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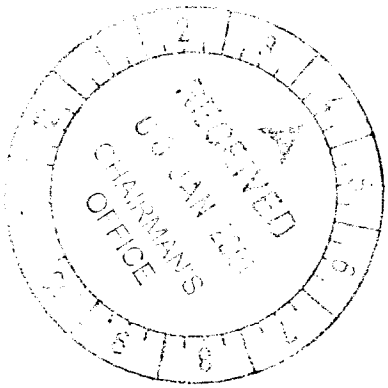


Mr Gary Banks
The National Access Regime Inquiry
Productivity Commission
PO Box 80, Belconnen, ACT, 2616

Dear Mr Banks

Thank you for the opportunity to comment on the Commission's Issues Paper for the inquiry into the National Access Regime.

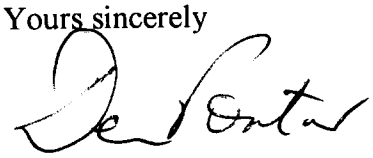
The members of the NSW Minerals Council are major consumers of monopoly rail access services. The Council has had what is possibly unique experience in the application of Part IIIA, having been closely involved in the processes of applications for declaration and certification plus an appeal to the Australian Competition Tribunal. It also has direct practical experience of negotiation under a negotiate/arbitrate regime, without a regulator. Our submission deals mainly with our experience of those processes.

The impression that we have drawn from our experiences is that the use of Part IIIA by a consumer of monopoly services is a long, difficult and costly process. Application of Part IIIA to rail may be more difficult because of the lack of an agreed national approach and the mixture of pricing traditionally applied to rail services – from monopoly rents to cross subsidies to CSOs. Despite this, the changes that have occurred in rail freight of coal in NSW through the application of Part IIIA have been of great benefit to the NSW coal industry and the cause of economic efficiency. Without the avenues provided by Part IIIA much of this progress would not have been possible.

Notwithstanding this progress, there is considerable scope for improvement in the way that Part IIIA operates. I hope that this submission assists the Commission in finding ways in which the National Access Regime can be improved.

Despite the prominence of the negotiate/arbitrate model in Part IIIA, the NSW Rail Access Regime is unusual amongst major Australian access regimes in that it is a pure negotiate/arbitrate access regime, without a regulator. The NSW Minerals Council's experience of access negotiation under such a regime confirms that genuine transparency to access seekers of vital information is essential for such a regime to operate successfully. This is of such fundamental importance that such regimes should have provision for independent auditors to ensure that the correct, relevant information is provided before negotiations commence.

Yours sincerely



Denis Porter
Executive Director

PRODUCTIVITY COMMISSION INQUIRY

THE NATIONAL ACCESS REGIME

RESPONSE TO ISSUES PAPER

BACKGROUND TO THE COUNCIL'S SUBMISSION

The NSW Minerals Council ("**Council**") represents the great majority of the participants in the NSW coal industry. Coal represents Australia's largest commodity export earner, with exports valued at around $8.3 billion in 1999/2000. Around 40% of Australia's coal exports are from NSW. As at 30 June 2000 the coal industry provided direct employment for over 9,500 persons in NSW. Most of these are involved in the production of coal for export. Many more people are employed indirectly, for example in upstream industries and in the railing of coal to port. The coal industry represents over 2% of NSW's GDP and is the State's largest export earner.

Transport of coal to port plays a vital part in the export process. Most NSW coal exporters are located in the Hunter Valley, and nearly all of those are required by the terms of mining leases or development consents to use rail for transport of coal to port. The cost of rail freight for Hunter export coal typically represents over 10% of f.o.b. costs. Until 1st July 1996 all coal was carried by the Freight Rail Division of the government-owned State Rail Authority.

Under the terms of the *Transport Administration Amendment (Rail Corporatisation and Restructuring) Act 1996* (NSW) ("**TAA**"), structural changes took effect on 1st July 1996. The former State Rail Authority, which was a vertically integrated rail freight and passenger carrier, was split into four separate entities

- Rail Access Corporation ("**RAC**"), which owns or has vested in it all essential rail infrastructure
- the "new" State Rail Authority ("**SRA**"), a rail passenger carrier
- Freight Rail Corporation ("**FreightCorp**"), a freight carrier
- Railway Services Authority ("**RSA**"), a rail infrastructure and rolling stock maintenance contractor (later corporatised and renamed Rail Services Australia)

Of these four entities, RAC is the only structural monopoly. Because of the nature of its operations and of the Sydney rail network, SRA has an effective monopoly of Sydney urban and suburban passenger services.

The NSW Government on 21st August 1996 established the NSW Rail Access Regime ("**Regime**"). The purpose of the Regime was to regulate aspects of third party access by rail users to the monopoly rail infrastructure owned by or vested in RAC. The Regime was developed without any public consultation. In February 1997 Specialized Container Transport (SCT), a road/rail transport operator, sought declaration of the Sydney-Broken Hill rail service under the terms of section 44F of the *Trade Practices Act 1974* (Cth) ("**TPA**"). This was followed in April 1997 by an application from the NSW Minerals Council that the

Hunter Railway Line Service be declared.

