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Our Ref:

Tuesday 2 September 2008

Mr Russell Dumas
Director- Gas and Rail Access
Economic Regulation Authority
6th Floor, 197 St George's Tce
Perth WA 6000

Dear Mr Dumas

The Economic Regulation Authority has called for public comment on the Pilbara Infrastructure Pty Ltd (TPI) proposed segregation arrangements, train management guidelines and train path policy. HPPL has had reports prepared for it by the consultants Acil Tasman and GHD that review the documents for HPPL. The reports are attached and together are the submission by HPPL in response to the ERA call for comment on the TPI documents.

These are late submissions and the ERA agreed to accept their submission

HPPL notes that the ERA has recently released the overpayment and costing principles submitted to the ERA by TPI for a period of public comment and HPPL intends to provide a submission on both by the closing date of 1 October.

Peter Murphy
General Manager, External Affairs and Government Relations
Hancock Prospecting Pty Ltd



Commentary on TPI proposed rail access arrangements

Segregation
Train management guidelines
Train Path Policy

Prepared for Hancock Prospecting

August 2008



ACIL Tasman
Economics Policy Strategy

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ACIL Tasman
Economics Policy Strategy

Commentary on TPI proposed rail access arrangements

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1 Introduction

On the 1 July 2008, the The Pilbara Infrastructure Pty Ltd (TPI) railway was included in the WA rail access regime, with the Railway and Port (TPI) Agreement Act making amendments to both the Railways (Access) Act 1998 (the Act) and the Railways (Access) Code 2000 (the Code) to effect TPI's inclusion.

TPI is majority owned and controlled by Fortescue Metals Group (FMG), which operates mining interests in the Pilbara region. TPI owns and operates the new railway line between Cloudbreak mine and Port Headland, a line for which Hancock Prospecting and possibly other mining companies are interested in gaining access. FMG is responsible for marketing and shipping the iron ore.

Rail access issues are unlikely to cause serious problems if the railway owner (TPI in this case) and operator (potentially Hancock Prospecting) have compatible incentives. Incentives would be compatible if:

- there was pure vertical separation in which the railway owner did not have direct or indirect interests in one of the operators (e.g. the ARTC model), or
- where the railway owner, for wider commercial policy reasons, favoured non-discrimination between operators (as may be the case with TPI, given that its owner, Fortescue Metals Group, is an access seeker on the lines).

In each case the railway owner faces an incentive to encourage access, in order to better spread its fixed and semi-fixed costs and to more readily finance expansion. This is compatible with the interests of operators who want access.

However if there is vertical integration between the railway owner and an operator in another part of the supply chain, where there is potential for competition with a future Access Seeker, the incentives may be incompatible. In such circumstances, carefully developed segregation, train path and other access policies are needed in order to oblige the railway owner to treat its operator customers in a non-discriminatory way.

This report summarises ACIL Tasman's comments on the three documents provided to date by TPI, namely the segregation arrangements, train path policy and train management guidelines, and makes recommendations as to what changes should be made to ensure that the arrangements are fair and compliant with the Act and the Code.

2 Segregation Arrangements

2.1 TPI's proposed segregation arrangements

2.1.1 Commentary

TPI's proposals on segregation do not appear to be sufficient, in that they do not comply with the Act. In addition TPI's creation of two stages, with the lesser obligations under Stage 1, fail to address the need for confidentiality in the area where conflicts of interest are likely to be most important.

Nature of segregation required

Without limiting Section 28 of the Code, in carrying out the duty to segregate the railway owner must ensure that the requirements of Sections 31, 32, 33 and 34 of the Act are satisfied¹. This means that the segregation arrangements must be carried out in a manner that ensures the requirements of these later sections are met – including that confidential information is protected and conflicts of interest avoided.

Section 28 of the Act specifies that the railway owner must segregate its access-related functions **from its other functions**. This could be taken to mean simply that TPI rail infrastructure must be segregated from TPI rail haulage.

However, TPI has noted that FMG staff involved in mining or marketing of iron ore could face a conflict of interest if they are in receipt of information regarding access applications. For Hancock Prospecting, the most important conflict of interest involves the potential for their future plans for iron ore extraction and shipping to be revealed to a competitor long in advance of when a rival mining operation would otherwise learn of such plans. In a strongly competitive market such as iron ore marketing, Hancock regards the preservation of confidential information as crucial. Accordingly, in order to satisfy the requirements of Sections 31 and 32, the segregation arrangements must ensure appropriate segregation of TPI's rail infrastructure functions from both FMG and TPI rail haulage.

¹ Section 30 of the Act

Compliance of TPI's proposals with the Act

In considering TPI's proposals, the first point to note is that it is inappropriate to refer to another jurisdiction and cite the fact that a particular rail regime has no legislative obligation to segregate access-related functions. Given the enactment of the State Agreement, TPI is subject to the WA Rail Access which does require segregation and that is what governs TPI's obligations.

Secondly, TPI's proposals make an inappropriate distinction between the arrangements appropriate for an Access Seeker and the arrangements for an Access Holder/third party haulage operator. As was made clear in submissions to ERA in connection with the 2002 review of segregation arrangements for WestNet Rail, access seekers regard full segregation and confidentiality for the negotiation process as essential. Confidentiality is particularly important in the access-seeking stage of the negotiating process, because that is when information is revealed about future plans regarding expansion of mining operations. TPI's proposals to involve FMG staff in access-related functions during Stage 1 are particularly inappropriate.

Thirdly, there are several aspects of the proposals that fail to provide adequate segregation of functions even under Stage 2. We recognise that there is an appropriate balance to be struck between cost of compliance, which is greater for a small and new railway owner such as TPI, and protection for access seekers. However, TPI has opted for minimal compliance costs by providing minimal protections - particularly in Stage 1. We do not believe this to be in the public interest, and hence consider that TPI's segregation proposals do not comply with the Act. However, we do recognise that it may well be appropriate for the final segregation arrangements to be less onerous than those applied to larger infrastructure providers with greater potential for upstream or downstream competition.

Staffing arrangements

TPI is a vertically integrated railway owner and rail haulage service provider. TPI's proposed arrangements, particularly in respect of Stage 1, do not provide adequate segregation arrangements for staff. There is no requirement for segregation of staff during Stage 1, only that staff do not perform access related duties concurrently with duties for other areas of TPI or FMG.

