



## AUSTRALIAN RAIL TRACK CORPORATION LTD

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National Access Regime  
Productivity Commission  
LB2 Collins Street East  
MELBOURNE VIC 8003

### **National Access Regime**

#### **ARTC Submission to the Productivity Commission Issues Paper**

ARTC welcomes the opportunity to provide a response to the Productivity Commission Issues Paper in relation to its review of the National Access Regime published in November 2012.

#### **Background**

ARTC currently operates the interstate rail network between Brisbane and Kalgoorlie connecting to ports in Sydney, Melbourne and Adelaide (but excluding metropolitan passenger commuter networks and that part of the interstate rail network between Sydney and Newcastle). ARTC also manages the Hunter Valley coal network to Newcastle ports, as well as several parts of regional rail networks in NSW and Victoria.

ARTC recently commenced management of the Sydney metropolitan freight network (MFN) connecting the interstate rail network to Port Botany, and opened for operations its \$1bn 36km Southern Sydney Freight Line (SSFL) between Macarthur in southern Sydney to Sefton Park permitting, for the first time, the operation of freight trains into Sydney from the south and free of the Sydney metropolitan commuter network. This new dedicated line will go a long way to alleviating a major bottleneck on the interstate freight rail network and will more than triple the capacity of this important rail corridor. Importantly, it will complement work now underway upgrading the rail corridor through the City's northern suburbs to Newcastle and the

line to Port Botany, as well as support the development of the new intermodal terminal in Sydney proposed to be built at Moorebank.

ARTC has an agreement in place with the owners of that part of the interstate network in WA that provides for consistency in conditions of key elements of access and operations for interstate services between Kalgoorlie, Perth and the Port of Kwinana.

Almost all parts of the interstate rail network managed by ARTC are now covered by a voluntary access undertaking (ARTC Interstate Access Undertaking (IAU)) accepted by the Australian Competition and Consumer Commission (ACCC) in 2008. ARTC is currently working towards extending coverage of this access undertaking to include those parts that have recently come under ARTC control including:

- NSW/Queensland Border to Acacia Ridge in Brisbane; and
- SSFL/MFN in Sydney.

The interstate rail network in WA and the important rail freight line connecting Brisbane to far north Queensland continues to be covered by the rail access regimes administered by state based regulators in those states respectively. As significant interstate rail freight travels on these parts of the national rail network, the application of commercial and regulatory frameworks in these jurisdictions can have a significant impact on interstate freight markets and ARTC business.

ARTC's Hunter Valley coal network connecting coal mines in the Hunter Valley and Gunnedah coal basins to the port of Newcastle is covered by ARTC's voluntary access undertaking (ARTC Hunter Valley Coal Network Access Undertaking (HVAU)) accepted by the ACCC in 2011. The HVAU replaced the previous coverage of the NSW rail access undertaking and introduced a new framework for commercial and operational arrangements in the Hunter Valley intended to provide greater certainty for present and future access to the rail network and promote future investment in rail and complementary coal chain capacity to underpin substantial growth in demand for export coal through Newcastle in the foreseeable future. Further detail into the development of this voluntary access undertaking will be provided later in this submission.

Remaining parts of the ARTC network in regional NSW and Victoria remain covered by rail access regimes administered by regulators in those States respectively.



ARTC, and its shareholders, have long held an objective to achieve greater consistency of regulation of rail networks in Australia generally and, in particular, on the interstate rail network. This should not be taken to mean uniform regulation across rail networks where ARTC recognises that the different commercial and operating frameworks of rail networks require different regulatory treatments and greater flexibility in arrangements (referred to later in this submission), but consistent arrangements where network users have greater certainty as to how they will be treated so as to instil confidence in using and investing in the rail network and complementary parts of relevant supply chains.

On the interstate rail network, consistent regulatory and commercial arrangements have been developed over the last decade primarily through a combination of:

- increasing the extent of single (ARTC) management of the interstate network through lease of those parts of the interstate network in Victoria (1998), NSW (2004) and Queensland (2011); and
- establishing and maintaining goodwill and cooperative arrangements between jurisdictions at an operational level.