The National Competition Council ("**NCC**") on 1st September 1997 recommended to the NSW Premier that he declare the Hunter Railway Line Service. The Premier did not make a formal decision on the recommendation and was deemed to have not declared the service. In a letter to the NCC of 3rd November 1997 the Premier did not challenge the inference of the recommendation that the Regime was not effective.

On 12th June 1997 the NCC received an application from the NSW Government to recommend to the Commonwealth Treasurer that he certify the Regime as "effective" under the terms of sections 44M and 44N of the TPA. The Issues Paper on the application published by the NCC stated that the NCC aimed to forward its recommendation to the Commonwealth Treasurer by 25th August 1997, a few days before the NCC was expected to send its recommendation on declaration of the Hunter Railway Line Service to the Premier. It was in March 1999 that the NCC eventually forwarded its recommendation to the Minister for Financial Services and Regulation that he certify a significantly modified version of the Regime. The Minister certified the Regime on 15th November 1999 until 31st December 2000.

The Council lodged an appeal with the Australian Competition Tribunal on 20th November 1997 against the deemed decision by the NSW Premier not to declare Hunter Railway Line Service. The appeal was contested by RAC.

At the second directions hearing of the appeal, on 16th April 1997, the parties agreed to refer the question of application of S78 of the *Competition Policy Reform Act 1995* (Cth) ("**CPRA**") to the Federal Court. Section 78 imposed a moratorium on the application of the CPRA to government coal carrying services until 22nd November 2000. RAC sought to exclude the application of Part IIIA of the TPA to access to the Hunter Railway Line Service until November 2000 on the basis of S78. The Federal Court handed down its judgment on 9th October 1998, that S78 did not apply to the Hunter Railway Line Service.

Directions hearings in the Tribunal on the appeal resumed on 4th November 1998. During hearings, the President of the Tribunal expressed his disappointment that the NSW Government did not seek to be a party to the proceedings. At the fifth directions hearing of the appeal on 28th April 1999 the Tribunal was advised that the NCC had made a recommendation on certification of the Regime to the Minister. The nature of the recommendation was not disclosed at that time.

The appeal fell into abeyance pending a decision by the Minister. Two more directions hearings were held. Both were told that the Minister had not yet made a decision, pending further information from the NCC. When the Minister certified the Regime as effective, the Council withdrew its appeal on 9th December 1999.

The NCC issued a Draft Recommendation on certification of the Regime in April 1998. This draft recommendation identified several features of the Regime that would need modification before the NCC would recommend certification, but it did not clearly define a regime that could be recommended for certification. Included in the Draft Recommendation was a statement that "if the Regime adopted capital cost methodologies for asset valuation, rate of return and depreciation, verified independently by a suitably qualified expert, it would meet the requirements of the CPA on capital costs".

On 2nd November 1998 it was announced that the Independent Pricing and Regulatory Tribunal of NSW ("**IPART**") had been asked by the Premier of NSW to investigate and report on cost definitions, asset valuation methodologies and an appropriate rate of return on assets for the Regime. IPART was asked to report by 28th February 1999. The terms of reference to IPART did not specifically mention the need for IPART's recommendations to be consistent with the Competition Principles Agreement. On the same day, 2nd November 1998, the NCC issued a 'circular' stating that it expected to recommend certification of the Regime by end-February 1999.

On 16th December 1998 the NSW Government published a draft amended NSW Rail Access Regime ("**amended regime**"). The amended regime was substantially different from the regime then in force, which had been Gazetted on 22nd August 1996, and from the regime submitted to the NCC for certification. Under the provisions of the *Transport Administration Act 1988* (NSW) the Minister for Transport is obliged to make a draft of proposed amendments to the Regime available for public comment for at least 30 days and to have regard to any submission he receives. The Minister invited public comments on the amended regime by 22nd January 1999. The Council made a submission proposing extensive changes to the amended regime. The amended regime was Gazetted on 19th February 1999, with one minor modification to the draft.

To accommodate recommendations from the IPART review of the regime, which was taking place during the consultation period under the TAA and the NCC's deliberations, the amended regime as Gazetted provided that the recommendations of the IPART review would automatically be incorporated into the Regime.

The effect of these various events in the period November 1998 – February 1999 was that

- IPART, in the first part of its review of the Regime, did not know what was in the amended regime. It did not know what changes would be made to the amended Regime as a result of the public consultation process until the amended regime was Gazetted on 19th February

- in making initial submissions to the IPART review, rail users did not know what was in the amended regime

- in making submissions to the NSW Minister for Transport on the amended regime, rail users did not know what IPART's recommendations were which would automatically become part of the Regime

- the NCC expected to make its final recommendation to the Minister on the same day as publication of the IPART recommendations which were to be automatically incorporated into the Regime. The Terms of Reference to IPART had not specified that its recommendations should be consistent with the CPA, so the NCC could not be sure that that was the case

Presumably in recognition that the timing in the proposed process meant that there would be a lack of transparency in finalisation of the Regime, IPART issued a Draft Report on 1st March 1999. On 25th March, the NCC forwarded to the Minister for Financial Services and Regulation its recommendation that he certify the Regime as Gazetted on 19th February,

which provided that IPART's final recommendations be incorporated into the Regime. In making its recommendation, the NCC explicitly stated that it expected that IPART's Final Report would address several issues identified but not resolved in the Draft Report. Some of those issues were not addressed in the Final Report.

