



Government of **Western Australia**
Department of Treasury

Introducing cost recovery for the WA Rail Access Regime

Workshop Paper September 2018



Disclaimer

© State of Western Australia

The information, representations and statements contained in this publication have been prepared by the Department of Treasury and are provided for information purposes only. Views expressed in this publication are not necessarily the views of the Western Australian Government or the Treasurer. The State of Western Australia, the Treasurer, the Department of Treasury, and their respective officers, employees and agents:

1. make no representation or warranty as to the accuracy, reliability, completeness or currency of the information, representations or statements in this publication (including, but not limited to, information which has been provided by third parties); and
2. shall not be liable, in negligence or otherwise, to any person for any loss, liability or damage arising out of any act or failure to act by any person in using or relying on any information, representation or statement contained in this publication.

Contents

Disclaimer	i
Contents.....	ii
The purpose of this paper	1
Context	2
The rationale for cost recovery.....	2
Western Australia’s Rail Access Regime	2
ERA’s role in Rail Access	3
How the ERA’s functions are currently funded	3
The ERA’s Rail Access functions and associated activity costs	5
Principles for recovering the ERA’s costs of regulating Rail Access	5
Introducing cost recovery	6
Potential standing charge for Rail Access functions	6
Specific charges for Rail Access functions	7
Options for allocating Standing Charges	7
Preliminary Assessment of options	7
Option 1: Equal share of costs allocated to each railway owner.	7
Option 2: Allocation of costs based on asset value of each railway.....	8
Option 3: Allocation of costs using the route length of each railway	9
Option 4: Allocation using the total freight task of each railway.....	10
Workshop Consultation Questions	11
Next Steps	11
Contact Details	11
Appendix 1 List of ERA functions to be cost recovered	12

The purpose of this paper

The Western Australian Government is intending to introduce legislation to allow the cost of regulatory oversight of the Rail Access Regime to be funded by industry from 1 July 2019. The decision to introduce cost recovery was made as part of the State Budget in 2017-18.

This Workshop Paper provides background on the rail access regime, the Economic Regulation Authority (ERA) functions relating to that regime and the purpose of cost recovery. It also outlines cost recovery options and questions to assist industry stakeholders to have input into the design of cost recovery arrangements.

Context

As part of the 2017-18 State Budget deliberations, a decision was made to introduce industry charges to recover the cost of regulatory oversight of the Western Australian Rail Access Regime from 1 July 2019.

The rationale for cost recovery

The Western Australian Government provides a diverse range of services, support and benefits to the Western Australian public, businesses and industry to achieve its policy outcomes. These activities are funded from different revenue sources, including general taxation, sales of public assets, government investments, and cost recovery.

Cost recovery can be defined as the method for recovering an expenditure that government (or business) incurs for an activity or service that it provides. In a public sector context, it involves the Western Australian Government charging the non-government sector some or all of the costs of a specific government activity. That activity may include the provision of goods, services or regulation, or a combination of them.

Cost recovery is important because it can:

- promote equity whereby the recipients of a government activity, rather than the general public, bear its costs;
- influence demand for government activities;
- improve the efficiency, productivity and responsiveness of government activities and accountability for those activities; and
- increase cost consciousness for all stakeholders by raising awareness of how much a government activity costs.

Western Australia's Rail Access Regime

The Western Australian Rail Access Regime commenced on 1 September 2001. There are currently four regulated rail networks in Western Australia:

- The urban network operated by Public Transport Authority;
- The freight network operated by Arc Infrastructure;
- The Pilbara Infrastructure (TPI) railway, a fully owned subsidiary of Fortescue Metals Group; and
- The Roy Hill Infrastructure (RHI) railway, a fully owned subsidiary of Roy Hill Holdings.

The urban and freight railway networks have been regulated since the Regime commenced in 2001. The Pilbara Infrastructure railway became regulated in July 2008 and the Roy Hill Infrastructure railway in 2010.

ERA's role in Rail Access

The Rail Access Regime was originally the responsibility of the Office of the Rail Access Regulator and was funded by an appropriation from Government. That office was abolished when the *Economic Regulation Authority Act 2003* (ERA Act) was enacted and responsibility for the rail access regime was transferred to the ERA (Box 1).