ARTC recognises that, in 2006, governments agreed, through the Competition and Infrastructure Reform Agreement (CIRA), to provide for more simple and consistent national economic regulation of nationally significant infrastructure, including railways. ARTC participated, with the ACCC, in the development of a proposal for a code that would apply to all rail networks that would govern central decision making in relation to the coverage and intensity of regulation applicable to rail networks as well as the application of a consistent set of principles for the development of access undertakings to rail networks. This proposal was considered by governments, but ARTC understands that relevant governments elected to proceed with an alternative path to seek certification of existing state based regimes in order to satisfy CIRA requirements.

ARTC has participated in previous Productivity Commission reviews of the National Access Regime and related legislative arrangements including:

- the National Access Regime in 2001; and
- National Competition Policy arrangements in 2004.

Three broad themes submitted by ARTC to these inquiries were:

- ARTC is of the view that there should be a single adjudicator with respect to regimes for access in Australia.
- ARTC is of the view that the differentiation of access regimes should be on the access providers' market and industry position.
- ARTC is of the view that Industry Codes should be able to be departed from by access providers as long as it can be demonstrated to the ACCC that the proposed regime satisfies the requirements of an access undertaking.

ARTC continues to broadly support these positions in the light of its more recent experiences in regulation of the national rail network. Further commentary and qualifications in this regard are provided in the more specific issues addressed by ARTC later in this submission.

## **Specific ARTC commentary and views**

ARTC will now provide some commentary and views in relation to several key themes below. ARTC's commentary and views will primarily be limited to application of the National Access Regime to the national rail network, and specifically the ARTC rail network, although ARTC expects that there will be broader application to other nationally significant infrastructure.

### **1. Progress towards achievement of consistent regulation across the interstate rail network.**

ARTC is of the view that it is important that economic regulation is applied consistently across the interstate rail network. This will provide for greater confidence amongst users of the interstate rail network in relation to equity in treatment and certainty of access. Furthermore, investment decisions (above rail and below rail) are made by infrastructure providers and users in the context of the efficiency of service availability and efficiency across the entirety of the interstate rail network requiring the application of a consistent framework for investment.



As stated earlier, ARTC considers that greater consistency of regulation across the interstate rail network has largely been driven through increasing the extent of the network under single (ARTC) management over the last decade and through the engenderment of goodwill and cooperation at operational levels between access providers in the areas of customer service, access negotiation and planning, and capacity and network management.

These drivers have largely arisen from within the industry and through commercial necessity, where the interstate rail network competes against a strong interstate road network that does not face jurisdictional and regulatory barriers to efficiency to the same extent.

There remains parts of the interstate rail network that are subject to state based regulation. These include:

- those parts of the interstate rail network in the Sydney metropolitan network being the SSFL (and the alternative adjacent metropolitan rail line used prior to commencement of the SSFL), the MFN including Port Botany, and the metropolitan commuter line between Sydney and Newcastle which are covered in the NSW Rail Access Undertaking (NSWRAU) administered by the NSW Independent Pricing and Regulatory Tribunal (IPART);
- the standard gauge interstate rail network between the NSW/Queensland Border and Acacia Ridge (Brisbane) not presently covered under a state based regime;
- the interstate network between Kalgoorlie and Perth, a key part of the east-west rail corridor covered by the WA rail access regime administered by the WA rail access regulator; and,
- although not formally part of the defined interstate rail network per se, the narrow gauge rail network connecting Brisbane to major regional and interstate markets along the Queensland coast line, which is covered by the Queensland Rail Access Undertaking administered by the Queensland Competition Authority (QCA).

In relation to the SSFL, MFN/Port Botany and the standard gauge network in Queensland, that are now under ARTC management, it is ARTC's intention to apply to the ACCC for coverage of these networks under ARTC's IAU during 2013.

That part of the interstate rail network in northern Sydney, currently referred to as the Northern Sydney Freight Corridor (NSFC), is the existing metropolitan commuter line between Sydney and Newcastle. The Federal and NSW Governments are funding an upgrade of the NSFC (\$1.1b) to be delivered by ARTC and the NSW Government between 2012 and 2016 that is intended to improve daily freight capacity between Sydney and Newcastle by 50 per cent to support growth on rail and complement ARTC's \$2.5 billion investment in the Melbourne-Sydney-Brisbane corridor.

