AUSTRALASIA RAILWAY

ACCESS REGIME

Final Recommendation
February 2000

Application for Certification under Section 44M(2)
of the Trade Practices Act 1974

National Competition Council

Executive Summary

The Council has recommended the certification of the AustralAsia Railway Access Regime, covering the rail line from Darwin to Tarcoola until 31 December 2030.

In the past, when considering certification of Access Regimes the Council has looked at the specific circumstances of the infrastructure and the services being covered by each Regime. For instance, a Regime covering a vertically integrated access provider needs greater attention to treating all train operators consistently than one where the access provider is structurally separated.

In this case, the Regime covers what is, in part, an entrepeneurial greenfields project. The Consortium intending to construct and upgrade this rail line will need to generate considerable demand if this project is to be profitable – it is taking a considerable risk, even though this risk has been substantially mitigated by Government contributions. In a number of ways, this differs from an established infrastructure facility or a facility built to serve an established market.

Regulation of entrepreneurial greenfields projects needs to deal appropriately with the ex ante risks facing the investor. Ignoring these risks will undermine the incentives to invest in new infrastructure projects. Therefore, regulation needs to balance the interests of the access provider and access seekers. While on the one hand, access arrangements must not deter investment, on the other they must promote access and promote competition in related markets.

The AustralAsia Railway Regime now incorporates a balanced approach to access. It provides a framework for access negotiations that gives investors sufficient certainty to proceed with the project, while ensuring access on terms and conditions that could be expected in a competitive market.

The certification recommendation is for a relatively long period – an operational period of 27 years. This gives further certainty to the access provider. However, the rail line is yet to be built, there is no history to indicate how the access provider will manage its above and below rail businesses and a few of the Regime's approaches are unique. Such a long certification could see inappropriate elements in the Regime entrenched for the entire period. This increases uncertainty for rail operators.

To rebalance these respective risks, the Regime now incorporates a comprehensive review three years after operations commence. This review will be public and conducted by the Northern Territory and South Australian Ministers, supported by the Regulator's assessment of the effectiveness of the Regime. This gives the Northern Territory and South Australian Governments an early opportunity to make the changes necessary to address any problems revealed through the first years of operations. (Section 1)

Key Features of the Regime

Independent Regulator

A key feature of this Regime is that it allows for the central involvement of an independent Regulator who can develop guidelines, assist in dispute resolution and generally monitor the effectiveness of the Regime. (Section 4)

Safeguards Against Favouring the Access Provider's Train Operator

The regime provides safeguards against the infrastructure owner favouring its rail operator at the expense of others:

- The pricing approaches either automatically treat all train operators equally (in the "sustainable competitive approach") or specifically provide for comparison with the prices of similar rail services (in the "floor/ceiling" approach);
- commercially sensitive information cannot be disclosed to those with a conflict of interest or misued for commercial gain or in any other way not provided for by the Regime; and
- the access provider must keep separate records for its above and below rail businesses, which increases transparency and reduces the risks that access charges will be inflated.

These safeguards are discussed under "**Competitive neutrality**". (Sections 2 and 3.1.1)

Access Prices

Access prices set under this regime will be compatible with those generated by other complementary rail access regimes. (Section 3)

All prices for access are to be struck within a floor/ceiling band, set in accordance with efficient forward looking costs.

Where competition from non rail freight is sufficient to discipline rail operators to minimise their costs and prices, the Regime's "sustainable competitive" approach uses the price of the competitive non rail freight as the starting point for calculating the rail access price between the floor/ceiling band. This ensures that access prices are based on competitive principles.

The Council tested the practicality of the "sustainable competitive" approach. It calculated some indicative access prices using the pricing formula. The base case model generated a rail access price a little less than currently charged by the ARTC on the Tarcoola/Alice Springs sector. This price is within the range of access prices charged under other rail access regimes. Therefore, the Council considers that, while actual prices will vary according to individual freights, the base case provides a useful benchmark for general freight

While the model is sensitive to the assumptions used, the scenarios that produced high access prices required volumes of freight and efficiencies in rail transport that were above those projected for this rail line. If it were possible to achieve these efficiencies in rail the effectiveness of the competitive pressure exerted by the non rail mode of transport may

need to be questioned. Where, for whatever reason, a service provided by the infrastructure owner ceases to meet the competitive discipline test for being priced under the "sustainable competitive" approach, the regime will, from that time forward, apply the floor/ceiling approach.

Further, the regime includes safeguards to ensure that monopoly rents are not built into access charges by periodically testing and, if necessary, adjusting those access prices vulnerable to monopoly pricing (priced under the floor/ceiling approach) to verify that the infrastructure owner is not earning an excessive return.

To ensure that all prices and the pricing review are based on appropriate estimates of costs:

- the regime specifies that efficient forward looking costs must be used;
- cost definitions have been amended to be consistent with those in other rail access regimes;
- the Regulator will develop guidelines on various aspects of calculating costs, including capital costs; and
- when developing capital costs guidelines, the Regulator has the flexibility to consider the most appropriate way of taking into account the government contributed assets and cash subsidies to the extent that this adjustment does not prevent the infrastructure owner from earning an appropriate return on its investment.

Timepath Management

The Council's work has not focussed exclusively on pricing issues. The quality of rail services can be just as important to the commercial potential of a train operator's business. Therefore, this Regime also recognises the importance of service quality, timepath allocation and reallocation policies and day-to-day train management. The access provider must develop policies on how it will manage these issues. These policies must be consistent with guidelines developed by the Regulator. (Section 3)

Dispute Resolution

Under an effective Regime, access negotiations need to be backed by enforcable dispute resolution processes. The arrangements in this Regime recognise that some issues may be small or time sensitive so that train operators may not take them to arbitration, given the time and costs it involves. Without a less costly means of dispute resolution, many small or time sensitive disputes could go unresolved. This would discourage access and competition in rail services. (Section 4)

This regime provides several levels of dispute resolution ranging from:

- advice provided by the Regulator on whether a negotiated outcome is consistent with the Regime;
- through voluntary conciliation by the Regulator;
- to full arbitration

Cross Border Issues

Initially at least, most train operations using the Darwin to Tarcoola track will be interstate.