In addition, the NCC's recommendation for certification assumed that all IPART's recommendations would be adopted. This has not yet been done. The result of these omissions is that the NCC recommended certification of an access regime which was not finalised when it made its recommendation. The actual final Regime is different from what the NCC thought would be the case. Some aspects of the Regime have not been finalised as IPART recommended and as the NCC assumed would occur.

One of the recommendations of the IPART review was that assets of the infrastructure owner should be valued by an independent consultant. This valuation is nearing completion and the final valuation should be released in early 2001, around 21 months after IPART's Final Report was published. A draft report values Hunter Valley assets for the purpose of pricing access for coal traffic at 57% of the value currently in use.

Negotiate/arbitrate regime

An unusual feature of the Regime is that it has no regulator. Most, if not all other Australian regimes for access to major infrastructure (other than the National Access Regime established under Part IIIA) have an appointed regulator. While neither the Hilmer Report recommends nor the TPA requires a regulator, the Hilmer Report makes it clear that in the absence of a regulator transparency is vital. It says, in relation to access regimes without an appointed regulator

> *To facilitate negotiation of appropriate access arrangements once a facility has been declared, 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.*[1]

Under these circumstances, it is clear that the Hilmer Committee expected a monopoly's customers to act in place of a regulator. To do this effectively they need some tools that a regulator would have available to it. The most important of these is knowledge of the monopoly's costs, as Hilmer acknowledges.

In practice, transparency of the infrastructure provider's costs under the Regime has been inadequate.

Use of efficient costs

In seeking to establish a meaningful right under the Regime to have efficient costs applied in setting prices, the Council encountered significant difficulties. The Regime still does not specifically provide for all costs used for pricing purposes to be efficient costs, although IPART's Final Report said that "RAC access prices should be based on forward looking (forecast) efficient costs". This is one of IPART's recommendations not yet fully reflected in the Regime.

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1 Hilmer Report, p256

When RAC was established, all its rail infrastructure maintenance was contracted to RSA without being put to public tender. It was stated at the time that it was intended that the work being carried out by RSA would be progressively put to open tender so that after four years all RAC's infrastructure maintenance would be subject to public tender. New South Wales was to be separated into about 12 regions and maintenance for a new region was to be put to public tender at intervals of three months. Work under the first such contract started in January 1998 and in February 1998 the NSW Government announced that the RAC's contestability program would be suspended.

The NSW Minerals Council pointed out to the NSW Premier, the NCC and the Productivity Commission that this suspension would penalise the Hunter coal industry because it would be paying for actual costs and not efficient costs. The NSW Cabinet Office, in separate submissions to the NCC and the Productivity Commission, claimed that

> *"The proposed arrangements during the suspension of the contestability program is* [sic] *for benchmarking of maintenance costs by the Independent Pricing and Regulatory Tribunal over all bundles [of proposed maintenance contracts] simultaneously."*[2]

and

> *"Benchmarking, supervised by the Independent Pricing and Regulatory Tribunal, will be introduced to ensure that maintenance costs are, at most, equal to levels which would be achieved by competitive tendering."*[3]

In late 1999 the NSW Government announced that public tenders would be invited for maintenance work on two additional regions including the Hunter. Tenders were invited for the Hunter but before a contract was awarded the Government announced that Hunter maintenance would continue to be carried out by RSA under existing arrangements. In October 2000 the Government announced that RSA and RAC would be amalgamated.

IPART has not been asked to benchmark any RAC maintenance costs. The Council has proposed to IPART that efficient costs be determined as part of the asset valuation currently being carried out, but this has not been done.

RESPONSES TO QUESTIONS AND DISCUSSION IN THE ISSUES PAPER

4. Rationale for a national access regime

Nature and significance of the underlying problem

Are the circumstances in which a facility owner would seek to deny access widespread? What sorts of costs does denial of access impose? Are there situations where denial of access would be desirable from the community's point of view?

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2 Attachment to letter from Mr R B Wilkins to Mr G Samuel, National Competition Council, 13 May 1998

3 Attachment to letter from Mr R B Wilkins to Mr J Coulter, Productivity Commission, 1 June 1998, p10

The original NSW Rail Access Regime Gazetted in August 1996 provided that only rail operators could negotiate with and enter into access agreements with RAC. In submissions on the NSW Government's application for certification the NSW Minerals Council argued that major rail users, such as coal exporters, should be entitled to negotiate with and enter into access agreements with RAC provided that rail haulage was conducted by accredited rail operators. RAC opposed this. The Regime that was certified did, however, include a right for rail customers such as coal exporters to negotiate with and enter into access agreements directly with RAC.

Rail operators do not necessarily have an interest in minimising access charges where the infrastructure owner does not discriminate between operators. Where there is discrimination between rail traffics, operators may have an interest in maintaining that discrimination to enhance their competitive position in some traffics against non-rail competition. Denial of access to coal exporters means that it is more difficult for them to achieve transparency in access pricing. It also makes it more difficult for coal exporters to obtain the services of new rail operators to compete with the incumbent operator or operators.

