



**AUSTRALIAN RAIL TRACK CORPORATION LTD**

**Ref No:**

5 August 2005

Mr. Lyndon Rowe  
Chairman  
Economic Regulation Authority  
GPO Box 8469  
Perth Business Centre  
Perth WA 6849

Dear Mr. Rowe

**REVIEW OF THE RAILWAYS (ACCESS) CODE 2000  
DRAFT REPORT  
ARTC SUBMISSION**

Please find attached a submission prepared by the Australian Rail Track Corporation in response to your review of the Code.

The submission contains no information that ARTC would consider commercial-in-confidence.

For further information regarding the preparation of this submission, could you please contact Mr. Glenn Edwards, (08)82174292 (Ph), (08)82174578 (Fax), [gedwards@artc.com.au](mailto:gedwards@artc.com.au) (Email).

David Marchant  
Chief Executive Officer

# REVIEW OF THE RAILWAYS (ACCESS) CODE 2000

## DRAFT REPORT

### ARTC SUBMISSION

#### Background

The Western Australian Economic Regulation Authority (“Authority”) has sought submissions from interested parties with respect to the Draft Report from its review of the Railways (Access) Code 2000 (“Code”). ARTC notes that the Western Australian Rail Access Regime (“Regime”) has been in place since September 2001. The review to take place on every third anniversary of the commencement of the Regime (and every five years thereafter) is required under the Railways (Access) Act 1998 (“Act”). The Act requires that the purpose of the review “is to assess the suitability of the provisions of the Code to give effect to the Competition Principles Agreement (“CPA”) in respect of the railways to which the Code applies”.

#### The WA Regime

In its previous submission to the Authority, and its previous involvement in the consultation processes conducted by the Authority (or its predecessor) and the NCC in relation to the WA Rail Access Regime, ARTC’s positions and comments have largely been based around two broad themes, being,

- ❖ The need for a consistent approach to access to the interstate network, including that part of the interstate network in WA
- ❖ The need for the WA Access Regime and regulatory supervision to ensure that adequate measures are put in place to provide the market with confidence that access to the WA network can be gained in a timely, fair and equitable way when the access provider is vertically integrated

ARTC’s supports the general view taken by the Authority that the Code could be improved by addressing the problems of transparency and information asymmetry that are inherent in attempting to introduce a contestable market in a monopoly industry. These problems are magnified where the access provider is vertically integrated, as they are two key areas in which an incumbent can seek to stifle third party entry to the network.

ARTC's submission will consider the major amendments to the Code proposed by the Authority. ARTC notes that there are a number of areas that have been identified as requiring amendment which are linked to matters covered by the Act and outside the scope of the review. Such matters include the definition of railway infrastructure (where submissions commented that the Act should include yards, siding and terminals) and the way that the Act deals with 'greenfield lines' where the criteria for inclusion in the Code leaves a possible lengthy waiting period before a developer knows whether a line will be included in the Regime, seen as a potential disincentive to investment. Of particular importance to ARTC is an acknowledgement made by the Authority of ARTC's comments with respect to achieving greater consistency between regimes covering the interstate network. ARTC noted that in the previous regulatory assessment of the Regime, the National Competition Council ("NCC") proposed consideration by the WA Government of providing for the track owner to submit an access undertaking to the Australian Competition and Consumer Council ("ACCC") to adopt the new national regime, in the event that a national regime was developed. The WA Government decided against this approach arguing that it was concerned about automatically committing to a national regime without knowing the detail of that regime. In the interests of better addressing Clause 6(4)(p) of the CPA, ARTC seeks that the Authority put the same proposal to the WA Government now that a national regime (in the form of ARTC's Access Undertaking) exists, at least with respect to that part of the interstate network subject to the Regime. ARTC notes that the Authority intends to separately forward a summary of comments made in submissions relating to the Act issues to the Treasurer for consideration by the WA Government.

ARTC also notes that issues raised in submissions relating to Part 5 instruments (Train Management Guidelines, Train Path Policy, Costing Principles, and Over-Payment Rules) have been reviewed, but detailed changes to the contents of these instruments will be referred to the future review of these specific documents. On this note, ARTC would prefer, in the interests of efficiency and greater certainty, that reviews of the Code and the part 5 instruments were synchronized.