Interstate rail operators will have a choice of negotiating directly with the infrastructure owner or relying on the ARTC (Australian Rail Track Corporation managing interstate rail services) to negotiate a package on their behalf. The access provider's above rail business will need to negotiate an access contract with the ARTC for freight beyond Tarcoola. On the other hand, if the ARTC wants to sell rail services to Darwin, it will need to negotiate with the access provider.

Therefore, the smooth running of interstate freight services is very important to the success of rail traffic on this corridor and several aspects of this regime address interstate issues directly:

- specific clauses facilitate the ARTC negotiating broad access contracts, covering a range of freight, that it can then onsell to other rail operators;
- the Regulator is required to consider interstate issues when developing guidelines; and
- the Regime allows for an arbitrator to be selected who can conduct arbitrations under other regimes. If this is not possible the arbitrator under this Regime must consult with arbitrators under other regimes when relevant to the dispute being considered.

It is likely to be at least several months before the national interstate access arrangements are finalised. It is also likely that they will change from time to time. The AustralAsia Railway Access Regime has the flexibility to accommodate such changes and to facilitate co-operation and compatibility, regardless of the approach adopted for interstate freight.

This regime also goes beyond co-operation with the ARTC. If issues that are relevant to the way trains travel on this rail line arise under other access arrangements, for example certified State regimes, then the AustralAsia Railway Access Regime allows for consideration of these issues in the development of its guidelines and arbitration processes.

Duration of Certification

The Council has recommended certification of this regime until 2030. Past considerations have focussed on, among other things, relevant investment cycles and the need to review access regimes regularly. However, the resulting recommendations were all for periods substantially less than 27 years.

This Regime includes a comprehensive review of all elements of the Regime after three years of operation. The review is an opportunity to consider whether implementation has been inappropriate or unexpected factors have emerged. There is no requirement to undertake a further comprehensive review until 12 months prior to the expiry of certification.

The Regime relies heavily on the independent Regulator to ensure that it can adapt as circumstances change during the period of certification:

- the Regulator has the power to amend guidelines and adapt its approach over time. Though, it is limited to developing only those guidelines specified in the Regime; and
- The Regime allows the Regulator to address the question of monopolistic pricing. Its first review monopoly profits is after 10 years of operations. Thereafter, a review is scheduled each 5 years. The remedy will not return excessive profits already earned, but set prices going forward that anticipate no monopoly profits over the forthcoming five year period.

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FOREWORD

On 18 March 1999, the National Competition Council (the Council) received an application from the South Australian and Northern Territory (NT/SA) Governments to certify the "**effectiveness**" of the AustralAsia Railway Access Regime (the Regime) for rail services on the line from Tarcoola to Darwin, part of which is yet to be completed.

The Council must assess the effectiveness of an access regime in accordance with the principles set out in **Clauses 6(2)-6(4)** of the *Competition Principles Agreement* (CPA). If an access regime is certified as effective, the services it covers cannot be "**declared**" for access under Part IIIA of the *Trade Practices Act 1974* (TPA).

The Regime

The AustralAsia Railway Access Regime consists of the *AustralAsia Railway (Third Party Access) Act (NT), AustralAsia Railway (Third Party Access) Act (SA)*, and the *AustralAsia Railway (Third Party Access) Code*, which is attached as a schedule to each Act. The Regime also includes two safety Acts - *the Northern Territory Rail Safety Act (NT) and the Rail Safety Act (SA)*. The Regulator is nominated as the SA Independent Industry Regulator, and hence the *Independent Industry Regulator Act (SA)* is also relevant.

The Regime covers the facilities necessary for the operation of the railway from Tarcoola to Darwin. The Regime is to commence operations when some services on the new part of the line from Alice Springs to Darwin can be provided – this might occur before the full line is completed. When these services can be provided, the Regime will also apply to the existing line from Tarcoola to Alice Springs.

The Regime establishes a right to negotiate access to use the railway infrastructure between Tarcoola and Darwin. It sets out the rights and responsibilities of both access seekers and the access provider and covers matters such as the negotiation process, dispute resolution, terms and conditions. It follows a negotiate/arbitrate model, where parties first attempt to agree on an arrangement, with dispute resolution processes available if necessary.

The Process to date

The Council adopted a public consultation process in assessing this application. In response to its published issues paper, it received eight submissions. The Council met with key stakeholders to gain a greater knowledge of issues raised in these submissions. It also engaged a pricing consultant, Professor Henry Ergas, to advise on the Regime's pricing approaches.

As a result of this process, a number of significant issues became evident:

- There were concerns about the **pricing principles** including:
  - The rates of return set in the Regime;
  - The use of "**sustainable competitive**" pricing to derive access prices where rail freight competes with other modes of transport;

- The non-competitive or "**floor/ceiling**" approach to pricing included a price cap set at twice average costs;
- The appropriateness of definitions used to set the floor and ceiling parameters for non-competitive pricing; and
- The treatment of the cash and asset subsidies provided by the State, Territory and Federal Governments when calculating capital costs.

- Independence of the regulator.
- The lack of a low cost dispute resolution process.
- The negotiation framework, including the required response times, the level of information made available by the access provider and the access provider's discretion to opt out of negotiations.
- Cross border issues.
- Duration of certification.

NT/SA Governments' amendments

Over a substantial period of time, the Council held discussions with the NT/SA Governments. Over this period the Governments agreed to progressive amendments that were brought together in the amended Regime that formed an attachment to the draft assessment, put out for public comment in November 1999. The Council received a further six submissions against its draft recommendation. All submissions are available from the Council's web page at http://www.ncc.gov.au.