Should vertically integrated bottleneck facilities be treated differently than non-integrated facilities? Is the real concern underpinning access regimes denial of access, or the price and conditions of access? Are the two concepts separable from a regulatory point of view, or should they be addressed in tandem?

In rail, difficulties can arise where a customer has a right to access under an access regime or agreement, but access to a particular timetabled trainpath may not be available. There is a need for rail users' rights to the track, where conflicts with other users are possible, to be clearly spelt out. This should be done by means of publicly available Operations Protocols. In NSW these are not publicly available. The result is that additional costs can be imposed on a user if it is denied access to a trainpath allocated to it as a result of a higher priority train using it. This can occur even on lines where the lowest priority user pays the highest access charge.

The *Transport Administration Act 1988* (NSW) and the NSW Rail Access Regime both provide that passenger traffic has priority over other traffic. In the Hunter Valley, in practice coal traffic has lowest priority of all traffic, even on lines where it pays all fixed costs and non-coal traffic pays only variable costs. This presents difficulties on line sectors shared by coal and non-coal traffic, particularly where demand is close to or exceeds capacity.

If capacity is not increased when required, passenger and other non-coal traffic will have priority over coal traffic even though coal traffic pays all fixed costs and capital charges. A remedy is for coal traffic to pay for the increased capacity, but in these circumstances coal traffic would be paying for more capacity than it requires. This is contrary to efficient pricing principles and to the NSW Rail Access Regime. Nevertheless the infrastructure owner has advised informally that on a particular line sector where this situation applies, capacity will be increased only if coal traffic pays for it.

The Second Interim Report of the Special Commission of Inquiry into the Glenbrook Rail Accident noted similar problems being encountered by the SRA in effecting new investment in capacity enhancements[4]. In that case the SRA initiated and paid for necessary capacity

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4 Second Interim Report of the Special Commission of Inquiry into the Glenbrook Rail Accident, p20-21

enhancements. The cost was ultimately paid by the NSW Government regardless of who pays in the first instance, but that is not the case in the Hunter.

Although the infrastructure owner is not vertically integrated, coal traffic can be discriminated against because of the lack of publicly available Operations Protocols and the practical application of train control arrangements. The change to these train control arrangements under the Transport Administration Amendment (Rail Management) Act 2000 recently enacted by the NSW Parliament will not change this.

Experience with the NSW Rail Access Regime therefore shows that access and price and conditions of access are not easily separable.

Does the denial of access (or monopoly pricing of access) have significant efficiency effects, or does it result mainly in transfers of income? Are there circumstances where one or other effect would predominate? From a policy perspective, is this distinction important?

In the early to mid-1990s the NSW Government extracted over $80M per year in monopoly rent from Hunter Valley coal exporters by way of rail charges. It is likely that if that rent had not been charged, the industry would have been more competitive in its international markets and hence would have supplied more. The effect would have been one of efficiency and level of output as well as transfer of income.

What is the role for formal access regulation?

What is the evidence that access regulation reduces prices and/or improves the range and quality of services available to end users?

Access regulation has led to the elimination of most of the approximately $80M per year in monopoly rent, acknowledged and unacknowledged, previously imposed on rail freight of Hunter coal exports. It has not yet resulted in a significant improvement in the range or quality of services available to rail users, but some improvements are hoped for in the future.

How do the costs of access regulation compare with the costs of not facilitating access for third parties? Does the magnitude of the costs of access regulation primarily depend on the associated pricing principles/rules?

Are disincentives to investment in bottleneck facilities likely to be significant? To what extent could any such disincentives be offset by greater incentives to invest in upstream and downstream activities? Is increased investment in related activities necessarily desirable from the community's point of view, or does it depend on whether the specific access requirements are appropriate?

Does the relativity between benefits and costs vary across infrastructure sectors? Do relativities change over time, or in response to other policy changes? For example, is access regulation necessary to underpin structural separation of some government infrastructure providers? Will technological developments make infrastructure

provision more contestable and thereby reduce the need for access regulation in the future?

As indicated above, the NSW Rail Access Regime is unusual in that it has no designated regulator. Nevertheless it has had some regulatory input in that the Independent Pricing and Regulatory Tribunal of NSW has been called upon to determine the meaning of cost definitions in the Regime, the value of the maximum rate of return on assets that can be included in access prices, and asset valuations for the Hunter rail network for use in pricing. Once this work has been completed, there is nothing in the Regime to indicate how future determinations of rate of return and asset values are to be made. The IPART Report on Aspects of the NSW Rail Access Regime made recommendations on these issues, but contrary to NCC expectations these have not yet been incorporated into the Regime.

If the Regime remains in its current form, access seekers will have to take on the role of regulator to interpret and apply the findings of IPART to access prices. It is likely that the only way this can be done under the current Regime is through arbitration. Because the Regime has no regulator, rail users have to take the place of the regulator. The transparency provisions of the NSW Rail Access Regime have not resulted in rail users being provided with adequate information on costs of access[5].