### **Preliminary View 1**

*In relation to proposals to amend the Code to require the Authority to approve the Standard Access Agreement as a new Part 5 instrument, the preliminary view of the Authority is that it is unclear that such an approach would yield better outcomes nor is it required to improve consistency with the CPA. This initial view is based on the CPA stating that terms and conditions can be different; the absence of specific complaints relating to certain terms of the current standard agreement being unfair; the regulatory costs involved in establishing a Part 5 instrument; the risk that the Authority's involvement could stifle innovation; and a desire not to intervene where matters can be settled through commercial negotiation. The Authority seeks further views on this issue*

*and remains open to considering other reforms such as amendments to Schedule 3 of the Code where this could become a set of principles.*

ARTC would support the development and availability of a Standard Access Agreement (as a Part 5 instrument) to be approved by the Authority and subject to a process of public consultation. ARTC believes that the availability of a Standard Access Agreement would promote confidence in the market place by enabling parties operating in the same end market to obtain terms and conditions of access (including pricing) that are equitable with other users in that market. ARTC agrees that this would also streamline the process of access negotiation.

ARTC is not suggesting that parties must use the Standard Access Agreement, and are free to agree to terms and conditions outside of the Standard Access Agreement, where Schedule 4, Clause 13 of the Code would act to ensure equitable treatment still applies.

Such an approach is also consistent with the application in many other jurisdictions, and would enable users to obtain access on the interstate network in WA on consistent terms and conditions as the remainder of the interstate network (where the Standard Access Agreement is consistent with that offered under the ARTC Access Undertaking).

## **Preliminary View 2**

*The preliminary view of the Authority is that the issue of precluding the railway owner from earning a return on assets funded by government subsidies is better addressed by changes to the Over-payment Rules. The Authority seeks further views on this issue and remains open to considering other reform approaches.*

ARTC considers that the preclusion, or otherwise, of the ability of the access provider to earn a return on government subsidies should depend on the government expectation for such a return. ARTC accepts that this is more relevant where a government has an equity interest in the access provider (as in ARTC's case), but there is nothing to prevent an arrangement between the government and a private access provider being made that includes an expectation of some return.

Further, the access provider is required to maintain and replace assets in the long term, regardless of the initial funding of the asset. Whilst the initial funding may have been made available to address a social imperative (such as increasing the use of rail, or to improve network safety), the access provider should still be permitted to earn sufficient to maintain and replace the asset in the longer term (without any government commitment to such), meaning ongoing maintenance and depreciation should be included in the regulatory revenue ceiling.

The Authority suggests that changes that could be made to the Over-Payment Rules to address the issue of precluding the access provider from earning a return on government subsidized assets would include ensuring that subsidies and contributions could only be allocated to the relevant upgraded route section (and so could not be recovered by allocating over-recoveries to neighbouring route sectors as is currently permitted to recognize the 'route' rather than 'segment' nature of the business). ARTC has no issue with this.

### **Recommendation 1**

*Part 2 of the Code needs to clarify that access negotiations completed without the use of the negotiation framework (Parts 2 and 3) of the Code are not entitled to any of the protections of rights under the Code. Part 2 also should be amended to require the railway owner to specifically agree with the access seeker whether negotiations are to proceed with or without using the processes within Code. If the Code is to be utilised the Authority should then be informed. Part 5 of the Code should also be amended to state that the Part 5 instruments apply only to access agreements negotiated under the Code. However, the railway owner and access seeker may agree to apply the same Part 5 instruments to access agreements negotiated outside the Code.*

ARTC understands that this may already be the case under the Code, but that the Code is not entirely clear that an access seeker must make a key decision early in the negotiation process as to whether to conduct negotiations under the Code or outside the Code. Whilst ARTC has no issue with regards to an access seeker that chooses for access negotiations to proceed outside of the Code having no protection under the code and agrees that the choice should be clearly delineated in the Code, it is concerned that such an access seeker must seek the agreement of the access provider in order for the Part 5 instruments (Train Management Guidelines, Train Path Policy, Costing Principles, Over-Payment Rules) to be incorporated in a resulting access agreement. Many of the provisions made in the Part 5 instruments serve to provide certainty and equitable treatment to all network users, whether agreements have been made within or outside of the Code. Different treatment for different users may result in a loss of overall efficiency of network utilisation with adverse affects for both 'types' of users.