At this time, ownership of the NSFC will remain the present owner, RailCorp, and this part of the interstate rail network/commuter network will remain covered by NSWRAU administered by the IPART.

For those parts of the national rail network upon which interstate rail freight markets operate that are likely to remain under state based access regimes (such as WA and north of Brisbane), and for reasons described earlier, ARTC considers that increased priority should be placed on achieving greater consistency in regulation. ARTC recognises that the certification process under Part IIIA, administered by the National Competition Council, contemplates consistency of regulation across jurisdictions to the extent interstate markets are affected (as provided under the Competition Principles Agreement). It is not clear to ARTC that this consideration has delivered effective and consistent outcomes for interstate rail freight users.

## **2. Is it still desirable to have consistent regulation across the entire rail network, including mining networks?**

In its inquiry "Progress in Rail Reform" in the late 1990's, the Productivity Commission distinguished four different types of rail network in terms of commercial and operational characteristics as follows:

- interstate network;
- high volume regional network (minerals);
- low volume regional network (agricultural); and
- metropolitan commuter network.



ARTC agreed with this differentiation at the time, and considers that the commercial and operational characteristics of these networks remain largely unaltered.

ARTC remains of the view that economic regulation should be applied consistently across the national rail network. This is not to say that uniform regulation in the form of access regimes or undertakings should apply in all circumstances. As indicated in section 3 below, there should be differentiation between access regimes based on the access providers' market and industry position. The access provider's market position in relation to the three types of freight networks above can vary. Both the interstate network and many low volume agricultural regional networks do face intermodal competition (primarily from road) and therefore have limited ability to exert monopoly power over rail customers where reduced volume generally manifest in reduced profitability. Access providers on these networks are generally incentivised to promote utilisation of the network.

On the other hand, most high volume mineral networks are not exposed to intermodal competition and are able to act monopolistically in this sense. However, such networks predominantly serve and are part of a broader export supply chain which competes in international markets with other supply chains. As such there are some constraints on monopolistic behaviours on these networks and there is a recent trend in the focus of access regulation towards promoting efficiency not just in the use of and investment in the regulated network but in the wider supply chain.

As such, with respect to these networks, ARTC considers that consistency could apply with respect to the decision (made by a single national body) to cover the network and to the form and intensity of regulation to apply (refer section 3) and that consistency should apply with respect to the requirement for the access provider to submit an access undertaking (or similar) to the relevant regulator for approval. Consistency could apply (similar to the form/intensity decision above) in determining where a rejected access undertaking could be withdrawn, or whether a regulator could impose an access undertaking.

Undertakings should be reviewed by a single body (national rail access regulator) and should contain certain minimum prescribed requirements for consistency covering negotiation and dispute resolution, regulatory reporting and where vertically integrated, ring fencing. Prescribed guidelines for other mandatory components of an undertaking could provide enough flexibility to deal with the specific commercial and operational requirements of the different types of freight networks listed above whilst maintaining a sufficient degree of consistency.



### **3. Differentiation of access regimes should be based on the access providers market and industry position.**

In previous submissions to the Commission, ARTC has proposed that there should be differentiation between access regimes based on the access providers' market and industry position. Specifically, the characteristics of an access regime are different when applicable to a service provider related to entities operating in upstream or downstream markets (as opposed to a provider with no such interest), on the basis that the commercial motives of the two providers are different and such motives govern the way the providers operate. Secondly, the characteristics of an access regime differ where the extent to which provision of services utilizing a natural monopoly facility confers market power on the provider of the services.

To exclude entities from coverage of Part IIIA on the basis of industry structure (vertical separation) alone may create some undesirable outcomes. Also, the provision of services utilizing a natural monopoly facility does not necessarily confer market power, assuming an appropriate market definition. ARTC considers the competitive forces in the markets from which it derives a significant portion of its revenue on the interstate rail network do not permit it to conduct its business with market power.

