code, in connection with the determination of costs and/or the review and redetermination of costs, and
- in connection with any of the pricing reforms discussed elsewhere in these submissions, including the approval of indicative tariffs and the established asset base.

(c) Question 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?

As discussed above, any merits review process will need to be designed to ensure that any delays are minimised by restricting as much as possible the time it takes to engage in administrative review. This will involve carefully defining the permissible grounds of review, restricting the evidence to be considered, and imposing strict deadlines.

Part 5 of the NGL, as it stood before it was recently amended,[138] is an example of a limited merits review regime which in CBH's view dealt with this balance in an efficient way.[139] For example, merits review is only able to be made to the

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137 Act, section 5.

138 *Competition and Consumer Amendment (Abolition of Limited Merits Review) Act 2017* (Cth).

139 Guide to Certification at 6.15.

Australian Competition Tribunal (**Tribunal**) for "reviewable regulatory decisions" on certain specified grounds, and the Tribunal is only permitted to have regard to certain "review related matter." The Tribunal is also required to consult with users and consumers before it makes a determination, and must be satisfied that its decision will result in a "materially preferable decision" that contributes to achieving the national gas objective.[140] CBH notes that merits review of arbitration determinations is also provided for under Part IIIA of the CCA.[141]

5.4 Issue 3: Whether to implement ERA recommendations about Part 5 instruments

The Issues Paper discusses whether to implement two previous ERA recommendations in relation to the variation and review of Part 5 instruments.

In the following sections of this submission, CBH responds to this discussion by addressing questions 2.8 and 2.9 of the Issues Paper.

(a) Question 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?

CBH supports the ERA's Final Recommendation 4 in relation to amending section 45 to include the costing principles and over-payment rules, in order to ensure consistency in the public consultation process across all Part 5 instruments. Given the importance of the issue of access pricing in meeting the object of the Code, and the fact that the over-payment rules apply to the entire network, it is in the public interest that these instruments are open to public consultation.

CBH also supports the regular review of all Part 5 instruments every five years or as otherwise determined by the ERA.

CBH has concerns about the ERA's proposed change to section 42 of the Act, which would mean that public consultation for variations to segregation arrangements are only required where the ERA considers that they would constitute a material change. The risk with this proposal is the ERA may not be in a position to determine whether a proposed change is material or not without consulting with all who might be affected by the change. While it would be in the interests of a railway owner to claim that a change is not material, that may not actually be the case in practice. That, presumably, was the reason for the current form of section 42.

Having said this, CBH does recognise that AI is not currently vertically integrated. For that reason, segregation arrangements are not currently a material concern for CBH. That would, however, change if there was any suggestion that AI was to become vertically integrated, including if any entity in the Brookfield group was to take an interest (even a minority interest of, say, 30%) in an above-rail operator.

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140 Guide to Certification at 6.15.

141 CCA, section 44ZP.

(b) Question 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?

As this recommendation relates to new railways, CBH does not have any comments in relation to this question, other than to observe that the preparation of a standing set of Part 5 instruments to be maintained by the ERA may also be more broadly useful. This would provide a benchmark against which the Part 5 instruments for existing covered railways can be assessed.

6. CAPACITY EXPANSIONS AND EXTENSIONS

6.1 The Issues Paper (section 3.3)

The Issues Paper observes that the WARAR:

> "…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… 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".[142]

The Issues Paper then goes on to explore three specific issues:

(a) (**Issue 1**) whether the WARAR's failure to provide detail about how a required expansion is to proceed creates a barrier to access negotiations or an imbalance in negotiating power, and whether and how more guidance might be appropriately provided;

(b) (**Issue 2**) whether the WARAR's ambiguity about when an extension and expansion proposal can be made is a barrier to access negotiations or an imbalance in negotiation power and, if so, whether to accept a previous ERA recommendation to provide clarity; and

(c) (**Issue 3**) whether there is uncertainty about the extent to which, for brownfields investments, extension and expansion costs are recognised in the pricing provisions.

The following sections of this submission provides feedback on these issues, as well as a number of other issues.

6.2 Meaning of "capacity"

The particular issues and questions identified in the Issues Paper are concerned with how an expansion is to proceed and the ambiguity associated with when extension and expansion proposals can be made.

There is, however, a more fundamental issue in relation to capacity expansions and extensions. It relates to the meaning of "capacity" under the Code.

CBH considers that the current definition of "capacity" is uncertain and that there is scope for parties to apply different meanings to the term (and, perversely, for a different interpretation to be applied to each access proposal). For example, parties may interpret "capacity" as referring to the underlying infrastructure capacity of the particular route, or on the other hand, as referring to the current state of repair of the route.

However, arbitrations under the Code are private and are not binding on subsequent access proposals. The meaning of the term therefore needs to be clarified, to ensure it is interpreted consistently by all parties.

CBH submits that, on a proper interpretation, capacity refers to the underlying infrastructure capacity of the particular route, and not its current state of repair. CBH notes that the ERA has supported this interpretation. In its determination of costs relevant to CBH's access proposal (dated 30 June 2014), the ERA stated that it:

> "…considers that the Code refers to extensions and expansions in the sense of creation of capacity in excess of the existing MEA specification of the route. The ERA considers that restoring capacity on the

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[142] Issues Paper, at p.17.

> Tier 3 routes would not be considered an extension or an expansion in that sense, but more properly a repair or restoration as this would bring capacity back up to the MEA standard."[143]

CBH therefore submits that the meaning of "capacity" under the Code should be clarified to refer to the underlying infrastructure capacity of the particular route, and not its current state of repair.

6.3 Issue 1: Level of detail in the Code

CBH's responses to the particular questions in the Issues Paper in relation to Issue 1 are as follows.

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

The Issues Paper notes that, in contrast to other rail access regimes, "[t]he Code does not provide detail about how an expansion, if required, will proceed". It further observes that "[t]his 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".[144]

CBH agrees that the WARAR lacks detail about how required extensions and expansions are to proceed. It also agrees that the consequent uncertainty increases risk.

In CBH's view, that uncertainty creates a barrier to access negotiations and an imbalance in negotiating power. It provides a railway owner with the opportunity and ability to delay negotiations, extract unreasonable prices for extensions and expansions by exploiting its monopoly power, and to exploit the information asymmetry that it enjoys. At a practical level, it also makes it difficult to assess competing access options.

(b) Question 3.2: If more guidance is provided under the Code, which of the approaches outlined above (a or b) [in the Issues Paper] would be most appropriate?

CBH considers that, as a matter of principle, the provision of further guidance under the Code may assist in overcoming the barrier to access negotiations and imbalance in negotiating power.

However, it is important to ensure that the further guidance does not, in and of itself, provide a further barrier to negotiations and imbalance in negotiating power. This might occur if, for example, detailed, bureaucratic procedural requirements are prescribed that allow the railway owner to delay the extension/expansion, or to impose onerous pre-conditions to progress with the extension/expansion process.

CBH's general position is that questions of capacity should not be threshold issues for the commencement of negotiations. The preferred position is that extensions and expansions be a matter that is addressed in commercial negotiations (with recourse to arbitration in the event the parties cannot agree). Further, the onus in relation to capacity and extension/expansion issues should shift to the railway owner.

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143 ERA, Determination of costs relevant to CBH's access proposal dated 10 December 2013 (dated 30 June 2014) at paragraph 71.

144 Issues Paper, at p.17.

Accordingly, CBH is prepared to offer guarded support for the provision of more guidance in relation to extensions and expansions. It will, however, be necessary to ensure that any guidance is consistent with CBH's position as outlined in these submissions.

CBH does not have a fixed view about which of the approaches outlined in the Issues Paper would be most appropriate. Having said that, it does seem that option "a" - outlining a high level set of principles to guide the negotiation – may better address CBH's concerns than option "b" - a more detailed process which sets out the steps to be taken in developing a project from concept, pre-feasibility and feasibility studies.[145]

In addition, CBH has reservations about whether it is feasible to develop a model along the lines of option "b" that applies to all railways. If that option were to be adopted, then it would be worth exploring whether to require each railway owner to prepare, and have approved by the ERA following public consultation, an extensions and expansions policy as a Part 5 instrument.

6.4 Issue 2: Clarity around timing of an expansion proposal

CBH's responses to the particular questions in the Issues Paper in relation to Issue 2 are as follows.

(a) Question 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?

CBH submits that it is necessary to clarify the meaning of sections 8(4) and (5) of the Code so that there is certainty that a proponent can propose an extension or expansion at any time after making a proposal.

The effect of the Code must be to allow the parties to propose extensions or expansions at any time, including before or during negotiations. Clause 6(4)(j) of the CPA, read together with clause 6(4)(a), requires that matters of extension and expansion should be subject to negotiation between the parties. To properly facilitate such negotiations, it must be possible for an access seeker to propose an extension or expansion at any time.

Further, the failure to specify an extension or expansion in an access proposal should not provide a reason for the railway owner to refuse to deal with the proposal (or to claim that it is not a valid proposal).

In CBH's view, the lack of clarity around this issue has led to a barrier to access negotiations proceeding. In addition, it tilts the balance of negotiating power in favour of the railway owner who, having the incentive to exercise its market power, is then given the ability to use that power by refusing to reach the point of negotiations unless and until it is satisfied about any proposals for an extension or expansion that may need to be made. This is exacerbated by the requirements of section 15 of the Code, as discussed above.

Following receipt of CBH's access proposal, AI claimed that CBH could not seek access to certain routes that it claimed had no capacity (i.e. the Tier 3 lines). AI then refused to deal with CBH in relation to those lines and claimed that CBH's proposal was not valid in relation to those lines, unless and until CBH specified an

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[145] If CBH's submissions in relation to section 15 are not accepted, then CBH will need to consider whether option "b" may be more appropriate. CBH requests further public consultation if that is the case.

extension or expansion. The railway owner should not be permitted to dispose of an access proposal in this way.

The ERA itself has acknowledged this position, in the TPI Section 10 Decision. The ERA stated, at page 5, that it was:

> "…of the view that the failure to specify an extension or expansion in an access proposal does not invalidate the [access proposal]".

(b) Question 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?

CBH made submissions to the effect set out above to the ERA in the course of its 2015 Code Review. Following those submissions, as well as similar submissions made by others, the ERA made Recommendation 4. Accordingly, CBH generally supports the implementation of the recommendation.

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

Issue 3 is discussed in Part 7 of this submission.

7. PRICING MECHANISMS

7.1 The Issues Paper (section 3.4)

The Issues Paper notes that the WARAR provides for an access seeker and a railway operator to negotiate the price for access to a route. In general terms, the access price must fall within the range established by the "floor price" and "ceiling price" for the route.

The Issues Paper then discusses three important issues in relation to this pricing model:

(a) (**Issue 1**) that the WARAR does not provide for the regulator to approve a "benchmark" or "reference" tariff (or tariffs) for access to a service (or services);

(b) (**Issue 2**) the WARAR's idiosyncratic use of a "gross replacement value" (**GRV**) methodology in determining the capital cost component of access charges; and

(c) (**Issue 3**) uncertainty in relation to pricing for major expansions.

The following sections of this submission provide feedback on these important issues.

7.2 Issue 1: Indicative tariffs

In Part 4 of these submissions, CBH submits that the spread of potential access prices between the floor price and ceiling price results in a lack of up-front certainty in relation to potential pricing outcomes under the WARAR. As a result of that uncertainty, access seekers are significantly dissuaded from using the WARAR to seek access. The railway owner may then have the opportunity to use its market power in "out of Code" negotiations.

This concern was supported by the Committee in the Freight Rail Network Inquiry. It stated that:

> "…the fact that the Code permits such a vast gulf between nominated floor and ceiling costs limits the usefulness of these parameters in any negotiation."[146]

The uncertainty associated with the extreme spread of potential access prices is compounded by the limited regulatory oversight of the price-setting process. Section 21 of the Code allows a proponent to apply to the ERA for an opinion as to whether or not the price sought by the railway owner in negotiations for an access agreement meets the requirements of clause 13(a) of Schedule 4. However, that opinion is not binding and is for the information of the applicant only. As described in the Freight Rail Network Inquiry, this is essentially an "empty provision" and "irrelevant, which effectively means that the ERA has no role in establishing specific access prices".[147]

In contrast, other access regimes involve a more transparent method of determining access prices, based on the setting of reference prices that are approved by a regulator. For example:

(a) Under the ARTC IAU, ARTC commits to offering indicative services at indicative access charges set out in the undertaking.[148] The level and structure of these charges are reviewed and approved by the ACCC as part of its approval of the undertaking.

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146 Freight Rail Network Inquiry, paragraph 6.37.

