Asciano Submission to the Economic Regulation Authority in relation to the Review of the Railways (Access) Code 2000: Issues Paper

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1 INTRODUCTION AND BACKGROUND

Asciano welcomes the opportunity to make a submission to the Economic Regulation Authority (ERA) Issues Paper relating to the current review of the Railways (Access) Code 2000 (the Code). The Code was established under the Railways (Access) Act 1998 (the Act) and outlines procedures for negotiating access and addressing access disputes.

Asciano recognises that it is the Code and not the Railways (Access) Act 1998 (the Act) which is the subject of this current review. Asciano also recognises that the Code has been previously reviewed in 2003 and 2011.

Asciano' undertakes numerous rail activities throughout Australia via its Pacific National subsidiary, which is one of Australia's largest above rail operators. Asciano has a strong interest in improving the regulatory and access regimes which currently apply to Australian rail infrastructure.

Pacific National undertakes currently undertakes the following above rail operations in Western Australia:

- interstate intermodal rail operations – these operations use Brookfield Rail (BR) standard gauge rail infrastructure between Kalgoorlie and Perth. This infrastructure is subject to the Code. Asciano is the access holder for these rail operations; and
- intrastate bulk mineral rail operations – these operations are on behalf of a third party access holder and use BR standard gauge rail infrastructure between Kalgoorlie and Perth. As the access and commercial interfaces for these operations are between BR and a third party access holder this submission makes no comment on issues relating to these operations.

This submission is public.

2 SCOPE OF THE REVIEW OF THE CODE AND CPA PRINCIPLES

As outlined in the Issues Paper (page 4) the primary purpose of the review is to assess the ability of the Code to give effect to the Competition Principles Agreement (CPA). Thus under the scope of the review the ERA can only consider Code amendments which are consistent with the CPA.

The Issues Paper (page 5) identifies clause 6 of the CPA, particularly clauses 6 c), 6 e) and 6 f) as being most relevant to the assessment of the Code. These three clauses address requirements to be met by effective state infrastructure access regimes; these requirements include provisions related to the negotiation of access, dispute resolution and the promotion of the efficient use of the covered infrastructure.

3 ASCIANO COMMENT ON THE CODE, ACCESS PRICING AND INFORMATION PROVISION

Problem with "Negotiate and Arbitrate" Approach and Floor and Ceiling Test

Asciano believes that in broad terms the CPA requires the efficient use of monopoly infrastructure assets to promote competition in related markets. This is achieved by providing for third party access to these monopoly infrastructure assets, where this access is protected by dispute resolution and separation provisions and where this access is priced at efficient cost.

In relation to access pricing the Code (Schedule 4 clauses 7 and 8) currently requires the establishment of a floor price (effectively a price based on incremental cost) and a ceiling price (effectively a price based on stand alone cost), and the access seeker and access provider then negotiate the final access price between these two price limits. The Issues Paper (page 9) seeks comment on this floor and ceiling price test.

Asciano strongly believes that the floor and ceiling price test is inadequate as the test requires the use of a "negotiate and arbitrate" access approach between two broad pricing parameters. The "negotiate and arbitrate" access approach is problematic as it requires access seekers to negotiate with a monopoly rail infrastructure provider. Under the "negotiate and arbitrate" approach these negotiations are likely to be unbalanced due to both the bargaining power imbalances and information asymmetry between the two parties. These imbalances will always result in outcomes more in favourable of the rail infrastructure monopolist[1] as the access seeker has a limited ability to counter the market power of the monopolist.

[1] Asciano has made this point in numerous regulatory submissions including for example:

- Asciano Submission to QCA in Relation to Queensland Rail Draft Access Undertaking July 2012 pp 5-7
- Asciano Submission to the Commonwealth Competition Policy Review Issues Paper June 2014 pp 8-9
- Asciano Submission to ESCOSA issues paper relating to the 2015 South Australian Rail Access Review pp7-8

Asciano recognises that there are dispute mechanisms to potentially address these imbalances but to date Asciano understands that there have been no disputes under the Act and Code arising from a Western Australian rail access negotiation. This could be because access seekers are unwilling to test the dispute resolution process or they are wary of the costs involved in the dispute resolution process.