ARTC is supportive of a more inclusive view with regards to the coverage of services under Part IIIA, at the risk of some cost and inefficiency to industry. It is ARTC's view that these risks can be mitigated by more formally addressing the market and industry position differences between access providers.

ARTC has proposed two types of regime. A **third party access regime** applicable in circumstances where the access provider is related to entities with upstream or downstream market significance (vertically integrated) is more prescriptive and covers a range of issues including access application, negotiation and pricing, dispute resolution, service performance, anti-competitive conduct, accounting separation and ring fencing. This is necessary to minimize the anti-competitive behaviour that such an entity has a commercial imperative to engage in. An **open access regime** would apply in circumstances where the access provider has no upstream or downstream interests, has access revenue as its principle source of income and has a commercial imperative to promote competition in the use of the



facility in order to grow the market. The primary regulatory concern here relates to monopoly pricing, where the provider has market power.

Within each of the two types of regimes, the extent of issues covered and the degree of prescription required is largely dependent on the extent of market power that the access provider has. A highly prescriptive third party regime would be applicable with respect to a vertically integrated provider with significant market power. On the other hand a flexible open access regime (or no regulation at all) would be applicable to a separated provider with little or no market power. Figure 1 below illustrates.

Figure 1

Structure	Market Power	
	Significant	None
Vertically Integrated	<b>Third Party Access Regime</b> Highly Prescriptive Focus on anti-competitive behaviours and monopoly pricing	<b>Third Party Access Regime</b> Highly Prescriptive with respect to anti-competitive behaviours. Less prescriptive with respect to pricing.
	<b>Open Access Regime</b> Only prescriptive with respect to denial of access and monopoly pricing.	<b>Open Access Regime</b> Little or no prescription

A formal differentiation of regimes in Part IIIA may create more efficient outcomes in that regimes could be tailored to specifically address the market and industry position of the provider. Further, unnecessary costs of regulation can be minimized.

Decision making in relation to the type of regime that could apply to particular infrastructure could be made using a similar process and decision maker to a coverage decision for that infrastructure.

#### **4. The historic balance/focus of economic regulation towards efficiency rather than sustainability should be reviewed.**

The fear of competition and the sometimes constrained return that the asset owner is able to achieve inhibits asset renewal to an extent that could produce market failure. Regulatory practice to date has focused more-so on delivering efficient service (and lower end user cost) rather than on investment for sustainability and future growth capacity. Significant gains have been achieved for the industry and now the focus needs to be re-balanced towards the need and incentives for infrastructure owners to renew assets and invest for capacity enhancement. This needs to be recognised in the regulatory framework.

ARTC has sought to improve this balance in the regulation of its network by introducing some relatively new and innovative provisions in its access undertakings which have received regulatory support. These include a focus on ex-ante, industry based approval of capital expenditure for inclusion in the cost base, and the introduction of capitalisation of early year losses into the cost base in order to encourage riskier investments (sought and supported by industry) in capacity ahead of demand so as to ensure that the rail network does not become the constraining element in the relevant supply chain as demand increases. Further detail in relation to these innovations can be found in the HVAU<sup>1</sup> and supporting documents.

Part IIIA provides for an infrastructure provider to permit extension of a facility where sought by a user (subject to certain economic criteria being met) but does not necessarily require the access provider to fund an extension. This provides for the possibility of a user or users to directly fund an extension through some form of initial up-front capital payment (as opposed to initial funding being provided by the access provider recovered through access charges or some other re-payment stream over time).

However, the provision of initial capital payments by users for extensions to a facility may introduce a range of uncertainties for both parties in relation to ownership of extended facilities, the taxation treatment of the initial capital payments, and taxation treatment of ongoing depreciation of the assets. Such uncertainties may result in the legal and financial framework surrounding such arrangements becoming far more complex than otherwise might be necessary in order to mitigate the risks arising from

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<sup>1</sup> <http://www.accc.gov.au/content/index.phtml/itemId/994049>



these uncertainties, posing a constraint to the completion of such arrangements and investments in the network.