Following concerns raised in the submissions to the draft recommendation, the Council negotiated further amendments with the NT/SA Governments. These principally relate to the misuse of confidential information, an early review of the Regime's elements (including pricing approaches), treatment of the cash and asset subsidies provided by State and Federal Governments and the Regulator's role with regard to day-to-day management of timepaths.

The principal amendments incorporated in the Regime, that formed part of the Council's draft recommendation, are listed below. The amendments subsequent to the draft recommendation, that have now been incorporated in the Regime that forms part of this Final Recommendation, are also listed below:

Amendments detailed in Draft and Final Recommendations

Draft Recommendation	Final Recommendation
Negotiation framework	
Modifications to the negotiation process to rebalance the responsibilities and rights of the access provider and the access seeker; Provision of information on service quality, timepaths and costs is now required	Penalties for misusing confidential information increased to $100,000. Requirement that confidential information should not be disclosed inadvertently or to an "unauthorised" person - penalty $10,000. ARTC operations specifically provided for.
Pricing principles	
The two pricing approaches now both set prices within a floor/ceiling band that is consistent across both approaches; The threshold criterion that establishes whether a service is "**effectively constrained**" by "**sustainable competitive**" pressure has been narrowed; and Services that do not pass the threshold test are priced under a "**floor/ceiling**" approach based on efficient forward looking stand alone costs. The cost definitions are not more consistent with other Regimes.	ICar deduction further clarified. A DORC valuation is required, but the Regulator can adjust it (by an amount that does not prevent the access provider from achieving an appropriate return on the capital it has invested) to take account of the cash and asset subsidies. This then allows the Regulator to take the effects of the subsidies through any capital cost component it considers appropriate.
Independence of the Regulator	
The Regulator is now the South Australian Independent Industry Regulator established under the *Independent Industry Regulator Act 1999* of South Australia.	
Powers and functions of the Regulator	
Produces guidelines on how the access supplier should allocate and reallocate timepaths; Produces guidelines on how the access provider determines costs including capital costs; On request, can rule on negotiation issues to ensure that they consistent with the Regime. While full arbitration remains an option, an access seeker can seek the Regulator's verification to ascertain if aspects of the negotiated offer comply with the Regime. If the negotiations fail and a dispute is formally acknowledged, the Regulator can be asked to conciliate prior to referral to full arbitration; and Will conducts a periodic review to determine if monopoly rents have been achieved by the access provider from operators categorised as not competing with other transport modes (those priced under the floor/ceiling approach).	Guidelines to also cover service quality and day–to-day timepath management. Guidelines to generally take into account "interface issues". Guidelines on capital costs to take into account the cash and asset subsidies provided by Governments which can be adjusted by an amount that does not prevent the access provider from achieving an appropriate return on the capital it has invested.
Arbitration	
	Amendments to matters to be considered by the Arbitrator: - less direction on project risk - direction to consider interface issues

Cross Border Issues	
	Amendments to facilitate ARTC's operations. Provisions to ensure that this Regime meshes with others covering common services. These provisions cover both the negotiation framework, (through recognition of ARTC's operational needs) as well as terms and conditions (through consideration of interface issues in the development of guidelines) and arbitration (through appointment of an arbitrator who can act across regimes).
Duration	
	Assisted by the Regulator, Ministers will conduct a comprehensive public review of all elements of the regime, after 3 years of operations. This is to allay concerns that elements that either do not mesh with other Regimes or deter access can be dealt with in the early period of operations and not become entrenched for the full certification term.

These amendments are more fully detailed in the following assessment and are effected in the attached amended Regime. A snapshot of the amended Regime is included in Annexure 1. The final Regime forms Annexure 3.

The Council concludes that the amendments made by the Governments since application allows the Regime to now meet all the Clause 6 principles. In support of this conclusion, the Council has detailed its assessment of the Regime in the following report.

The Council has finalised this process by sending its final recommendation to the Commonwealth Treasurer. The Council has recommended that the Treasurer certify the Regime up to 31 December 2030.

Queries on this matter should be directed to Ms Trish Lynton on 03 9889 9888 or Ms Deborah Cope on 03 9285 7491. Should you have any queries on administrative matters, please contact Ms Angela Houpis on 03 9285 7089.

ASSESSMENT OF THE REGIME

The relevant assessment criteria

Section 44M and 44DA of the *Trade Practices Act 1974* (TPA) provide for the Council to assess an access regime, established by a State or Territory Government, against the principles set out in **Clauses 6(2) to 6(4)** of the *Competition Principles Agreement* (CPA). **Clauses 6(2) to 6(4)** are reproduced in Table 1.

The Council will generally look for a Regime to satisfy all criteria before it can recommend certification to the Minister. However, the passing of the *Gas Pipelines Access (Commonwealth) Act 1997* does give the Council and the Minister flexibility in applying the CPA principles.

Table 1. Clauses 6(2),(3) and (4) of the CPA

6(2)	The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless: (a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or (b) substantial difficulties arise from the facility being situated in more than one jurisdiction.
6(3)	For a State or Territory access regime to conform to the principles set out in this clause, it should: (a) apply to services provided by means of significant infrastructure facilities where: (i) it would not be economically feasible to duplicate the facility; (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist. (b) incorporate the principles referred to in sub clause (4).
6(4) (a)-(c)	A State or Territory access regime should incorporate the following principles: (a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access. (b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility. (c) Any right to negotiate access should provide for an enforcement process.
6(4)(d)	Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.
6(4)(e)	The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.
6(4)(f)	Access to a service for persons seeking access need not be on exactly the same terms and conditions.
6(4)(g)	Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.
6(4)(h)	The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.
6(4)(i)	In deciding on the terms and conditions for access, the dispute resolution body should take into account: (i) the owner's legitimate business interests and investment in the facility; (ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets; (iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake; (iv) the interests of all persons holding contracts for use of the facility; (v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility; (vi) the operational and technical requirements necessary for the safe and reliable operation of the facility; (vii) the economically efficient operation of the facility; and (viii) the benefit to the public from having competitive markets.
6(4)(j)	The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to: (i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility; (ii) the owner's legitimate business interests in the facility being protected; and (iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.
6(4)(k)	If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement that was made at the conclusion of the dispute resolution process.
6(4)(l)	The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.
6(4)(m)	The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.
6(4)(n)	Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.
6(4)(o)	The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.
6(4)(p)	Where more than one State or Territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

How the criteria will be applied to this Regime

The Council has approached this assessment by grouping the CPA criteria under broad issues and then assessing if the Regime meets all the criteria relevant to each broad issue. The groupings and their relevant criteria are set out in Table 2.

