PRODUCTIVITY COMMISSION REVIEW OF THE NATIONAL ACCESS REGIME
NSW MINERALS COUNCIL RESPONSE TO POSITION PAPER

The NSW Minerals Council ("**Council**") welcomes the opportunity to comment on the Productivity Commission's Position Paper ("**Paper**") on its Review of the National Access Regime.

The Council generally is in agreement with the thrust of the Paper. It welcomes in particular findings and proposals

- to emphasize the desirability of promoting investment
- for objectives to be included in Part IIIA (Proposal 5.1)
- for explicit recognition that the regime covers eligible services provided by non-integrated facilities (Proposal 5.2)
- that pricing principles be included in Part IIIA (Proposal 5.3)
- that the service provider be required to provide sufficient information to an access seeker to enable that access seeker to engage in effective negotiation (Proposal 6.3)
- for the principles used to assess the effectiveness of existing regimes to be included in Part IIIA (Proposal 7.1)
- for the certification provisions of Part IIIA to specify that an effective access regime should include specific clauses and provisions (Proposal 7.4)
- that greater use of productivity-based approaches for setting price caps would be desirable and regulators should give priority to developing external productivity benchmarks necessary to implement their use (Finding 8.1)
- for consideration to be given to making explicit provision for productivity-based approaches to setting price caps in the criteria for certification (Proposal 8.2)
- for the decision-making role of Ministers in Part IIIA to be ended (Proposal 9.1)
- for appeals against decisions to declare services under Part IIIA to be abolished (but appeals against rejected declaration applications or arbitrated terms and conditions for declared services to be retained) (Proposal 9.2)
- for specifically requiring greater transparency in processing of applications for declaration and certification, for publication of the reasons for decisions on declaration, certification and undertakings, and for the basis for an arbitrator's decisions (Proposals 9.6 – 9.9)

Suggested modifications to proposals

The Council suggests that some proposals be modified as follows

Proposal 6.1

Proposal 6.1 (Tier 1): The Part IIIA declaration criteria should be modified as follows:

• s 44G(2)(a) be amended to: 'that access (or increased access) to the service would lead to ~~a substantial~~ an increase in competition in at least one market, other than the market for

the service, such that the benefits arising from the increased competition are likely to exceed the costs of regulation of that access (or increased access).'

• s 44G(2)(b) be amended to: 'that it would be uneconomic for anyone to develop a ~~second~~ competing facility to provide the service.' (p.141)

It is proposed that the words struck out be deleted and the underlined words added. These modifications would appear to get to the heart of the intent of the Commission's proposals and eliminate definitional problems.

Proposal 6.2

For a service to be declared under Part IIIA it must meet all the following criteria:

...

(c) competition in downstream markets is insufficient to prevent the provider of the service from exercising substantial market power ...

In the case of the Hunter rail network, downstream coal markets are highly competitive yet the provider of rail access has exercised substantial market power by charging monopoly rents on access. One result of this was that some mines closed down sooner than they would otherwise have done. In other words, the service provider exercised substantial market power regardless of the highly competitive nature of downstream markets.

It is suggested that this criterion be changed to

(c) the provider of the service exercises substantial market power

Proposal 6.8

Proposal 6.8 (Tier 1): When arbitrating a dispute for a declared service, the ACCC should be able to require that a service provider permit interconnection to its facility by an access seeker. However, scope for the ACCC to require extensions of facilities should be removed. (p. 166)

This proposal would not adequately deal with problems of the type currently being experienced on the Hunter rail network. The NSW Rail Access Regime, which deals with access to this network, has been certified as effective in its current form although this certification has lapsed. The network accommodates several types of traffic, including coal, passenger, grain and general freight. The most heavily trafficked part of the network is double track, with single track starting at Antiene and extending north.

Demand on the single track between Antiene and Muswellbrook is approaching capacity. Duplication of around 10km track is required to provide adequate capacity. Traffic on this track is about half coal and half non-coal and under the infrastructure owner's projections would be adequate indefinitely for either of coal traffic or non-coal traffic alone.

Under the principle that no user should be required to pay for more infrastructure than it requires, neither coal nor non-coal traffic alone can be required to pay the cost of two tracks. Both the NSW Rail Access Regime and the *Transport Administration Act 1988* (NSW)

provide that passenger traffic has priority over other types of traffic. In practice, coal traffic has lowest priority behind all other regular traffic. Passenger and other non-coal traffic pays only variable cost for access while coal traffic pays all fixed and capital-related costs for the existing Antiene – Muswellbrook line.