Under WestNet Rail's segregation arrangements, all access-related functions are undertaken by WNR staff. In its review of WestNet's proposals, ERA regarded the restriction of sharing of staff between WNR and AWR as a key measure to

prevent conflicts of interest, and required WNR to establish a protocol for restricting staff secondments. The only exception was in the case of emergencies.

TPI's Stage 2 proposals implement a more appropriate approach to segregation, by making it explicit that staff performing access-related functions will not perform any haulage related functions, and that there is to be a separate infrastructure division within TPI. Accordingly, we recommend that the Stage 1 arrangements be dropped and Stage 2 apply throughout, including prior to the signing of an Access agreement.

Further issues, including the location of staff and required procedures, are considered in the following sections on conflict of interest, confidential information, duty of fairness, accounts and records and compliance.

2.1.2 Recommended changes to arrangements

Addition of a clear statement of the objectives of the segregation arrangements, to say²:

TPI recognises its obligation to comply with the Act and the Code and specifically Section 28 and Sections 30 to 34 of the Act. The objective of this segregation arrangement is to ensure that TPI complies with the requirements of Sections 28 and 30 of the Act to segregate its access related functions and in particular to give effect to the obligations set out in:

- i. Section 31 of the Act which requires an effective regime for the protection of confidential information arising from performing access related functions.
- ii. Section 32 of the Act which requires the avoidance of conflict of interest between the duties of a relevant officer in performing access related functions and duties involved in other business of the railway owner.
- iii. Section 33 of the Act relating to the duty of fairness which requires that relevant officers in performing their duties must not have regard for the interests of the railway owner in a way that is unfair to persons seeking access or to other rail operators.
- iv. Section 34 of the Act which requires that accounts and records are maintained to ensure that it accurately records and distinguishes income, expenditure, assets and liabilities related to carrying out access related functions from other activities of the railway owner. This also

² As per the Westnet Segregation Arrangements

requires that any apportionment required between its access related functions and other functions be done in a fair and reasonable way.

TPI should provide a full set of definitions, including of Code, Confidential information, Contractor, Duty of fairness, Regulator and Segregation manual.

Under the list of access-related functions, add an initial function being:

- Compliance with the provisions of the Act and the Code and with the requirements of the Regulator under that legislative framework including but limited to:
 - Calculating the floor and ceiling costs for approval by the Regulator, and applying the costing principles, the overpayment rules, the train management guidelines, and the train path allocation policy;
 - Ensuring that suitable controls, measures and procedures are established to give effect to the segregation arrangements approved by the Regulator
 - Undertaking the steps defined in Parts 2 and 3 for the negotiation of Access Agreements.

Stage 2 arrangements for separation of functions between railway infrastructure and haulage should apply from the start.

2.2 TPI's proposals for avoidance of conflict of interest (Section 32)

2.2.1 Commentary

TPI's Stage 2 arrangements are designed to address potential conflicts of interest between TPI's railway and haulage business units. For this reason, TPI expects that the arrangements can be delayed in their implementation until an Access Seeker's haulage operations are about to commence.

TPI proposes these arrangements on the basis that the conflict of interest will be greatest when the Access Holder is running train services in competition with TPI train services. However this is to ignore other potential sources of conflict of interest concerning downstream iron-ore markets. FMG will be marketing iron ore in world markets in direct competition with potential Access Seekers. Information regarding future haulage volumes and time frames could easily be misused, and certainly have the potential to give rise to conflicts of interest.

These wider issues also raise concerns for the composition of the Boards of FMG and TPI. They suggest that cross Board membership should be minimised. Where confidential information is provided from TPI rail infrastructure division to the

TPI and FMG Boards, it will need to be clearly identified as confidential. TPI also needs to identify the procedures it will follow for the protection of confidential information, while allowing the FMG Board to carry out its statutory duties.

TPI's proposed segregation arrangements indicate that TPI will develop control measures to manage potential Board level conflicts of interest. These are envisaged to involve Segregation Awareness Statements and obligations not to disclose access-seeker confidential information.

When reviewing WestNet Rail's segregation arrangements in 2002, ERA considered that one approach to safeguarding information would be to not provide the CEO and Board of ARG with "deal level" confidential information on new access proposals. ERA recognised that this may not be realistic at a practical level if aggregate information is insufficient to allow the Board to carry out its duties. As a consequence, ERA determined that WestNet Rail (WNR) needed to implement a protection mechanism for the purpose of not identifying the access seeker(s) and their preferred train operator when reporting such information to the CEO and Australian Railroad Group (ARG) Board. Similarly procedures were required to be developed by WNR for briefing the CEO of ARG outside of Board meetings.

For a Pilbara rail line, the identity of an Access Seeker is likely to be obvious from the location at which they wish to connect to TPI's infrastructure. On the other hand, information about future plans regarding expansion of mining operations and consequential requirements for port capacity would be of value to a rival mining operation and is where the conflict of interest concerns lie.

For these reasons, we endorse TPI's proposal that any person performing below-rail functions (unless indirectly by virtue of a senior executive position) will be precluded from also performing above-rail functions.

However the segregation arrangements do need to establish a clear protocol for restricting staff secondments between the business units within TPI and between TPI and FMG. Unless an emergency situation arises, staff from outside the rail infrastructure unit should be precluded from being rotated into nominated access-related positions. If an emergency situation should eventuate, TPI should be required to inform the Regulator, with the seconded employee required to sign a Segregation Awareness Statement.

2.2.2 Recommended changes

Stage 2 arrangements to be implemented from the outset.

TPI should provide a commitment that it will manage its access related functions so that, for relevant officers, no conflicts of interest exist.

Train scheduling and train control functions should be undertaken by TPI staff from the rail infrastructure division who are subject to Segregation Awareness Statements.

Staff should not be rotated between TPI rail infrastructure division and related entities into positions that are covered by the Segregation Awareness Statement.

The control procedures included in the Segregation Manual should include the provision, and type, of information to be given to the Board of Directors of TPI and FMG, and to the CEO and other senior management of FMG. Where confidential information is to be presented, TPI should have a procedure in place which clearly identifies the information as confidential and all recipients should have signed a Segregation Awareness Statement.