The Council considers that this approach allows it to isolate and work through the Regime's structure in a systematic way, while still ensuring that the Regime meets the Competition Principles Agreement's (CPA) criteria.

The Regime is divided into the five broad issues set out in Table 2. The recommendation then moves through each of these issues:

- Setting out the CPA criteria relevant to this broad issue;
- Outlining how the original Regime addressed this issue and its relevant criteria;
- Outlining the participants and the Council's concerns;
- Detailing the amendments proposed by the NT/SA Governments to address those concerns; and
- Giving the Council's consideration of those amendments.

Table 2 Linkages between broad issues and CPA criteria

1. Natural monopoly characteristics	*2. Negotiation framework*	*3. Terms and conditions*	*4. Dispute resolution*	*5. Cross border issues*
6(3) - not feasible to duplicate; facilitate up/downstream competition; safe use of the facility	**6(4) (a) – (c)** negotiation framework should support right to negotiate	**6(4) (a) – (c)** The regime should provide for the development of terms and conditions that both encourage efficient use of the infrastructure and provide a fair return to the infrastructure owner	**6(4) (a) – (c)** right to enforceable dispute resolution in compliance with CPA	**6(2)** - facilitate access across borders
6(4)(d) - periodically assess if facility still meets 6(3)	**6(4)(e)** -access provider to facilitate negotiation	**6(4)(f)** - access need not be on the same terms and conditions	**6(4)(g)** - required to appoint arbitrator if no agreement can be negotiated	**6(4)(p)** - when infrastructure crosses a state or territory border, it should be consistent with regimes in other jurisdictions
	6(4)(k) - Regimes can allow for a contract to be reopened if there is a material change in circumstances.	**6(4)(n)** - the access provider is required to keep separate accounts for the access business	**6(4)(h)** - arbitrator's decisions should be binding but appeal rights should remain	
	6(4)(m) -the parties cannot hinder each other from gaining or utilising access	**6(4)(i)** – issues the arbitrator must consider in dispute resolution should be reflected in terms and conditions	**6(4)(i)** - issues the arbitrator must consider in dispute resolution	
	6(4)(n) - the access provider is required to keep separate accounts for the access business	**6(4)(j)** – issues the arbitrator must consider when it determines if the access provider should invest in extensions should be reflected in terms and conditions	**6(4)(j)** - issues the arbitrator must consider when it determines if the access provider to invest in extensions	
		6(4)(l) – provision for negotiation of compensation for the original right holder	**6(4)(l)** - the arbitrator transfers rights only after considering compensation for the original right holder	
			6(4)(o) - the arbitrator should have access to financial and accounting information relevant to the services	
			6(4)(n) - the access provider is required to keep separate accounts for the access business	

1 NATURAL MONOPOLY CHARACTERISTICS

Relevant CPA criteria

Clause 6(3) – necessary characteristics of any infrastructure to come under Part IIIA

For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:
  (i) it would not be economically feasible to duplicate the facility;
  (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and
  (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist.

(b) incorporate the principles referred to in sub clause (4).

Clause 6(4)(d) – a regime should include a review to ensure Part IIIA is still applicable

Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

Clause 6(3)(a) gives the threshold criteria for assessing if users would benefit from the establishment of an access regime. It assesses if the facility has natural monopoly characteristics and so would be likely to provide the supplier with an opportunity to collect monopoly rent, or to deny access altogether. This natural monopoly test is similar to that applied under an application for declaration. A regime should apply to a service provided by a "bottleneck" facility – such as electricity transmission – where the inability to gain access to that service would constrain competition in at least one other market - such as electricity generation. If the infrastructure failed to meet this criterion, the Council would consider that there was no need for a Regime and so recommend against certification.

For the Regime to meet **Clause 6(3)(b)**, it must meet all of the criteria falling under **Clause 6(4).** These are reviewed separately, under the relevant broad issues below. The Council will generally look for a Regime to satisfy all criteria before it can recommend certification to the Minister. However, the passing of the *Gas Pipelines Access (Commonwealth) Act 1997* does give the Council and the Minister flexibility in applying the CPA principles.

Clause 6(4)(d) is designed to provide for a periodic review to determine if the infrastructure still embodies the characteristics specified in **Clause 6(3)(a).** This allows reassessment of the infrastructure over time to establish if changes in circumstances meant that the infrastructure no longer met **Clause 6(3)(a)**. For instance, demand may increase so that the infrastructure becomes economic to duplicate.

The NT/SA Regime – as initially submitted

In their application, the NT/SA Governments drew on a long history of research and planning to develop this railway to support their arguments that the Regime met the requirements of **Clause 6(3)(a)**. They argued that:

- the size, cost and importance of the line makes it a significant infrastructure facility;

- the size of capital costs, compared to the revenue potential means that it is not economically feasible to duplicate the railway;
- despite some areas where road and rail are competitive, there are markets where access regulation is necessary to permit effective competition; and
- access can be provided safely.

To meet **Clause 6(4)(d)**, S.50 of the Regime provides for the Ministers to review the operation of the Regime to consider if it "**is to remain in force**". The Ministers could conduct such a review at any time but are required to do so no later than a year before the expiry of the certification period.

Certification Issues

Clause 6(3)(a) – is this a significant infrastructure facility?

No substantial issues were raised against the arguments put by the Governments that the core infrastructure necessary to provide rail line services would meet the **Clause 6(3)(a)** criterion.