### **Recommendation 2**

*It is proposed that the Code be amended to require the public release of floor and ceiling prices in addition to floor and ceiling costs. These prices would be based on a standard reference train service assuming the most common train configuration for the route and would be calculated for routes requested by the Authority where the Authority believes there may be third party interest.*

ARTC notes that the Authority has taken the view, at this time, that it is not seeking to undermine the existing negotiate-arbitrate model by requiring publication of prescriptive pricing information, such as reference tariffs. Instead it is proposing to require the publishing of floor and ceiling prices (floor and ceiling revenues divided by tonnage information required to be made available under the Code). Given that sufficient information is already made available under the Code to enable an access seeker to estimate floor and ceiling prices, ARTC does not see that the publishing of this information on the website will significantly add to the negotiation process. Further, the difference between floor and ceiling pricing is still likely to be significant; and not providing much guidance to access seekers, or reduction in information asymmetry.

ARTC has stated in its Undertaking, it will provide floor and ceiling revenues for each part of its network and, in recognition that the width of the floor-ceiling band is often too large to provide any guidance to users as to the pricing of access on the network, ARTC also publishes indicative pricing for indicative services and terms and conditions, about which pricing can be negotiated and differentiated where appropriate. ARTC has found that such an approach provides a positive framework for negotiations and gives the industry some certainty as to available pricing and confidence that pricing against competitors is equitable.

ARTC considers that these benefits of published reference or indicative pricing outweigh any suggested reduction in negotiating flexibility (particularly given the requirement not to discriminate pricing for common services provided both between third parties and between a third party and above rail associates). This would particularly be the case in more significant markets in which the above rail associate operates, and likely to be amenable to third party access.

ARTC notes that Recommendation 4 provides for internal pricing to be made available to the Authority by the access provider, so that the Authority may be able to express an opinion to an access seeker that pricing made available is consistent with prices charge to an above rail associate. The publishing of this pricing by the access provider (or the Authority) is not a huge move from this position (as affectively the access seeker will be given a close indication of internal pricing anyway) and would further improve the efficiency of negotiations, and market confidence, without constraining flexibility in pricing any more than other provisions in the Code.

### **Recommendation 3**

*It is proposed that the railway owner be required to publicly release, on their website, detailed Information Packages including capacity information for routes requested by the Authority. The packages should be updated at least every two years or potentially more often where significant changes have occurred to the rail network.*

ARTC supports the public release of an information package on the access provider's website. Most other access providers (including ARTC) publish substantial information on their websites to assist potential access seekers. Obviously, a separated access provider would be commercially motivated to do so, and other integrated access providers are required to do so under an applicable access regime.

ARTC has no issue with the type of information to be published, as proposed by the Authority, and suggests the publishing of appropriate performance indicators could be included. This would create a more consistent framework with regard to seeking access to the interstate network.

ARTC considers that published information should be updated as and when any relevant information changes, so as not to become misleading at any point in time.

#### **Recommendation 4**

*Section 21 of the Code should be strengthened to allow the Authority to request from the railway owner the internal prices and related information by route section for relevant parts of the network with such information to be provided within 10 working days. This would improve the Authority's ability to quickly express an opinion as to whether the price sought by the access seeker in negotiations for access is consistent with prices charged to associates of the railway owner.*

ARTC supports, per se, the ability of the Authority to be able to obtain internal access pricing for a vertically integrated access provider for the purpose on confirming to access seekers that pricing sought by an access seeker is consistent with pricing charged to above rail associates of the access provider. On the other hand, ARTC is not aware of any ability of the Authority to confirm that the pricing provided by the access provider is an appropriate price for the service in question. A vertically integrated access provider has an incentive to price high to its above rail associate with the objective of being able to squeeze the third party out of a market (or prevent entry to a market) and then cross-subsidise associate above rail losses.