Management reports provided to the TPI and FMG Boards should not identify individual access customers or the details of their rail operations (including tonnages). The Segregation Arrangements should detail the content of typical management reports, which would include:

- Operational matters related to the performance of the network
- Seeking approval for or reporting progress on capital works
- Issues related to the management of leases
- Reports on significant incidents
- Contracts, including access agreements, that have been entered into but only at a broad level of detail and without disclosure of full terms and conditions.

If TPI believes there is an emergency and cannot obtain staff other from TPI haulage division or FMG then it may use such staff in these positions only after it advises the Regulator of:

- a) The circumstances giving rise to the emergency
- b) The expected duration of the emergency
- c) The steps TPI will take to protect against a conflict of interest in these circumstances including those people who are proposed to be used signing a Compliance Statement.

2.3 Protection of confidential information

2.3.1 Commentary

TPI refers to the possibility of negotiations taking place outside the WA Rail Access Regime in its discussion on documentation³. This is incorrect, as TPI is covered by the regime and all negotiations will necessarily take place within the regime. We assume that TPI is referring to the possibility of negotiations taking place outside the *Code*.

The Acts defines confidential information in Section 31, and this is the definition that is binding on TPI. In its 2002 review of WestNet's Segregation arrangements, ERA sought additional legal advice on the provisions of Section 31 of the Act and its definition of "confidential information". The advice received indicated that confidential information covered both "input related" information, where information is passed to the railway owner during the negotiation process, as well as "output related" information, such as operational and management records, data bases and reports, access prices and terms and conditions of access agreements. ERA concluded that WNR should provide examples of what constitutes confidential information and that this should include both "input" and "output" type information. The list of information provided by TPI for Stage 2 is consistent with these requirements.

In its review of WestNet segregation arrangements, ERA noted that some jurisdictions have required the use of separate premises and IT systems to secure the protection of confidential information⁴. However, ERA argued that this requirement could lead to a loss of the synergies obtained from operating as a vertically integrated business and that the requirements of segregation can be met by stringent, but fair and reasonable measures without the need for separate premises and IT systems. However, ERA did require WNR to provide quite detailed information regarding office security, firewalls, controls on administrators of security systems and so on.

Consequently, the details on how confidential information is to be protected should be strengthened considerably. In particular, the Rail Infrastructure division should have a separate and lockable office area from other TPI business units. In addition, TPI should have office accommodation which is clearly separate from FMG and lockable. Information on how the rail infrastructure division's office

³ TPI Segregation Arrangements, p19

⁴ ERA, June 2002, Segregation Arrangements to apply to Westnet Rail, p10

area is to be secured should be provided, and what protection is to be provided to its files on the shared IT system.

2.3.2 Recommended changes

Stage 2 should apply from the start.

The last sentence in Section 4.4.2 should refer to negotiations being inside or outside of the Code, not the WA Rail Access Regime.

TPI should detail its control over access to its offices and those of the rail infrastructure division.

TPI should also detail the approach to be used to secure the electronic records of TPI's rail infrastructure division, including the location of file servers, management of user ids and passwords, and restriction of access and ability to generate according to user id.

2.4 Duty of fairness

2.4.1 Commentary

TPI states that it will apply the steps specified in parts 2 to 4 of the Code as part of its observation of its duty of fairness. Hancock Prospecting will want clarification on whether this is the case even for access agreements being negotiated outside the Code (in which case Part 2 to 4 would not ordinarily apply). If this is not TPI's intention, then additional comfort is required on how the duty of fairness is to be observed.

In submissions to the review of WestNet's segregation arrangements, the Regulator noted a common theme that WNR and AWR be required to operate at arms length and on a competitively neutral basis from one another. This requirement is met by the commitment that, under Stage 2 TPI will ensure that the key terms and conditions of internal access arrangements will be broadly comparable to those provided or offered to third party Access Seekers.

We note that the first of the two mechanisms cited by TPI (that access seekers may ask the Regulator to determine the fairness of prices negotiated under section 21(1) of the code), only provides protection to access seekers who have chosen to negotiate under the Code.

2.4.2 Recommended changes

Stage 2 should apply throughout.

TPI should confirm whether it intends to apply steps 2 to 4 of the Code to Access Agreements negotiated outside the Code.

TPI should inform access seekers at the onset of negotiations of their rights to confidentiality.

2.5 Preparation of accounts and records

2.5.1 Commentary

In its review of WestNet Rail's Segregation arrangements, ERA was of the view that access-related financial records should not, wherever possible, be centralised outside WNR. ERA also considered that WNR should be self-sufficient for regulatory accounting, access pricing and revenue management, but could share statutory and cost accounting functions.

In the light of the conflict of interest issues identified above, TPI's proposals that Stage 1 separate accounts and financial records be prepared by FMG's Finance Group are not acceptable. In particular, FMG Finance Group would be given confidential information regarding an Access Seekers' application, to assist TPI to respond to the Access Application. As it is relatively easy to outsource the relevant accounting and record keeping functions, we do not believe this would impose any significant burden on TPI.

TPI's Stage 2 proposals are that TPI be substantially self-sufficient for regulatory accounting, access pricing and revenue management purposes. However, these proposals imply that the rail infrastructure division will not be self-sufficient (only TPI as a whole). Sharing of the accounting function between the above and below rail divisions does not provide adequate protection of confidential information.

Where accounting and finance functions are provided by FMG, strong control measures need to be implemented and should be documented in the Segregation Manual. For example in the case WestNet, although the collection of access related payments is performed by ARG's accounting group, detailed information supporting the invoice is provided direct to customers by WestNet.

While it is recognised that sufficient information has to be provided to the Boards of TPI and FMG to enable their directors to fulfil their duties, it is important that such reporting be done only on an aggregate level.

ERA noted that the intent of Section 34 of the Act is to prevent “cost shifting”, ie the attribution of costs from providing haulage services to regulated below rail services⁵.

Consequently, it is noted that all stakeholders were keen to understand how WNR intended to allocate costs and structure their regulatory accounts to ensure that perceived or actual cost shifting does not occur.