Regime Coverage

NRC agreed that the Regime should cover the group of core assets necessary to deliver rail line services. However, it was concerned that the open-ended nature of the "**railway infrastructure facilities**" definition under S.3 could cause non-core assets (without **Clause 6(3)(a)** characteristics) to be included in the Regime's coverage (and so be pulled into the cost calculations). The definition read:

> *(a) the Railway track;*
> *(b) stations and platforms;*
> *(c) the signalling systems, train control systems and communication systems;*
> *(d) such other facilities as may be prescribed;*
> *but not including:*
> *(e) rolling stock; and*
> *(f) such other facilities as may be prescribed.*

NRC further argued that:

> The inclusion of the phrase "such other facilities as may be prescribed" suggests that the authors of the Regime wish to have the flexibility to expand the definition of the nominated infrastructure to include anything inadvertently 'left out'. This loose definition is unacceptable in the context of a Regime which could be 'effective' and therefore beyond reach if the discretion it gives is used unreasonably. It would leave the way open for the ambit of the Regime to be extended arbitrarily to any rail functions and facilities and the services they provide, other than rollingstock.

The Council's assessment

Clause 6(3)(a) – Is this a significant infrastructure facility?

The Council considered the Governments' arguments, that the core infrastructure met **Clause 6(3)(a),** were strong. The Council noted that the railway from Tarcoola to Alice Springs (830 km) had a replacement cost of about $500 million. It also noted that the new line from Alice Springs to Darwin had a construction cost of about $1 billion and would ultimately connect Darwin with the national rail network.

The Governments had argued strongly over a long period of time that the project was of vital importance to their regions. In its submission to the Committee on Darwin Report (1995) the SA Government stated that:

> The South Australian Government views the Darwin-Alice Springs Railway as the major piece of infrastructure of national significance requiring completion. The railway represents the 'missing link' in the nation's transport system. (p. 125)

The Committee concluded that the railway would prove important to the regions involved:

> The rail link does have a high profile in the Northern Territory and South Australia and its completion would have considerable symbolic significance. Such a commitment's impact on self-perceptions should not be underestimated, nor should the impact on the perceptions of our regional neighbours. But this is a major infrastructure project involving vast public expenditure. It demands corresponding benefits, which are difficult to foresee on the basis of this argument alone. (p. 128)

The Governments referred to a 1995 Study by Symonds Travers Morgan to quantify their estimates of the project's economic benefits.

The draft recommendation considered that the arguments put by the Governments were convincing and concluded then that the infrastructure met this criterion. Submissions to the draft recommendation did not significantly disagree with the Council's conclusion.

Conclusion

The Council considers the Railway is a significant infrastructure facility.

Regime Coverage

The coverage of the Regime involved two issues:

- whether all of the facilities listed in the definition of the "**railway infrastructure facilities**" were all necessarily the core assets required to deliver the natural monopoly services; and

- whether the openness of the "**railway infrastructure facilities**" definition introduced too much uncertainty into the Regime's potential coverage.

The Council raised both of these concerns with the NT/SA Governments. In response, the Governments agreed to delete "**stations and platforms**" from the definition of "**railway infrastructure facilities**" and limit the exemptions to rolling stock:

> S.3 "railway infrastructure facilities"..*means facilities necessary for the operation or use of the railway, including –*
> *(a) the Railway track;*
> *(b) the signalling systems, train control systems and communication systems; and*
> *(c) such other facilities as may be prescribed;*
> *but not including rolling stock;*

The following subsection was added to S.3. It constrains elements of the above definition:

> *S.3(5) The following provisions apply with respect to the prescription of any facilities under paragraph (c) of the definition of "railway infrastructure facilities" in subclause (1):*
>
> *(a) the Ministers must not prescribe a facility without first consulting with the regulator; and*
> *(b) the prescription of a facility must be consistent with the criteria set out in Clause 6(3)(a) of the Competition Principles Agreement referred to in the Trade Practices Act 1974 of the Commonwealth.*

The Council considers that the additions remove considerable ambiguity and discretion over the assets that can be covered by the Regime. The Council also considers that the Regulator has sufficient powers to ensure the appropriate application of the new provisions. In the Ministerial review (S.50) scheduled to occur after three years of operations, or in general consultations, the Regulator can advise Ministers whether it considers assets meet the **Clause 6(3)(a)** tests and so be included or excluded from cost parameters. The Council noted in its draft recommendation that the amendments met its concerns. Submissions to the draft recommendation raised no further significant issues.

Conclusion

The Council considers the Governments 'amendments meet its concerns.

6(3)(a)(i) Is this facility economically feasible to duplicate?

This criterion is designed to test the facility to see if the services are likely to be provided at lower cost by one facility or by two or more competing facilities.

The Industry Commission has considered the following factors in assessing whether infrastructure exhibits natural monopoly characteristics:

- the existence of substantial fixed costs (and whether many are sunk[1]);
- the existence of relatively low variable costs – this suggests that the facility currently has no capacity constraints and most likely enjoys economies of scale;
- the existence of excess capacity, which, in part, may be due to the "lumpy" or indivisible nature of track investments; and
- if duplication is not normal commercial practice elsewhere, this may suggest, but is not conclusive, that the facility has natural monopoly characteristics. This may be explained or contributed to by regulation of the industry or economic compulsion by a statutory monopolist[2].

[1] Sunk costs are those costs which are not readily recoverable should the owner wish to exit the industry.

2 Industry Commission 1997a, Submission to the National Competition Council on the National Access Regime: A Draft Guide to Part IIIA of the Trade Practices Act, IC Canberra.

————————, 1997b, Submission to the National Competition Council on Specialized Container Transport's Declaration Application, IC Canberra

All submissions agreed that this rail line is not economically feasible to duplicate, given the likely demand for the services it will provide. For example Northlink Rail Consortium considered:

> Northlink sees it as self-evident that it would be uneconomic to duplicate the facility given the history of attempts over many years to initiate the project.

