

REVIEW OF THE RAILWAYS (ACCESS) CODE 2000

ARTC SUBMISSION

Background

The Western Australian Economic Regulation Authority (“Authority”) has sought submissions from interested parties with respect to 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 Government made an application for certification of the Regime to the National Competition Council (“NCC”) in February 1999. The certification review undertaken by the NCC effectively requires it to assess the draft Code with respect to the provisions of the CPA. As such, the Regime has previously undergone a similar review. ARTC notes that following some refinement of the Code required by the NCC, the NCC considered the Regime broadly ‘effective’ (consistent with the CPA provisions, except for the issue of providing for an effective interface between the Regime and ARTC’s Access Undertaking (which may largely form the basis of a national regime) that was yet to be approved by the ACCC. The NCC suggested that the Regime be amended to require the track owner, in the event that a national regime was developed, to submit an access undertaking to the Australian Competition and Consumer Commission (“ACCC”) to also adopt the new national regime. 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 end, the WA Government withdrew its application for certification.

ARTC actively participated in the NCC review of the Regime. ARTC arguments in its submissions largely from its concerns as to whether the Regime would act as an effective stimulus to third party access in an environment where the infrastructure owner was vertically integrated, and whether the Regime would be sufficiently consistent with the provisions for access that may apply on the broader interstate network.

Following these events, the WA Government sold the freight business of its railway, Westrail, to the Australian Railroad Group (“ARG”). The sale required to create a subsidiary infrastructure manager, WestNet Rail (“WNR”), which has a 49 year lease of the freight rail infrastructure, including that part of the interstate rail in WA between Kalgoorlie and Perth (including Kwinana).

ARTC was created after the Australian and State Governments agreed, in an Inter-Governmental Agreement (“IGA”), in 1997 to the formation of a ‘one stop’ shop for all train operators seeking access to the national interstate rail network. The IGA had a term of 5 years, which expired in 2003. ARTC is a company, under Corporation Laws, in which shares are owned by the Australian Government through the Ministers for the Departments of Transport and Regional Services and Finance and Administration.

Under the IGA, ARTC would be responsible for negotiating access to the national interstate rail network between Brisbane and Perth by virtue of direct ownership or lease of certain parts of the network, or under wholesale arrangements to be negotiated with State Government owners of other parts of the network as applicable.

ARTC initially had responsibility for the management of 4430 route kilometres of standard gauge track, mainly in South Australia, Victoria and Western Australia. ARTC owns the following rail corridors:

- ❖ Wolseley - Kalgoorlie
- ❖ Pt Augusta - Whyalla
- ❖ Broken Hill - Crystal Brook
- ❖ Tarcoola - Alice Springs (long term lease to Asia Pacific Transport, operators of the Alice Spings - Darwin Railway)
- ❖ Parts of the Adelaide metropolitan track between Dry Creek and Outer Harbour.

In Victoria, ARTC leases the two mainline interstate standard gauge corridors from the Victorian Government, being:

- ❖ Melbourne - Wolseley
- ❖ Melbourne - Albury

ARTC also manages access to the connection from the interstate mainline network to the Appleton and Swanson Dock precincts in Melbourne.

ARTC also has a 60 year lease on the interstate mainlines in NSW from Albury to Sydney, Cootamundra west to Broken Hill, the Hunter Valley network and from the north of the Sydney urban area to the Queensland border.

Over these corridors, ARTC is responsible for:

- ❖ Selling access to train operators
- ❖ Pricing access to train operators
- ❖ Development of new business
- ❖ Capital investment
- ❖ Operational management
- ❖ Management of infrastructure maintenance

Under the IGA, ARTC submitted a voluntary access undertaking in accordance with Part IIIA of the Trade Practices Act (1974) ("TPA") to the Australian Competition and Consumer Commission (ACCC) in January 2002. The undertaking was approved by the ACCC in May 2002, and applies to the interstate network currently controlled by ARTC, and sets out the framework under which access to that network can be negotiated with ARTC in a fair and balanced way. In endorsing ARTC's access undertaking, the ACCC recognized that a large part of ARTC's revenue is derived from rail operations that compete in markets subject to strong intermodal competition, particularly road. The ACCC also indicated that it saw ARTC's access undertaking as laying a foundation for the development of a consistent 'national' rail access regime in conjunction with other state based jurisdictions.