Box 1: About the ERA

The ERA is an independent statutory authority established under the ERA Act. Its purpose is to benefit the Western Australian community by promoting an efficient and customer focused economy. The ERA has a range of regulatory, reporting and review functions (inquiries) that are intended to achieve this purpose. The ERA regulates the electricity, gas, water and rail industries. It has legislative reporting responsibilities to the following ministers:

- The Minister for Energy, on matters related to the wholesale electricity market and electricity and gas licensing;
- The Treasurer, on economic inquiries and rail code reviews; and
- The Minister for Water, in relation to water licensing.

Many of the ERA's functions in relation to administering the rail access regime relate to oversight, though they also include determinations of railway owners' costs when an access proposal is made. A list of functions that the ERA is currently required to undertake as part of its obligations under the *Railways (Access) Act 1998* (the Rail Act) and the *Railways Access Code 2000* (the Rail Code) can be found at Appendix 1 of this discussion paper.

How the ERA's functions are currently funded

Section 61(2) of the ERA Act allows regulations to be made for the imposition and payment of fees and charges in connection with the performance of the ERA's functions. This reflects the Government policy intention, when the ERA was established, that its regulatory functions would be industry funded. This regulation making power has been used to create industry funding for some of the ERA's functions and it is intended to use it for the rail access function.

The ERA currently sources funding for its rail access activities from a Government appropriation. Table 1 outlines the functions of the ERA and how they are funded.

Table 1: The ERA's functions and how they are funded

Function	Funding Source	Funding Mechanism
Undertaking inquiries referred by the State Government	Government appropriation ¹	
Annual review of the effectiveness of the merger arrangements between Verve Energy and Synergy that occurred on 1 January 2014	Government appropriation ² (under review)	
Regulating access to certain parts of Western Australia's rail network	Government appropriation	
Regulating access to Western Power's electricity network	Industry – network operator – standing and specific charge	Economic Regulation Authority (Electricity Networks Access Funding) Regulations 2012
Regulating access to regulated gas pipelines	Industry – network operator – standing and specific charge	Economic Regulation Authority (National Gas Access Funding) Regulations 2009
Licensing energy and water service providers	Industry – licensees - annual fee, standing and specific charge	Economic Regulation Authority (Licensing Funding) Regulations 2014
Monitoring, reporting, compliance and enforcement activities in the Wholesale Electricity Market	Industry – market participants – Regulator's fee – monthly payment	Wholesale Electricity Market Rules
Providing Secretariat and financial support to the Wholesale Electricity Market Rule Change Panel	Industry – market participants – Regulator's fee – monthly payment	Wholesale Electricity Market Rules
Approving amendments to and investigating any non-compliance with the Gas Retail Market Scheme	Industry – market participants - Regulator's fee – one off annual payment	Gas Retail Market Procedures
Approving amendments to and monitoring compliance with the Gas Services Information Rules	Industry – market participants – fees and charges – quarterly payment	Gas Services Information Regulations 2012

¹ As the Treasurer refers inquiries to the ERA, it is appropriate for that function to continue to be funded by Government.

² This function is currently under review by the Public Utilities Office (PUO). That review will consider how frequently, if at all, the review should occur. If the function is to continue the PUO will need to recommend an appropriate funding mechanism.

The ERA's Rail Access functions and associated activity costs

As mentioned earlier, the functions that the ERA is currently required to undertake as part of its obligations under the Rail Act and Rail Code mainly involve oversight, but also include making cost determinations and reviewing certain regulatory instruments, required under Part 5 of the Rail Code, that are submitted by railway owners (a list of these functions can be found at Appendix 1).

Some of these specific activities and their cost may change if proposed changes to the Rail Access Regime are implemented. However, the costs incurred by the ERA in the past are shown below to provide an indication of the potential magnitude of costs that will be recovered. Further information on proposed reforms to the Rail Access Regime can be found at <http://www.treasury.wa.gov.au/Economic-Policy/Rail-Access-Review/>.

The annual costs of the Rail Access Regime reflect the level of activity that occurs. The costs are calculated by adding a proportion of overheads to the known costs of administering the regime. The following table (Figure 3) provides an overview of the costs for the last five years and shows where activity has increased the costs slightly.