The Governments agreed. Their application argued that the costs of construction, when compared to the projected freight task, indicated that it would not be economically feasible to construct a second rail line. Available estimates anticipate a commercial return only in the latter years of the Railway's operations. This lack of viability is further emphasised by the decisions of the NT, SA and Federal Governments to provide substantial cash and asset contributions to the access provider to ensure that the necessary construction and upgrading works take place[3].

The Council considered the Governments' arguments persuasive. Given the marginal nature of the Railway, it could be readily concluded that the costs of operating a second line would be prohibitive.

Conclusion

The Council considers it is not economically feasible to duplicate the facility.

6(3)(a)(ii) Is access necessary to permit effective competition in another market?

The NT/SA Governments argued that rail will compete with other modes of transport in some freight markets:

> For general containerised freight, road and rail transport are close substitutes with relatively low switching costs between operators and modes. This is evidenced by the strong rivalry and intense competition between interstate rail operators and road transport operators. In other cases … the market will be restricted to the transport of freight by the rail mode …Examples might include the transport of certain types of freight where rail has such a clear technical superiority that the possibility of substitution by road transport is not strong.

In considering whether access is necessary to permit effective competition in downstream or upstream markets the Council needs to assess whether:

- the service covered by the access regime is in a separate market from downstream and upstream markets; and
- access will permit competition in at least one of those markets.

The Council has previously used the following test[4], to assess if the relevant markets are separate:

(a) The industry layers at issue should be separable from an economic point of view. This involves an assessment that the transaction costs for the provision of the

[3] The Governments of the Northern Territory and the Commonwealth have undertaken to contribute $165M each. The Government of South Australia has undertaken to contribute $150M. The Commonwealth Government has also undertaken to lease to the access provider the line from Tarcoola to Alice Springs (estimated to equate to $500M) at a minimal rent.

[4] This test was developed from the papers and advice of Professor Henry Ergas.

good or service by separate businesses at each industry layer are not so high that separate provision is uneconomic; and

(b) Each industry layer should utilise assets specialised to that layer. Supply side or asset substitution between the activities of the layers should not easily occur. If it does, it could unify the field of rivalry between the two layers making separate provision uneconomic.

In previous certification and declaration applications for rail services, the Council has analysed the characteristics of rail line and freight transport services and concluded that these services are in separate markets.

It can be concluded that the two services are separable from a transaction cost point of view. This is evidenced by the current viable separate operation of the two activities in other areas of Australia. Submissions to this process indicate separate operation will also occur on this line.

It can also be concluded that the assets used by the two activities are very different and unable to be switched between activities. The below rail service relies on assets such as signalling, sleepers and tracks whereas the above rail service relies on assets such as locomotives and wagons.

To assess whether access is necessary to permit effective competition in freight transport markets, the Council has drawn on the comments of the NT/SA Governments and the views presented in submissions. Several submissions pointed to areas where they felt an effective access regime would increase competition. For example:

- the transport of bulk commodities;
- the transport of commodities where rail has a natural cost advantage; and
- when an established cost advantage for rail may mean that it emerges as a more dominant mode of transport and, therefore, access will be necessary for effective competition to exist.

Most submissions, however, recognised that for a range of freight services, rail is likely to compete with other modes of transport so that the effect of access on competition may not be substantial.

The Council considers that access is necessary to permit competition in the downstream markets for freight transport services. While, not affecting all of these services, it will have an impact on several important aspects of those markets.

- For certain freight now carried by other modes, such as road, but most suited to rail transport, the introduction of rail will provide a new dimension to competition in existing freight services.

- For freights that cannot be transported economically by other modes, such as bulk minerals over long distances, the new railway will allow the development of projects dependent on rail transport for viability. The approaches now contained in the Regime should ensure that operators, other than the access provider's operator, are able to compete to provide rail services to such projects.

- The linkage of the current national railway with this new railway will allow current national operators to enter and compete in a range of freight markets, using the scale available from national operations to increase competitive pressures.

Conclusion

The Council considers that access to the AustralAsia Railway is necessary to permit effective competition in some freight transport markets.

6(3)(a)(iii) Can safe use of the facility be ensured at economic cost?

The safe use of the Railway will be ensured by the:

- Northern Territory Rail Safety Act 1998 (NT); and
- Rail Safety Act 1996 (SA).

Both Rail Safety Acts adopt the Australian Rail Safety Standard and contain a safety accreditation regime for railway operators and railway owners and a mechanism for mutual recognition of accreditation between jurisdictions. The Governments argued that safety was ensured because:

> Railway operators and railway owners are required to hold accreditation and have in place a comprehensive safety management plan that:
>
> - identifies significant potential risks;
> - specifies the systems, audits, expertise and resources to be employed to address those risks; and
> - specifies the person responsible for the implementation and management of the plan.

Most of the Railway is yet to be constructed and therefore a review of accreditation charges is not meaningful. Given the comprehensive public review to be conducted by Ministers after 3 years of operations and the Regulator's ability to raise issues of relevance to the Regime's effectiveness with Ministers, the Council considers that there are sufficient opportunities for matters such as uneconomic safety charges or inefficient practices to be addressed.

Conclusion

The Council concludes that there are appropriate provisions to ensure the safe use of the Railway at an economically feasible cost.

6(4)(d) Review to test the continuing need for a Regime

To meet **Clause 6(4)(d)**, S.50 now includes two specified reviews. The first requires that the Ministers publicly review the Regime three years after commencement of operations. The second requires that the Ministers publicly review the Regime not later than 12 months before the expiry of the certification period. No reviews are scheduled for the

period in between these two dates. However, S.50 also provides for the Ministers to review the operation of the Regime *"at any time"* to consider if it *"is to remain in force"*.

While it would prefer the Regime to specify times for the interim reviews, the Council considers that the regulatory costs of maintaining a Regime impose sufficient incentive to encourage the parties to seek a review when it is no longer necessary. The Council is also mindful of the substantial role the Regulator plays in the Regime and notes that the Regulator can report to Ministers on matters they should review, including operational elements and, potentially, the need for the Regime.