147 Freight Rail Network Inquiry, paragraph 5.18.

148 ARTC IAU, section 4.6.

(b) Under the Victorian *Rail Management Act 1996* (Vic), the railway owner is required to submit an access arrangement for approval by the regulator, including the price to be charged in respect of the provision of each reference service.[149] The regulator must then determine whether to approve the access arrangement, having regard to the pricing principles and Pricing Principles Order.[150] This leads to the development of approved reference tariffs for each reference service. For example, under Pacific National's access arrangement for the South Dynon Terminal Access Arrangement (approved in June 2012 and as varied from time to time), Pacific National offers and publishes set reference prices for nine different reference services (under Annexure D).

(c) Under the *Queensland Competition Authority Act 1997* (Qld), the Queensland Competition Authority may require an access provider to develop a draft access undertaking for approval, and to give an access seeker a "reference tariff" (which is a price, or a formula for calculating a price, that has been approved by the authority), to set the basis for negotiation of the price for access to the service under an access agreement.[151]

CBH believes that a similar reference tariff approach should be adopted under the WARAR. This would provide certainty for access seekers that there is a reference price in place, and would address the information asymmetry between the access seeker and railway owner and set the scene for fair and reasonable negotiations. Greater regulatory scrutiny over the price-setting process, and monitoring over the railway owner's performance, pricing and revenue, should also be introduced to ensure the railway owner is held accountable for complying with the pricing principles and is not permitted to misuse its market power.

As part of this approach, the access seeker and railway owner could be given the freedom to negotiate away from the reference price – on the basis that it is merely a reference point for a standard reference service provided on a route – to better reflect the nature of the risks and rewards associated with particular access proposals. This approach, which is generally consistent with that found in other access regimes (such as the NGL and Electricity Networks Access Code), would ensure that economically efficient outcomes can be achieved (e.g. by avoiding the extraction of monopoly rents by eliminating prices in excess of those that would be found in a workably competitive market).

CBH's responses to the particular questions in the Issues Paper in relation to Issue 1 are as follows.

(d) Question 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?

For the reasons set out above, CBH considers that the benefits of having approved indicative tariffs are likely to outweigh the costs.

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149 *Rail Management Act 1996* (Vic), sections 38W and 38X(1).

150 *Rail Management Act 1996* (Vic), section 38ZF; Rail Network Pricing Order 2005.

151 *Queensland Competition Authority Act 1997* (Qld), sections 101 and 133.

CBH is not convinced that the efficient incremental costs of requiring railway owners to prepare and approve indicative tariffs would be significant. Railway owners, such as AI, already know the costs of their operations and their desired pricing on a route-by-route basis, and readily have this information available for "out of Code" negotiations. It therefore seems that the only relevant costs would be their engagement in the approval process, as well as the ERA's costs in the approval process (assuming it approves the indicative tariffs).

On the other hand, the benefits of having indicative tariffs are likely to be significant. While not easily measurable, they are likely to include greater certainty in the WARAR negotiate-arbitrate process and greater use of that process. Both of these factors are likely to lead to more efficient access pricing and terms and conditions, and to promote competition in dependent markets. For these reasons, CBH considers that having approved indicative tariffs will provide certainty for access seekers in relation to potential pricing outcomes under the WARAR. It will address the information asymmetry between the access seeker and railway owner and set the scene for fair and reasonable negotiations.

Accordingly, CBH considers that the answer to this question, based on the limited set of circumstances in "a.", "b." and "c." of the question, is "yes". However, CBH submits that the answer to the question would also be "yes" even if "a.", "b." and "c." were deleted from the question.

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

Questions 4.1 and 4.2 are based on a distinction between a given set of circumstances (as set out in Question 4.1) and "other circumstances".

That division seems to be based on a presumption that the given set of circumstances might justify the imposition of the "regulatory burden" of having indicative tariffs. By implication, requiring indicative tariffs in "other circumstances" would result in an "undue regulatory burden" (an implication that CBH does not agree with, for the reasons set out below).

The given set of circumstances appears to be drawn from the ERA's draft report in relation to its 2015 Code Review. That set of circumstances was drawn from a submission from one of the railway owners, AI. CBH asked Frontier Economics to consider that set of circumstances put forward by AI, and accepted by the ERA, and whether there were any other circumstances that justified requiring approved indicative tariffs. In its report, Frontier Economics stated:[152]

> "These circumstances appear to be *sufficient* but not *necessary* (or the only) reasons for more prescription.
>
> We do not consider these circumstances are necessary to support more prescription via reference tariffs. More prescription is justified because:
>
> - The Code offers no guidance as to how parties should negotiate where track is not close to replacement condition (and where the negotiation range is so large as to be meaningless).
> - It is unclear what economic relationship GRV should have with actual investments made by rail providers (e.g. where in practice there has been no capital investment for a long period, should the access price offered be a long way below GRV?).

[152] Note that Frontier Economics refers to "reference tariffs" rather than "indicative tariffs". There is no substantive difference between the two.

- The most obvious reference point for access prices where assets are not in replacement condition are the marginal costs of access plus a reasonable return on capital actually invested (or agreed investment), but there is no information produced during the Code processes which would help with establishing these costs.

Even if the ERA is not minded to recommend a 'prescriptive' approach for the Code, it should recognise that as it stands the Code does not provide any real guidance about the likely approach of an arbitrator in an access dispute. This lack of information hinders negotiation.

The Guidelines in s.13 of the Code essentially provide the only further guidance point: that prices should reflect the standard of the infrastructure concerned. However, it is not clear how this should be reflected – particularly when the GRV ceiling is supposed to be an estimate of all costs that would be incurred by the access provider in supplying the service in the long run.

An example of the kind of information that is lacking was produced by the ACCC in its (previous) arbitral role in telecommunications. Its Access Pricing Principles were designed to inform interested parties of the principles that would guide the Commission when considering access pricing issues for declared services under Part XIC. These provided more specific detail about how the general pricing concepts in Part XIC (e.g. relating to efficient use of, and investment in, infrastructure) would be interpreted using specific costing concepts. Further:

> …although these principles are not intended to unreasonably limit the outcomes of commercial negotia ions, an indication of the approach the Commission will take in arbitrating disputes may assist parties in commercial negotiations by narrowing the boundaries for those negotiations. For the same reason, these principles may also be a useful tool in alternative dispute resolution processes.

There is no guidance of this form provided in the Code." [153]

CBH submits that the arguments advanced by Frontier Economics were correct in 2014 and remain so today.

Based on these arguments, and for the reasons set out above, CBH considers that the benefits of having approved indicative tariffs beyond the circumstances set out in Question 4.1 outweigh the costs (noting that CBH is not convinced that the relevant incremental costs are likely to be significant).

If the Government is not prepared to move to a prescriptive pricing model across all access services, then CBH considers that there will continue to be a substantial efficiency loss across the WA economy. To minimise that loss, the Government would need to at least ensure that the WARAR requires ongoing and regular assessments of whether a railway owner's costs reflect the efficient costs that would be incurred by a prudent railway owner.

At a minimum, CBH submits that the Code requires amendment to reflect clause 6(5) of the CPA. This relevantly provides that:

> "A State … access regime … should incorporate the following principles: …
>
> (b) Regulated access prices should be set so as to:
>
> (i) generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services and include a return on investment commensurate with the regulatory and commercial risks involved;
>
> (ii) allow multi-part pricing and price discrimination when it aids efficiency;

[153] Frontier Economics, "Response to the ERA's draft report on the WA Access Code Review", October 2015, at section 2.3.5, footnotes omitted.

(iii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other third parties is higher; and

(iv) provide incentives to reduce costs or otherwise improve productivity."

Clause 6(5) was inserted into the CPA after the Coalition of Australian Governments agreed to amend it under the CIRA. It was not part of the CPA when the Code was originally made, and it has not been expressly incorporated into the Code in subsequent amendments. This opens the door for railway owners to argue for inefficient costs.

In particular, section 29(1) of the Code sets out what the arbitrator must do in hearing and determining a dispute. It relevantly provides that the arbitrator must "take into account the matters set out in clause 6(4)(i), (j) and (l) of the [CPA]". CBH submits that this section should be amended to expressly require the arbitrator to also take into account the matters set out in section 6(5)(b) of the CPA.

CBH expects that railway owners will object to this approach on the basis that placing primacy on "efficient costs" places too much weight on "technical / productive" efficiency, and insufficient weight on "allocative efficiency" and "dynamic efficiency". CBH submits there is still scope for an arbitrator to account for those matters in pricing and, in particular, other terms of access, while still placing primacy on efficient costs. CBH also submits that such considerations are more likely to be relevant when a route is close to full capacity (as CBH considers the term should be defined).

7.3 Issue 2: Assessing the capital charge using GRV

CBH's firm view is that the ceiling price:

(a) does not provide a suitable constraint on the total price that can be charged by a railway owner; and

(b) allows a railway owner to recover costs as if it were "gold plating" (when, in fact, it is not).

That is because the ceiling price methodology is based on the GRV, which is basically the cost of building a replacement network (based on modern equivalent assets). It does not reflect the current standard of the network. While it may be reasonable to use a "modern equivalent asset" approach when dealing with a new railway, many of the grain lines that are leased by AI are over 100 years old. Therefore, a price methodology that uses a modern equivalent asset to determine what the price should be to run on that asset is flawed.

CBH has identified the following issues with the use of GRV methodology:

(a) **No link with performance standards** - The use of GRV methodology (based on modern equivalent assets) leaves the access seeker in a difficult position when a railway owner's performance standards associated with the ceiling price (i.e. a brand new railway) are in excess of what is required (a point supported by the Freight Rail Network Inquiry). That is because the ceiling cost pertains to brand new infrastructure that exceeds the current requirements, and that also exceeds what the railway owner is currently willing to provide. This allows the railway

owner to effectively price on a "gold plated" basis when determining its ceiling costs. This is an unrealistic parameter for access agreement negotiations.[154]

(b) **No incentive to invest in the network** - The GRV methodology also fails to provide an incentive for the railway owner to invest in developing or maintaining the network. Instead, the railway owner is already compensated on the basis that it has invested in a new network. This creates a strong incentive for the railway owner to delay the cost of investing in new or replacement infrastructure. This problem was recognised by the ACCC when applying a methodology equivalent to GRV to set prices for telecommunication services. The ACCC observed a comment made by Telstra to a Senate Committee that:

> "…the [cost] models [are] actually already optimised, so the cost pool out of which access prices are determined is already in place and in fact is already almost a [FTTN] network. What that means is that we could spend multiple billions of dollars doing a [FTTN] roll-out – multiple billions – and the total cost pool we are allowed to recover from wholesale and retail prices would not go up a jot."[155]

Evidence of this problem is also clear from the state of the WA grain rail network. CBH has been using many of the lines on the network since CBH was established in 1933. However, AI's costing principles (approved by the ERA in April 2011) (**Costing Principles**) appear to show that it is using much lower annuity lives in calculating the GRV for the purpose of the ceiling price determination.[156] The fact that AI has contended that the Tier 3 lines have no capacity, and has attempted to place them in "care and maintenance", also shows its failure to invest in new or replacement infrastructure on these lines. The Freight Rail Network Inquiry also stated that "an inadequate portion of fees paid since 2001 for access to certain line segments has been reinvested into those lines."[157]

While the floor price is set low, it is likely to be closer to the level of prices that should be charged in line with the efficient pricing principles – i.e. a level that is sufficient to cover efficient costs and provide a return on investment in line with the risks involved in the provision of access.

(c) **Complex and flawed** - As explained by Frontier Economics in the Frontier Report, the GRV approach:

(i) is complex and not transparent to access seekers, as it relies on a "hypothetical" estimation of optimised replacement costs, which cannot be tied to current investments;

(ii) appears to be implemented in a way that has the potential to enable railway owners to recover more than efficient costs; and

(iii) appears to be based on the flawed premise that sending "build or buy" signals to access seekers will promote economically efficient outcomes when, in fact, they do not because a naturally monopolised market is one in which it is efficient for a single supplier to meet all demand.[158]

(d) **Out of step with reality** - The GRV approach is grossly out of step with what has actually happened in Western Australia, and the actual state of the railway

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154 Freight Rail Network Inquiry at paragraph 6.38.

155 Senate ECITA Commission, 13 February 2016, page 75.

156 Costing Principles (approved by the ERA on April 2011) (**Costing Principles**) at section 2.4 and Annexure 7.1.

157 Freight Rail Network Inquiry at paragraph 6.24.

158 Frontier Report at section 3.3.2.

network. Specifically the GRV methodology calls for a hypothetical assessment of the cost to build a new railway network in circumstances in which the existing railway network is, for many routes relevant to the grain freight network, over 100 years old and built using very different technologies and techniques. This results in an estimated capital cost that is completely inconsistent with the value of the existing network.

In the case of the grain freight network, this issue is compounded by the fact that AI originally acquired control of the network through leases from the State, and not by constructing the network itself. The total lease price paid by AI in December 2000 (then called WestNet Rail Pty Ltd) was $321,717,627.78 (including GST) for the entire railway network. CBH understands that this price was determined through competitive tender, and therefore represents a "market price". CBH believes that this actual purchase price is of fundamental significance, and is a factor which must be taken into account in determining an economically efficient price.