The IGA provided for ARTC to negotiate wholesale access arrangements with each of the track managers in NSW, Queensland and WA, which would give ARTC exclusive rights to sell access for interstate operations to those parts of the interstate network within these jurisdictions.

ARTC has negotiated an agreement with the West Australian Government (assigned to WestNet Rail) that gives ARTC such exclusive rights with respect to new agreements or the novation of existing agreements. WestNet Rail still effectively controls the maintenance, investment and operations between Kalgoorlie and Perth. As yet, no operations are being conducted on this part of the network pursuant to an access agreement developed under the wholesale arrangements. The wholesale arrangements sought to facilitate voluntary novation of existing access agreements for interstate operations in WA to ARTC. To date, no incumbent operators have novated agreements largely resulting from a stated preference for a direct relationship with the party responsible for maintenance and control of the network, rather than an indirect relationship through ARTC.

Greater consistency of the terms and conditions of access (including pricing) to the national interstate rail network is one of ARTC's, its shareholders', and the rail industry's key objectives, and is one of the key outcomes of ARTC's management of the network in NSW. ARTC will be submitting an undertaking to the ACCC with respect

to the interstate network in NSW that is largely consistent with ARTC's undertaking with respect to its existing network.

The WA Regime

ARTC has actively participated in the consultation processes conducted by the Authority (or its predecessor) and the NCC in relation to the WA Rail Access Regime and the regulatory supervision of the track manager in WA, including:

- ❖ The WA Government's Certification application to the NCC
- ❖ Segregation Arrangements, Costing Principles, Overpayment Rules, Train Management Principles, Train Path Policy, Key Performance Indicators and Rate of Return to apply to WNR
- ❖ Floor/Ceiling Determination

Throughout this involvement, 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

National Consistency

The WA Access Regime is, in many areas, broadly consistent with similar provisions incorporated in ARTC's Access Undertaking. However, there are still a number of different treatments that can cause some uncertainty in access to the operator of an interstate service including, for example, provision for capacity transfer, resolution of capacity demand conflicts, open-ness in pricing, and treatment of costs in floor/ceiling limits.

ARTC supported the suggestions made by the NCC to the WA Government during its consideration of application for certification of the WA Regime to extract interstate services from the scope of the WA Regime for inclusion within the scope of the national regime, or make provision in the WA Regime for the track manager to submit an access undertaking to the ACCC, in the event that a national regime was developed.

ARTC now has an access undertaking which is approved by the ACCC, and which the ACCC has indicated that it saw as a foundation for the development of a consistent

'national' rail access regime. The WA Government's stated reasons for concern with these options and rejection of the NCC's suggestions have, for some time, no longer been the case. ARTC sees no reason why the WA Government could not be again approached with a similar proposition. This would give rise to an access undertaking in WA that would promote entirely consistent access to the interstate network from Brisbane to Perth, including the administration of a single regulator, the ACCC. This consistency and simplicity of regulation on the interstate network has been demanded by the interstate rail freight industry for many years, and would further reduce the substantial barrier to new entrants to the industry.

Performance of the Regime

Assessing the performance of the Regime effectively addresses the second of the two themes above. That is, has the Regime promoted market confidence and enhanced competitive outcomes, and efficient utilization of, and investment in, the network, given the vertically integrated nature of the access provider.