The difficulty that this presents is that coal cannot be required to pay the cost of duplication, because it is already paying the full cost of the existing line. To require non-coal traffic to pay the cost of duplication would seem to be inconsistent with Government policy. Because of this, it would be uneconomic for the infrastructure owner to duplicate this line.

Even under Clause 6(4)(j) of the Competition Principles Agreement, it is possible that the owner may not be required to duplicate the track on the grounds that it is not economically feasible. Yet the reason that it is not economically feasible is that the owner is applying commercial principles and social welfare principles to the same line. Because the NSW Rail Access Regime contains no Operations Protocols that protect the access rights of users who pay all the fixed costs, the commercial traffic is disadvantaged to the benefit of non-commercial traffic.

Proposal 6.8 would confirm the right of the infrastructure owner not to expand capacity in cases such as this where clearly economic efficiency would be advanced by proceeding with an expansion. It is inappropriate to force coal traffic to pay for the whole of the capacity expansion under these circumstances.

Proposal 7.4

Proposal 7.4 (Tier 2): The certification provisions in Part IIIA should specify that an effective access regime must include:

- *an objects clause;*

- *coverage arrangements that focus mainly (though not necessarily exclusively) on services for which the entry to the market of a second provider is unlikely to be economically feasible;*

- *clearly specified dispute resolution arrangements and provisions to establish the terms and conditions of access;*

- *clearly specified criteria and pricing principles applying to regulated terms and conditions;*

- *cost-effective appeal and enforcement provisions;*

- *revocation and review requirements for all determinations under the regime; and*

- *where appropriate, provisions to facilitate consistency across multiple State and Territory access regimes applying to a particular service.*

The degree of reliance on negotiation relative to arbitration and regulation to set terms and conditions of access should not be a part of the effectiveness test. (p. 183)

The certification provisions should also include a requirement for the infrastructure owner to provide to the assess seeker sufficient information to enable the access seeker to engage in effective negotiation (see the Commission's Proposal 6.3).

In addition, the arbitrator should be required to publish post-arbitration reports (see Commission's Proposal 9.9)

It would be desirable for this to be a Tier 1 Proposal.

Proposal 8.1 (Tier 1): The pricing principles in Part IIIA should specify that access prices should:

• generate revenue across a facility's regulated services as a whole that is at least sufficient to meet the efficient long-run costs of providing access to these services, including a return on investment commensurate with the risks involved;

• not be so far above costs as to detract significantly from efficient use of services and investment in related markets;

• encourage multi-part tariffs and allow price discrimination when it aids efficiency; and

• not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, unless the cost of providing access to other operators is higher. (p. 206)

The Council supports the incorporation of appropriate pricing principles in Part IIIA. It considers however that the principles proposed need to be modified. While the Council does not object to the principles proposed, they need to be modified considerably to protect users

- the first part would not prevent cross-subsidisation of one part of a network by another.

- the second part would permit prices that detract from efficient use of services and investment in related services, provided it was not 'significant'. There is a problem assessing what is significant

- the third part would allow price discrimination when it aids efficiency.

  There is a problem of proving that efficiency is improved by the discrimination. For example, it has been asserted by the infrastructure owner, but never proved, that the discrimination allowed by and practiced under the NSW Rail Access Regime enhances efficiency.

  ACIL Consulting has carried out an analysis for the Council that showed that the loss in efficiency arising from rail access pricing on the Hunter rail network based on fully distributed costs (FDC) was not much less than the efficiency loss arising under perfectly applied Ramsey pricing. The analysis also showed that imperfect application of Ramsey pricing can result in efficiency losses considerably higher than FDC pricing. For the Hunter rail network there is a high risk that Ramsey

pricing will not be perfectly applied and that efficiency losses would be higher under discriminatory pricing than under non-discriminatory pricing.

A copy is attached of a paper presented by Mr. John Daley of ACIL Consulting to a Rail Freight conference in Sydney in September 1997. This paper describes the analysis carried out by ACIL.