Even accounting for inflation, the acquisition price is significantly lower than the estimated GRV of $6.2 billion (let alone annual ceiling price of $526 million per annum), which are only for the grain network, and not the entire railway network. Despite this, the Code does not expressly prevent AI from receiving revenue up to the ceiling price, which would allow it to earn returns many orders greater than the long term weighted average cost of capital.

This effectively places AI in a position to earn monopoly rents on its investment in the railway network, at the expense of access seekers including CBH. This does not advance the objectives of the Code.

For these reasons, CBH strongly favours a move away from the GRV methodology and the adoption of an alternative approach.

In its response to the ERA's draft decision on the 2015 Code review, Frontier Economics outlined the benefits of moving to an asset valuation methodology in the WARAR (which it called a "line in the sand" approach). It said:

> "As we expressed in our submission, moving from a periodic revaluation approach such as GRV to a 'line in the sand' approach to asset values is likely to better achieve the objects of the CPA. Under the 'line in the sand' approach, no periodic revaluation of the asset base would occur going forward; rather, an initial asset value would be established by some suitable method, and that value would fall over time as assets are depreciated, and rise over time as new capital expenditure is incurred. This would:
>
> - Remove asset valuation as a source of dispute between access seekers and asset owners.
> - Remove a source of information asymmetry between the parties (since railway owners typically have better information about their own assets than do access seekers).
> - Move away from a regime that, at least in principle, tries to encourage inefficient duplication of natural monopoly infrastructure (by sending inappropriate build-buy signals to access seekers).
> - Prevent inefficient income transfers from access seekers to access providers.
> - Provide better incentives for investment, as there is a direct link created between investment and cost recovery." [159]

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159 Frontier Economics, "Response to the ERA's draft report on the WA Access Code Review", October 2015, at p.5 (footnotes omitted).

For the reasons set out above, CBH strongly supports the use of a "line in the sand" approach in place of the current GRV methodology.

CBH's responses to the particular questions in the Issues Paper in relation to Issue 2 are as follows.

(a) Question 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?

As outlined above, CBH strongly supports the use of a "line in the sand" approach in place of the current GRV methodology.

The EAB methodology proposed by the ERA in its 2015 Code Review incorporated the use of a "rolled forward capital value, incorporating depreciation". This would then "reflect the written down value of the route rather than replacement value".[160] If that proposal is appropriately implemented (using a suitable measure of depreciation - e.g. based on assumed residual asset lives), then in the ERA's view, that should result in more realistic opening asset values, particularly on the Tier 3 routes.[161]

In CBH's view, this would provide more effective guidance to access seekers as to the likely asset charges under the WARAR, and reduce investment risks in relation to extensions and expansions.

However, CBH does not agree with the view of the ERA in so far as it found that "the determination of Total Costs (as the maximum allowable revenue) over a fixed regulatory period is warranted…".[162] The reason the ERA came to that view was that regular reviews "would involve an unnecessary increase in prescriptiveness within the negotiate-arbitrate framework".[163] Rather, it appears the ERA believes that there should be an initial value established and approved, but that the value will only be updated and visible to access seekers if and when they seek access.[164]

In CBH's view, it is imperative that the EAB and adjustments to it are periodically reviewed and approved (or not approved) by the ERA. Otherwise, there is a high risk that the EAB will not address the information asymmetry enjoyed by the railway owner, allowing it to continue to use its market power as outlined in Part 3 of these submissions. Not having regular, periodic reviews by the ERA of adjustment to the asset value (in the form of depreciation, additions and removals) will seriously compromise the effectiveness of the new EAB mechanism.

At the same time, it is unclear to CBH how implementing such reviews would significantly increase the burden on either the regulator or railway owners. As Frontier Economics pointed out:

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160 2015 Code Review at para 128.

161 2015 Code Review at para 135.

162 2015 Code Review at para 137.

163 2015 Code Review at para 137.

164 For example, see the discussion in the 2015 Code Review at para 138.

> "We recognise that moving to a line in the sand approach will require the regulator to have an ongoing role in recording the regulatory value of assets (i.e. via a set of regulatory accounts). This will require certain changes from the current regime. However, in terms of the overall net burden on the regulator (and regulated firms), it is far from clear that this approach would be more burdensome than the current approach." [165]

CBH therefore submits that the Government should introduce such a review mechanism.

(b) Question 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?

CBH anticipates that railway owners, including AI, will have comments in relation to the specific consequences for owners of changing from a GRV approach to an EAB approach. CBH considers that it is appropriate to wait until that occurs before commenting on the consequences, on the basis that individual railway owners are likely to face different consequences.

CBH requests the opportunity to respond in due course those concerns have been articulated. For present purposes, CBH concurs with the following observations made by Frontier Economics:

> "Railway line owners have previously argued that a change away from the GRV approach to asset valuation is likely to have serious adverse effects on their financial interests. In respect of this argument, we make two observations:
>
> - Firstly, if the financial interests of access providers are reliant upon income transfers from access seekers, deterioration in those financial interests should not be a relevant consideration to the setting of access prices.
>
> - Secondly, the legitimate financial interest of the access seeker would not be adversely affected if the alternative to the GRV approach satisfies the principle of financial capital maintenance. In other words, if access prices are set in such a way as to allow the owner to recover its initial investment in the asset, and a fair return on that investment, the asset owner should be able to meet all its costs (including the opportunity cost of funds of its investors). Access prices based on increasing GRVs over time would lead to over-recovery of the asset owner's initial investment (including a commercial return that is commensurate with risks) and, therefore, inefficient overcompensation to the access provider's investors. [166]

As such, and subject to considering any submissions made by railway owners, CBH supports the change to an EAB approach.

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165 Frontier Report at section 3.5.

166 Frontier Report at section 3.3.3.

(c) Question 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?

CBH considers that the design of the pricing mechanism should be the subject of careful and separate review if the EAB valuation method is applied. CBH encourages the Government to examine in detail a range of mechanisms with different design options, with appropriate consultation with interested parties, to ensure that the pricing mechanism is designed so as to achieve the WARAR objective. CBH would be pleased to participate in that process, including in a steering committee or working group structure.

Accordingly, CBH reserves its position on each of these questions. Having said that, CBH's general comments at this stage are as follows.

(i) If the EAB valuation method is to be applied, then other elements of the pricing provisions should as a matter of principle be consistent with that method. It is important the pricing model has integrity and is consistent across all of its elements – a piece-meal solution of inconsistent elements is highly undesirable.

(ii) In general terms, a railway owner should be entitled to recover the efficient total costs it incurs in providing access. Those total costs would be the sum of operating costs, a return of capital, and a return on capital.

(iii) In response to "a." above, it follows that capital costs may be the sum of depreciation (return of capital) and return on capital.

(iv) In relation to depreciation (return of capital), CBH does not currently have a view as to whether there should be flexibility in the depreciation schedule, but is open to considering the merits of the issue. The Issues Paper does not deal with this issue in depth, so it is unclear how the Government proposes that flexibility would operate and when (other than "where circumstances warrant").

(v) CBH considers that extensions and expansions should as a matter of principle be included in the EAB, subject to certain conditions. A railway owner should not be entitled to add capital expenditure on an extension or expansion just because it incurs that capital expenditure. The precise conditions would need to be carefully considered and designed, alongside more rigorous tests in relation to the additional capital expenditure more generally. Issues to be considered would include:

(A) the treatment of extensions and expansions funded by persons other than the railway owner;

(B) the treatment of user specific facilities; and

(C) the design of an appropriate regulatory test that is to be satisfied before the addition of capital expenditure to the capital base.

In relation to the regulatory test, CBH considers it important to ensure that the relevant capital costs do not exceed efficient costs (having regard to economies of scale or scope and the increments in which capacity can be added, and whether the lowest sustainable cost of providing access to the relevant services forecast to be sold over the relevant period requires the capital expenditure). Further, the railway owner should be required to demonstrate that incremental revenue will exceed the capital cost, that the capital expenditure provides a net benefit that justifies a higher tariff, or that the underlying works are necessary to maintain the safety or reliability of the regulated routes.

(vi) The inclusion of extensions and expansions in, and the subtraction of depreciation from, the EAB implies that the EAB will be adjusted over time to reflect changes in the underlying assets. Consistent with this, the EAB should also be adjusted to remove redundant assets.

(vii) Under the WARAR, if modern equivalent assets are determined to be appropriate, then the operating costs are to be the costs that would be incurred were the infrastructure replaced using those modern equivalent assets.[167] Conceptually, this gives rise to a risk that those costs differ from the actual efficient costs of the railway owner who, in reality, may be operating an old railway network. To address that risk, CBH can see that there may be benefits in defining costs used to determine the incremental and total costs to better align with efficient costs for (at least) the period for which access is sought, given the actual age and condition of the assets. However, in doing so, it would be important to ensure that this does not provide railway owners with the opportunity to recover costs that they may not actually incur because they do not actually maintain old and run down assets. In addition, it would be important to ensure that the railway owner can only recover efficient costs and to provide a mechanism to challenge the veracity of those costs.

(viii) In its 2015 Code Review, the ERA recommended that clause 2 of Schedule 4 of the Code be amended to provide for an EAB valuation in place of the GRV approach, and that other parts of the Code be amended to accommodate an EAB basis for valuation (Recommendation 2). It further recommended that, if Recommendation 2 is adopted, the Code also be amended to include a new Part providing for merits review or other non-judicial review of the regulator's cost determinations (Recommendation 3) on the following basis:

> "By using this approach to determining costs, the regulator's decisions would appropriately be open to review, due to the increased prescriptiveness of determining capital costs using an EAB approach, as opposed to the GRV approach."[168]

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167 Code, Schedule 4, clause 1.

168 2015 Code Review at para 159.

CBH agrees with the ERA and believes that merits review should be made available for ERA decisions on costs.

7.4 Issue 3: Uncertainty about pricing for major expansions

As discussed above, CBH agrees that the WARAR lacks detail about how required extensions and expansions are to proceed. This consequent uncertainty increases risk and creates a barrier to access negotiations and an imbalance in negotiating power. It provides a railway owner with the opportunity and ability to delay negotiations, extract unreasonable prices for extensions and expansions by exploiting its monopoly power, and to exploit the information asymmetry that it enjoys.

CBH considers that the same issues exist in relation to the lack of guidance in the Code about the pricing of expansions.

CBH's responses to the particular questions in the Issues Paper in relation to Issue 3 are as follows.

(a) Question 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?

For the same reasons that CBH set out in relation to uncertainty about how required extensions and expansions are to proceed, CBH considers that the lack of guidance in the Code about the pricing of expansions creates a barrier to access negotiations and an imbalance in negotiating power when expansions are required.

(b) Question 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?

For the reasons set out, CBH considers that the use of an EAB in the determination of floor and ceiling costs would assist the WARAR negotiation process. As a general proposition, CBH also considers that the inclusion of expansion costs may also assist in the negotiation process.

The use of an EAB and inclusion of expansion costs would enable access seekers to better understand the costs of providing access and, therefore, the prices they are likely to pay for access. If the EAB and expansions costs mechanism is properly designed it should provide transparency and enable access seekers to understand whether access on various routes (or pathways) is economically viable at various demand levels.

However, CBH believes that much will depend on the design model used for the mechanism. CBH is keen to work with the Government on that design.

(c) Question 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?

CBH has a number of serious concerns in relation to the over-payment rules in other parts of this submission.

In relation to this question, CBH considers that inconsistency as to how the costs, including expansion costs, are assessed for the purpose of an access proposal, and the subsequent assessment of costs for the over-payment rules or later access

applications, creates a risk that the railway owner will not recover the costs or over recover costs for the reasons outlined in the Issues Paper.

However, the risk of over-recovery is much greater than the risk of under recovery. This is largely due to the lack of transparency in relation to the extent to which the railway owner scopes, carries out the work and obtains funding from access seekers for expansions (e.g where it might secure funding for the same expansion from more than one user, or extract funding well in excess of the efficient cost of an expansion).

These risks highlight the inadequacies of the current pricing mechanisms under the WARAR and provide further support for the implementation of an EAB approach.

As noted above, CBH considers that the design of the pricing mechanism should be the subject of careful and separate review if the EAB valuation method is to be applied. CBH would be pleased to participate in that process.

8. MARGINAL FREIGHT RAIL ROUTES

8.1 The Issues Paper (section 3.5)

The Issues Paper observes that Schedule 1 of the Code specifies routes to which the Code applies, including a number of 'Tier 3' rail lines that were closed after July 2014. It also notes that sections of those closed lines are still listed in Schedule 1 of the Code and therefore remain subject to the provisions of the Code.