ERA responded to these concerns by indicating that they would be dealt with in the Regulator’s determination on costing principles. This is not entirely satisfactory, however, as the costing principles apply only in the event that access is negotiated under the Code.

2.5.2 Recommended changes

Stage 2 should apply throughout.

Staff within TPI’s rail infrastructure division should maintain separate accounts and financial records for the purposes of complying with the Act and the Code. They should also control and manage the information used to produce the regulatory accounts and other information such as that used to calculate floor and ceiling tests.

Detailed procedures regarding confidential information supporting the billing process should be contained in the Segregation Manual.

Any financial information released by TPI’s rail infrastructure division for normal internal reporting purposes should be aggregated to prevent disclosure of confidential information. To the extent that TPI or FMG finance staff or auditors are given access to confidential information, they should be required to sign a Segregation Awareness Statement.

2.6 Compliance

2.6.1 Commentary

The information provided by TPI on the proposed Segregation Manual does not include any specific details as to what the manual will cover. This is in contrast to the WestNet Segregation Arrangements statement. Based on WestNet’s arrangements, we propose some additional points for inclusion below.

⁵ ERA, June 2002, o25

The period of 30 days in which to advise the Regulator of a complaint would seem too relaxed. For consistency with the audit obligations we propose a 10 day period for advising the Regulator of any complaint received.

2.6.2 Recommended changes

TPI's Segregation Manual should include:

- Specific details of the security arrangements in place to protect confidential information including details of the arrangements for securing paper and electronic records and for access to information systems
- Details of the physical location of staff and security systems in place in those workplaces
- A list of the types of behaviour which may breach segregation arrangements and the appropriate corrective arrangement for each breach
- A compliance plan, including the preparation of an annual report for internal and external audit requirements. The annual report will include details of all instances of non-compliance and rectification strategies. The compliance plan will be a key monitoring tool for the Regulator in assessing effectiveness of the segregation arrangements.
- Controlled procedures required to give effect to these arrangements including:
 - The use of staff from TPI haulage and rail safety and other related entities by TPI rail infrastructure in an emergency
 - The preparation by operators of amendments to daily or weekly plans for services which experience variable demand
 - The provision, and type, of information to be given to the Boards of Directors and (outside of these structured meetings) to the CEO and other senior management of TPI and FMG
 - The provision, and type of information to be given to the FMG accountancy group
 - The identification and storage of, and access to, confidential information
 - The report of a breach of segregation arrangements to the Regulator
- A list of all positions of employees and contractors who must sign Segregation Awareness Statements.

TPI should use all reasonable endeavours to advise the Regulator within 10 days of any complaint it receives.

3 Train Paths

3.1 Introduction

3.1.1 Commentary

In its Train Path Policy, WNR volunteered to apply its policy to all train paths, not just to access arrangements negotiated inside the Code. TPI's document should offer this also.

Efficient utilisation of the network may affect a particular operator's interests -- for example if the operator has paths that it has not used recently, the railway owner may wish to reallocate them. The TPP constrains how this may be done, as discussed below.

3.1.2 Recommendation

TPI should apply its policy to all train paths, irrespective of whether the access agreement is inside or outside the Code.

3.2 Allocation of capacity

3.2.1 Commentary

Analysis of capacity

A maximum additional time period should be specified for the detailed capacity enhancement analysis.

The WNR TPP has some useful words (in section 2.2.2) on negotiating new train paths which we suggest be included in the TPI TPP:

- [TPI] will refer to the Master Train Control [Plan] to
 - ... determine if the path(s) are available, or
 - ... if possible, seek changes to or the deletion of train paths allocated to other operators to create the requested train paths, or
 - ... advise the operator the train paths as requested are not available and suggest alternatives that may be available
 - ... at all times maintain dialogue with the operator to ensure all alternatives are explored.

Problems may arise, however, where capacity is adequate for the initial operator (which might be related to the railway owner) but new capacity is required to accommodate the second operator (which might be a competitor). The railway owner would want the newcomer to pay, directly or through access charges, for the entire cost of the enhancement. Other problems might arise where there were surges in demand or where an operator wanted to retain unused paths in the interests of flexibility or later expansion (discussed further below).

Capacity Allocation

The proposed TPP provides the possibility of bidding for scarce paths, and refers (without being specific) to allocation criteria applied elsewhere in Australia. ACIL Tasman has not found reference to such criteria in other rail access documents (e.g. Queensland, New South Wales, ARTC). It is aware that the ARTC proposed such an approach in its submission to the review of the WA Code, but this was rejected by the ERA (ERA *op.cit.*, paragraphs 64 to 68) – and as a consequence the WNR TPP says (section 5):

If two operators request the same available train path and it is not possible to satisfy both requests by using alternative but similar train paths, the available train path will be provided to the operator who first requested the train path and can establish that it has a requirement for the train path.

The Regulator favoured the “first come first served” principle for allocating train paths, on the condition that the access seeker will also have to establish that it has the requirement to use the path. Commercial approaches such as bidding are problematic under vertical integration, as the operator that is related to the infrastructure owner would effectively be paying itself. We judge that Hancock, as a non-related operator, could be disadvantaged by such approaches. Even so, there is an opportunity through vertical integration for negotiations to be advanced more rapidly with a related party than with an external party. This could disadvantage Hancock also.

Note also that one area of judgement, emphasised in italics above, is unclear, and needs to be reworded (and an opportunity to comment further provided to Hancock).

The dispute settlement mechanism essentially involves arbitration, and would be bolstered by referring to the Code provisions (Division 3 – arbitration of disputes – sections 24 to 35) rather than just to section 25; in particular section 30 allows the arbitrator to refer questions to the Regulator and seek his or her opinion, advice or comments. The WNR TPP has some useful wording in section 8 that

endeavours to reduce the need for arbitration (which can be costly, cause delays, and produce results that the parties do not “own”):

...disputes will be resolved by a three stage process as follows:

- Firstly, negotiation of dispute between the parties with a seven-day time limit and using reasonable endeavours
- Secondly, by mediation between the equivalent Chief Executive Offices and after 14 days if no agreement is reached by expert mediation, and
- Thirdly, by arbitration...