The following should be included in any pricing principles incorporated in Part IIIA

- pricing should be based on efficient costs
- no user or group of users should be required to pay for assets it does not need or use for its operations
- before price discrimination is applied, the infrastructure owner should demonstrate to the users affected, and to a regulator if users request it, that the proposed discrimination will improve efficiency. The application of discrimination should be made transparent in any pricing. That is, the infrastructure owner will clearly show in its pricing to each customer the degree of discrimination applied

Requests for further information

The Commission sought further information or participants' views on a number of issues. Included in these were

• *examples of specific impacts of access regulation — positive or negative — on investment in essential infrastructure (p. 65);*

The NSW Rail Access Regime (Regime) has a discouraging effect on investment in essential infrastructure. This is made clear by the following extract from a submission dated 30th March 2001 by the infrastructure owner Rail Infrastructure Corporation (RIC) to Booz Allen & Hamilton in their capacity as contractors to IPART for determining the DORC of the Hunter rail network

> *Based on the ... DORC valuation [prepared by Booz Allen & Hamilton], RIC will be constrained in effectively operating, upgrading and enhancing the network. As such, RIC would need to inform its customers of its reduced investment capacity (to an amount below optimal expenditure).*

The Council believes this constraint on investment is exacerbated by the combinatorial pricing principles incorporated in the Regime. A specific example of the effect of these was given earlier in this submission in the discussion on Proposal 6.8. Under common practice that prevailed before the Regime was established, the duplication would be built with little hesitation and coal traffic pay all the cost, subsidising non-coal traffic.

• *the merits of providing scope to use price monitoring as an alternative, or complement, to declaration of services under Part IIIA and the most appropriate institutional arrangements to give effect to such monitoring (p. 149);*

The use of price monitoring as an alternative, or complement, to declaration of services implies that the price monitor would need to monitor all prices as a matter of course. This could be a greater task than responding to declaration applications as they arise.

The most appropriate institutional arrangement for price monitoring could be for the monopoly's customers to be the monitor. This was proposed by the Hilmer Committee. It considered two broad approaches to the setting of access prices (p255 of the Hilmer report). It favoured an approach under which parties are free to negotiate access agreements subject to specific pricing principles established by a Minister. Its report (p256) says, in relation to this type of price setting

> *To facilitate negotiation of appropriate access arrangements ... the owner of the facility should be required to provide relevant cost or other data to the party entitled to seek access and, if need be, to the arbitrator.*

The Council is of the view that what was proposed here was essentially monitoring and regulation by the monopoly's customers. If the customer has access to all the information needed to monitor prices, regulators should need be called upon rarely. Monitoring by customers would be more timely than monitoring by a regulator and it would be carried out by those who are closest to the pricing.

Allied with adequate transparency and a requirement for transparent justification by infrastructure owners for discriminatory pricing, this could be a means of applying 'light-handed' regulation. Help from a regulator may be needed to establish prices initially, but from then on with adequate transparency users should be able to adequately monitor prices. Infrastructure users would need to be able to call on a regulator if their price monitoring revealed anomalies. There could be difficulties where a monopoly's customers use mainly small amounts of the regulated service and do not have adequate resources to carry out monitoring.

Alternatively monitoring could be carried out by a regulator on request of an infrastructure user. The regulator would need to satisfy itself that the prices it monitored were appropriate, and be given some powers to correct what is sees as anomalies, so it would be little different from an industry regulator. Price monitoring by a regulator would not necessarily detect or resolve problems with the non-price aspects of access.

• *the nature of the information that would be required to fulfil the 'sufficiency' requirement under proposal 6.3 (p. 155);*

As indicated in the response to the issue of price monitoring, the Hilmer report (p256) says, in relation to negotiated prices

> *To facilitate negotiation of appropriate access arrangements ... the owner of the facility should be required to provide relevant cost or other data to the party entitled to seek access and, if need be, to the arbitrator.*

If infrastructure users are to act as regulators, they should have access to all the information any regulator needs to carry out its role adequately. In individual cases it will depend upon the regime.

The NSW Rail Access Regime is a good example of one extreme of the need for information for users to be satisfied that their pricing is consistent with the Regime. The Regime is a 'negotiate and arbitrate' regime, with no regulator at all. Because the 'ceiling test' in the Regime requires testing the revenue from any group of access seekers, access revenue for all possible groups of access seekers (which means the revenue from each access seeker separately, without necessarily identifying individual access seeker) needs to be known.