The Issues Paper also acknowledges that the Committee discussed some of the limitations of the regulatory regime for the freight rail network, particularly the "limited role of the regulator in price setting, concerns about timeliness and a lack of transparency in the access application/price setting process".[169]

The Issues Paper then goes on to discuss a single issue: the coverage of marginal routes and asks three questions. This Part of the submission responds to those questions.

8.2 Question 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?

CBH considers that the issue of "marginal routes", as they are described in the Issues Paper, is fundamentally important. Those routes form an important part of Western Australia's grain freight network.

The Committee explained the importance of the network, including the "marginal routes", at length in its Freight Rail Network Inquiry report.[170] CBH does not repeat that analysis in these submissions, but wishes to stress the importance that "marginal routes" play in CBH's supply chain and for growers and the regional communities in which they are located (as discussed elsewhere in these submissions).

It is imperative that CBH is able to secure ongoing sustainable access to those routes. Access is the only means by which the routes can be utilised and the benefits associated with them realised. And, as CBH has not been able to secure access in commercial negotiations with AI, the WARAR is the only way of achieving that.

If AI is not obligated to negotiate for access to those routes, then there will be no way to ensure that significant infrastructure that CBH and growers want to use can actually be used. The real risk – borne out of experience – is that AI would move to close them down or, in what amounts to the same thing, put them in "care and maintenance". If that occurs, then the benefits associated with the routes are likely to be lost.

In addition, it is important to recognise that the "marginal routes" act as feeder lines into the major routes on the grain freight network. As such, they provide an important source of freight for the major routes and contribute to the economic viability of the major routes. There is no guarantee that all of the freight associated with the "marginal routes" would continue to be fed onto the major routes if access is denied to the "marginal routes". For example, some of the freight could shift to road based transport, with the adverse consequences that would have for road safety and the well-being of communities along the road transport system or. Alternatively, some farms could cease to operate as they may not be viable at the increased road rates.

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169 Issues Paper, at 3.5.1.

170 See the Freight Rail Network Inquiry, including the Chairman's Foreword at page 5, Chapter 1 and Chapter 2.

In responding to this question, CBH has not answered it in the abstract way in which it has been posed. That is because the situation with the marginal routes is a very particular one that cannot be satisfactorily answered in an abstract way by asking about the position of a hypothetical "railway owner or manager". The fact is that AI took ownership of the network in the knowledge that it had been privatised on the basis that the WARAR provided for regulated access to all routes, including "marginal routes", so as to protect the public interest in the maintaining access to the whole network. CBH simply does not accept that it is now reasonable or good policy to allow AI to side-step the need to keep the routes operating by taking them outside of the WARAR.

CBH also notes that, if AI considers that it does not want to provide access to routes that it considers are "uneconomic to provide", then that implies AI no longer wishes to operate them. In that case, AI should be required to hand them back to the Government so that someone who is prepared to can operate and utilise them in recognition of their importance to local communities and the State of Western Australia. AI should not be entitled to hold CBH, growers and the State to ransom by refusing to negotiate access or divesting itself of the obligation to provide access to these State assets.

In addition, CBH notes that there would be something odd in a proposition that a railway owner should have its infrastructure removed from the scope of an access regulation regime because it claims access is uneconomic to provide, but then allows that railway owner to negotiate for access (including by refusing access) on a commercial basis unconstrained in the use of its monopoly power. This becomes even more unusual when it is left to the monopolist alone to determine whether and on what basis it is "uneconomic" to provide access.

Regardless of the above, CBH has no wish to force AI to provide access on a basis that is not truly economically viable and damaging to the network as a whole. Rather, it wishes to have the right to negotiate for access to the "marginal routes" under an access regime that allows (as a last resort) an independent decision maker to determine whether access is or is not economically viable and, if it is not, then the price at which access does become economically viable.

Further, to the extent that there is an issue about whether the "marginal routes" are economically viable because AI considers that CBH should pay higher access prices than it is prepared to pay, solutions may be available. For example, the Government could - acting as the ultimate owner of the relevant routes – fund any necessary and reasonable expansions on the routes (provided they have not fallen below acceptable standards due to AI's failure to appropriately maintain them), with CBH paying for the incremental costs of access. Or it may be possible to not carry out expansions and for CBH to continue to use them as they currently are.

Finally, CBH does not accept the paragraph in section 3.5.2 of the Issues Paper that seems to summarily conclude that it is questionable whether access to the marginal routes would satisfy the coverage criteria in the Act. CBH is concerned that this prejudges the issue in the absence of all of the available evidence in relation to the application of the criteria. For example, the reference to "current competition from road transport" seems to simply assume that road transport acts as a competitive constraint in relation to all of the "marginal routes", when that may not be the case.

8.3 **Question 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?**

CBH's strong preference is for additional guidance to be included in the WARAR in relation to the pricing of "marginal routes", rather than removing the routes from coverage under the regime.

In CBH's view, the issues associated with the pricing of access to such routes are more complex than those associated with other routes. They have been the subject of considerable debate between CBH and AI over the past 4 years. There is little doubt that the process of obtaining access would have been easier had the WARAR included additional guidance.

What CBH can say at this stage is that any guidance will especially need to deal with issues in relation to the railway owner's obligations to maintain the routes, appropriate performance standards, funding remediation works (including where the railway owner has permitted the condition of routes to fall below acceptable standards), the timing of expansions, the asset value attributed to the track, and track maintenance regimes.

8.4 **Question 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?**

The Issues Paper states that there is no mechanism in the WARAR to trigger a reassessment of the coverage of routes.

On CBH's reading of the Act, the Minister has the power to amend the Code.[171] That power extends to determining which routes are to be prescribed under section 4(2)(b), with the Minister required to consider the questions set out in section 5(3).[172]

It therefore seems to be the case that there may already be a mechanism to enable routes to be brought into and out of the WARAR. The trigger is a decision by the Minister acting at his or her discretion (e.g. at the request of a person) or following a review of the Code under section 12 of the Act.

However, CBH acknowledges that the existing mechanism lacks transparency and certainty. For that reason, CBH agrees that there would be benefit in amending the WARAR to provide a clearer, more enforceable and more transparent mechanism for seeking coverage and revocation of a railway infrastructure under the WARAR. It could reflect existing mechanisms under the National Gas Law, Part IIIA of the CCA and the Western Australian Electricity Networks Access Code (2004).

However, CBH would not agree with the inclusion of such a mechanism if it is not appropriately linked with the lessee's obligations under the privatisation lease for the rail freight network or if it allows "marginal routes" to be excluded from coverage. As discussed above, CBH believes that those routes should remain covered by the WARAR or that AI should divest itself of them.

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171 Act, sections 10 to 11B. Also refer to the Act, section 9 and the *Interpretation Act 1984* (WA), section 43(4).

172 Act, section 5(1).

9. CONSISTENCY WITH THE NATIONAL ACCESS REGIME

9.1 The Issues Paper (section 3.8.2)

The Issues Paper recognises that "…there are important differences between the Western Australian rail access regime, and the access framework that applies on the adjoining interstate rail network".[173] It also acknowledges that the NCC raised "several concerns" in 2011 when the WARAR was submitted for certification as an effective access regime under the National Access Regime.

The Issues Paper then focuses on:

(a) (**Issue 1**) the desirability of "consistency across access regimes" for both interstate and intrastate freight routes (other than those located in the Pilbara region); and

(b) (**Issue 2**) certification of the WARAR as an effective access regime under the National Access Regime.

This Part of the submission sets out CBH's views on these issues, as well as the need to move all rail access regime to a nationally consistent rail access law.

9.2 The need to move to a nationally rail access law

In its 2015 Code Review, the ERA recommended that:

> "The Government consider options to bring interstate services offered by [AI] on the interstate route under regulations consistent with the ARTC undertaking, in line with the 2006 Competition and Infrastructure Reform Agreement."[174]

At the time, CBH expressed support for the transfer of regulation of services provided by means of the route from Kalgoorlie to Kwinana to the ACCC, using the ARTC undertaking as a model.[175] However, CBH argued that <u>all</u> of the services provided by means of the AI network (not just those provided by means of the route from Kalgoorlie to Kwinana) should be transferred. This was CBH's position unless the Code was substantially amended to address the concerns raised by CBH, and other access seekers, during the ERA's review process.

As things stand today, the Code has not been amended at all, and all of CBH's concerns remain. And, unfortunately, CBH's experience in pursuing access under the WARAR since 2013 – including a full access dispute arbitration with AI - has now led it to conclude that the WARAR is fundamentally broken.

In CBH's view, it is not possible to tinker with the WARAR in a piece-meal fashion, as the ERA has previously recommended. The only sure way to ensure that there is effective and efficient rail access in relation to the AI network is to either fundamentally remodel the regime or abolish it and shift regulation to a national regulatory scheme.

Even if the WARAR is fundamentally remodelled in a way that addresses CBH's concerns, a number of issues would remain. The most important are:

(a) the resourcing and expertise of local regulatory and appeal bodies; and

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173 Issues Paper, section 3.8.1. That access framework is set out in the ARTC Interstate Access Undertaking, approved by the ACCC under the Part III of the CCA.

174 2015 Code Review at p.13, Recommendation 1.

175 That would require AI to submit an undertaking to the ACCC for approval under section 44ZZA of Part IIIA of the CCA.

(b) the inefficiencies that will result from having another State-based access regime that is inconsistent with rail access regimes in other States and Territories.

In CBH's view, the preferable option is to abolish the WARAR and shift regulation to a national regulatory regime that is consistent across all jurisdictions and administered by well-resourced national regulatory and appeal bodies that have the economies of scale and scope required to effectively regulate access in the rail industry. This could occur using the mechanisms already available under Part IIIA of the CCA, or through the development of a "National Rail Access Law".

While CBH acknowledges that such a move would require considerable work and reform, the benefits could be substantial. In addition, such models have already been developed for other nationally significant industries, such as the gas transmission and distribution sector.

9.3 Issue 1: Interstate freight routes

(a) Question 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?

The benefits of providing consistent access regulation for interstate services over their entire route include lower transaction and operating costs and a reduction in contractual and regulatory risk for access seekers. Access seekers will be able to achieve greater levels of efficiency due to the fact that they need only understand and operate under one set of consistent access laws.

CBH is not in a position to comment on the current wholesaling agreement due to a lack of transparency, but encourages the Government to treat with scepticism any claim that the current wholesaling agreement provides these benefits. The mere existence of that arrangement suggests an additional layer of complexity and risk.

Further, CBH notes that a request to transport oats from Western Australia to South Australia using the interstate route was not able to be processed with a single operator and two separate requests had to be made. In this instance, it does not appear that there was any benefit obtained from the wholesaling agreement. Ultimately, the price to move the freight between Perth and Kalgoorlie was the same as the much longer route from Kalgoorlie to Crystal Brook.

(b) Question 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 [AI] would be required to provide access to different services on the same route under different access frameworks; or

b. the interstate route, meaning that [AI] would be required to provide access to intrastate services using this route under two different access frameworks.

CBH's comments on sub-questions "a." and "b." are as follows.

Sub-question "a"

The scenario envisaged under "a." above suggests that access to interstate services would be regulated under the national access regime while services to intrastate services would continue to be regulated by the WARAR. That would be

the case regardless of whether those services are provided by means of the same infrastructure. Put another way, interstate services to a particular route would be available under the National Access Regime, while intrastate services would be available under the WARAR.

The most obvious consequence of this type of inconsistent treatment is that the way in which access is regulated (and, in that sense, made available and priced) would be determined not by reference to the use of the relevant infrastructure but by the purpose of that use.

Accordingly, an access seeker might, for example, pay a different price if it intends to run rolling stock across a route to an interstate destination, than if it wants to run it to an intrastate destination. That may be the case even though the use is fundamentally the same and the costs and risk of providing access are fundamentally the same. Similarly, access seekers may face the burden of ensuring that they understand and can operate under both regimes, depending on their intended use of the relevant infrastructure. They may also pay different prices, and operate under different terms and conditions, for the use of what is fundamentally the same service. That would then raise a question as to whether the application of the two regimes could lead to inefficient outcomes and additional cost.

In addition, a railway owner would be faced with the obligation of complying with the requirements of two different regulatory regimes in relation to the same infrastructure. It would also need to deal with the added complexity of ensuring that its aggregate returns under both regimes are adequate and sufficient to recover its efficient costs. This would presumably add a layer of additional cost, risk and inefficiency.

Further, there could be additional regulatory burdens associated with cost allocations for services provided under the two regimes and ensuring consistency between regulatory instruments under both regimes. For example, tensions could arise if there are conflicts between the requirements of regulators in relation to the types of policies that are currently Part 5 instruments.

In CBH's view, these factors suggest that this type of inconsistency should be avoided by moving all services to a national access regime.

Sub-question "b."

The scenario envisaged under "b." above seems to suggest that that access to intrastate services would be regulated by two access regimes - the national access regime and the WARAR. As CBH understands it, the national access regime would apply to the interstate route on the AI network and the WARAR would apply to all other parts of the AI network.