There has been only one arbitration under the Regime, in 1996 between National Rail Corporation and RAC. No information was disclosed publicly about the outcome of that arbitration that would help access seekers in assessing reasonable pricing under the Regime. The Regime has since been changed to provide for the outcome of arbitration to be disclosed publicly, although this can be circumvented by commercial confidentiality provisions. The common ownership of RAC and most major rail users in NSW, and the disadvantages of arbitration, have probably prevented Access Seekers seeking arbitration. Disadvantages of arbitration include its adversarial nature, high cost (perhaps $½M to $1M for each party), delays in resolution and piecemeal approach to pricing.

It is likely that the costs of regulation through arbitration, if that option were pursued to the extent necessary to provide reasonable clarity on pricing, would exceed the cost of regulation through the more usual regulator.

These costs need to be compared to the opportunity costs of not having an effective regime – monopoly rents, inefficient pricing and lack of incentive to improve efficiency.

Under the NSW Rail Access Regime, there are considerable disincentives to invest in bottleneck facilities, while there are no apparent incentives for the infrastructure owner to invest in upstream activities. For example, there is currently a need for duplication of a line sector on the Hunter rail network. Under the Baumol/Ramsey combinatorial pricing in the NSW Rail Access Regime, this duplication is not required for coal traffic, so coal traffic cannot be called upon to pay for it. The infrastructure owner appears reluctant to charge other traffic for the duplication, and no progress is being made on its construction.

Because of the requirement in the Regime and in the TAA for passenger traffic to receive priority in access, and because other non-coal traffic is given priority, the situation could

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5 See the Second Interim Report of the Special Commission of Inquiry into the Glenbrook Rail Accident, p22, second paragraph.

arise, if this duplication is not built, that coal traffic could be paying the full fixed costs of the single line while having to wait for gaps in non-coal traffic to use it.

Industry-specific versus national access regulation

Should access regulation be in the form of a national regime, industry-specific arrangements, or a combination of both? In practice, would the outcome from a national regime as opposed to a series of industry-specific regimes operating under the same principles and broad rules be significantly different?

If a dual system were to be retained, would the current relationship between the national and industry-specific regimes be broadly appropriate? Does Clause 6 of the CPA provide an appropriate link between them?

Rail access regimes in Australia currently include both the national regime plus several state-based regimes, with the added complication that it is proposed that more than one regime apply to the same section of track. The state-based rail regimes, unlike gas and electricity regimes, are not derived from the same national regime. The only certified effective industry-specific regimes applying to rail in Australia are the NSW Rail Access Regime and the AustralAsia (Northern Territory – South Australia) Access Regime. Efforts are being made to develop an access regime for all interstate track, but progress seems very slow. It would seem that if the track break of gauge problem inherited from the 19th century is not to be replaced by a regulatory break of gauge problem in the 21st century, a single national rail access regime should apply.

The fragmented nature of rail access regulation probably resulted from rail not being included amongst the specific industries targeted by COAG for reform.

It is noted here that in its Report on Progress in Rail Reform, the Productivity Commission recommended various structures for different types of railways. These included

Interstate freight network	vertical separation
Regional freight networks	horizontal separation, vertical integration
Main coal networks	horizontal separation, vertical integration
Urban passenger networks	horizontal separation, vertical integration

Under these types of structures, and particularly in the Hunter which has characteristics of all the network types, it would be desirable for a single type of access regime to apply to all networks to help ease border problems between networks. There would be benefits in simplicity, consistency and efficiency in operation, pricing and regulation.

In general, the same principles for access and pricing should be equally applicable to all monopoly infrastructure networks. Rail regimes however seem to have presented particular difficulty in devising access regimes because of the problems of existing CSOs, the fact that few parts of State-owned rail networks in Australia receive more in revenue than cash operating costs and the perception that different rail users have widely differing capacity to pay for the same rail service. This has led to rail access regimes in particular having provision for discriminatory pricing which is not so apparent in other regimes.

Clause 6 of the CPA is a tenuous link between Australian rail access regimes.

5 Improving the current national access regime

Objectives and coverage

Should the national access regime contain a clearer statement of objectives? What should these objectives be? Is promoting competition in related markets an objective in its own right? Or is it a means to fulfil broader objectives?

The NSW Minerals Council agrees with the Hilmer Report that competition policy should seek to promote efficiency and economic growth through competition rather than pursue competition *per se*. The difficulty is in translating this objective into practical, tangible guidelines or procedures.

For example, the assessment of 'long-term' benefits will be a subjective one, and many will be unhappy with short-term benefits being foregone in favour of long-term benefits. It also needs to be recognised that it is in the best interests of end users of services that providers of such services prosper and have appropriate incentives to improve their efficiency and to invest.

Should Part IIIA focus on access provision, or more broadly on the exercise of monopoly power by owners of 'essential' facilities when dealing with access seekers? Would the latter require a change to the broad orientation of the regime, or could it be accommodated through the regime's detailed requirements? Could other parts of the TPA or prices control/surveillance provide a more effective remedy where access is generally provided, but at monopoly prices? If so, should access regulation focus solely on vertically integrated infrastructure providers? Given the coverage of existing industry-specific regimes, if Part IIIA were to be limited to vertically integrated facilities, in practical terms, how many other facilities might it apply to?