Conclusion

The Council considers that the Regime satisfies ***Clauses 6(3)(a)*** *and* ***6(4)(d)****. As outlined below, the Council considers that the Regime meets all the* ***Clause 6(4)*** *criteria. Therefore, the Council considers that the Regime also meets* ***Clause (6)(3)(b).***

2 NEGOTIATION FRAMEWORK

Relevant CPA criteria

Clause 6(4)(a)-(c) - negotiation framework, terms and conditions should not preclude access. Arbitration should support negotiation

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Clause 6(4)(e) - access provider should accommodate access

The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

Clause 6(4)(k) - remedies for a material change in circumstances

If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

Clause 6(4)(m) - access provider should not hinder access

The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

Clause 6(4)(n) - accounting separation of businesses

Separate accounting arrangements should be required for the elements of a business which are covered by the access regime

The negotiation framework should provide a solid environment in which negotiations are encouraged and are likely to produce outcomes similar to those expected in a competitive market.

The parties should be required to negotiate in a productive manner and the Regime must not contain any element that simply deters access. The Regime needs to outline the obligations on each of the parties. The parties should be obliged to respond in a timely and relevant way to each other's reasonable requests. The access seeker should be provided with the level of information similar to that it would extract in the process of

negotiating in a competitive market. For instance, in a competitive market a consumer could gain information on relative costs by securing a number of quotes. These would also specify the quality of the service linked to those costs, any technical details and relevant conditions of sale. The Regime needs to cover these elements to meet **Clause 6(4)(a) and (b), 6(4)(e) and 6(4)(m).**

The framework also needs to include a means by which the parties can resolve access disputes after allowing sufficient scope for bilateral negotiations. The time allowed should be sufficient to ensure negotiations, pursued with commitment, can take place but not so long as to prevent the access seeker from being considered by a prospective customer.

To support negotiations, the dispute resolution mechanisms must be robust. The anticipated arbitration outcome will strongly influence negotiated outcomes. As a consequence, it is important that the Regime ensures that arbitrated outcomes resemble those expected in a competitive market and that sufficient information regarding this probable outcome is provided to the parties. A Regime that covers these elements is likely to meet **Clause 6(4)(c).**

In this Regime, the access provider is likely to be vertically integrated and compete with other rail operators. Therefore, the framework of this Regime should provide safeguards against the access provider favouring its affiliated rail operator. It should also guard against the access provider using the access seeker's confidential information to benefit its affiliated rail operator. This has implications for **Clauses 6(4)(a)** and **(b), 6(4)(e) and 6(4)(m).**

To meet **Clause 6(4)(k)**, the Regime can allow for the parties to negotiate what constitutes a "**material change in circumstances"**. Alternatively, an access regime could make general provisions for determining when contracts should be reopened if there is "**a material change in circumstances".**

Accounts should be separated according to above and below rail activities, in accordance with **Clause 6(4)(n),** to ensure that the prices that are negotiated reflect the appropriate costs.

Certification issues

The Regime contained a "**negotiate/arbitrate**" framework, with provision for assistance by the Regulator. The Regime did not impose strong obligations on the access provider to participate positively in the negotiation process and submissions raised a range of issues in support of this argument. These are detailed below:

1 Independence of the Regulator

In the original Regime, the Regulator was subject to the control and direction of the relevant NT/SA Ministers. This lack of independence precluded it from taking a central and decisive role in the Regime.

2 General framework

Support for negotiation - A number of submissions (NRC, Toll, FreightCorp) considered the framework in the initial regime discouraged negotiation. While S.11

required the parties to negotiate in good faith, S.9(c) appeared to give the access provider the discretion not to negotiate.

Availability of information - Submissions also argued that the Regime did not require the access provider to give access seekers sufficient information for them to negotiate effectively. For instance, S.9 did not require the provision of any information on the approaches to defining and calculating costs - a fundamental requirement for effective negotiation.

Affected access holder - The access provider must, also within 21 days of receiving the proposal, notify any access holder affected by the proposal. It is then up to the access seeker to negotiate compensation with the access holder – the access provider does not participate in this negotiation. There was some concern regarding the access seeker's ability to negotiate effectively with any access holder, given the information available to it.

Material change - S.36 was the means of addressing the requirements of **Clause 6(4)(k**). It allowed the Regulator to revoke an award if all the parties agreed. If the parties did not agree, the Regulator had the discretion to refer the matter to arbitration. In deciding whether to refer a dispute to arbitration, the Regulator was to consider if there had been "**a material change in circumstances**" since the award was made or last varied.

ARTC considered that the Regime should require all agreements to address the matter of "**material change of circumstances**" and that the Regime itself needed to separately cover this issue. Other Regimes that had come before the Council included issues that must be negotiated in any access contract – these had included the matter of a "**material change of circumstances".**

Hinder access - S.38 specifically dealt with the requirements of **Clause 6(4)(m)**. It made it an offence for a person to prevent or hinder another's access to the railway services and allowed penalties of $100,000 and $10,000 for each day the offence occurred.

Dispute trigger - Access seekers were required to negotiate for a specified period before they could seek arbitration. Negotiations were considered in dispute if either the access holder or access provider did not enter into negotiations within 30 days after the response date (21 days after receipt of the proposal). However, the access seeker could wait as long as 180 days after the response date before the parties were deemed to be in dispute.

3 Competitive neutrality

Submissions also raised issues of competitive neutrality[5]. They noted that the access provider expected to conduct a rail freight business and therefore would have an incentive to promote the business opportunities of its affiliated rail operator over those of unaffiliated operators. The framework contained no provisions to ensure equal treatment for affiliated and unaffiliated operators. For instance, the above and below rail businesses of the access provider were not required to operate in separate establishments.

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[5] Where ownership characteristics give one party an advantage over those it competes with, mechanisms must be provided to ensure that these advantages are neutralised. These mechanisms can include increased transparency and/or regulation over areas that provide the advantage.