If that is the case, then an access seeker that wishes to run rolling stock on the AI network using the "interstate route" for part (but not all) of its journey would then be required to secure access:

(i) for the parts of the journey that use the interstate route, using the national access regime; and

(ii) for the parts of the journey that do not use the interstate route, using the WARAR.

This would directly affect CBH, which regularly operates rolling stock on this basis from agricultural areas through to Kwinana and the Port of Esperance.

This type of regulatory structure would require CBH to negotiate, enter into and operate under two different sets of access contracts under two different access regimes. This would lead to a high risk of inconsistency for CBH as well as adverse cost implications due to the need to understand and operate under two access regimes. It would also lead to consequences for the railway owner, of the type discussed in the Issues Paper.

CBH is concerned that such a proposal would lead to increased costs and lower efficiency in its rail operations, with consequent effects on grain growers and the WA economy.

CBH notes AI's summary of the issues raised by this proposal in its response to the ERA's draft report on the Code review in 2015. It observed that:

> "Simply transferring access regulation for the route would cause significant disruption to the regulation currently applicable to portions of many intrastate services by potentially subjecting them to an alternate method of access regulation…. It does not appear that this is the ERA's intention, but assuming continued applicability of the Code as the WA rail access regime, two regulators, two contracts and two regimes would exist for numerous individual tasks. This would represent an increased regulatory burden for both the railway owner and users alike and something which needs to be taken into account in the ERA's decision."[176]

It is, therefore, the case that CBH and AI share similar concerns about this model. Where the two depart is in relation to what that then means.

In CBH's view, these concerns can be eliminated by abandoning the proposal and moving all services (and routes) to a national access regime along the lines discussed above.

(c) Question 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 [AI] 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?

For the reasons discussed above, CBH supports Recommendation 1 on the condition that it applies to all of the services (and routes) on the AI network that are currently covered by the WARAR (not just the interstate services or routes). If that does not occur, then there will be a range of adverse consequences for users and owners, as outlined in our comments in response to questions 8.1 and 8.2.

If the Government decides to proceed on this basis, CBH believes that AI should not have the application of the Code removed from any or all parts of its network without conditions. Coverage should only be removed if and when the ACCC approves an access undertaking submitted by AI under Part IIIA of the CCA that covers an appropriate range of services. CBH is open to discussing what that range of services might be, but it should at least cover those that would be sought by a significant part of the market.

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176 AI, "BR Submission to publication of "Review of the Railways (Access) Code 2000 Draft Report" issued on 23 September 2015 by the Economic Regulation Authority", at para 1.3.9. Available at https://www.erawa.com.au/cproot/13966/2/Brookfield%20Rail.pdf

Further, CBH considers that there should be an express obligation on AI to make the access policies and terms, including as to price, as consistent as practicable with those in the approved ARTC undertaking.

Having said this, CBH encourages the Government to consider the possibility of developing of a "National Rail Access Law" that applies consistently throughout Australia and which uses nationally resourced and funded regulatory and appeals bodies. Such a regime could be implemented by force of Commonwealth, State and Territory legislation, using the ARTC undertaking as a starting point. CBH notes that such regimes have been developed and implemented, with sufficient flexibility, in other industries, including the gas industry (the NGL).

9.4 Issue 2: Certification as an effective access regime

The Issues Paper notes that the certification of the WARAR as an effective access regime under Part IIIA of the CCA expired in February 2016. As a consequence, it is possible for an access seeker to seek declaration, under Part IIIA, of services provided by means of railways that are subject to the WARAR. This effectively means that it is possible for two access regimes to apply to the services provided by means of the WARAR railways. The Issues Paper also records the Government's intention to consider applying for re-certification, after any changes have been made to the WARAR.

CBH considers that the WARAR, as it stands, is not an effective access regime. Accordingly, it will consider opposing any application for certification of the regime as an effective access regime under Part IIIA of the CCA. That will be the case unless the Government makes fundamental changes of the type proposed in this submission.

CBH therefore encourages the Government to amend the WARAR before it proceeds with any application for re-certification. If the Government does amend the WARAR, then CBH will consider its position in relation to certification based on the effectiveness of the reformed regime.

However, CBH has serious reservations about whether the appetite exists for the level of change that is required to transform the WARAR into an effective access regime. For that reason, if change of the level outlined in this submission cannot be achieved, CBH would generally support the move of the entire AI rail network to regulation under a national rail access regime.

(a) Question 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?

While this question is directed to railway owners, CBH does wish to express a general view about this question.

CBH does not consider that the possibility of access seekers using either the WARAR or Part IIIA of the CCA should be a material issue for owners. That is because Part IIIA does not currently apply to any railway owners covered by the WARAR and therefore does not impose any obligations with which they are required to comply.

The only burden that railway owners face is the possibility that a person might seek declaration of a service. That, however, is not a significant issue because declaration can only succeed following a lengthy public assessment, recommendation and decision making process involving the NCC, the designated Minister and, potentially, the Australian Competition Tribunal. That process requires that all of the "declaration" criteria in sections 44G and 44H of the CCA be

satisfied, which should take into account the availability of regulated access under the WARAR.

CBH can appreciate that the availability of dual access regulation regimes has the potential to affect the appetite of investors for substantial new investments. This is because it may introduce a level of uncertainty as to the particular regulatory arrangements that might apply to the investment, and could affect the confidence investors have in their ability to recover their investment and a reasonable return on it. But CBH doubts that is the case in relation to brownfield railways that are currently regulated by the WARAR and incremental expansions to them.

(b) Question 8.5: How important is consistency in approach to access regulation for new rail developers? What are the benefits?

CBH makes no comment on this question, other than to refer to the comments it has made in response to question 8.4.

10. OTHER ISSUES

10.1 Vertical integration

At the time of it was privatised almost 20 years ago, the Western Australian rail freight was vertically integrated in that it incorporated both above-rail and below-rail businesses. In 2006, that vertical integration ended when Queensland Rail (now called Aurizon) acquired the above-rail business and Babcock and Brown (which was later called Prime Infrastructure) acquired the below rail-business. In 2010, Prime Infrastructure merged with Brookfield Infrastructure, the owner of AI.

Had vertical integration not ended in 2006, the problems with the WARAR would have been even more acute. A regime that cannot adequately address access regulation for a non-vertically integrated railway business would certainly not have effectively regulated a vertically integrated above and below-rail business, particularly where that business is privately held and the below-rail entity has incentive and ability to use its market power to the advantage of a related above-rail operator.

Consistent with this, CBH is concerned about the prospect of AI becoming vertically integrated in the future. That concern extends to effective vertical integration due to another member of the Brookfield Infrastructure group taking an interest in an above-rail operator.

CBH considers that the WARAR should include strict "ring fencing" and segregation rules that protect against a railway owner or any of its related bodies from carrying on, or holding an interest in, an entity that carries on a "related business". A "related business" should be defined to be a business that involves any above-rail operations on the relevant rail network where there are other users. It is only on the so called "marginal freight rail routes" where vertical integration may be necessary or desirable.

10.2 The WARAR must have, or provide for, minimum service quality standards

Need for performance requirements and minimum service standards

The WARAR imposes no substantive obligations on the railway owner in relation to performance requirements and minimum service standards. Rather, performance requirements are matters for which provision is to be made in the access agreement,[177] or (in the case of AI) otherwise enforced by the Public Transport Authority (**PTA**) as the lessor of the railway networks.

A railway owner has little incentive to maintain the performance of the network out of existing access revenue in the absence of firm obligations to do so, or unless an access seeker agrees to fund the very work that should be the core responsibility of a railway owner. The recent criticism of AI's performance on the grain rail network in WA (for example, in the Freight Rail Network Inquiry) demonstrates the need for minimum standards to be imposed as a firm obligation under the Code, rather than being open for negotiation.

Previous experience under the Code

Performance standards were a key issue for CBH in its negotiations with AI for access to the WA grain rail network. The efficient operation of the grain rail network is a critical component of the grain supply chain, helping to ensure WA grain growers remain internationally competitive. However, while access fees were increasing, performance standards on the network were steadily decreasing. CBH has been increasingly concerned

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[177] Code, clause 11 of Schedule 3.

about the current standard of the grain rail network, given the considerable speed and mass restrictions placed on Tier 1 and Tier 2 line sections, and the closure of the Tier 3 sections. Those restrictions had significantly affected the efficiency of CBH's operations and, in respect of the Tier 3 lines, had meant that CBH needed to utilise other means to transport its grain to port (such as road). As stated in the Freight Rail Network Inquiry, "notwithstanding the express requirements of the lease, some parts of the rail network have not been maintained so that they are fit for purpose."[178]

Not only had this caused issues for the efficiency of CBH's rail operations, but it also proved to be a difficult issue in negotiating an access agreement (both inside and outside the Code). Without an enforceable minimum standard, CBH was unable to know whether AI was offering terms that were below the minimum standards in the lease or not, or whether the lease had standards that were unworkable. It was also difficult to assess the reasonableness of any price offered, as CBH did not know what it was paying for in relation to the minimum standard performance, speed or weight, and what it should be getting for the access fees paid by it. Without an enforceable minimum standard, there was no effective way for CBH to have this discussion with AI during negotiations.[179]

An example of this issue can be found in the closure of the Quairading to York line by AI in October 2013. That line was closed following a derailment on the line,[180] despite obligations in the privatisation lease to maintain the lines to their initial performance standards.

CBH also notes the findings of the Freight Rail Network Inquiry in relation to the withdrawal of the line from service in June 2009. During June 2009, the PTA advised that the Trayning to Merredin, York to Quairading, Katanning to Nyabing and Tambellup to Gnowangerup lines were withdrawn from service. However, according to the Freight Rail Network Inquiry, the suspension of those lines from service was not undertaken pursuant to any specific provision of the lease, and may in fact have been a breach of the lease.[181] The Freight Rail Network Inquiry stated that the lessee's ability to suspend the lines without consequence was an example of the inadequacy of the lease instrument to protect the state's interests,[182] and:

> "...the fact that [the suspension] could occur demonstrates an inherent problem with the lease. There are no clear remedies if there is a unilateral withdrawal of lines or suspension of lines from service."[183]

CBH is also concerned that the ability of a railway owner to "close" a line (or otherwise put it in "care and maintenance") may potentially be used by the railway owner as leverage to obtain a favourable access price, or other terms. For example, the railway owner could argue that, unless access prices are increased, then a route will be closed (or, if already closed, will not be re-opened).

CBH believes that the current state of grain rail network shows that it is not currently being operated in an economically efficient manner. This view was clearly supported by the views of the Committee under the Freight Rail Network Inquiry, which recommended that there be more proactive management by the PTA in relation to AI's performance

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178 Freight Rail Network Inquiry at paragraph 7.21.

179 Freight Rail Network Inquiry at paragraph 6.31.

180 Brad Thompson, "Wheatbelt rail lines to close" published in the West Australian dated 3 October 2013 (available at https://au.news.yahoo.com/thewest/countryman/a/19223720/wheatbelt-rail-lines-to-close/).

181 Freight Rail Network Inquiry at 7.88 and Findings 22 and 23.

182 Freight Rail Network Inquiry, Finding 24.

183 Freight Rail Network Inquiry at 3.113.

obligations under the lease.[184] AI clearly has no incentive to do so if it is not held to any firm performance standards under the Code.

CBH's recommendations for standards under the Code

CBH submits that there is an overwhelming need for the Code to take a more rigorous approach to regulating the availability, quality and standard of access services.

The ACCC has supported the specification of minimum service quality standards as an important part of access regulation.[185] In its approval of ARTC's Hunter Valley Access Undertaking (dated 23 June 2011 and as varied from time to time) (the **HVAU**), the ACCC emphasised the importance of including incentives in the HVAU that should promote the economically efficient operation and use of infrastructure (consistent with the objects of the National Access Regime), and that should encourage ARTC to reduce costs and improve productivity (consistent with the pricing principles under the National Access Regime).[186] In accordance with this, the ARTC access undertakings have more satisfactorily addressed performance standards in the following ways:

(a) Under ARTC's IAU, ARTC is under an overarching obligation to maintain the network in a condition which is fit for use by the operator to provide rail transport services, having regard to the terms of its access agreements.[187]

(b) Under the HVAU, ARTC is required to negotiate in good faith the key performance indicators to be included in an access agreement. These are specifically required to be consistent with the performance indicators contained in the "NSW Lease" between ARTC and State of NSW over the Hunter Valley rail lines and infrastructure.[188] If the parties do not agree otherwise, the key performance indicators will be a subset of certain key performance indicators set out in Schedule D to the HVAU.

    ARTC is also required to prepare and publish on its website a proposed performance incentive scheme which has the objective of encouraging ARTC, through financial reward, to improve operating, maintenance and capital expenditure efficiency and achieve desirable safety performance. This scheme is developed through a consultative process, where ARTC must invite submissions from access holders and other stakeholders on the proposed scheme, and lodge with the ACCC a report for addressing options for the proposed scheme.[189]

Similar performance regimes should be considered under the WARAR, in particular by doing the following things.