As stated earlier, ARTC considers a better option, where the access provider is vertically integrated, would be for the Authority to approve and publish indicative pricing for indicative services on the network. This would result in efficiency and market confidence benefits as well as mitigate the above behaviour.

## Recommendation 5

*It is proposed that some additional principles be included within section 9(2)(b)(ii) of the Code to require that cost sharing arrangements for network expansions be set equitably between all users of the line based on a combination of relative current usage and economic benefits.*

The issues has been raised that there is nothing in the Code to prevent the access provider seeking full contribution from an access seeker for the funding of a network expansion required to provide additional capacity to enable the access seeker to operate on the network. ARTC accepts that there is a potential for the access seeker to pay a higher charge for access for services in the same end market as incumbent operations that secured capacity before the expansion, giving the incumbent operation a competitive advantage.

On the interstate network, ARTC notes a number of areas where incumbency results in competitive advantage. For example, the first user of a network gains the best paths (most closely meet preferred market windows for pick-up and delivery of freight); whilst those users subsequently entering the market pick up less market desirable paths. As a result the first user gains a competitive advantage over subsequent users by being able to offer a better service to the market. Clearly, options for mitigating this advantage (if that is a desirable outcome) would be to better match pricing of paths with the value to the market of those paths, possibly through some form of auctioning mechanism. Further, two-part pricing offers significant efficiency benefits on the network, but depending on the way it is structured, can result in an advantage to an incumbent player in the market that has built its market to an efficient level, over a new market entrant that is, at least initially, unable to do so. It could be argued that both of these situations are simply normal market outcomes.

Further, a similar situation can occur with respect to terminals, where an incumbent owner may be fully utilizing the capacity of the terminal, and where third party access to the terminal is permitted, any new entrant may have to fund the cost of additional incremental capacity, against a by-pass option often used in economic assessments, of building its own terminal capacity in order to enter the market.

As such, ARTC does not consider the issue of an incumbent user of infrastructure having a natural competitive advantage over an access seeker as unique to the situation of capacity expansion. Nevertheless, incumbent use of scarce infrastructure facilities represents one of the most significant barriers to entry to the above rail market.

The proposal seeks to apply the cost of a capacity expansion to all users equitably, based on a combination of relative current usage and economic benefits. Notwithstanding the above experience on the ARTC network, this approach would



mitigate the competitive advantage of the incumbent network user(s). However, quantifying the relative benefits to users of the expansion may be difficult. If, for example, the expansion was designed only to create sufficient capacity to cover usage by the access seeker, it could be argued that the expansion results in no benefit to the incumbent users. Incumbent users would argue against paying a higher charge for the same service, and the access seeker would still fund the cost of expansion.

In a situation where all users would benefit from the capacity expansion, and additional charges for the expansion was less than the quantum of that benefit to users, it is likely that the expansion would be economically feasible and would be attractive to the access provider to fund, in which case the access provider could equitably increase pricing to recover the cost of expansion. In this case, the Code should prevent a vertically integrated access provider from refusing to fund the expansion solely to protect the interests of incumbent associates. If the access seeker funded the cost through up-front payment or higher access charges then it should be possible to make arrangements for the access seeker to recover the proportional cost of other users' usage and benefit through some form of pass through the access provider, or a rebate scheme. ARTC considers this to be the most common scenario and presumably the scenario that the proposed amendment to the Code is seeking to address.

Where the expansion is not economically viable (i.e. the benefits to incumbent users are insufficient to justify additional pricing that would cover the cost of the expansion), the access seeker would need to fund the shortfall of additional pricing that could be achieved compared to the cost of expansion.

In any event, whilst ARTC supports an amendment to the Code that might reduce entry barriers to access seekers, and create an equitable framework for competition, providing for a mechanism that might cause the incumbent user to pay for a share of a capacity expansion that is higher than the benefit it could currently, or in the future, extract from that expansion in order to achieve equity with the access seeker then a loss of economic efficiency may result. If the access seeker is required to pay a higher charge for the surplus of cost over benefit to itself and incumbent users, then this a commercial decision for the access seeker, which should not be distorted by the application of an access regime.