Figure 3: Rail Access regime costs 2012-13 to 2017-18

Year	Annual Cost	Activity
2012-13	\$675,793	Assisting with an access proposal for The Pilbara railway
2013-14	\$859,694	Undertaking the 2014 Rail Code Review and making a determination of costs for the freight network
2014-15	\$401,774	General oversight year
2015-16	\$375,351	General oversight year
2016-17	\$606,411	Approval of initial Roy Hill regulatory instruments and review of Public Transport Authority's regulatory instruments
2017-18	\$521,397	Review of Arc Infrastructure and The Pilbara Infrastructure Railway regulatory instruments

Principles for recovering the ERA's costs of regulating Rail Access

As discussed at the beginning of this paper, recovering the costs of government services can improve economic efficiency and equity. With these goals in mind, the following principles have been used to guide the development and assessment of options to recover the ERA's costs of regulating rail access.

Efficiency

1. *The total charges paid by regulated parties should equal the total costs of administering and enforcing the regulatory scheme.*

By recovering no more and no less than the total costs incurred in regulating access to railways, the Government can ensure that the funding regime is not a tax or subsidy being imposed on, or provided to, regulated parties for the ERA's regulatory services.

2. *The charges paid by individual regulated parties should reflect the costs directly attributable to activities relating to the railway owned by that individual party.*

This ensures that each railway owner pays for the costs that the ERA incurs when undertaking regulatory activities for their particular railway, or an access proposal relating to their railway. It seeks to avoid the situation where railway owners that have not received an access proposal pay for the ERA's activities related to an access proposal for a different railway.

3. *The method of cost recovery should be administratively simple.*

This principle seeks to ensure that the costs of implementing an accurate, efficient and equitable method do not exceed the benefits.

Equity

4. *Those parties that are similar in their demands of the ERA's regulatory services should pay similar charges.*

This is similar to principle 2, but seeks to achieve equity in the treatment of regulated parties, regardless of whether it achieves economic efficiency.

Introducing cost recovery

The Government proposes to introduce a funding regime that mirrors regimes that currently exist for gas and electricity access and licensing³. These regimes have the concept of a standing charge and a specific charge and are administered in arrears on a quarterly basis. A standing charge is a calculation of the core-function costs associated with administering the regime, and a specific charge is a pass through of costs associated with an activity for one particular regulated party.

Distinguishing between standing and specific charges ensures that the cost recovery principles of equity and efficiency are met. Otherwise, all railway owners would be required to pay a proportion of the cost of specific activities undertaken by the ERA for individual railway owners. This would not be efficient or equitable.

Potential standing charge for Rail Access functions

A standing charge could occur quarterly and be made up of the costs of undertaking the core functions of administering the regime. These costs would cover:

- employee expenses involved in regime oversight and administration;
- supplies and services (excluding costs of consultants engaged to work on an activity for a specific railway); and

³ The gas and electricity access funding regimes can be viewed at www.legislation.wa.gov.au.

- an allocation of overhead costs to recover Governing Body and corporate costs, accommodation and other operating costs that are indirectly attributable to the Regime.

The core functions activities include:

- general oversight activities required under the Rail Act and Rail Code; and
- five yearly reviews of the Rail Code.

Specific charges for Rail Access functions

A specific charge would reflect costs that relate to an activity related to a particular railway, rather than general oversight activities which apply to all regulated railways. These costs would relate to functions identified in Appendix 1 as a specific charge (these functions will appear in a schedule to the funding regulations) and be restricted to activities involving:

- consultants, contractors or any substantial staff costs directly incurred to work on a specific project related to a particular railway, including accommodation costs, travel costs and equipment costs;
- photocopying, mailing, publishing and advertising costs; and
- costs associated with public consultation.

Options for allocating Standing Charges

Four options have been identified for allocating the standing charge across railway operators as follows:

1. Equal share to each railway owner (i.e. divide by the number of railway owners).
2. Use the asset value of each railway to apportion costs.
2. Use the route length of each railway to apportion costs.
4. Use the total freight task of each railway to apportion costs (freight task is generally measured on a “gross tonne kilometre” basis).

The potential advantages and disadvantages of these options are discussed below. However, the Department of Treasury also welcomes stakeholder views on any other options that have not been included here.

Preliminary Assessment of options

Option 1: Equal share of costs allocated to each railway owner.

Administratively, Option 1 is the easiest allocation for the standing charge. It is used in allocating the core function costs of the ERA’s licensing functions across the electricity, gas and water licensing regime.