(a) Incorporating **minimum service standards** that the railway owner must meet. In particular, AI is under minimum performance standards under its lease arrangements with the State, including to maintain the network to a "fit for purpose" standard. Minimum service standards imposed under the Code should be linked to the higher of the standard required under the privatisation lease, and the standard required to be fit for the access seeker's present-day purpose, for a consistent approach. This could be similar to the provision in the HVAU regarding consistency with the "NSW Lease". To make this effective, CBH believes that users

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184 Freight Rail Network Inquiry at paragraph 7.56.

185 PC 2013 Inquiry at page 94.

186 ACCC, Approval of the ARTC's HVAU dated 29 June 2011, section 5.6.3.

187 ARTC IAU, section 8.1.

188 HVAU, section 13.2(b)(ii).

189 HVAU, sections 13.3, 13.4 and 13.5.

should be able to have input into the standard that is considered "fit for purpose". Existing users of the line are in the best position to judge what standard is required for their present and reasonably anticipated future purposes. A mechanism should be introduced that would allow users to have input into the minimum service standard requirements, for example, through a consultation process overseen or managed by the ERA.

(b) Ensuring the **pricing adopted under the Code reflects the level of service standards actually being provided**. This can be achieved by requiring the railway owner to provide information on how its price relates to the level of service quality being provided (as discussed above) and develop a **performance incentive scheme that has financial consequences** for the railway owner if it does not comply with the minimum service standards.

(c) Incorporating express obligations, consistent with other access regimes, that expenditure undertaken by a railway owner be expenditure that would be undertaken by a hypothetical **prudent railway owner, acting efficiently and in accordance with good industry practice**.

10.3 There must be a tighter enforcement regime under the Code

Lack of enforcement under the Code

The obligations imposed under the Code are only enforceable by commencing arbitration proceedings (and then only for limited kinds of "disputes"), or by applying to the Supreme Court for an injunction.[190] There are few other sanctions imposed on a railway owner for failing to comply with its obligations. This means there is no real incentive for the railway owner to comply with the Code, other than the threat of court proceedings or an unfavourable award at arbitration. In addition, as described in the Freight Rail Network Inquiry, the role of the ERA in regulating the market for access to the freight rail network can "best be described as minimal."[191]

In CBH's experience, this lack of enforcement power has made it difficult and costly to enforce the railway owner's preliminary obligations, such as information provision requirements. For example, CBH has been forced to either seek injunctive relief in the Supreme Court, or suffer the consequences of non-compliance. This process has significantly delayed its progress in negotiations, and has been an inefficient use of its time and resources.

In this regard, CBH notes that clauses 6(4)(a) – (c) of the CPA require access regimes to create an environment in which the parties are able to enter into effective negotiations, and require there to be an effective enforcement mechanism. This requires the railway owner to comply with its obligations to negotiate in a timely and efficient manner. CBH does not consider that a period of over 45 months to reach the point of an arbitration is timely or efficient – and it is certainly not efficient to have to overcome the significant hurdles found within the Code in order to enforce its rights to negotiate.

As discussed above, CBH does not believe that extending the meaning of "disputes" to encompass the Part 2 and Part 3 obligations will sufficiently address this problem. This will result in the parties needing to commence arbitration proceedings each time there is a dispute about whether a party has complied with its obligations. In most instances, this process could be longer and more costly than Supreme Court proceedings. Arbitration is also not an appropriate forum for enforcing regulatory obligations.

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190 Act, sections 36 and 37.

191 Freight Rail Network Inquiry at paragraph 5.31.

Issues to be addressed

The Code should be amended to introduce a tighter, more streamlined enforcement regime, with clearer obligations. CBH believes that there are two major issues that need to be addressed as part of this:

(a) The consequences for failing to comply with the provisions of the Code should be more significant. Procedural requirements of the Code (e.g. Part 2 and Part 3 obligations) should be elevated to offences, or at the very least, civil penalty provisions. Sanctions and penalties should apply for a failure to comply with these provisions. Compensation should also be available for persons (including access seekers) who have suffered loss or damage as a result of a contravention of the Code.

(b) The ERA's enforcement powers need to be increased, so that it can take a more active role in enforcing the Code. For example, the ERA should have the power to issue infringement notices to enforce a failure to comply with the Code. At an absolute minimum, the ERA should be able to give directions or recommendations in relation to the railway owner's obligation to comply. This would at least ensure a degree of certainty and confidence by the access seeker that its rights can be enforced, without needing to resort to expensive and disruptive court proceedings.

Addressing these issues will improve the ability of the Code to facilitate a more streamlined path to negotiated outcomes (in line with the discussion at Part 3 of this submission).

The ability to impose civil pecuniary penalties through both infringement notices and court action, and other sanctions on businesses for non-compliance with regulatory obligations, are part of the regulatory environment in most jurisdictions.[192] Generally under other rail access regimes, civil penalties are imposed on the railway owner for failing to meet certain obligations, including information provision obligations. The regulator is given the power to enforce these penalty provisions on behalf of the access seeker. For example:

(a) Under the SARAR, if the railway owner fails to provide the access seeker with the required "information brochure", it is taken to be guilty of an offence and is subject to a maximum penalty of $20,000.[193] The court is also empowered to order compensation of persons who have suffered loss or damage as a result of a contravention of the Act or an arbitration award, on application by the regulator or an interested person.[194]

(b) In Victoria, the *Rail Management Act 1996* (Vic) imposes pecuniary penalties on parties who fail to comply with certain penalty provisions. Examples of penalty provisions include where the railway owner fails to comply with the terms of an access arrangement (which encompasses obligations under that access arrangement to provide information to the access seeker and to comply with negotiation guidelines).[195] The ESC has the power to apply to the Supreme Court for an order in respect of a contravention by a person of a penalty provision. If the Court is satisfied that a person has contravened a penalty provision, or has

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192 BERI Working Paper at page 71.

193 *Railways (Operations and Access) Act 1997*, section 28(6).

194 *Railways (Operations and Access) Act 1997*, section 66.

195 *Rail Management Act 1996* (Vic), section 38ZZT.

attempted to do so, it may order the person to pay a pecuniary penalty of up to $1,000,000.[196]

(c) The NGL has a tight and effective enforcement regime that includes penalty provisions and the issuing of infringement notices. The ERA has the power to issue an infringement notice to a person if it has reason to believe it has breached a civil penalty provision. An infringement notice imposes an infringement penalty on the person for the breach (which is up to $20,000 for a body corporate).[197]

CBH believes that the Code needs to include an infringement notice mechanism, so that the ERA can take a more active role in enforcing the Code.

10.4 Section 8 – preservation of status quo pending access proposal

The Code does not address the situation in which an access seeker has an access agreement currently on foot with the railway owner, but wishes to proceed under the Code to negotiate a replacement access agreement. As discussed above, the Code processes can be time consuming and unpredictable, particularly if the parties are unable to reach agreement and must proceed to arbitration. While the Code process is underway, the existing arrangements in place between the access seeker and railway owner may come to an end, and the access seeker may be forced to accept unfavourable interim arrangements to ensure service continuity for their business.

In CBH's case, it had to engage in negotiations "outside" the protections of the Code for extensions to its interim arrangements after lodging its proposal, to ensure continuity for its supply chain. Those arrangements have been on terms that are unfavourable to CBH. This has greatly affected the efficiency of its operations, and has resulted in increased costs for CBH, its members and its growers.

CBH believes the Code should be amended to include a provision that requires the status quo to be preserved under an existing access agreement between the access seeker and railway owner, where an access proposal process is underway between those parties for a replacement access agreement. This would recognise the access seeker's interest in maintaining access to the rail network on reasonable terms while the Code process is followed, without needing to spend considerable time and resources in negotiating numerous extensions to interim arrangements. Such a change would be consistent with the following provisions of the CPA:

(a) clause 6(4)(e) - which provides that the railway owner must use all reasonable endeavours to accommodate the requirements of persons seeking access. This may include a requirement for service continuity e.g. - for access rights to be secured from the date its existing commercial arrangements expire; and

(b) the underlying objective of access regulation under clause 6(5)(a). As discussed above, this objective encompasses a requirement to promote competition in activities that rely on the use of the railway, and to ensure the efficient use of infrastructure (particularly by preventing access providers from misusing market power). CBH believes that the competitiveness of its grain operations has been jeopardised by the need to negotiate unfavourable interim arrangements. In addition, the competitiveness of Western Australian grain growers (i.e. upstream market participants) has been hampered not only with each other, but also with international competitors.

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196 *Rail Management Act 1996* (Vic), section 38ZZZE.

197 NGL, sections 277 and 279.

CBH also notes that railway owners may attempt to include a provision in an access agreement made outside the Code, which prevents users from seeking access under the Code in the future. This is in contrast to the requirements of clause 6(4)(m) of the CPA. In the Freight Rail Network Inquiry, the Committee recommended that Part 4A of the Code be amended to make it clear that parties are not able to expressly prohibit the future operation of the Code under an access agreement.[198] CBH supports this recommendation - it is necessary to ensure that the requirements of clause 6(4)(m) of CPA are met.

10.5 Confidentiality issues

The current confidentiality regime in section 50 of the Code does not allow a railway owner to make confidentiality claims over the provision of information that is required to be provided under the Code. However, due to its ambiguous drafting, section 50 has been applied so as to allow the railway owner to make extensive confidentiality claims. This makes it difficult to establish a transparent process, in line with the objects of the CPA.

CBH considers that there are two broad issues in relation to the confidentiality regime under the Code:

(a) first, that the railway owner should not be permitted to claim confidentiality over information that it is required to provide under the Code; and

(b) second, that the ERA should be compelled to publish regulatory decisions made under the Code, including costs determinations, in full and without confidentiality restrictions.

Information required to be provided under the Code

There are a number of features of the Code that can only operate effectively if the railway owner is required to disclose information about its operations and pricing, and if an owner's purported "compliance" is not designed to frustrate the access process.[199]

Examples of the railway owner's requirements to disclose information include:

(a) the obligation to publish, in hard copy format, the "required information" (Part 2A of the Code);[200]

(b) the requirement to submit the Part 5 instruments for approval (and the publication of those instruments by the ERA);

(c) the processes for public consultation on the determination of costs under clause 9 and clause 10 of Schedule 4;

(d) the railway owner's requirements under section 48, to provide the section 9(1)(c) information that it provided to the access seeker to **any entity** who requests it (whether or not the person is an operator, proponent, potential proponent, or whether the person has any interest in the railway); and

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198 Freight Rail Network Inquiry, Recommendation 6.

199 For example, by requiring access seekers to view information on unfriendly wbe pages that require a user to look up only one piece of information at a time.

200 CBH submits that, in addition to a hard copy, the railway owners should also be obligated to provide electronic copies of the "required information".

CBH submits that there is a legitimate public interest in the prompt publication of decisions, particularly decisions that followed a public consultation process. To deny the public the opportunity to see whether, and how, those submissions were taken into account risks eroding confidence in the public consultation process. For example, the ERA's floor and ceiling cost determination for TPI's route subject to Brockman Iron Pty Ltd's access proposal (dated September 2013) was heavily redacted. In fact, the parts of the decision from pages 16 through to 37, which contained a breakdown of the GRV determination, were largely all redacted, as was the determination of the operating and overhead costs. TPI's costing model was kept confidential – which is in direct contrast to the ERA's statements in its 2011 Cost Requirement Review about its intention to continue to publish costing models. At paragraph 73 of the Cost Requirement Review, the ERA stated that:

> By far, the most useful component of existing determinations is the railway owner's costing model, which the [ERA] currently publishes as a part of every determination. The costing model provides sufficient technical information for potential access seekers to estimate route replacement costs and route expansion costs which may apply to any future access proposal. The [ERA] will continue to publish railway owners' costing models.

If the determinations are not published, and the costing models are not published, there is very limited cost transparency. The failure to publish this information is inconsistent with other statements made by the ERA in relation to the importance of transparency in costs. In the Cost Requirement Review, the ERA stated that "the intent of the Code is to provide transparency in costs",[213] and that "ongoing cost transparency… is advantageous to the achievement of the objectives of the rail regime." [214]

In the Freight Rail Network Inquiry, the Committee also described the difficulty it faced itself in requesting a full, unredacted, copy of the ERA's costs determination. The Committee's initial request for a copy of the determination was denied on the grounds of confidentiality. It was only after the Committee Chairman authorised the Clerk of the Legislative Assembly (under the *Parliamentary Privileges Act 1891* (WA)) to issue a summons to the ERA Chairman ordering the production of the determination, that the Committee received a full copy of the determination on 14 July 2014.[215] In CBH's view, it is remarkable that a parliamentary committee was required to go to such lengths to obtain a full copy of a relevant regulatory document.