Is Part IIIA an appropriate vehicle for pursuing distributional concerns (for example, the interests of consumers relative to facility owners), or are these better addressed through other measures? Have distributional concerns influenced decision making under Part IIIA to date?

Access may be of little value if it is only an entitlement to be subjected to unfettered monopoly power. As indicated previously, experience in rail in NSW is that access regimes should be concerned with both access and terms and conditions of access, including price. They should apply to vertically separated monopoly infrastructure providers as well as vertically integrated providers. A feature of the structure of rail in NSW is that, although it is vertically separated, it has some of the characteristics of a vertically integrated operation. Recent changes to the *Transport Administration Act 1988* (NSW) are likely to strengthen the similarity to vertical integration through closer coordination of infrastructure and passenger services. This could disadvantage freight services that operate on lines which are also used by passenger services, particularly in the absence of public Operations Protocols.

Another notable feature of the NSW Rail Access Regime is that it gives the infrastructure owner considerable discretion in the allocation of access charges between users. This discretion has been exercised in using the Regime as a means of imposing disparities in the distribution of access charges. On the Hunter rail network, charges to coal traffic are maximised while charges to non-coal traffic are minimised. The explanation for this unequal distribution is that coal traffic can afford to pay, while other traffic cannot, but there seems to be no concrete evidence to justify this explanation. For example, RAC has told the Productivity Commission that "There is no rule to apply in determining capacity to pay. It is something that becomes evident in the negotiating process"[6].

The conclusion from this is that under Part IIIA facility owners have considerable freedom to distribute charges on a discriminatory basis, without clear objectives or objective justification.

Negotiate/arbitrate issues

Is the emphasis in Part IIIA on prior negotiation between the parties likely to encourage efficient access arrangements, or better outcomes than would eventuate in an unregulated environment? What changes to the negotiating framework would improve outcomes? For example, would a requirement for the facility owner to disclose certain information to the access seeker help to address the problem of information imbalance? What level of public disclosure should apply to negotiated terms and conditions?

Is collusion likely to be a significant problem under the negotiate/arbitrate approach? For example, will it be feasible where there are, or could be, multiple access seekers? Would general competitive conduct provisions in the TPA be a deterrent to collusion?

Commercial negotiation with a monopoly is not possible. If it were, there would be no need to prescribe negotiation. The monopolist will always have total control unless regulation reduces some of that control. One of the main sources of the monopolist's power is its monopoly on knowledge of such matters as its costs. Only if this is removed can anything resembling a commercial negotiation take place. This was recognised by Hilmer, as already pointed out on p4 of this submission.

Anything that increases transparency will reduce the power of the monopolist. In the experience of the NSW Minerals Council, a requirement for a monopoly infrastructure owner to provide information is not enough. The Council applied for relevant information under the provisions of the NSW Rail Access Regime, which require the infrastructure owner to provide certain information to an Access Seeker. When information was provided, it was for the previous year, rather than the then current year, and it was inconsistent with information provided in the infrastructure owner's Annual Report. A request for clarification did not elicit information relevant to the current or subsequent year, or clarification of inconsistencies.

The Council concluded that to obtain the information sought would have required initiating arbitration. A further conclusion is that in a regime that relies solely on negotiation and arbitration with a monopoly service provider, the service provider holds all the power unless

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6 Transcript of evidence to Black Coal Industry Inquiry, Sydney, 18/11/1997, p146.

Access Seekers decide to invoke the arbitration provisions often enough to be equivalent to regulation.

For access seekers engaged in a fully competitive export market, there is no incentive for collusion with the facility owner.

What are the pros and cons of separating the decision to declare a service under Part IIIA from any subsequent arbitrated decision on terms and conditions? Would handling the two together always be feasible?

Would a half way house be to establish some pricing principles or indicative terms and conditions at the time of declaration, to provide some guide to the access seeker about whether it is worthwhile to continue pressing the claim? If so, how specific could any such prices or conditions feasibly be?

A major disadvantage of combining the declaration decision with arbitration is that the declaration decision could thereby be subject to compromise. The result would be uncertainty about the criteria for declaration. In the case of the Council, no negotiation on access had taken place prior to its lodging an application for declaration. Its concerns were about fundamental matters of principle rather than finalising details of an access agreement.

The disadvantage of separation of these processes is the time taken to work through the procedures required.

One source of uncertainty to the Council during the process of certification of the NSW Rail Access Regime (which was closely related to the progress of the appeal on declaration) was that it was unclear what the NCC would accept as an affective regime. This was accentuated by the NCC leaving the finalisation of the Regime to IPART, with IPART not including adequate details in those of its recommendations which were automatically incorporated into the Regime (such as who revises the rate of return on assets, when and using what guidelines and processes).

Criteria for declaration

Does the limited declaration case history, together with general guidance from the NCC on the interpretation of the declaration criteria, provide sufficient certainty to access seekers and providers? Should there be more guidance in Part IIIA itself?

There is considerable variety in and differences between access regimes that have been certified. More guidance in Part IIIA itself would be useful. For example, there is little guidance in Part IIIA on pricing issues, such as a requirement that pricing should reflect efficient costs, there should be no monopoly rent, the degree of price and access discrimination permitted amongst users, etc

What modifications, if any, are required to the 'promotion of competition in related markets' criterion? Does any need for change stem solely from suggested changes to the broad objectives of Part IIIA, or are changes also required to give better effect to the current legislation?