These negotiating imbalances can be addressed via several channels including:

- the development and use of regulator–approved standard access agreements;
- the development and use of standard regulated prices; and / or
- the provision of sufficient information to allow a more balanced negotiation.

Standard Access Agreements

Asciano recognises that under the Code (clause 6) the access provider's standard access agreement has to be provided. Asciano believes that the ERA should have the power to approve this agreement, with this agreement then being the default agreement with the access seeker and access provider being able to negotiate away from these agreements if there is mutual agreement.

Standard Regulated Pricing

Asciano believes that in order to ensure efficient pricing the Code should provide for the ERA to determine benchmark tariffs for benchmark services, with the access seeker and access provider being able to negotiate away from these prices if there is mutual agreement. These benchmark tariffs can also be used as a reference point when negotiating "non-benchmark" services.

Cost Information Provision

Under the "negotiate and arbitrate" model there is a lack of independently tested cost information available to access seekers, which in turn places access seekers at a disadvantage in negotiating efficient, cost reflective access prices with the access provider, as only the access provider has detailed knowledge of their costs. Thus, in the event that the "negotiate and arbitrate" access model continues to be applied then rail access negotiations and outcomes would be improved by requiring rail infrastructure providers to supply a level of cost information which facilitates even handed price negotiations.

Asciano recognises that the Code (clause 9) requires the provision of floor and ceiling prices to the access seeker; however in themselves the floor and ceiling are not sufficient to address the imbalance in cost information between the access provider and the access seeker.

If the "negotiate and arbitrate" model is to be maintained the level of service provider cost information available must be increased in order to allow negotiations to be appropriately conducted between the two parties on an even basis. An access regime where equal cost information is available to both negotiating parties is much more likely to result in an access price which is efficient and cost reflective than a price negotiated in a regime where one party has incomplete information.

Consequently, if this position relating to regulated agreements and pricing above is not adopted then Asciano would seek that the ERA consider requiring the access providers to release detailed cost information packages to access seekers prior to the commencement of any access negotiation. An outline of the cost information required could be included in an amended Schedule 2 of the Code.

As an absolute minimum the ERA should return to the approach to floor and ceiling price information provision that existed prior to 2011. Prior to an ERA Decision[2] in August 2011 BR had to submit to the ERA at regular intervals the proposed maximum and minimum costs applicable to sections of their network on which access proposals were likely to be made, with these proposals then being reviewed by the ERA. While these would only be a series of floor and ceiling prices and thus not be sufficient on their own, the fact that there would be ERA scrutiny of the prices and the fact that there would be a consistent series of maximum and minimum costs would provide a minimum level of information to access seekers.

EISC Inquiry

The Issues Paper (pages 12-13) discusses concerns with the Code raised by the 2014 Economics and Industry Standing Committee (EISC) inquiry. The EISC inquiry recommended that this current ERA review include an evaluation of why so few access seekers choose to use the Code[3] (that is evaluate why access seekers negotiate outside the Code). While there may be a range of reasons why access

[2] ERA Final Decision Review of the Requirement for Railway Owners to Submit Floor and Ceiling Costs August 2011

[3] Economics and Industry Standing Committee: The Management of Western Australia's Rail Freight Network page 96

seekers negotiate outside the Code, Asciano believes that one of these reasons is that the Codes light handed “negotiate and arbitrate” approach coupled with limited information provision provides very limited protection against the monopoly position of the infrastructure provider, and given this access seekers engage with monopoly access providers outside the Code as engagement within the Code offers few additional protections.

This does not mean that there is not a Western Australian rail access market; rather it means that the market occurs outside the Code as the Code offers little protection from the monopoly access providers.

A move towards a more prescriptive regulation approach within the Code (such as regulator approved access pricing for benchmark services as outlined in this submission above) is likely to result in more access seekers seeking access within the framework of the Code. A more prescriptive approach would provide a more balanced position for access seekers and access providers.

Summary

Pricing and cost certainty and transparency are not provided under the Code by the current “negotiate and arbitrate” model and the floor and ceiling price process. The Code’s approach to pricing should shift towards a more prescriptive approach; ideally the Code should provide for ERA approved access agreements and ERA approved access tariffs for benchmark services.