It may be assumed, but is not explicitly stated, that where there is competition for path(s), the parties will first try to resolve the problem with some give and take (in ACIL Tasman’s experience, where there is no commercial interference, railway operators can usually find pragmatic solutions unless there is an overall shortage of capacity that requires capacity enhancements to resolve). A situation where tensions could rise is that of demand surges, in the short term (to meet shipping schedules) or medium-term because of a rapid increase in end customer demand.

3.2.2 Recommendations

Analysis of capacity

- The wording of section 2.2.2 of the WNR TPP should be included in the TPI TPP
- There should be a maximum time period for examination of whether there was a need for capacity enhancement (e.g. three months to cover assessment of the increased demand, train path modelling, and determination of what extra capacity was needed)
- The provisions of the TPP should be supplemented by a process – that is, the sequential steps and time limits -- that would apply when an operator sought paths that required capacity enhancement.

Capacity allocation

- The reference to dispute settlement should be to all of division 3 of the Code, not just section 25
- In Section 2.3 of the draft TPP, TPI proposes that “Access Rights will be allocated to the first Access Seeker with whom TPI can negotiate and execute and Access Agreement in relation to the Access Rights that are the subject of the application which, *in the opinion of TPI, is most favourable to it*”. (Italics added). This wording should be clarified, and then parties such as Hancock given the chance to comment

- There should be an explicit reference to all parties using every reasonable endeavour and working together to modify train path needs to avoid clashes
- The reference to a commercial basis, market testing and allocation criteria from other access regimes, requires substantial elaboration – what type of testing, what allocation criteria and how would it work. Once elaborated, Hancock would require the chance to comment.

3.3 Management of capacity

3.3.1 Commentary

Permanent variations to train paths

The terms permanent, temporary and variation are not defined in the draft TPP or in the Code.

The provisions for variation by TPI are vague and give little assurance to an operator. TPI has to give reasons but can still do what it likes. “Reasonable grounds” are not defined, nor is it stated who would decide (implicitly it is TPI). The main assurance, which is in the following paragraph on operator-requested variations, is that in principle an operator’s path would not be varied to suit another operator, unless there was agreement.

References to safety need to be qualified to reduce the possibility of it being used as an excuse as it has been elsewhere (e.g. the two driver policy in NSW). The railway owner should be required to demonstrate that there is a safety issue.

Resumption of capacity

If there is plenty of capacity, the railway owner has little incentive or need to resume capacity. If there are capacity constraints it has an incentive to resume capacity and sell it someone else. However the operator that is not using all its capacity may wish retain it so that it has the flexibility to cope with future demand surges or general demand increases. Ideally it should pay for that, so that the railway owner is indifferent between different operators (irrespective of whether or not they use their paths) and faces a neutral position with respect to expansion.

However in the short term it would be possible for one operator to block access or expansion by another, by buying slots it does not need and not using them. It could get away with this for almost half a year, comprising the quarter plus 30 days plus 28 days referred to under Resumption of Capacity in section 3.2 of TPI’s

draft TPP. This scenario is covered by section 10 of the Code and it would be worth including the related wording from the WNR document (section 3):

Where a request for a train path... may preclude other entities from gaining access to that infrastructure to train path(s) will not be granted without the approval of the ERA in accordance with section 10 of the Code. If the ERA grants approval then [TPI] will commence negotiations.

Note that in its 2002 review of WestNet's Train Path Policy, the Regulator expressed the view that WNR's entitlement to cancel a train path should only apply if there is a reasonable indication that the train path is sought by and would be allocated to another operator⁶. This prompted the further useful wording in section 2.5.1 of WestNet's TPP:

If [TPI] proposes to withdraw a train path because of lack of use it will do so only when:

- There has been a request for use of the path from another operator, or
- It would allow better management of the train paths and encourages efficient use of the network, or
- The operator agrees to its withdrawal.

If either of these first two points applied, "if the operator failed to operate the service using the train path from more than six weeks in aggregate in the period of six months from the date of... notice...[TPI] will withdraw the train path at the end of this six-month period, provided that the failure to operate the service is not a consequence of the force majeure event or [TPI] not making the network available."

Section 2.5.2 of the WNR document also has useful wording to cover the situation where an operator loses part of or of its freight haulage contract which the train paths are allocated for.

Review of service entitlements

This is broadly similar to the WNR document and appears acceptable.

3.3.2 Recommendations

Permanent variations to train paths

- The terms temporary and permanent should be defined

⁶ ERA, October 2002, Train Path Policy to apply to WestNet Rail, p16

- Any references to safety reasons should be elaborated, so that it is clear that the railway owner must demonstrate (rather than merely assert) that there is a significant safety issue
- The provisions for permanent variations requested by TPI should be elaborated, in particular the term “reasonable grounds”, and Hancock should then be given a chance to comment
- A dispute settlement mechanism should be available.

Resumption of capacity

The above wording from the WNR TPP should be added to be TPI TPP.

3.4 Other matters

3.4.1 Commentary

Cancellation of services

Although the TPI draft covers under-utilisation, it does not cover circumstances when it may be acceptable for an operator to cancel services. The WNR TPP (section 2.7) has such provisions. Operators have the right to cancel train paths without penalty in any one of the following circumstances (provided they are beyond the reasonable control of the operator): public holidays, mechanical difficulties with rolling stock, failure of the operator’s equipment, repair/maintenance/ upgrading of the network, derailments collisions etc on the network, and “the operator is unable to load trains because of a lack of products at terminals or is unable to unload product at terminals or ports because of insufficient storage space or because of mechanical difficulties with the loading or unloading equipment at terminals or ports”. TPI should have a similar level of protection for cancellation by operators in reasonable circumstances.

On-selling of paths

During the review of WestNet’s train path policy in 2006, there was debate about whether an operator should be able to sell its rights to use a train path to another operator – see paragraphs 56 to 63 of ERA *op.cit.* The Authority concluded in favour of allowing on-selling train paths, and as a consequence the WNR TPP (section 4) allows operators to do this subject to certain conditions (Appendix A) that were approved by ERA. The TPI TPP does not have provisions for on-selling train paths; it is recommended that it should.

External audit

WNR's compliance is subject to an annual independent external audit. The ERA may select and manage the auditor with costs paid by WNR (See section 9 of the WNR TPP). The same could be considered for the TPI case though perhaps with less frequency – e.g. annual if requested by an operator or the ERA, otherwise every three years.