Is the requirement to distinguish the market(s) in which competition will be promoted necessary? Is the NCC's current approach to defining markets appropriate? Does the inclusion of the rider 'whether or not in Australia' in the related market test serve a useful purpose?

The rider 'whether or not in Australia' does serve a useful purpose in that it helps Australian exporters become more competitive in overseas markets through application of competition policy.

Should there be a need to demonstrate that the provision of access would lead to a large increase in competition? Should there also be a requirement to demonstrate resulting benefits for end users? Would this be possible in advance of the event, other than in 'in principle' terms?

The basic requirement is an increase in economic efficiency, brought about by an increase in competition. It would probably not be useful to require a large increase in competition. In any case the definition of 'large' would be a problem. There is an implicit assumption that an increase in competition will benefit end users, but to demonstrate the benefits in advance rather than in 'in principle' terms would be difficult.

What is meant by national significance? What sorts of facilities clearly meet, or fall outside, this test? In seeking to delineate the national and State-based access regimes, could the national significance criterion leave important intrastate facilities outside the purview of any regime?

Provided that there is a certification or similar mechanism in place for State-based access regimes to minimise the potential for regulatory duplication, is a national significance test for declaration necessary? Could materiality concerns be adequately addressed by a requirement that the denial of access to a facility would have large and adverse economic effects?

Facilities serving exclusively access seekers in one state can still have national significance. The Hunter rail network is an example of such a facility. Any significance test should be set as low as reasonably practicable.

Given the other criteria, is a specific public interest test in Part IIIA necessary? If so, should the legislation spell out the matters to be considered under the test? Should the focus of the test be on efficiency, or is this better spelt out in the overall objectives for the regime, with the test providing a way to take other issues into account? What guidance, if any, should be provided to regulators on the relative importance of particular public interest test considerations?

Is it appropriate that the onus of proof in the public interest test be at odds with the usual presumption that the party seeking change should demonstrate a benefit from that change? Or does the public interest test simply offer the facility owner a chance to present other arguments against declaration when the key considerations suggest there is a strong case for doing so?

If there is to be a public interest test, it is appropriate that it be expressed as it is at present.

Certification and undertakings

Is there a rationale for having different criteria for the three access routes accommodated by Part IIIA? In practical terms, do these differences matter much? If the criteria were to be aligned, which of the current three sets would be the most appropriate?

Does the specification of the tests for an effective State or Territory regime provide scope for significant variation in industry-specific access requirements, either for like facilities across jurisdictions, or between different classes of infrastructure? Does this enhance or reduce efficiency? Does it increase compliance costs for firms operating in more than one jurisdiction?

The distinct between certification and an undertaking appears to be that the criteria for certification are more strict than those for an undertaking. Accordingly Part IIIA provides for public consultation for an undertaking, while there is no public consultation specified for recommendation of certification.

The NCC has nevertheless undertaken public consultation, which is appropriate. In practice, there is little between them although the consultation process followed for undertakings has been more open than that for certification.

Reasons for limited use of the undertaking process could include

- Part IIIA requires a process of public consultation for undertakings
- where certification is sought, the relevant Minister of the State concerned has some control over the outcome, plus the right of appeal to the Australian Competition Tribunal
- there could be a perception that it is easier to devise a regime that complies with the certification criteria than to gain approval for a regime that does not comply with those criteria

Role of Ministers

What are the pros and cons of Ministerial involvement in Part IIIA processes? Is involvement necessary to maintain support for a national access regime? Does it help to reduce the scope for regulatory failures? Is there sufficient onus on Ministers to justify departures from recommendations by the NCC? Would it be possible, or desirable, to provide for a greater onus in the legislation? What is the rationale for the different decision making structure for undertakings?

There is no onus on the Minister to justify departures from NCC recommendations. When the NCC recommended declaration of the Hunter Railway Line Service, the Minister did not

declare the service and did not give any reasons for his decision. The State was not a party to the appeal in the Australian Competition Tribunal against the Minister's deemed decision.

There appears to be little or no justification for Ministerial involvement in Part IIIA processes. If Ministerial involvement is not required in the undertaking process, there seems no reason for Ministerial involvement in the certification process, which has more stringent criteria.

There is no justification for Ministerial involvement in the declaration process. If the legislation maintains Ministerial involvement, it should place the onus on the Minister to justify any departure from NCC recommendations, by reference to the criteria for declaration.

Appeal Processes

Are current appeal processes effective and appropriate? How could they be modified to reduce processing times? What is the rationale for not having a general right of appeal in relation to undertakings?

The current appeal processes can be very drawn out. The appeal against the deemed decision of the NSW Premier not to declare the Hunter Railway Line Service was lodged on 20 November 1997 and withdrawn on 9th December 1999, one month after the Commonwealth Minister for Financial Services and Regulation certified the NSW Rail Access Regime as effective. There had been seven directions hearings, and the appeal was complicated by a referral to the Federal Court of the question of the applicability of S78 of the *Competition Policy Reform Act 1995.*

Administrative and transparency issues

Where are the main bottlenecks in Part IIIA processes? How might these be addressed? Would it be possible, or desirable, to use some form of sanction to increase the incentives for timely negotiation of terms and conditions for declared services?