Example

In a general oversight year, such as 2014-15 and 2015-16, the costs of administering the rail regime were around \$400,000. As discussed above, the cost that the ERA incurs may change if reforms to the Rail Access Regime are implemented. However, if the cost in any particular year were \$400,000, each railway owner would pay \$100,000 for the year (\$25,000 per quarter).

Preliminary Assessment of Option 1

Advantages	Disadvantages
<ul style="list-style-type: none">Charges will be fairly constant and consistent with the level of activity being undertaken each year, creating more certainty for railway owners.Meets principles of efficiency as total charges paid by railway owners would equal the total costs incurred by the ERA for administering and enforcing the regime and individual railway owners pay for the costs they impose on the ERA.Meets cost recovery principle of equity as common costs are equally distributed among owners.Meets cost recovery principle of being administratively simple as the standing costs are simply divided by the number of railway owners.	<ul style="list-style-type: none">Does not reflect the freight task or number of kilometres owned by railway owners.May not be seen as fair by some, because railway owners with a less valuable asset/smaller asset would pay the same as owners with a more valuable/larger asset.

Option 2: Allocation of costs based on asset value of each railway

This method of allocation is used in the gas access regime to allocate core function costs of that regime across gas pipelines that have a different asset value. The allocation percentage is set in a schedule to the regulations.

If this option was applied to the rail regime, asset values for each railway owner could potentially be based on figures provided in the railway owner's annual report or equivalent, if these were all valued on a consistent basis by different railway owners.

Example using hypothetical railways and an annual standing charge of \$400,000

Railway Owner	Asset Value 000,000	Allocated Standing Charge \$'000
Railway Owner 1	16	164
Railway Owner 2	6	31
Railway Owner 3	8	82
Railway Owner 4	12	123

Preliminary Assessment of Option 2

Advantages	Disadvantages
<ul style="list-style-type: none"> • May be seen as fair by some, as railway owners whose assets are more valuable would pay more. • May meet the first two principles of efficiency as total charges paid by railway owners would equal the total costs incurred by the ERA for administering and enforcing the regime and individual railway owners pay for the costs they impose on the ERA. 	<ul style="list-style-type: none"> • May not meet the cost recovery principle of equity, since railway owners for whom the same regulatory services are provided may pay different amounts. • May not meet the last cost recovery principle of efficiency (administratively simple), if all railway owners do not have consistently measured publically available asset values. In that situation the ERA may have to engage independent advice to assess the value of railway owners' assets, and then assign charges (which would in itself be an additional charge to railway owners), and there would need to be agreement on the form of valuation used. • Railway owners may have to provide regular updates of asset values to the ERA, if these are not regularly published.

Option 3: Allocation of costs using the route length of each railway

Option 3 is similar to Option 2, but applies a different unit of measurement (i.e. kilometres of railway track) to determine cost recovery charges for each railway owner. This method is currently used in the gas and electricity licensing regime to further allocate the share of some core functions costs across each licence type. The unit of calculation for distribution and transmission licences is the number of kilometres covered by each licence as a share of total kilometres.

Example using hypothetical railways and an annual standing charge of \$400,000

Railway Owner	Route length ,000 kms	Allocated Standing Charge \$'000
Railway Owner 1	5000	325
Railway Owner 2	200	13
Railway Owner 3	350	23
Railway Owner 4	600	39

Preliminary assessment of option 3

Benefits	Costs
<ul style="list-style-type: none"> • May be easier to implement than Option 2 as the ERA would not be required to assess valuations submitted by railway owners for the purposes of cost recovery. • May be seen as fair by some, as railways owners who own more kilometres of regulated track would be required to pay more. • May meet the principles of efficiency as total charges paid by railway owners would equal the total costs incurred by the ERA for administering and enforcing the regime and individual railway owners pay for the costs they impose on the ERA. • May be easier to administer than option 2, if consistent valuations of railway assets are not currently available. 	<ul style="list-style-type: none"> • May not meet the cost recovery principle of equity, since railway owners for whom the same regulatory services are provided may pay different amounts. • May be seen as unfair by some as it does not account for low use of certain rail sections or routes, such as the grain lines, which are only used for a few months a year but make up a large proportion of the rail network. • May be more difficult to administer than option 1 as the ERA would have to be able to obtain the required route length information under part 2A and Schedule 2 of the Code.

Option 4: Allocation using the total freight task of each railway.