4 Train management guidelines

4.1 Introduction

4.1.1 Commentary

TPI states that the TMG applies to all operators. It implies that the guidelines apply whether or not the Access Agreement was negotiated within the Code, which provides greater clarity regarding the operation of the railway. However TPI should be asked to state explicitly that the guidelines cover agreements negotiated outside the Code. The Regulator considered that confirmation of this intent was important in the case of WestNet.

TPI's introduction could also indicate that ERA must approve or determine the train management guidelines after a period of consultation.

4.2 Scheduling principles

4.2.1 Commentary

The provisions in regard to the Master Train Path and the Weekly Train Path have no equivalents in WestNet's Train Management Guidelines. In particular, Sections 3.1 to 3.4 of WestNet's TMG contain a substantially different presentation of the principles for train management. We are not able to comment on the appropriateness or otherwise of TPI's proposals on a practical level.

4.3 Real time management of services

4.3.1 Commentary

Services presented on time, late or early

TPI's proposals are similar to the Train Management guidelines issued by WestNet Rail in 2006, following the Regulator's final determination and approval.

However there are a number of places where TPI has relaxed the railway owner's obligations or increased those of operators:

- WestNet **will ensure** that on time trains exit on time, while TPI offers best endeavours

- WestNet requires advice **within 15 minutes** of the scheduled departure time (or early departure time) rather than TPI's 30 minutes
- WestNet will use **best endeavours** to ensure that late trains recover lost time, rather than TPI's reasonable endeavours

On the other hand, TPI offers reasonable endeavours to ensure that an early service holds its gain, whereas WestNet provides best endeavours to ensure that such services depart no later than the scheduled time.

Although we recognise that there may be differences between a network in the South West and a heavy haulage railway in the Pilbara that might make some differences in TPP requirements appropriate, the changes here and in other places almost universally favour TPI. TPI should be required to justify the dilution of its obligations relative to those offered by Westnet.

Instructions

TPI's proposals are very similar to WestNet's provisions, except that WestNet specifies that the operator needs to comply with instructions (other train control directives) only if it was given a reasonable time before the required time for compliance.

WestNet also recognises that the operator is not responsible for any delay suffered or cost incurred by WestNet in the operator complying with a proper instruction, and WestNet releases the operator from any such claim. TPI's proposals should contain a similar clause.

4.4 Managing infrastructure issues

4.4.1 Commentary

Network repairs, maintenance and upgrades

TPI's provisions are very similar to those offered by WestNet. However, there are a number of places where TPI has diluted the requirements placed on itself under the TPP, and should be asked to justify these. Thus WestNet offers **best endeavours** to provide an alternative train path, where TPI offers only reasonable endeavours. WestNet also says that it **will at all times** consult with operators whose train paths are affected by possessions, whereas TPI proposes only reasonable endeavours for such consultation.

TPI should be asked to provide 2 weeks notice of possessions that will affect train paths between for periods 6 to 48 hours, as offered by Westnet.

WestNet is required to give six months notice of possession for major maintenance or long term upgrades, in comparison with TPI's endeavours to give at least 3 months.

Unlike WestNet, TPI does not specify the content of any notices. WestNet notices will describe the extent and nature of maintenance and upgrade works, the potential effect on train paths and what alternative arrangements are proposed.

In its 2002 review of WestNet's TMG, ERA noted that it does not have the power to make determinations regarding the compensation of operators for adverse impacts of WNR track management, and that:

The Regulator would expect that these issues would be addressed in the equivalent access agreement. Nevertheless, if it can be proven that WNR has unjustifiably disrupted the train paths of one operator more than another operator, the Regulator may consider whether WNR has breached the provisions of Section 34A of the Act which deals with conduct aimed at hindering or preventing access⁷.

Management of emergencies or other incidents

TPI's provisions are similar to those of WestNet, except that WestNet stipulates that another operator is not required to provide assistance if it will incur cost and risk unless agreement is reached on how the cost and risk is to be shared.

Disputes

The WestNet TMG provide detail of what is required regarding dispute resolution under the Code. TPI should be asked to provide similar detail.

Other issues

TPI's TMG includes no discussion of the process for agreeing Key Performance Indicators. Previously the Regulator commented that the TMG should refer to the fact that agreed KPIs in the access agreement will establish a method of measuring performance⁸.

⁷ ERA, October 2002, Train management guidelines to apply to WestNet Rail, p15

⁸ Op cit, p15

Commentary on TPI proposed rail access arrangements

TPI's TMG also contain no information regarding the process of review and public consultation on the TMG required by the Code. In its 2002 review of WestNet's TMG, the Regulator commented that:

A statement to confirm the intended inclusion of operator specific KPIs within individual access agreements should be included in the TMG⁹.

TPI has provided a comprehensive set of definitions, which is to be welcomed.

⁹ Op cit, p24



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Hancock Prospecting Pty Ltd
Review of Rail Access Obligations
TPI Network, Western Australia

August 2008



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1. Background

The Economic Regulation Authority of WA (ERA) has released a number of documents from The Pilbara Infrastructure Pty Ltd (TPI), a wholly owned subsidiary of Fortescue Metals Group (FMG) regarding its rail access obligations under the state Agreement. The ERA is asking for comment from interested parties.

Hancock Prospecting Pty Ltd (HPPL) is an interested party and is considering a submission. GHD has been approached by HPPL to assist by providing specialist advice regarding access seeker arrangements from a train operator's perspective on the released documents. ACIL Tasman has been asked to consider the documents from a regulatory and economic perspective and that report has been made available to GHD.



2. The Documents

Three documents released by ERA and produced by TPI are relevant to this issue. There are:

- “Train Management Guidelines” which deals with the protocols to be used in the management of trains from the point of planning to the point of day to day operation;
- “Segregation Arrangements”, which deals with the institutional arrangements to ensure fair treatment to third parties using the infrastructure and,
- “Train Path Policy”, which deals with the protocols to be used in the way in which trains are allocated space on the infrastructure.