The NSW Rail Access Regime has a requirement (Section 8.1) that the infrastructure owner must provide an "Information Package" to an access seeker that requests it. Attachment 1 to this submission is a copy of Schedule 5 of the Regime that specifies the information to be provided in the Information Package.

The Council has been critical of the information required in the Information Package, in particular its relevance to the pricing principles in the Regime. This is because even if all the information specified in the Information Package were provided, and it were accurate and relevant to the period of interest, rail users could not determine whether their access charge is appropriate.

The Council asked for a copy of the Package on 28th May 1999. Access prices for Hunter coal traffic are renegotiated each year and apply from 1st July. A copy of the Package was provided on 28th July 1999. It contained information for 1997/98 and so was two years out of date for rail users trying to assess the reasonableness of prices for 1999/00. Moreover, the information in the Package was not consistent with information provided in RAC's 1997/98 Annual Report, or with information provided to IPART for its Review of Aspects of the NSW Rail Access Regime.. It was also internally inconsistent.

The Council wrote to RAC pointing out the dated nature of and inconsistencies in the information, but the information was never clarified or updated.

In the past few weeks the Council has requested an Information Package that will provide information to assist in negotiations for 2001/02 access charges. RIC has advised that it will provide actual cost data for 1999/00, again two years out of date.

This experience is what prompted the Council to suggest in its submission to the Commission of 20th December 2000 that information provided to access seekers should be audited by an independent auditor to ensure it is accurate and relevant, particularly in cases where there is no regulator.

The Council is of the view that for monopolists selling prices should not be considered commercially sensitive. By definition a monopolist has no competitors and so it has no 'competitive position' in relation to its customers. Its returns will be capped in some way by a regulator or an access regime. Where information on any supplies to the monopolist are commercially sensitive there may be cause to protect the provider of these supplies in some way, but there are ways of doing this other than withholding the information altogether.

As set out earlier in this submission in the discussion on Proposal 8.1, the Council considers that monopoly service providers should clearly set out the extent of and justification for any discriminatory pricing.

• *the merits of final offer arbitration as a dispute resolution mechanism in the context of Part IIIA (p. 157);*

Final offer arbitration might work if it were applied to access pricing alone. If however a dispute were to involve complex technical matters it is unlikely this type of arbitration would work satisfactorily. It is perhaps something that could be made available as an option if both parties agree.

• *ways in which the practical difficulties of targeting those projects/services that should be granted an access holiday within Part IIIA might be overcome (p. 194);*

The perceived need for projects or services to be granted an access holiday is based on the premise that granting access will reduce the return on investment of the infrastructure provider in cases where an investment is expected to be only marginal. It should not be impossible to devise an access regime such that providing access to third parties does not reduce returns in these circumstances. Provided there is no monopoly rent involved (and by definition, a marginal project will not involve monopoly rent) providing access to third parties should enhance rather than reduce the return of the infrastructure provider.

• *the advantages and disadvantages of the key methodologies for valuing infrastructure assets (p. 222);*

This can depend upon the particular regime. For example, the NSW Rail Access Regime has a ceiling test that requires that for any group of users, access revenue must not exceed the full economic cost of assets required for that group on a stand alone basis. This requires an assessment of what assets are needed for each group, considering its requirements only, so DAC will not be appropriate for many groups of users. For this Regime, DORC is the basis most consistent with the pricing principles.

Whatever the methodology used, it should apply the principle that users should not be required to pay for assets they do not use and actual past depreciation should be used as much as possible in determining a regulatory asset value.

• *the NCC's suggested target time limits for declaration and certification processes and whether such indicative limits should apply also to the assessment of undertakings and to arbitrations for declared services (p. 237);*

The Council supports time limits for Ministerial decisions (if they were to continue) on declaration and certification. For the assessment of undertakings, imposition of a time limit may result in adequate consideration being given to all the issues. For arbitration on declared services, imposing a time limit for commencement of arbitration could disadvantage the access seeker. For example, one of the reasons why the Council initiated a declaration

application for the Hunter Railway Line Service was that under the terms of the NSW Rail Access Regime it was not entitled to negotiate at all with the infrastructure owner. Had the service been declared, it is unlikely that the Council would have been in a position to start arbitration 30 days later.

• *the value of implementing a fast-tracking arrangement for second-round certifications and undertakings (p. 244);*

There may be merit in an arrangement such as that proposed by the Commission. But the regulator would need to be prepared for considerations of second-round certifications and undertakings to be more than a rubber stamp.