This option is based on the use of the railway (total freight task). Freight task is generally measured on a “gross tonne kilometre” basis.

This option is not currently used to recover the costs for regulating any other industry in Western Australia, but is included as an alternative measure to those used in Options 2 and 3 that seeks to reflect the use of the railway.

Example using hypothetical railways and an annual standing charge of \$400,000

Railway Owner	Freight task ,000 tonnes	Allocated Standing Charge \$'000
Railway Owner 1	20	114
Railway Owner 2	10	57
Railway Owner 3	19	109
Railway Owner 4	21	120

Preliminary assessment of option 4

Benefits	Costs
<ul style="list-style-type: none">• May be seen as fair by some, as railway owners who operate highly utilised tracks would be required to pay more than those who have less utilised tracks.• May meet the principles of efficiency as total charges paid by railway owners would equal the total costs incurred by the ERA for administering and enforcing the regime and individual railway owners pay for the costs they impose on the ERA.• May be easier to administer than option 2, if consistent valuations of railway assets are not currently available.	<ul style="list-style-type: none">• May not meet the cost recovery principle of equity, since railway owners for whom the same regulatory services are provided may pay different amounts.• May be more complex to administer than options 1 and 3 since, although the ERA would be able to obtain the required information under part 2A and Schedule 2 of the Code, it may require more time to verify it.• ERA would have to verify estimates, which would in itself be an additional charge to railway owners.

Workshop Consultation Questions

1. Which of the four standing cost recovery options is your preferred option and why?
2. Do you have any concerns about any of the options? If yes, please outline these concerns and provide any suggestions that you may have about how to overcome these concerns.
3. Are there any benefits to any of the options that have not been considered in this paper?
4. Are there any costs arising out of any of the options that have not been considered in this paper?
5. Are there any other standing charge cost recovery options that the Department of Treasury should consider?
6. Do you have any suggestions as to how any of the options could be improved?

Next Steps

The Department of Treasury will hold a workshop with railway owners (date to be confirmed via email) to discuss the above consultation questions. The Department of Treasury will then review all railway owner responses, consider any issues raised, and determine a preferred option based on the feedback received. The preferred option will then be recommended to the Treasurer for decision and approval to draft the legislation. This is expected to occur in late 2018.

Contact Details

Further information on this paper, or the regulatory process, can be obtained from Andrew Dolling, Director, Economic Policy at Andrew.dolling@treasury.wa.gov.au or on (08) 6551 4689.

Appendix 1 List of ERA functions to be cost recovered

Function	Section of Rail Act or Rail Code	Type of Potential Charge
Review of Rail Code every five years	Rail Act, s.12	Standing
Determination of WACC annually for each railway network, and consulting once every five years on that matter	Rail Code, Schedule 4 cl.3	Standing
Provide determinations of costs if the ERA considers an access proposal is likely to be made	Rail Code, Schedule 4 cl.9	Specific
Provide determinations of costs if an access proposal is made	Rail Code, Schedule 4 cl.10	Specific
Redetermination of costs if the ERA considers there has been a change in circumstances since a determination was made	Rail Code, Schedule 4 cl.12	Specific
Ensure information provision obligations (Schedule 2) are met by railway owners. This includes hard copy of information listed in section 7A, and the current standard access agreements, which must be available for purchase at any time.	Rail Code, s.7(c)	Standing
Provide approval to negotiate where the railway owner considers providing access would preclude other entities from access	Rail Code, s.10	Specific
Ensure Railway Owner maintains an up-to-date register of access proposals	Rail Code, s.12	Standing
Provide opinion on price sought for access if required	Rail Code, s.21	Specific
Maintain pool of arbitrators	Rail Code, s.24	Standing
Provide response to any questions from an Arbitrator	Rail Code, s.30	Specific
Maintain an up-to-date register of access agreements	Rail Code, s.39	Standing
Disseminate information that relates to the carrying out of the Rail Act and Rail Code	Rail Code, s.50	Standing
Audit compliance with certain instruments (in particular Segregation Arrangements, Over-payment Rules and Train Management Guidelines)	Potential Rail Code change	Specific
Review operation of railway owners' instruments. Ensure they are up-to-date and consistent with each other	Rail Code, Part V	Specific
Respond to railway owners' and other stakeholders' calls for review of instruments	Rail Code, Part V	Specific