In addition we have reviewed the document by ACIL Tasman called “Commentary on TPI proposed rail access arrangements”, which includes subsections including Train Management Guidelines, Train Path Policy and Segregation Arrangements. We agree with all of the comments made by ACIL Tasman and we will not repeat those comments.

We draw your attention to primary sources of concern in Sections 3, 4 and 5.

We have emphasised the important issues in **bold**.



3. Train Management Guidelines

3.1 Railway Definition

In adding the definition of the TPI Railway into Item 52 of Schedule 1 of the Access Code, **as a single line entry, the opportunity exists for TPI to manage the railway as a single entity including the operation of all tracks at the Port.** This precludes the operation of a part of the railway where for example a Third Party operator may wish to join or leave the railway part way along.

We note that the WestNet network for example has been segmented into many separate sections in the Code, and there are recognisable differences in the way an operator may wish to access the various parts of the WestNet and PTA networks.

3.2 Operation of the Train Plans

The practicality of this provision is borne out in TPI's TMG where it indicates that the Weekly Train Plan "will be prepared in consultation with the Port Operator"¹. Further, in the traffic management matrix on page 27, Rule 3, which is an important rule for determining priority, the "priority may be dictated²... on instructions received by the Train Controller from the Port (acting to maximise the efficiency of the supply chain as a whole)".

We note that the definition of Port is the Fortescue Herb Elliot Port.

Therefore, the railway³ is proposed to be managed by maximising the operation of the trains that use the railway AND the port in order to maximise the efficiency of the FMG⁴ supply chain as a whole.

On this basis the concept of open access to the railway is compromised because not only does the Port "instruct" the railway, which would be concerning even if both entities were owned separately, but that both entities are owned by the same owner.

In order to provide true open access to the railway TPI must decouple the Port from the railway. This has been accomplished in other jurisdictions by either separating ownership and/or by providing staging⁵ facilities so that the railway can operate independently of the ports⁶ it services.

We conclude that the TMG is designed to maximise the FMG supply chain and which includes mine, rail and port, and other operators will

¹ Despite the capitals, there is no definition in the extensive definition list

² Interpreted by us as being unilateral

³ The whole of the railway, as a single line entry in the definition in the Access Code

⁴ FMG includes all of the mine, railway and port

⁵ Staging is a term to describe a short term storage function to permit buffering between interfaces

⁶ Note the emphasis on plural, where TPI has implied the singular



only be entitled to any remaining portion of capacity entirely at FMG's authority.

3.3 Contractual Obligations

The contractual arrangements about TPI's integrated approach⁷ to the management of the railway also make it plain that a Third Party attempting to use the railway is in great danger of being provided with secondary service.

The Third Party operator may⁸ not have any contract with the Herb Elliot Port, preferring to use its own port for example. **Therefore, when it is attempting to satisfy its contractual obligations to its own port, what means of negotiation or contract does the Third Party have? It would appear none.**

3.4 Supply Chain Optimisation

3.4.1 Legislative Requirement

There is no requirement to optimise the supply chain in the Access Code. Nor is there any explicit requirement in the Rail and Port Pilbara Infrastructure Agreement Act.

However, by the method of defining the railway as a single entity and by effectively tying the development of the Port as a unit, in as much as the Act is titled accordingly, the result is that the intention is that all of the management of the railway will have as its primary focus the efficient operation of the TPI/FMG supply chain.

3.4.2 Broader Requirements

The coal supply chain in Australia has recently been criticised for its bottleneck, denying Australia valuable export earnings.

There is no doubt a need to optimise supply chains and there is also no doubt that TPI wishes to optimise its supply chain.

In Queensland and NSW the coal supply chains are being optimised using a common railway system largely by cooperation amongst stakeholders. Our emphasis here is that multiple supply chains can operate using a single railway infrastructure resource.

The TPI TMG does not require consultation to the level required for MUTUAL supply chain optimisation.

⁷ An argument used by Hamersley Iron when Robe River attempted to gain access to its railway

⁸ It is possible a Third Party will use the Herb Elliot Port



3.4.3 Capacity of the Railway

Ultimately, the use of the railway and its satisfactory achievement of supply chain targets will rely on the capacity of the railway in terms of available pathways.

If a railway is built to satisfy only one supply chain it will have been optimised for that supply chain and manifest in the number of crossing loops and length of double track.

Typically, new entrants to a railway who require capacity over and above that needed for the initial operation will require new crossing loops and other enhancement infrastructure. In some cases this involves the installation of a signalling system, or enhanced communications or double track.

It is most likely that the TPI network has been optimised, with the object being lowest capital cost, for the tonnage requirements of its initial task. A subsequent operator will most likely need to contribute to the capital cost of an expansion of the network or have that requirement built into its access price.

However, the requirement to cooperate in this way is not explicitly provided for in the TMG given the powerful role provided to the Port. This may be particularly relevant if a Third Party wishes to use another port.

3.5 First Come First Served

It is usual amongst Access Agreements between Train Operators and Network Owners to construct the provision that involves the first operator the right of access, within certain timeframes and commercial provisions, to the available capacity of the railway.

Typically it is possible for the first operator to “reserve” train paths by the payment of access fees and retain those pathways, even if they are not used, for a defined and limited time. There is a “reasonableness” test applied by Regulators to ensure that a (first party) operator is not able to preclude other operators from entering the market while at the same time recognising that the use of paths is not an instantaneous activity.

Often an operator will foreshadow a future requirement with the network owner. The network owner will “pencil” the requirement into its Master Train Plan and if the paths are then requested by another operator will be offered to the first.

Even if the fees are paid, the operator is required to use those paths in a defined period of time before being taken back by the network operator for sale to a bona fide user.

This principle is also used on a day to day basis when the allocated user has first right to use a path.

TPI’s documents are relatively silent on this matter and further detail of these provisions is required.



4. Segregation Arrangements

4.1 Use of Precedents

TPI have attempted to use the precedent of the FreightLink Railway, Tarcoola to Darwin, in respect of segregation arrangements. This example is not relevant to that of TPI because the railway has other obligations that are relevant only to road competition, a factor not present for the TPI railway.

In addition, given that the FreightLink Railway was partially funded by the Commonwealth it is in the Commonwealth's interest to make sure the railway remains competitive with its competition, that is, road transport.