If such an approach to access and pricing is not possible then as a minimum the Code should require access providers to provide sufficient cost information to facilitate more balanced access negotiations and more efficient access pricing. (At a minimum the ERA should return to the previous requirement whereby access providers submit proposed maximum and minimum costs applicable to sections of their network to the ERA for review and publication).

A shift towards a more prescriptive access pricing regime may address concerns raised by the EISC report in relation to the lack of use of the Code by access seekers.

4 DETAILED ASCIANO COMMENT ON ISSUES RAISED IN THE ISSUES PAPER

The Issues Paper (pages 18 to 23) explicitly raised a series of issues in the form of questions. This section addresses these questions.

Section 8 (4) and 8 (5) – when can an extension or expansion be proposed?

Asciano believes that an access proponent should be able to propose an extension or expansion either in the initial proposal or at any time after making the proposal.

The need for an extension or expansion (or size of an extension or expansion) may not necessarily be clear at the time of the access proposal but following exchanges of information and during the course of negotiations the need for an extension or expansion may become clearer.

Clauses 8 (4) and 8 (5) should be clarified to allow an access proponent to be able to propose an extension or expansion at any time after making the proposal. Asciano recognises that if an extension or expansion is proposed then the various time limits which apply in the Code may need to be adjusted to take into account the amended access proposal.

Section 10 – when is section 10 relevant (allowing access may preclude access by other proponents)?

The Issues paper (page 18) invites comment on whether the intent of section 10 of the Code, (which relates to situations where access for one entity precludes access for other entities) should be clarified.

Asciano believes that the intent of this section should be clarified; especially given network expansion is usually an option available to address constrained capacity.

Sections 14 and 15 - can a railway owner challenge the validity of a proposal prior to receiving the information required by those sections from the proponent?

A railway owner should not be able to challenge the validity of an access proposal before it has received any information it has required to be provided under sections 14 and 15. If a railway owner seeks information then it should wait for the information and then consider the information before challenging the validity of an access proposal.

Section 16 – what does the term “unfairly discriminate” mean?

The term unfairly discriminate should be clarified.

Asciano understands that it would be unfair to discriminate between two access proponents in similar circumstances or if they were seeking access services with similar characteristics. However, discrimination may be justified in order to discriminate between two access proponents if their circumstances were not similar or if economic efficiency is aided by price discrimination (as allowed by CPA 6 f) 2. 2).

Should Part 3 prescribe a time limit for the conclusion of arbitration?

As noted in the issues paper (page 21) an indeterminate time frame may provides an incentive for one party to delay, particularly if one party will benefit from the delay and the other will not. A time limit should be prescribed for the conclusion of arbitration; however this time limit should be able to be varied if both parties agree to an extension of time.

Section 50 – should a railway owner be able to declare any information confidential, or only information which is not otherwise required by the Code to be provided by the railway owner?

Asciano's understanding is that access providers can indicate that cost information provided to the ERA is confidential and so under section 50 (3) of the Code the ERA cannot make this information public. This in turn makes it impossible for interested parties to make any informed comment on the appropriateness of the access provider's costs, and so makes any public consultation on costs and price settings problematic.

Given that rail infrastructure is typically a natural monopoly Asciano believes that the natural monopoly infrastructure owners should not be able to prevent these costs being made public. Asciano does not believe that making costs public should damage a natural monopoly. In relation to regulated natural monopoly pricing primacy should be granted to the transparency of access pricing and regulatory processes rather than protecting the information of the natural monopoly.

Clause 50 (3) should only allow for confidentiality following the application of a test that the broader public release of the information would be commercially damaging to the monopoly access provider in its role as an infrastructure provider charging efficient prices (that is with no reference to any other related activities of the infrastructure provider and no reference to the ability of a monopoly infrastructure provider to receive supernormal profits).

Schedule 4 Clause 2 – is there a better means of estimating capital costs of a railway than the GRV (Gross Replacement Value) method prescribed in clause 2?

Asciano's understanding of Gross Replacement Value (GRV) is that this asset valuation approach is likely to result in asset valuations that will differ from the Depreciated Optimised Replacement Cost (DORC) valuation approach. The DORC valuation approach is typically used as the upper bound of infrastructure capital valuations (including rail infrastructure) in most other Australian regulatory jurisdictions.