The delays in processing the application for declaration and the subsequent appeal by the NSW Minerals Council did have the effect of benefiting the facility owner. Some of the delay in this case arose from the application by the NSW Government for certification of a regime covering the service for which declaration was sought. There was a reluctance on the part of the NSW Minerals Council to seek to expedite hearings of the appeal when certification was under consideration. This was compounded by uncertainty about the nature of the recommendation by the NCC to the Minister on certification and the long time (nearly eight months) for the Minister to make a decision.

Are additional measures needed to promote open and transparent procedures for decision making under Part IIIA? If so, what might these involve?

There should be a requirement for the assessment of applications for declaration and certification to be a public process in the same way that the assessment of application for undertakings is.

It is acknowledged that the NCC does in fact invite public comment and provide some indication of progress in its consideration of applications, through the issue of Draft Recommendations. Any procedure specified should however preclude the situation foreshadowed in the NCC's circular of 2nd November 1998 in which it indicated it expected to recommend for certification a regime which was not finalised, and which has been certified but does not incorporate all the features that the NCC expected would be incorporated.

6 Pricing issues

Should Part IIIA include some explicit pricing principles/rules? Is there a need to tailor pricing regimes to the circumstances of particular industries? Does this militate against going beyond the inclusion of broad pricing principles in the legislation?

The inclusion of broad pricing principles in legislation would be useful and would help to enhance certainty and lower costs of regulation. The principles should not be different between industries, although details will obviously differ.

What should be the balance between pricing existing capacity efficiently, and encouraging investment in maintaining and developing existing facilities or in new facilities? Are the two goals necessarily at odds? For example, can two-part pricing regimes accommodate both short and longer-run requirements? How can access pricing regimes best deter the entry of firms that are unable to deliver services in related markets as efficiently as the facility owner?

If Part IIIA is to be used to deal with distributional concerns as well as efficiency goals, what are the implications for pricing arrangements?

What constitutes anti-competitive discriminatory pricing? For example, should pricing principles allow for some price discrimination between access seekers based on the nature and level of their demand? If so, how should regulators differentiate between efficiency-enhancing discrimination and anti-competitive behaviour? Does Clause 6.4 (f) of the CPA — stating that terms and conditions need not be exactly the same for all access seekers — provide sufficient scope for efficiency-enhancing price discrimination?

Should access prices be based on the existing configuration of facilities, or should they try to anticipate technological developments and the like? Would there be dangers in requiring regulators to speculate on future developments when setting access prices? If so, would such developments be better accommodated by reducing the time period for which particular access determinations apply?

The pricing principles in the NSW Rail Access Regime are designed to allow maximum discrimination between users. There are no objectives or guidelines in the regime as to the purpose or justification for this discrimination. In practice discrimination is applied against export coal traffic, which is generally obliged to use rail under the terms of mining leases or development consents.

There is nothing in the regime to prevent discrimination between rail operators engaged in carrying the same traffic.

There is no indication that the price discrimination applied under the Regime is based on any credible basis for assessing optimum efficiency. In evaluating the Regime, the NSW Minerals Council commissioned research by ACIL Consulting (ACIL) that indicated that the efficiency loss arising from applying prices based on activity-based costing (ABC) resulted in a very small loss in economic efficiency compared to perfectly applied Baumol/Ramsey pricing. There is significant risk however that Baumol/Ramsey pricing will not be perfectly applied and ACIL found that efficiency losses under these circumstances could be much greater than the slight efficiency advantage of perfect Baumol/Ramsey pricing over ABC pricing.

Pricing should be based on efficient facilities, rather than on existing facilities. Under the NSW Rail Access Regime pricing is based on facilities required for any access seeker, or group of access seekers, on a stand alone basis. IPART has interpreted this to mean that an allowance should be made for five years' demand growth. The meaning of this interpretation is not yet clear. Under one meaning there would be considerable disincentives for the infrastructure owner to invest for long periods of time.

The effect of the combinatorial test is that to comply fully with the Regime, millions of theoretical configurations of facilities have to be assessed against the test required. In practice, it has taken a consultant to IPART around five months to devise and value a single theoretical configuration for asset valuation purposes.

The test should be, what is the nature of facilities that would be provided in a competitive market? Under these circumstances, inefficient facilities will not attract a rate of return commensurate with the industry benchmark. If the industry rate of return is being applied, it should therefore be applied to efficient facilities.

Should access pricing principles acknowledge that other regulations and policies may be a consideration in setting prices for access? Given the industry-specific nature of most of these 'external' influences, would it be possible to do any more than acknowledge their relevance in a set of general principles?

Access pricing principles should acknowledge that the provision of community service obligations (CSOs) or other policies and regulations that impinge on prices should not result in access seekers who are not beneficiaries of those policies and regulations paying more than they would in their absence.

For example, the suspension of contestability of maintenance on the Hunter rail network should not result in users of this network paying more than they would if contestability had proceeded. This could be accommodated by specifying that efficient costs should be used for access pricing.