To this end, and in order to mitigate such barriers to investment, a review of the alignment of this element of Part IIIA and the relevant aspect of taxation legislation may be appropriate, with a view to promoting clear and simpler taxation treatment of these infrastructure funding arrangements.

## **5. Road infrastructure should be subject to economic regulation.**

In the end, market forces will dictate the most appropriate transport mechanism for the industry. It is up to Government to provide a policy, regulatory and investment framework in place that supports this. To this end, ARTC would support improved transparency and equity of modal infrastructure pricing and regulation in a manner that produces fair and efficient outcomes for the transport industry as a whole. It is therefore inconsistent with the achievement of efficient transport investment that the road network is not covered under the National Access Regime whilst the competing rail network is.

Recently there has been increased emphasis placed on the requirement for appropriate planning of freight movements by several state jurisdictions and by Infrastructure Australia. Included within a number of these policy positions is a requirement to address appropriate funding mechanisms, conditions of access and better alignment of supply and demand in transport planning, and particularly road planning for use by heavy vehicles.

There has been progress made in the past decade in the area of road heavy vehicle charging, structures and pricing, however current road regulation structures are ineffective as the National Transport Commission does not have the powers that the ACCC (or State regulators) have in terms of its ability to regulate or arbitrate pricing, and is trying to manage a national regime where each state still has various authorities.

To this end, ARTC has long supported improvement in the road cost attribution and allocation mechanisms and the introduction of mass-distance charging on roads (creating a similar basis of charging for rail and road). ARTC welcomes the establishment of the Heavy Vehicle Charging and Investment Reform (HVCI) towards achieving this aim and the recently endorsed approach by the Standing Committee

on Transport and Infrastructure (SCOTI) to consider alternate economic regulatory structures for the Heavy Vehicle industry.

ARTC is supportive of the advancement of either of the two options listed below which are being put forward by HVCI for further assessment.

*Option 2: MDL and Road Fund model*

*Reformed user charges set by independent economic regulator combined with jurisdiction based funds for heavy vehicle investment and maintenance*

*Option 3: Corporatisation Model*

*Reformed user charges set by independent economic regulator with funds flowing to corporatised service providers with separate funding for light vehicles*

The development of a regulatory structure as above will ensure that road costing and charging is undertaken on a similar basis to that which applies in rail as a result of economic regulation (at least on networks and in markets where road and rail compete) where recovery of efficient operating expenditure and an appropriate return of, and on, efficient capital investment is required and competition for road and rail investment is assessed in accordance with comparable criteria.

Such an approach appears consistent with addressing concerns with heavy vehicle pricing identified in the 'Australia's Future Tax System Review' (Henry), Garnaut Climate Change Review and through various freight transport planning strategies as referenced previously.

ARTC cannot see any obvious dis-benefit in having the critical road infrastructure utilised by heavy vehicles being subject to an appropriate regulatory regime as is the case with all other infrastructure in Australia that serves as a critical input to Australian businesses. On this basis ARTC hopes that this review would confirm the benefit to the development of transport supply chains of the introduction of an effective, national access regime in the road industry that supports the movement of freight.



## 6. Specific ARTC experiences and observations.

### a. Timing of regulatory process and approvals

ARTC's original submission of the IAU took place around 13 months ahead of final approval. This undertaking was essentially a replacement for its original access undertaking accepted in 2002.

ARTC originally submitted its HVAU around 26 months ahead of final approval. The original submission followed a period of 12 months of separate consultation with industry.

ARTC accepts that the regulator should have a reasonable period of time in order to give due consideration to regulatory instruments, and acknowledges the introduction of legislative provisions around time frames for regulatory decision making. ARTC also recognises the difficulty associated with balancing the interests of stakeholders that are often opposed even within a particular group of stakeholders (eg network users).

Regulators often seek to expedite the approval process by encouraging separation consultation and negotiation between the access provider and network users. In the case of the HVAU separate negotiation was complicated by the existence of 14 competing coal users with different interests and an industry body purporting to represent the interests of all coal users.