There is little doubt since the introduction of competition reforms in the rail industry in the mid 1990's that competition for rail freight services has taken hold most on the east-west interstate network. ARTC considers that this has occurred for a number of reasons including:

- ❑ horizontal and vertical structural arrangements on the bulk of this network that promoted above rail competition
- ❑ rail natural competitive advantage and the relative economics of intermodal freight transport on this network
- ❑ the improvement in quality and capability of the infrastructure that has led to improved rail efficiency and competitiveness.
- ❑ Infrastructure pricing that rewards rail users for improved operating efficiency

The outcomes of competition on the east-west interstate have resulted in improved transport outcomes for business and communities utilizing this network.

The environment with respect to the north-south interstate network is less conducive to above rail competition and resulting benefits are not yet being achieved.

It is fair to say, that above rail competition on the interstate network in WA had commenced and grown before the advent of the WA Access Regime. Since 2001, there has been little interest in operating east west interstate services from new third party entrants to the market, and no new operations commenced. Further, the market has become more concentrated since the privatisation of National Rail. There are a number of elements, other than access to the network, necessary to compete in the rail freight service market including:

- ❑ availability and access to terminal and yard facilities,
- ❑ availability of locomotives and rollingstock, and,
- ❑ critical mass of specific operations and overall business to achieve commercial sustainability

ARTC considers it unlikely that the above competitive outcomes on the east west interstate network have resulted from activities occurring under the Regime by itself, although it may be that competition in this market is being constrained by the fact that there is some inconsistency in access regulation on the east-west interstate network that is not being effectively mitigated by the wholesale arrangement framework. The absence of clear positive or negative evidence makes it difficult to conclude whether the Regime has, by ensuring adequate measures are in place to prevent anti-competitive behaviour and facilitating an environment where above rail competition is promoted, performed effectively in this regard.

There has been significant freight volume growth on the east-west interstate network. This has been driven for favourable economic conditions bringing about strong growth in transport services generally, and growth in rail market share. Most growth in rail market share was achieved prior to the commencement of the Regime, with subsequent volume growth driven by growth in the transport market generally. The recent plateau-ing slowing in market share growth may have resulted from a decline in rail competitiveness in these markets, or rail may have reached a point where it now carries all of the freight in contestable segments of the market. Again, it is difficult to assess the performance of the Regime in this regard.

The various state regional networks are, by and large, operated by vertically integrated entities required to achieve varying degrees of structural separation (vis-à-vis institutional separation) as provided for under state based third party access regimes. The exception is NSW where institutional separation between above and below rail activity and an open access regime has been established.

Interestingly, the only significant above rail competition on regional networks was achieved in southern NSW grain markets where Freight Australia and Australia Transport Network hauled grain to Pt. Kembla and ports in Victoria (partly along the Melbourne - Sydney interstate corridor). These operations commenced prior to the privatisation of National Rail and FreightCorp, and since the commencement of operations of Pacific National (PN), these operations have now been absorbed into PN's operations through acquisition. PN has recently gained access to the QR network to operate intermodal services.

There have been a number of attempts to enter regional markets in other states, including WA, but, for various reasons, none have been successful. ARTC accepts that

the threat of competition, rather than competition itself, may ensure that competitive outcomes are achieved. The extent to which such outcomes can be achieved is governed however by the seriousness of the competitive threat. Whilst there may have been attempts made by third parties to compete in tenders for freight with WNR associated above rail entity (AWR), these process are not transparent, so it is unclear as to whether the tender process was competitively neutral, the extent of frustration experienced by the third party entrant, and whether the tenders were eventually retained by AWR because of a superior above rail offering. This is particularly relevant given the less prescriptive approach of the Regime that allows WNR some room to move in this regard. ARTC considers that, whilst relevant aspects of the Queensland Rail Access Undertaking are more prescriptive and may add some cost, they are also likely to be more effective in ensuring neutrality in such tender process. If such a degree of prescription is necessary to achieve market confidence where the access provider is vertically integrated then so be it. ARTC cautions the Authority about placing too much weighting on the mere existence of another party in the tender process as evidence of a 'serious' competitive threat, supporting an argument that the Regime may be effective and sufficiently prescriptive. ARTC hopes that these parties make submissions to this review to share their experience in this regard. This would provide a better indicator of the performance of the Regime in this regard than inference drawn from the outcomes of the tender processes.