The NSW Government has commented on the short period of certification of the NSW Rail Access Regime. The Council considers the period of certification was appropriate considering

- the desirability for the NSW Regime to be consistent with a National Regime, and
- the fact that the recommendation of the regime was based upon findings in a draft IPART report (some of which were not included in the Final Report) and upon the recommendations of the Final Report being incorporated in the Regime (not all of them were).

  As a result, the regime that the NCC thought it was recommending for certification was not the regime that was certified. An application for second round certification of this Regime would need to take that into account.

• *how much detail concerning arbitrated terms and conditions could be included in post-arbitration reports (see proposal 9.9) without breaching legitimate confidentiality concerns (p. 249);*

In regimes such as the NSW Rail Access Regime, where there is no specified regulator, an arbitrator's findings are the only involvement of an independent body in pricing. Accordingly, the information disclosed should be no less that if it were the findings of a regulator.

In any regime, the greater the amount of disclosure, the better infrastructure users will understand the basis for pricing and the more likely it is that future arbitration can be avoided.

The Council is of the view that in monopoly infrastructure matters, few if any 'confidentiality concerns' are legitimate. See the earlier comments on transparency, pp5-7 of this submission.

Box 9.1

The Council also wishes to point out some minor inaccuracies in Box 9.1 (p234 of the Position Paper)

- it was the NSW Minerals Council, not the NCC, that lodged an appeal in November 1997 against non-declaration of the Hunter Railway Line Service

- at the fifth directions hearing of the appeal on 29th March 1999, the Tribunal was advised that the NCC had made a recommendation on certification to the Minister, but was not told what the recommendation was. Details of the recommendation were not disclosed until the Minister announced his decision to certify the Regime in November 1999

SCHEDULE 5 – INFORMATION PACKAGE

The Information Package will include:

(i) Network Configuration

Diagrammatic map of the Corporation's network, showing track configuration.
Diagrammatic map showing Sector codes, as used for asset management and costing purposes.
Route kilometres and track kilometres by Sector.
Curve and gradient diagrams, and ruling grades by Sector.
Line class and track design characteristics, by Sector.

(ii) Recurrent Costs

The Corporation's Total Costs disaggregated into:
- Infrastructure maintenance, further disaggregated into:
  - Routine maintenance
  - Major Periodic Maintenance
- Network control costs
- Terminal management costs
- Depreciation, where applicable
- Technical services costs
- Interest.
- Overhead costs, further disaggregated into:
  - Corporate overheads
  - Marketing overheads
  - Asset management overheads
  - Train operations and network control overheads.

Cost attribution methodology used to allocate costs to Sectors for the purpose of this Schedule.
Attributed costs by Sector.
Indicative variable cost rates by region.

(iii) Capital Costs

Depreciated replacement cost asset values by asset class, allocated by Sector.
Treatment of depreciation
Committed capital works and capital investment
Cost of debt
Capital structure.

(iv) System Usage

Gross tonnes per annum by Sector, aggregated into the following tonnage bands

gross tonnes per annum
0-200,000
200,001-500,000

500,001-1 million
1-2.5 million
2.5-5 million
5-7.5 million
7.5-1 0 million
10-15 million
15-20 million
thereafter in increments of 10 million gross tonnes

(v) Operational and other information:

Indicative sectional running times for various types of standard train.

Indicative maxim trailing tonnages for locomotives of various characteristics, by Sector.

Maximum axle loads and speed restrictions, by Sector.

Indicative maximum train lengths, by Sector.

The Corporation's Transit Space Standards (defining dimensional requirements for Rolling Stock).

The Corporation's standard access agreement.

The Corporation's credit policy, when available.

(vi) Unutilised Capacity

Indicative figures for the number of unutilised Train Paths for representative trains of various configurations and characteristics as follows:

by Sector;
by time period; and
by day of week.

That part of the Master Timetable (excluding Rail Operator identity) that is directly relevant to the Access Seeker.

(vii) Arbitration Information

A copy of any Determinations published by the Arbitrator in relation to the Regime.

THE ATTACHMENT FOR SUBMISSION NO. DR63 IS AVAILABLE FROM

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Attachment

Pricing Rail Infrastructure Services

Paper Delivered by

Mr. John Daley, ACIL Consulting

to the

IIR Rail Freight Conference

Sydney, September 1997