The approval process with respect to the HVAU for many reasons ended up being a protracted and very detailed process that resulted in a far more complex and wide reaching access framework than any party may have originally anticipated. This was further complicated by the changing interests and requirements of stakeholders and the regulator during the regulatory process, sometimes as a result of changing personnel being involved. Even then, the HVAU provides for a number of near term reviews intended to finalise a number of processes that could not otherwise be finalised during the regulatory process. The resulting product was an access arrangement that in the view of users and the regulator contained sufficient uncertainty at the time to warrant reducing the original term of the HVAU by half, such that the development and regulatory approval process for the next undertaking is likely to re-

commence only a few years after commencement of the initial undertaking. The extended time needed to develop and approve an access undertaking, as well as the early reviews of unresolved processes, more general mid-term reviews of undertakings, and conservative approach to the term of undertakings all impose significant additional cost and resourcing to the access provider. These costs are only immediately recoverable, if at all, by the access provider where the network is constrained. This is not the case on any part of the interstate network, and only on some parts of the Hunter Valley network.

Whilst ARTC accepts that there is need for due consideration of such regulatory instruments, ARTC considers that there needs to be further consideration of mechanisms that will aid the timeliness and efficiency with which regulatory decisions can be made.

**b. Decision making around related regulatory instruments**

During the early development of the HVAU in 2008 and 2009, a related regulatory development was occurring at the port of Newcastle arising from a government review of existing commercial and operational practices in the Hunter Valley that were seen to manifest in undesirable outcomes where contracted shipping volumes consistently outstripped the capacity of the coal chain resulting in excessive queues of ships awaiting loading off Newcastle with a high demurrage cost to industry.

The long term solution sought by Government required the port operators to seek authorisation for certain conduct needed to address these capacity constraints. A detailed framework for managing capacity at the ports was developed by the ports (directed by coal producers) which largely due to pressure to expedite the process and implement the solution did not, in ARTC's view, sufficiently address the need to consider other elements of the coal supply chain, including the rail network. A fundamental premise of the port arrangements reflected the fact that a tonne of coal arrived at the port was a tonne of coal irrespective of its origin. On the rail network, however, a tonne of coal originating from one mine can have significantly different capacity impacts to a tonne of coal originating at another mine.

The port capacity framework was considered and authorised in late 2009 by the ACCC in an expeditious manner, again under pressure to



implement the solution. During this time, the development of the HVAU was still in its early stages, and any alignment with capacity management protocols considered for the rail network at the time did not appear to be a major objective. At the time, ARTC recommended that the development of the two capacity frameworks should occur concurrently rather than sequentially in order to fully contemplate alignment issues.

In the end, following authorisation of the port capacity framework for a period of 15 years in late 2009, the only means then seen by the industry by which any sort of alignment between arrangements could be achieved was through altering or introducing related mechanisms in the HVAU and requiring ARTC to demonstrate that its proposed framework was aligned to the authorised port arrangements.

To assist, ARTC sought to make amendments to the HVAU to bring about alignment in a practical sense in a number of areas, but this substantially complicated and increased uncertainty in relation to many of ARTC's proposals, particularly where the port arrangements are premised on a different capacity paradigm as described above. This was further complicated by the inconsistent application of the port capacity framework to the two terminals at Newcastle, where one had yet to be constructed.

In the end, and in order to achieve practical alignment, a number of relatively straightforward mechanisms in the HVAU became increasingly convoluted and with uncertain outcomes going forward. Since the HVAU has been approved, and whilst many capacity management mechanisms are working due to cooperation of participants, there have been some failures identified that have now required further ongoing industry development and regulatory intervention to resolve. Again, a source of failure arises from the inconsistent application of, and commitment to, the port capacity framework in relation to the two terminals at Newcastle.

**c. Rate of Return considerations**

During the development and regulatory approval processes for both the IAU and HVAU, ARTC sought to develop and implement a number of innovative mechanisms to introduce the right sort of incentives for it and the broader industry, and sought regulatory recognition of a number of

specific circumstances and risks faced by ARTC in relation to each of these networks.