The Committee agreed that there is a need for transparency regarding how access fees are calculated, if "for no other reason than to assuage concerns that the network operator may in some way be abusing its monopoly power".[216] The Committee therefore decided to publish that part of the ERA's determination of the floor and ceiling costs that was

individual access seekers cannot be reasonably accommodated, if all access seekers are required to be bound to fixed instruments that they do not have a say in developing (apart from participating in public consultation on the approval of these instruments).

(b) Clause 6(4)(f) - which states that the regime should allow for access to be provided on different terms and conditions to different users. This is supported by the principles of negotiation in clauses 6(4)(a) to (c), as it is based on the notion that the terms of access should be open to be negotiated between the parties, first and foremost.

CBH believes it is more in line with the principles of negotiation under the CPA for the Part 5 instruments to merely facilitate commercial negotiations, without being binding. They should act as a safety net, if the parties cannot otherwise agree on suitable procedures. These arrangements should be subject to some limited exceptions, for example, the parties should not be able to negotiate a departure from the Part 5 instruments where this would result in disrupting the operation of the network or would affect other users.

CBH notes that it is not commenting on the Part 5 instruments themselves at this stage. As indicated by the ERA in the Issues Paper, the Part 5 instruments are to be reviewed in a separate process with key stakeholders.[224] CBH encourages a separate review of the Part 5 instruments and would welcome the opportunity to comment on the Part 5 instruments in detail as part of this process.

10.7 Cost Requirement Review

In its 2011 Cost Requirement Review the ERA determined that:

(a) it would only re-determine costs, if the ERA expects it is likely that a new access proposal will be made, or if the railway owner initiated a re-determination;

(b) all floor and ceiling costs which are published in relation to clause 9 and 10 determinations will apply for five years (instead of three); and

(c) the ERA will not require railway owners to submit costs for re-determination at the expiration of the five year period (where previously, an automatic re-determination of costs was required on the expiration of the previous determination).

This represented a major change from the ER's previous position, under which it required that a periodic review of floor and ceiling costs for the grain rail network be carried out every three years.[225] The ERA stated its view that a redetermination of costs is an "unnecessary regulatory requirement" in the absence of an access proposal being made for all or part of that route.[226] It also saw "limited circumstances when an existing determination would provide any more than a broad usefulness in indicating the likely terms to be offered by a railway owner".[227]

CBH does not agree with this assessment, and believes that the ERA's decision to reduce the amount of cost information available has placed users and access seekers at a disadvantage in dealing with the monopoly railway owner. Indeed, one of the primary rationales underpinning access regulation is to remedy the disparity of bargaining power between an access provider and access seeker. A key way to do this is by addressing the

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224 Issues Paper at paragraph 32.

225 Cost Requirement Review at paragraphs 24 and 25. This requirement is not set out in the legislation, but was stipulated in each floor and ceiling cost determination published by the ERA.

226 Cost Requirement Review at paragraph 46.

227 Cost Requirement Review at paragraph 72.

information asymmetry between the access provider and access seeker. Regular cost determinations are necessary to ensure continued compliance with the costing principles and over-payment rules, and is in the interests of potential access seekers and entities operating under agreements made inside and outside the Code. Further, the availability of transparent floor and ceiling costs (and publication of those costs) is critical to ensure ongoing transparency of costs and to address information asymmetries held by the monopoly owner. The lack of available pricing information was identified by Karara, in its submission to the Freight Rail Network Inquiry, as one of the reasons why it did not proceed under the Code.

CBH does not agree with the ERA's view that the costing model provides "sufficient technical information for potential access seekers."[228] The ERA's decision to cease the cost re-determinations is also in direct contrast to other statements made by it regarding the importance of cost determinations in administering the railway owner's over-payment account.[229] For example, the ERA acknowledged that revenues may breach the ceiling price test, if the ceiling cost is not re-determined.[230] However, placing the responsibility on the railway owner to initiate such a re-determination is not effective to ensure that the ceiling price test can be enforced - as the railway owner has no incentive to request such a re-determination.

The key reasons why the costs determination made by the ERA for CBH's access proposal took over 6 months to make were:

(a) the fact that no costs determination had ever been made in relation to many of the routes on the grain rail network; and

(b) that AI fundamentally changed its method of determining costs since the last costs determination in 2007.

CBH believes that if regular costs determinations were required to be made and kept up-to-date, then there would not have been such a delay in the costs determination made under clause 10 of Schedule 4 for CBH's access proposal.

At the absolute minimum, CBH believes that the requirements to periodically re-determine the floor and ceiling costs applicable to the grain rail network should be re-instated on a more regular basis (i.e. annually), and the ERA should publish these reviews on its website in the interests of transparency for access seekers and users.

10.8 Operation of ceiling price test and over-payment rules in relation to access agreements outside the Code

(a) Issues with ceiling price test

The ceiling price test under clause 8 of Schedule 4 of the Code places a cap on the revenue that is permitted to be recovered by the railway owner from all users (including third parties that have obtained access outside the Code) on a route. The ceiling price test takes into account revenue that is earned from users outside of the Code (and the railway owner's own use).

However, the test is currently not capable of operating effectively for users outside of the Code, and is not capable of being enforced at all times. Based on the approved over-payment rules for AI's network, it does not appear that the over-payment rules are administered in this way. This has provided an opportunity for

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228 Cost Requirement Review at paragraph 73.

229 Cost Requirement Review at paragraph 43.

230 Cost Requirement Review at paragraph 137.

railway owners to extract monopoly profits from users outside of the Code (and, in turn, provide railway owners with an incentive to keep access seekers "outside" the Code where possible).

There are several issues with the test that have resulted in it not working as intended. These include the following:

(i) It is difficult for the test to be enforced when there is no floor and ceiling price determination in place. This is because without a determination of the "total costs" in place under Schedule 4 of the Code, there is no transparency as to what the floor and ceiling prices are. The only express obligation to determine the "total costs" is triggered under clause 10 of Schedule 4 where a proposal has been made. Although the ERA has the power to make a determination of total costs under clause 9 of Schedule 4 if it considers that it is likely a proposal will be made, this is not a mandatory requirement (the ERA "may" determine the costs).

(ii) Users and access seekers (whether inside or outside of the Code) have no way of knowing what the "total costs" or total revenue earned by the railway owner is, as that information is not published. Consequently, there is nothing to prevent the railway owner from breaching the ceiling price test and extracting monopoly profits from multiple operators. This would allow it to recover more than its efficient costs and an appropriate commercial return on its investment.

(iii) The effectiveness of the ceiling price test is further undermined if the railway owner is permitted to keep the determination of its costs confidential (as was the case with AI's floor and ceiling costs determination for CBH's access proposal). Without transparency in the cost determination process, access seekers and other users of the railway are not able to see what the "total costs" have been determined to be, and cannot assess whether the ceiling price test has been breached. This is a particular problem for the multi-user routes, which were the routes that AI had successfully requested to be redacted in the ERA's final determination.

(iv) Further, even where the ceiling price test can be enforced, the over-payment rules only apply to operators outside the Code if the access agreement states that they apply.[231] The over-payment rules for AI (approved by the ERA in April 2011) (**Over-payment Rules**) state that:

> Access Revenue from Operators with Access Agreements negotiated outside the Regime (non-Regime operators) will also be included in evaluating [AI's] compliance with the Floor Price Test and Ceiling Price Test of the Code. Furthermore, in assessing the extent of over-payment under section 47 of the Code, Access Revenues from non-Regime operators are included in the Ceiling Price Test. However, since the Code does not provide non-Regime operators a legal entitlement to any refund for any over-payment, such over-payments will be returned to [AI] unless otherwise specified in an Access Agreement with an Operator.[232]

This outcome is inconsistent with the purpose of the over-payment rules, which is to address breaches of the ceiling price test in clause 8 of Schedule 4.[233] While the ceiling price test takes into account payments

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231 Over-payment Rules for Brookfield Rail Pty Ltd, approved by the ERA in April 2011 (**Over-payment Rules**) at section 3(6).

232 Over-payment Rules at section 2.3.

233 Code, section 47.

that are made by third parties who have obtained access outside of the Code, there is no provision for over-payments to be returned to out-of-Code operators. This then provides the railway owner with the opportunity to extract monopoly revenue from operators outside of the Code, and with an incentive to keep access seekers outside of the Code.

(b) Operation of the test needs to be clarified

The operation of the ceiling price test therefore needs to be clarified, to ensure that it operates at all times and can be enforced at all times. There should be regular (i.e. annual) determinations of the applicable costs for the rail network and whether the ceiling price test has been met by the railway owner, which determinations should be made available to the public. Regular "mop-ups" should be able to be enforced if excess revenue has been charged - including provision for over-payments to be returned to operators outside of the Code – and to address any issues in relation to spreading of costs over a route. This approach is consistent with the "line in the sand" approach proposed by Frontier Economics and described in Part 7.3 of this submission.

Examples can be taken from other access regimes, which require the railway owner to monitor and report on its costs. For example:

(i) Under the SARAR, the regulator has the power to require the railway owner to provide certain information relevant to monitoring the costs of railway services provided by the operator. If the operator fails to comply, it is subject to a maximum civil penalty of $60,000.[234] The regulator then has a duty to report to the Minister, if requested, on the costs of railway services.[235]

(ii) ARTC also undertakes to comply with considerable reporting requirements to the ACCC on its costing models and compliance with the applicable floor and ceiling tests. In the HVAU, ARTC must submit annual reports to the ACCC on, among other things, its compliance with the ceiling test, including allocation of the total under or over amount to customers. ARTC must also provide its spreadsheet or other models underlying calculations relevant to reconciling its access revenue with the applicable ceiling limit.[236] The structure of the access undertaking also means that the regulator approves ARTC's costs up-front, before the undertaking comes into effect. This avoids the problem under the Code that there is only a calculation of the "total cost" carried out once a proposal has been made.

(c) Audit provisions do not appear to be effective

The Over-payment Rules and Costing Principles applicable to AI's grain rail network provide for limited audits to be carried out by the ERA. However, CBH does not believe that these audits are sufficient to address the significant information asymmetries held by the railway owner, and to ensure that the ceiling price test is being met for users outside of the Code. Further, CBH has not been able to find reports of these audits on the ERA's website since 2009.

AI's Over-payment Rules currently provide for an annual audit of the over-payment accounts by an independent auditor appointed by AI, but only if there are

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234 *Railways (Operations and Access) Act 1997* (SA), section 60.

235 *Railways (Operations and Access) Act 1997* (SA), section 64.

236 HVAU, Schedule G.

operators with access agreements under the Code.[237] Given that there are currently no operators with access agreements under the Code, it appears as if no such audits are being carried out. The ERA is also required to monitor AI's compliance with the Over-payment Rules through an audit every 3 years, which is to be published on the ERA's website.[238] CBH has only been able to find records of these audits up until 2009 on the ERA's website.

AI's Costing Principles require the ERA to monitor compliance through an audit conducted every two years. The ERA is required to publish this report on its website.[239] Again, CBH has only been able to find records of these audits up until 2009 on the ERA's website.

This suggests that the existing audit provisions are not effective, and provides further support for CBH's submission in paragraph (b) that the operation of the ceiling price test needs to be clarified.

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237 Over-payment Rules at page 5 (point 15).

238 Over-payment Rules at page 11.

239 Costing Principles at page 19.

11. AMENDMENTS FROM ERA CODE REVIEWS THAT THE GOVERNMENT INTENDS TO IMPLEMENT

The Issues Paper notes that the ERA made several recommendations in the 2011 and 2015 reviews of the Code and that the Government intends to progress implementing those recommendations without repeating the consultation already conducted by the ERA.

The following table sets out CBH's responses to the table set out in the Issues Paper.