Asciano believes that the consistency of the Western Australian rail access regime with other Australian rail access regimes is generally desirable and consequently would support a move towards using the DORC approach as an upper bound on asset valuation on the basis of consistency.

Schedule 4 Clause 10 – is the prescribed 30 day time limit for the making of the regulator's determination sufficient?

Asciano believes that this thirty day time limit, which applies to the ERA determining costs, is fundamentally a matter for the regulator to assess. Asciano notes that the ERA indicates in the Issues paper (page 23) that the time frame is insufficient. Given this Asciano would not oppose any reasonable extension of the time limit.

5 Previous Asciano Submissions on the WA Rail Access Regime and Code

Asciano has previously made comment on the Western Australian rail access regime in various submissions over the previous five years. This section briefly summarises these submissions and demonstrates that issues of information provision, the even handedness of negotiations and regulatory monitoring have been ongoing concerns for Asciano in relation to the Western Australian rail access regime (including the Code).

Previous Asciano Comment on Western Australian Government Application to the NCC to Certify the Rail Access Regime

The Western Australian government applied to the National Competition Council (NCC) in May 2010 to seek that the NCC certify the Western Australian rail access regime as an effective regime. Asciano made a submission to this process which generally supported the Western Australian government position but argued that the rail access regime could be further strengthened by increasing levels of information

provision and levels of regulatory review of access agreements with the below rail service provider[4].

Asciano recognises that this application to the NCC is outside of the scope of the current Issues Paper and review but Asciano believes that these broad principles relating to the effectiveness of the access regime are relevant when reviewing assess the ability of the Code to give effect to the Competition Principles Agreement (CPA)

Previous Asciano Comment on Subsidiary Regulatory Instruments

The Issues paper (page 5) notes that there are five regulatory instruments which focus on developing details related to the broader principles contained in the Code. These regulatory instruments are:

- Segregation Arrangements;
- Costing Principles;
- Train Path Policy;
- Train Management Guidelines; and
- Over-payment Rules.

The Issues paper (page 5) notes that comments on these regulatory instruments are welcome. Asciano has previously provided submissions to the ERA on Train Path Policy and Train Management Guidelines. Asciano has also previously provided a submission to the ERA Review of Requirements for Railway Owners to Submit Floor and Ceiling Cost Proposals in 2011.

Asciano continues to stand by the comments made in these submissions. These Asciano submissions addressed issues such as requirements for networks to consult with operators, requirements for audits of network's regulatory compliance and requirements for network's to provide sufficient information (including cost information) to allow a more balanced negotiation of access charges.

[4] Asciano Submission to the NCC: Certification of the Western Australian Rail Access Regime: response to the WA Government Submission to the NCC June 2010

6 CONCLUSION

Asciano believes that under the Code's current "negotiate and arbitrate" model and floor and ceiling price process the negotiated access pricing will be based on an unbalanced negotiating model and thus the resultant access pricing may not be efficient.

The Code's approach to pricing should shift towards a more prescriptive approach; ideally the Code should provide for ERA approved access agreements and ERA approved access tariffs for benchmark services. If such an approach to access and pricing is not possible then as a minimum the Code should require access providers to provide sufficient cost information to facilitate more balanced access negotiations and more efficient access pricing. A shift towards this more prescriptive access pricing regime may address concerns raised by the EISC report in relation to the lack of use of the Code by access seekers.

In relation to issues of specific concern to ERA Asciano believes that:

- an access proponent should be able to propose an extension or expansion at any time after making the proposal;
- the intent of section 10 of the Code should be clarified;
- a railway owner should not be able to challenge the validity of an access proposal before it has received any information it has required to be provided under sections 14 and 15 of the Code;
- the term unfairly discriminate section 16 of the Code should be clarified;
- a time limit should be prescribed for the conclusion of arbitration; however the time limit should be able to be varied if both parties agree to an extension of time;
- clause 50 (3) of the Code should be revised to promote greater transparency of costs. Natural monopoly access providers should not be able to claim confidentiality on information unless they can demonstrate that the broader public release of the information would be commercially damaging to the monopoly access provider in its role as an infrastructure provider.