In the Hunter Valley, for example, specific circumstances faced by ARTC include:

- Exposure of the Hunter Valley coal network generally to a number of relatively finite, global markets (when compared to say domestic electricity or gas markets) which even can impact on the risks faced by ARTC in coal markets serviced by different parts of the rail network.
- Formal recognition of, and specific obligation to implement, alignment of rail network capacity management with that in relation to other parts of the coal supply chain with an objective to optimise outcomes for the coal supply chain rather than the regulated rail network. As described elsewhere in this submission, this can result in sub-optimal decision making for the rail network to the benefit of the coal supply chain as a whole. Whilst ARTC supports a coal chain focus, it is not unreasonable for the access provider to be adequately compensated through the rate of return for the additional risks it faces in this regard.
- The use of a performance mechanism designed to penalise ARTC for under-delivery of capacity entitlements through the rebate of revenue (unrecoverable through the revenue cap mechanism).
- The requirement to develop separate positive performance incentives designed to offset negative asymmetric performance mechanisms (above) to incentivise ARTC to outperform in the areas of capacity delivery and efficiency.
- The exclusion of the costs associated with raising equity at industry benchmark levels.

During the regulatory approval process, ARTC went to great lengths to convince the regulator that taking on such specific risks required recognition in the rate of return, in order to adequately encourage investment in the rail network and compensate investors for those specific risks.



ARTC found that the regulator found it difficult to take a flexible approach in this regard where it saw itself bound by a fairly narrow set of boundaries largely governed by regulatory precedent.

Whilst ARTC recognises that the CAPM framework and regulatory precedent can provide a useful input to current decision making and can provide a high degree of comfort to regulators in relation to the risk of legal challenge, there is a risk that operating within such a fairly narrow band of thinking in determining what may be adequate compensation for an access provider facing industry and specific risks, may result in under-compensation in the 'real' world in which it operates, as opposed to what might be considered a 'benchmark' operating environment.

ARTC considers that the greatest risk of regulatory error is the risk of under-investment in the infrastructure. The cost and impact of under-investment is evidenced in many industries, including rail.

In the Hunter Valley, the cost of access to the rail network, averaging around \$1-2 per tonne of coal represents such a small element of the total supply chain cost and the delivered coal price (around \$100 per tonne). Increasing the risk of under-investment in network capacity via an inadequate return, costing industry around \$100 per tonne in lost revenue, represents a an extraordinary cost benefit impact where, say, allowing an additional 0.5% in return to promote investment in network capacity may cost industry as little as 5-10 cents per tonne.

In ARTC's view, regulators should be encouraged to take a more flexible view in determining compensation for the risks faced by regulated entities, without the fear of legal challenge and perception of setting what may be considered undesirable precedent. It may be that limitations around the CAPM framework may prevent the necessary degree of flexible thinking by regulators in order to address the specific market and operating risks faced by a network, and investors.

In the case of the Hunter Valley, and in order to achieve what it considered to be an adequate level of compensation to attract investment in the rail network given the risks faced, ARTC saw it as necessary to engage in separate negotiation directly with the industry. In return for conceding amendments to the HVAU sought by industry, and further increasing

ARTC's risk. ARTC was able to secure what it considered to be an adequate return, higher than that considered adequate by the regulator based on benchmarked parameters and regulatory precedent.

The regulator supported this negotiated outcome.

**d. Access pricing flexibility**

On ARTC's interstate network, and even to some extent in Hunter Valley coal markets, there can be substantial differences in the markets served by users of the network, which results in differences in user requirements for access to the network. Such differences do not manifest substantively in relation to the non-price aspects of the terms and conditions of access to the network. However, it is ARTC's experience that substantial differences have and will continue to arise in different markets in relation to users requirements in relation to both the level and structure of access pricing, where users seek pricing arrangements that promote specific efficiency and competitive outcomes in their markets further down the supply chain.

As is the case in many regulated industries, it is difficult for the infrastructure provider to gain a detailed and robust understanding of the commerciality and competitiveness in a diverse range of downstream markets that the network may serve. As such, it is difficult for the access provider to foresee a particular access pricing arrangement may best support efficiency and competitiveness in downstream markets.