ERA Code Review 2015		
No.	**Summary**	**CBH Response**
5	Section 10 of the Code be removed.	CBH supports the ERA's recommendation that section 10 be removed from the Code, as it serves no useful purpose and may unnecessarily delay the Code process.
6	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. 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.	CBH does not support this recommendation because it submits that sections 14 and 15 should be abolished. If there is any issue about the financial capacity of the operator, or whether a route has sufficient capacity, then this can be addressed through either: (a) negotiations (for example by requiring an operator to provide security to support its financial position, or for an extension or expansion to be agreed on); or (b) an arbitration determination (on a similar basis). The Code does not provide any guidance about the level or quantity of information that must be provided by the proponent to the railway owner to satisfy sections 14 and 15, and there is no express requirement on the railway owner to act reasonably. Further, the process for satisfying the railway owner involves a number of steps. First, the railway owner may issue a notice under section 14 or 15 (or both). The proponent must then respond. If the railway owner is not satisfied with the proponent's response, then it may notify the proponent, in which case the proponent must decide (for itself) what further information should be given to the railway owner, and then provide that information. If the railway owner is still dissatisfied, then the railway owner is under no obligation to negotiate with the proponent. The only way to resolve the situation is for the proponent to notify the ERA there is a dispute, and have the matter resolved by arbitration. Throughout this period, the railway owner is under no obligation to negotiate. The prospect of delay is demonstrated by CBH's experience, where the process for dealing with a section 15 dispute took 12 months, formally starting in February 2014 and not formally concluding until 11 February 2015. This delay is unlikely to have been materially reduced by imposing timelines on the proponent to provide the information. Further, CBH submits that it is manifestly unreasonable for a proponent to be required to

		satisfy the railway owner that its rail operations are within the capacity of the route under section 15 (at its own cost). In CBH's experience, this is likely to require a proponent to engage an expert to assess the required information and preliminary information provided by the railway owner, particularly where a railway owner makes the bald assertion that a route is closed and not available for any rail operations. For the reasons given in response to Question 1.7 (see above), the information provided by a railway owner, including under section 7A is insufficient to address CBH's concerns about the operation of the relevant provisions. And, while amending section 18 as recommended by the ERA is a step in the right direction, it is only likely to take the parties on a road to further dispute. Further, it is not apparent that these amendments will be necessary if the onus in section 15 is shifted to the railway owner, and/or other proposals in relation to further guidance on expansions and extensions are adopted.
7	The term "days" in the Act and the Code be defined to mean "business days". All timeframes in the Code be adjusted accordingly. In particular, the timeframes prescribed in Part 2 of the Code ("Proposals for access") be amended to: Section 7(2) – 10 days Section 9(1) – 5 days Section 9(2) – 20 days Section 9(3a)(a)(i)(I) – 20 days Section 9(3a)(a)(i)(II) – 30 days Section 9(3a)(a)(ii) – 15 days Section 9(3a)(b) – 5 days Section 10(3) – 20 days	CBH supports this recommendation. However, it notes that a change to section 10(3) will not be required if recommendation 5 is implemented, as discussed above.
8	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.	CBH supports a reduction in the time between reviews under section 7C(2)(b). However, CBH submits that the review should occur at least once every 6 months (rather than every year as recommended by the ERA). CBH further submits that the Government should properly scrutinise the required information to ensure that it complies with the requirements of the Code. CBH also notes that there is an issue in relation to the obligation imposed on railway owners to provide information for routes in schedule 1 of the Code. It is that the railway owner may claim (in CBH's view, wrongly) that it is not required to provide the information if it unilaterally asserts there is no available capacity on that route. Unless the obligation to publish proper required information is enforced, then the utility of the Code is materially diminished. Otherwise, proponents are not able to properly assess whether or not to make a proposal, and railway owners are practically entitled to ignore the Code (particularly in circumstances where the only relevant remedy is an injunction). CBH submits that the ERA's general position that it

		is a matter for proponents to enforce the Code themselves (with which CBH strongly disagrees) is not applicable here, as it is entirely unreasonable to expect proponent contemplating access to take Supreme Court proceedings to simply require the railway owner to comply with the Code so that it can decide whether or not it is worth submitting a proposal.
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.	As discussed in Part 6.2 of this submission, CBH considers that it is appropriate to clarify the meaning of "capacity". As explained, CBH submits that the meaning of "capacity" under the Code should be clarified to refer to the underlying infrastructure capacity of the particular route, and not its current state of repair. CBH also generally agrees that there is merit in clarifying the meaning of the term "available capacity" in Schedule 2 of Code. In CBH's view, that term should be defined to make it clear that it refers to the amount of capacity (as defined above) of the particular route that is not committed to another operator. CBH agrees that any definition of "available capacity" must operate consistently with the meaning of the term "capacity" as defined in section 3 of the Code. It notes, however, that that defined term requires definition for the reasons discussed in Part 6.2 and that merely providing further detail that does not address the relevant issues will not provide additional clarity and meaning for access seekers. Despite all of this, CBH is seriously concerned that about the Government's statement to the effect that it intends to progress implementing this recommendation without repeating the consultation already conducted by the ERA. While CBH agrees that it would be inefficient to duplicate prior consultation, further consultation on this particular issue is required before this recommendation is implemented. That was clearly the case when the ERA stated, in making the recommendation, that it agreed with a suggestion made by AI that a further consultative process be undertaken to re-examine the appropriateness of the items in Schedule 2, including clarification of the definition of "available capacity". CBH agreed with that suggestion at the time and agrees with it now. CBH therefore submits that the Government should carry out further consultation with below-rail and above-rail operators on this point prior to taking any steps to implement it.
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	As explained in Part 4.5(a) of these submissions, CBH supports an amendment to section 26(2) to enable the parties to agree upon the appointment of an arbitrator. Accordingly, CBH generally supports this amendment. However, please refer to Part 4.5(a) of these submissions in relation to other issues in relation to the Code arbitration process. If the ERA is to appoint an arbitrator, then it is imperative that it be required to do so within a specified period. Otherwise, there is a potential for delay to the arbitration process. CBH suggests that specified period be set at 10 working days (unless the parties agree otherwise or the ERA is unable to appoint from the panel a person who is willing or able to act as the arbitrator).

	dispute. The Regulator must consult with the parties in dispute prior to the appointment of an arbitrator from the panel.	While CBH agrees that it important that the ERA consult with the parties prior to the appointment of the arbitrator, that should occur within the specified period. Otherwise, a party may be able to delay the appointment and the commencement of the arbitration proceedings.
ERA Code Review 2011		
No.	**Summary**	**CBH Response**
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.	CBH supports this recommendation as it would make it easier for prospective users to access the required information, without needing to spend time and resources in making requests to the railway owner for that information (and CBH notes that there is nothing in section 7A which requires the railway owner to provide the information in a hard-copy format within a reasonable time). In responding to CBH's requests for the required information under the Code, AI simply referred CBH to its website. CBH needed to make repeated requests for the required information to be provided in full in a hard-copy format, as required by section 7A of the Code. Any requirement for the required information to be published on the railway owner's website would therefore need to be effectively enforced by the ERA, to ensure that all required information is published and kept up-to-date. CBH also submits that, from a practical perspective, the specification of the required information in Schedule 2 of the Code needs to be improved. Items 4(l) and (m) of Schedule 2 require the railway owner to provide details of the "total gross tonnage" and "total tonnage of freight carried" (effectively a net tonnage). This demand information creates practical issues because it is not set out in a way that can be easily assessed by the access seeker. There are two issues with this information: • "Gross tonnes" and "net tonnes" do not align with the standard measure used for demand in the rail industry – which is gross tonne kilometres (or **GTKs**). GTKs are based on gross tonnes, plus estimated rolling stock weight, multiplied by track kilometres travelled by each gross tonne. The demand information in items 4(l) and (m) should be provided in GTKs, to ensure alignment with the measures used practically by the parties, and to ensure that usage can be more easily assessed by the access seeker. • The data in items 4(l) and (m) does not include the origination point for the usage on each route section. This makes it difficult to assess the actual proportion of usage on that section. Items 4(l) and 4(m) should therefore be amended to include a specification of the origination point for the usage data. However, CBH also submits that it is important for there to be a permanent record of the required information that is published from time-to-time. One of the problems with information being available on-line only, is that it can be changed quickly and without notice. This may lead to evidential issues—for example, in the event of an arbitration under the Code about capacity on a route, CBH submits that the required information published at the time the proposal was made is relevant (as contemplated by section 15(1)). This is most simply resolved by requiring the railway owner to actually provide the

		required information publication, and preliminary information, to the proponent in hard copy (as required by the Code), rather than simply referring the proponent to the website. This should be taken into account if the Code is amended.
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.	Subject to the concerns raised in this submission about capacity, particularly in respect of section 15, CBH supports this 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.	CBH makes no comment in relation to this 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.	CBH supports this recommendation.

SCHEDULE

Chronology of Key Events

Date	Event
17/12/2000	State Government privatises the freight network, and issues two leases: • Rail Freight Corridor Land Use Agreement (Narrow Gauge) and Railway Infrastructure Lease entered into between the Minister, Commission, Treasurer, WestNet Narrow Gauge Pty Ltd, Australia Western Railroad Pty Ltd and Australian Railroad Group Pty Ltd; and • Rail Freight Corridor Land Use Agreement (Standard Gauge) and Railway Infrastructure Lease entered into between the Minister, Commission, Treasurer, WestNet Standard Gauge Pty Ltd, Australia Western Railroad Pty Ltd and Australian Railroad Group Pty Ltd (together **Privatisation Leases**). At the time, the privatised business was vertically integrated. It operated a below-track business (under the name WestNet Rail), and a rail haulage business (under the name Australian Rail Group).
2006	Privatised business split when: • Queensland Rail (now called Aurizon) acquired the "above-rail" business (called Australian Rail Group); and • Babcock and Brown acquired the "below-rail" business (including the Privatisation Leases) for $835.5 million (called WestNet Rail).
July 2008	CBH began offering a grain logistics service to grain growers following the deregulation of the bulk wheat export market.
2009	Babcock & Brown Infrastructure became Prime Infrastructure.
August 2010	Prime Infrastructure merged with Brookfield Infrastructure.
16/03/2012	CBH enters into Interim Commercial Track Access Agreement with AI.
29/01/2013	Deed of Variation of Interim Commercial Track Access Agreement between AI and CBH (agreement itself undated).
23/10/2013	• CBH makes required information request to AI under section 7A of the Code. • CBH makes preliminary information request to AI under section 7(1) of the Code.
October to November 2013	AI responds to request for required information and preliminary information, and parties exchange correspondence about it.
28/10/2013	Deed of Variation of Interim Commercial Track Access Agreement (CBH Train Paths) between AI and CBH.
09/12/2013	Deed of Variation of Interim Commercial Track Access Agreement between AI and CBH.
10/12/2013	CBH submits its proposal for access under section 8 of the Code (the **Access**

Date	Event
	Proposal).
17/12/2013	AI asserted that the Access Proposal did not constitute a valid access proposal under the Code.
06/01/2014	The ERA calls for public submissions in relation to AI's proposed costs with respect to the Access Proposal.
17/01/2014	**Proceedings in relation to the Access Proposal** CBH commences proceedings in Supreme Court for declarations that proposal is valid and that AI is required to provide further information to CBH.
13/02/2014	The proceedings were settled and CBH clarified its access proposal (the **Clarified Access Proposal**).
27/02/2014	AI wrote to CBH requesting it to provide information satisfying section 15 of the Code in relation to the capacity of the Tier 3 and Miling Lines.
17/03/2014	
26/03/2014	CBH responded to AI's request under section 15 of the Code.
03/04/2014	CBH provided additional information for the purpose of satisfying AI's request in relation to section 15 of the Code.
09/04/2014	AI provided notice under section 18(1) of the Code that it was not satisfied of the matters referred to in section 15 of the Code.
20/05/2014	CBH provided notice under section 18(3) of the Code that there is a dispute between AI and CBH as to whether the requirements of section 15 of the Code have been met.
12/06/2014	**dispute** - CBH wrote to the ERA advising that there was a dispute between the parties in relation to and referring the dispute to arbitration in accordance with section 26 of the Code.
27/06/2014	Short Term Commercial Track Access Agreement between AI and CBH.
30/06/2014	**Floor and ceiling costs determination** – ERA determines floor and ceiling costs relevant to the Access Proposal under clause 10 of Schedule 4 of the Code.
22 – 23/09/2014	Hearings were held for the dispute arbitration.
24/09/2014	ERA published a redacted version of its costs determination.
14/10/2014	Further Short Term Commercial Track Access Agreement between AI and CBH.
27/01/2015	Arbitrator makes first interim award in the dispute.

Date	Event
11/02/2015	Arbitrator makes second interim award in the dispute to make orders to give effect to the first interim award, and costs orders.
18/03/2015	**Access negotiations –** CBH gives notice of readiness to begin negotiations under section 19(3) of the Code.
26/03/2015	CBH and AI begin negotiations under the Code.
15/04/2015	The ERA published a corrigenda to its floor and ceiling costs determination.
01/05/2015	Further Short Term Commercial Track Access Agreement between AI and CBH.
19/05/2015	CBH provides amended version of AI's Commercial Track Access Agreement for discussion.
24/06/2015	Access negotiations end without an access agreement being reached.
June 2015	The parties commence discussions with the State Solicitor about amendments to the Code in relation to the appointment of arbitrators.
10/11/2015	Further Short Term Commercial Track Access Agreement between AI and CBH.
04/12/2015	*Railways (Access) Amendment Code 2015* published in the Government Gazette (Gazette No. 181 at page 4846), which amends the Code in relation to the appointment of arbitrators.
18/01/2016	ERA writes to PCERA and the Resolution Institute asking for recommendations to remove or add panellists.
16/02/2016	ERA publishes notice of expanded panel.
17/02/2016	CBH by notice in writing to the ERA referred the dispute to arbitration in accordance with section 26(1) of the Code.
18/03/2016	Arbitrator appointed.
September 2017	Arbitration hearings.