With regard to specific issues raised by the Authority in its paper, ARTC makes the following comments and observations. A number of issues raised by the Authority have also been addressed earlier in this paper.

Is the Code resulting in the efficient allocation of resources and adequate investment in the network? What changes to the Code, including the public interest test, might be considered to an efficient allocation of resources and adequate investment in the network?

The general business and economic community has now realised from the evidence of the level of under-investment (and under-capacity) in essential infrastructure in Australia, that a greater focus on providing more incentive for owners to efficiently invest in infrastructure is needed. In the past the focus of most reform has been more on improving efficiency and reducing inputs, resulting in (possibly short term) benefits for the community. The Productivity Commission has recognized this as an issue in its recent review of National Competition Policy reforms. ARTC supports the view now being taken.

ARTC does not have sufficient information to be able to make an assessment as to whether investment in the WA rail network has been impeded in any way by the application of the Regime. ARTC would, however, be open to options for change to the Regime that might increase the incentives for investment.

What, if any, additional infrastructure could be included in the coverage to improve effectiveness of the Regime?

ARTC believes that the access regime should cover infrastructure that would reasonably be required by an access seeker in order to utilize the network where it is considered that the duplication of that infrastructure is uneconomic. This could include sidings and terminals. It is normal practice that an independent regulatory body to make an assessment regarding the viability of infrastructure duplication (albeit subject to final Ministerial approval of declaration). ARTC considers that it is appropriate for an independent body to make such an assessment and would strongly support the Authority making the decision in this regard. Should it be deemed necessary for a relevant Minister to finally approve or not approve a declaration decision, then ARTC considers that the current practice where, unless the Minister formally approves declaration, rejection is assumed should be changed so that, unless the Minister formally rejects declaration, the approval should be assumed. A rejection decision by the Minister should be supported by reasons that are made publicly available.

Is the Code and the wholesale agreement an effective framework for interstate access seekers? How could it be improved?

In developing the wholesale agreement with the WA Government, ARTC sought to negotiate the best outcome it could for interstate operators. As stated earlier, no operations are being conducted on this part of the network pursuant to an access agreement developed under the wholesale arrangements. This suggests that incumbent operators would prefer to deal directly with the party controlling maintenance and operations on the network rather than indirectly through ARTC. As such, ARTC does not consider the arrangement as being particularly effective, however it does provide a base for an effective ceiling on access pricing and terms for interstate operators with WNR.

Are there any inconsistencies between the ARTC Undertaking and the Regime which result in a loss of efficiency or make third party access more difficult?

ARTC has covered a number of inconsistencies (or different treatments) between the ARTC Undertaking and the Regime earlier in this paper that it considers may result in a loss of efficiency or make third party access more difficult. Some options for consideration, previously put forward by the NCC, are proposed.

Should access seekers be given the right to seek damages and other remedies in the case of a breach of an access agreement by the railway owner which causes significant damage or loss?

ARTC's Access Undertaking provides for neither party to an access agreement to be liable to the other for consequential losses including, but not limited to, economic loss, loss of profits, and loss of opportunity.

..., is there merit in introducing reference tariffs, which are firm prices for a defined service and route that the railway owners would offer access seekers? Would reference tariffs negate the effectiveness of the negotiate-arbitrate model?

For consistency, transparency, equity, certainty and market confidence reasons, ARTC would support the use of published reference pricing in WA. ARTC does not consider that reference pricing limits the effectiveness of the negotiate-arbitrate model but provides the benefits of certainty and equity to users.

Are the KPIs sufficiently meaningful?