As such, ARTC considers it important that the regulatory framework provide for sufficient access pricing flexibility to address user needs, particular where a network services a diverse range of different markets, which is often the case on transport networks, and particularly in interstate rail freight markets. To promote inflexible access pricing on a network can potentially impact on network competitiveness and utilisation of the network, and on network investment.

ARTC recognises that the pricing principles set out in Part IIIA provide for an access pricing structure that allows multi-part pricing and price discrimination where it aids efficiency. In principle, ARTC supports this objective as a flexible approach to pricing would appear to be supported.



It is ARTC's experience on both the interstate and Hunter Valley rail networks that regulators place significant importance on transparency in terms and conditions, including pricing, as a means of promoting utilisation of the network. ARTC supports transparency (publishing) of negotiated terms and conditions, and access pricing, as an important element in promoting user confidence and network utilisation.

The trend in this aspect experienced by ARTC is that greater transparency is sought in relation to how the level and structure of access pricing will be determined, resulting in the potential for greater prescription and rigidity in the regulatory framework as to how access pricing will be determined. Whilst this can provide greater certainty for potential users of the network, the ability to negotiate flexible pricing to suit particular user needs becomes constrained. ARTC believes that providing for transparency in indicative pricing (where it helps) and in relation to negotiated access pricing (and related terms and conditions) can provide greater certainty for users without constraining pricing flexibility. This approach is incorporated in the IAU.

As such, ARTC would support provisions under Part IIIA that place a clearer emphasis on promoting pricing flexibility to meet efficient outcomes in order to discourage the apparent regulatory trend towards prescriptive access pricing determination, particularly in relation to networks serving diverse downstream markets, such as a number of transport networks in Australia.

**e. Scope of Regulation**

In the development of access arrangements in the Hunter Valley both the industry and the regulator took a wide view as to what regulating ARTC as the network manager might be able to deliver. Specifically it was recognised very early on that the operation of the rail network would be a key driver of the efficient operation of the entire Hunter Valley coal chain in delivering coal onto vessels at Newcastle. ARTC recognised the importance of the rail network in this regard as part of a coal chain along with all other elements, and that efficiency across the coal chain required a coordination and support by all participants. As such, ARTC supported, in principle, the efforts of the industry and the regulator to achieve alignment across all aspects of the coal chain.

Despite adding a layer of further complexity in the development, negotiation and review of the HVAU, the approved document incorporates a range of provisions and measures that are clearly focused around delivery of efficient outcomes across the coal chain as opposed to efficient outcomes on the regulated rail network.

Such provisions/measures include:

- the staged development of the efficient train service and access pricing intended to result in optimal utilisation of the Hunter Valley coal chain; and
- the involvement of an industry coordinating body, the Hunter Valley Coal Chain Coordinator, in a number of network access and management activities including the development of an access application, the ensuing analysis of capacity, capacity investment, day to day network management.

ARTC incorporated such provisions in the HVAU to support increased alignment across the coal chain. However, it is ARTC's view that the outcome of seeking to use regulation of one part of a coal chain to deliver wider industry benefits has resulted in:

- regulatory oversight of only part of the wider coal chain using coal chain focussed efficiency objectives, where failure of other un-regulated elements of the coal chain to act to support the wider coal chain objective can undo any good outcomes that might arise through the application of the HVAU; and
- ARTC obligations under the HVAU intended to promote coal chain efficiency, where pursuing these obligations can result in sub-optimal decisions and outcomes for the regulated network itself. It has been assumed that optimal outcomes for the wider coal chain imply optimal outcomes for the utilisation of, and investment in, the regulated network, where the network is used for other purposes as well. In ARTC's view, this specific risk has not been recognised in the rate of return.



This trend to broaden the traditional scope of regulation under Part IIIA of monopoly infrastructure used to support a wider supply chain, in the interests of creating efficiency outcomes in wider markets is relatively new. It is not clear whether the existing provisions of Part IIIA are sufficiently developed and robust in order to support application to wider market perspectives beyond the covered monopoly infrastructure. This can create uncertainty and risk to infrastructure providers in particular, but also for users and regulators.

Yours sincerely

**Simon Ormsby**  
**Executive General Manager, Strategy and Growth**