It is true that no railway has had the IMPOSITION of full segregation arrangements but it is also true that others have undertaken to separate functions.

For example, NSW progressive separated its functions by firstly commercialisation state run organisations into separable parts and then privatising above-rail operations. There was further separation when NSW leased the interstate corridors to ARTC and also contracted ARTC to manage the Country Rail Network (CRN).

In regional Victoria an integrated private sector model failed when the privatised network and above-rail operations became uncommercial, but the state has since brought the management of the network into government control while the freight operations remain in private sector hands. Initially there was a lack of separation because a single private sector company managed above-rail and below-rail operations but now the two freight functions are completely separated. The government controls a passenger operation over the government controlled network.

In South West Western Australia the freight above and below rail operations are completely separated after an initial period of private sector integration by one organisation. The two sectors are controlled by the private sector.

In Queensland, while the government controls both an above rail operation and the below rail freight operations, the evolution of the arrangements in Queensland has seen the corporatisation of the entities and Third Party access arrangements are mature, notwithstanding the considerable barriers to entry a Third Party still endures.

Essentially, there is no exact precedent for the proposed TPI operation and therefore will need to be considered on its merits.



4.2 Two Stage Approach

In considering TPI's two stage approach the major area of concern hinges around the meaning of "TPI proposes that Stage 2 will be triggered by the signing of the first Access Agreement with an Access Seeker".

There are two issues here. Firstly, without a Standard Access Agreement, which is widely published by all other jurisdictions in Australia, and which is a template for the form and content of the contract between TPI and a Third Party operator, it is difficult to tell whether the Agreement will in fact provide fairness to the Third Party.

A Standard Access Agreement should accompany TPI documents.

Secondly, what is the meaning of "first" Access Agreement? Is this the Access Agreement that should be in place between TPI below rail and TPI above rail. If Stage 2 of the Segregation Arrangements do not come into force before an Access Agreement comes into effect with a Third Party then a potential "catch 22" arises.

There should be an Access Agreement between TPI above rail and TPI below rail, and any safeguards that would protect a Third Party from unfair treatment should be put in place as early as possible.

While having recognised stages in the implementation of Segregation Arrangements is a good idea, an appropriate transition should also occur with more specific staff quarantining during this transition.

For example, TPI train controllers should not be involved in determining the access pathing of a Third Party or if they are the Third Party should be able to review the process independently.

During this critical first stage transition precedent involving the allocation of access to the first Third party, the WA Regulator should independently assess the process.

4.3 Other Aspects of the Segregation Arrangements

TPI have done a good job of identifying the functions that are potentially subject to abuse and the measures to restrict conflict of interest have been addressed.

However, one area, which was the subject of earlier comment is the role of Port Operations, while not defined in the TMG, are interpreted to mean the controllers that manage both port operations as well as railway operations, or if two sets of people are closely related.

In as much as the TMG indicates that the focus on railway operations is to maximise the efficiency of the supply chain, it is obvious that in any segregation arrangement, there will be no action to reduce the focus on that objective.



The Segregation Arrangement paper has not mentioned the segregation that may be necessary between port operations and train control. TPI would interpret the functions as being mutually dependent, but clearly for a Third Party, the influence of port operations will have a dramatic effect on any planning or real time decision making.

TPI should therefore be more explicit about the separation arrangements of Port Operations and the train control function. Since the Third Party has no contractual arrangement with the Port, the Third Party needs to be protected from the Port making decisions that will affect the operations of the Third Party.

If the railway were segmented so that decisions about railway operation on the mainline was separated from decisions about the operations at the Port, then this would protect the Third Party. Typically this separation has occurred by track ownership.

For example, in the case of the interstate network, ARTC manages only the mainline and passing loops. Other parties manage yards and sidings. These other parties are typically above-rail operators. Only the mainlines have been Declared.

This is also the situation in Queensland where Network Access, the QR business managing the network, manages only the Declared Network which is only the mainlines, loops and certain "common user" facilities.

If a Third Party will not use TPI's Port, then it should not be constrained in its operations by the requirements of that port.



5. Train Path Policy

5.1 Reference to TMG

The TMG emphasis was focussed on short term management guidelines but did include references to long term management such as the construction of the Master Train Plan.

The Train Path Policy (TPP) addresses similar issues to the TMG but focuses on longer term aspects associated with path allocation at a planning stage.

Therefore many of the comments previously made in the section dealing with the TMG are applicable in this section.

5.2 Definitional Matters

The TPP suffers from the same problem as the TMG in that the Network is defined as 'means the track and infrastructure controlled by TPI... including railway infrastructure at the Port'. By including infrastructure at the Port, TPI have essentially vertically integrated port operations with the railway. If a Third Party wishes to use another port, TPI have the ability to adversely impact the Third Party operations by using exigencies at their Port (Herb Elliott).

5.3 Analysis of Capacity

We note that the TPI proposals are not materially different to those in operation in other jurisdictions except that there is a distinct lack of detail associated with the proposal.

For example, the method of assessing the "reasonable commercial basis" for which Access Rights may be allocated where two or more access seekers are involved in vying for the same paths is not detailed. The notion of "more advanced" is somewhat subjective. **In other jurisdictions date stamps are used on documentation and diary records made of meeting and conversations so that at the very least post audits can occur and lessons learned for both the Regulator and the Network Owner.**

5.4 Management of Capacity

TPI's general approach to the management of capacity is sound but again lacks some of the detail by way of example that are evident in other documentation. Of the minor points to raise the main issue concerns substitutional task.

For example if an Operator loses task to an above rail competitor, or if the mine wishes to operate its own train, should the path allocation from the original operator be "grandfathered" to the new operator. Our view is that the same paths should be allocated automatically to the new operator. While the



title of section 3.2.2 purports to address this issue, the body of text only deals with TPI's rights.

Clause 3.2.2 should also deal with the rights of the operators.

This raises the issue of who should be permitted to enter into an Access Agreement. In other jurisdictions mines or freight forwarders are able to enter into Access Agreements provided they could show that they have an agent that is a certified/approved above-rail operator. This permits single purpose operators such as mines to invest in their own rollingstock giving them added flexibility in their service provision by being able to contract with competitive suppliers of train operations.

Access Agreements should be made available to a broader range of operators.



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