ARTC has previously indicated to the Authority that it considers that KPI reporting by WNR, being vertically integrated, should be separated to associated party and third party use of the network respectively. ARTC has also advocated consistency of reporting and measurement on the interstate network (for interstate services where appropriate).

ARTC accepts that significant reporting to the Authority and publicly of performance relating to the negotiation framework, segregation arrangements, train path policies and management guidelines and service quality is necessary to adequately promote market confidence in fair and equitable treatment in a vertically integrated environment. In most of these areas, ARTC, being vertically separated, is commercially motivated to perform and as such reporting in these areas is not required by the ACCC.

ARTC's Access Undertaking provides for public reporting, on a quarterly basis, of KPIs in the areas of service reliability, transit time, track quality and unit costs. ARTC notes that public reporting of WNR KPIs is only required annually. ARTC considers that reporting on a quarterly basis would be more timely and meaningful. The market is likely to consider that receiving evidence of a deterioration in performance up to twelve months after it occurs as being too late in most cases.

With regard to the types of indicators used, ARTC makes the following comments in the context of meaningful reporting on the interstate network:

- ❖ service reliability – measures do not seem to recognize that a train can become unhealthy enroute, even though on time entry may have been achieved. This is not consistent with ARTC reporting if it was intended to be.
- ❖ No transit time indicators are reported
- ❖ TQI is not reported
- ❖ Speed restrictions – reporting only the change in number of restrictions is not particularly meaningful. The length of the restriction and the restricted speed are also important to train operations. As a minimum, the length of track under restriction should be publicly reported. This is a standard railway measure.
- ❖ Unit cost is not reported

In total, ARTC does not consider the public reporting in these areas as sufficient or particularly meaningful for users of the interstate network.

Should users have some right to seek Authority involvement in contracts which have been established 'outside the Code'?

ARTC would have thought that the access agreement would developed outside of the Code would still incorporate provisions for the resolution of disputes and independent arbitration. ARTC would have no issue with the Authority being identified in this capacity if this were agreed between the parties.

Would the benefits of having the Authority making and processing access applications, outweigh the costs of such a system?

ARTC considers that direct Authority involvement in the making and process of applications would merely add another layer of complexity and cost onto an exercise that is already complex, and is not likely to generate a sufficiently large benefit to compensate.

Capital Contributions

The paper states,

'If the railway owner receives government subsidies to support their operations, (eg Main Roads Western Australia generally funds 50% of the cost of new or upgraded level crossings), the Costing Principles do not require a reduction in ceiling costs to reflect this government contribution. However, in evaluating whether revenues obtained by the railway owner exceed ceiling costs using the Over Payment Rules, these subsidies are recognised as a form of customer revenue. A recent submission by ARG (parent company of railway owner WNR) to the review of the Victorian Rail Access Regime stated that "To the extent that there is external contributions to these

costs, such as the State Government providing contributions to upgrades, the ceiling should be adjusted downwards to the extent of that contribution.'

The approach to treating capital contributions in this regard has not been an issue for ARTC given that on all parts of the interstate network, revenue collected is significant less than the ceiling limit based on regulatory assessment. As such either removing the contribution from the ceiling limit or removing it from the asset valuation has no impact on ARTC revenue.

Where revenue is at ceiling limit, the approach used in the Regime creates the same outcome as if the infrastructure owner had made the investment (upfront loss of revenue equal to contribution and ongoing return of revenue equal to depreciation and regulatory return on investment).

On the Hunter Valley coal network, capital contributions are excluded from the asset base (although the approach to asset revaluation is different in the NSW Rail Access Undertaking). As such, no cost or benefit is passed to the infrastructure owner. ARTC would consider this to be the more common treatment.

On the surface, there would appear to be little difference between the treatments and, as such, ARTC has no issue with the approach adopted by the Regime, and, depending on the approach used for valuation and re-valuation of the Victorian assets, the more common treatment proposed by ARG may produce an equivalent outcome.