Access could be negotiated in the vicinity of the management of the affiliated above rail operator – the access seeker's competitor.

There was no requirement on the access provider to keep details of an access seeker's proposal confidential from its affiliated operator. To meet these concerns, the Regime would need to rely on S.38 and its general provisions against hindering access.

4 Separation of accounts

S.46 provides for the separation of the accounts and other information relating to the access provider's above and below rail businesses. Given that such separation must comply with the Regulator's guidelines, the Council considered that this matter was sufficiently covered in this context.

The Council's assessment of the NT/SA Governments' response

There has been a range of amendments to the negotiation framework. The current framework is captured in the following table.

Table 3 Negotiation framework – by Section

S9 The access provider must provide reasonably requested information including: . current capacity utilisation; . technical details and requirements; . time-path allocation and reallocation policies in accordance with guidelines published by the Regulator; . service quality and train management standards in accordance with guidelines published by the Regulator; and . relevant prices and costs in accordance with guidelines published by the regulator
S10. The negotiation starts with the access seeker submitting a proposal to the access provider. The access provider may, within 21 days request further information. The access provider must, within 21 days give the proposal details to the Regulator; any affected access holder and provide the affected access holder's details to the access seeker. Negotiations with ARTC are specifically provided for.
S11.All parties have a duty to negotiate in good faith.
S12 All parties must be in agreement before contracts are finalised.
S12A. No confidential information can be disclosed to an unauthorised person. No one can misuse confidential information for competitive advantage.
S12B Any party can refer a negotiation matter to the Regulator for advice or a direction. Penalties can apply if directions are not followed.
S13 An access dispute exists if: . a respondent fails to commence negotiations within 30 days of the response date (21 days after receiving a proposal); . the access seeker fails to obtain an agreement; or . all parties agree that there is no prospect of reaching agreement.
S14 An access seeker may request the Regulator to refer an access dispute to arbitration.
S17 The parties to the arbitration of an access dispute are: . the access seeker; . the access provider; . any other respondent to the access proposal; . any other person who applies in writing to be made a party and is accepted by the Arbitrator as having a sufficient interest; and . the Regulator.
S19 The Arbitrator must make a written award. Before making an award, the Arbitrator must give a draft to the parties and the Regulator and may take into account their representations on the proposed award
S35 Unless the access seeker elects not to be bound by the award within 7 days, it becomes effective in 21 days.
S37 Appeals on questions of law regarding an award, or a decision not to make an award, lie with the Supreme Court.
S38 Penalties can be imposed on any party hindering the access of another.
S42 The Supreme Court may grant an injunction restraining a person from contravening or requiring a person to comply with this Code.

The process starts with an approach by the access seeker, requesting information. In response the access provider must remit the specified information in a form that would be useful to an access seeker. The access seeker can then submit a proposal, to which the access provider must respond with the intent of entering into "**good faith**" negotiations. During the negotiation process, the access seeker may call on the Regulator for advice or to verify that an element of the access provider's proposal is within the bounds of the Regime.

The access seeker can notify the Regulator that a dispute exists any time after the proposal is received. The Regulator can consider if the dispute is legitimate, then either be called on to conciliate or can be asked to refer the matter to an arbitrator

The following outlines the Governments' specific amendments to the concerns raised above.

1 Independence of the Regulator

S.5 now appoints the SA Independent Industry Regulator, established under the *Independent Industry Regulator Act 1999*, as the Regime's Regulator. The legislation indicates the Regulator will have the independence and have access to sufficient expertise to carry out its enforcement responsibilities.

With regard to the negotiation framework, S.12B now allows the access seeker to call on the Regulator to ensure that negotiations progress in a reasonable fashion. Through this provision, the Regulator will be able to verify outcomes and give directions to parties. This makes low-cost dispute resolution easily accessible for negotiation matters.

2 General framework

Negotiation an option - S.9(c), which appeared to allow the access provider the discretion to negotiate, has been deleted.

S.11 still requires the parties to negotiate in good faith and to endeavour to accommodate each other's reasonable requirements and to reach agreement:

> *S.11(1) ... on whether the access seeker's requirements as set out in the access proposal (or some agreed modification of the requirements) could reasonably be met, and, if so, the terms and conditions for the provision of access for the access seeker.*

This section still contains an element of equivocation relating to whether the access provider will negotiate access. However, the Council considers that there may be some circumstances where the requested service can not be provided. Given the Ministerial review now scheduled to occur three years after operations commence and the extended powers and functions of the Regulator (particularly under S.12B) the Council has greater confidence that this approach will be applied appropriately throughout the course of certification.

Availability of information - S.9 now requires the access provider to give any person the following information:

> *S.9...*
>
> *(a) the extent to which the access provider's railway infrastructure facilities are currently being used;*
> *(b) technical details and requirements of the access provider, such as axle load data, clearance and running speeds;*
> *(c) time-path allocation and reallocation policies for the railway;*
> *(d) service quality and train management standards; and*
> *(e) relevant prices and costs associated with railway infrastructure services provided by the access provider, prepared by the access provider for reference purposes in accordance with guidelines published by the regulator.*

This can occur before the access seeker finalises its proposal.

The access seeker can request further information. S.11 requires the access provider to accommodate the access seeker's requirements. Should the access seeker be unable to obtain the information it requires, it can direct the matter to the Regulator (S.12B) for its decision on the reasonableness of the request.

If the information provided is too little or irrelevant, this can now be examined during the Ministerial review after three years of operations. In the meantime, the Regulator can suggest what additional information needs to be provided. In matters where the Regulator is required to develop guidelines according to S.45A, such as timepath and service quality matters, it can give directions that the access provider must follow.

S.10(4)(c) requires the access provider to give a preliminary indication of access terms and conditions within 21 days of receiving a proposal. This should allow the access seeker to consider its next step in the negotiation process.

Affected access holder - It is still up to the access seeker to negotiate compensation directly with the access holder. S.11 requires the access seeker and an affected access holder to negotiate in good faith – they follow the same process as the general framework and so can seek the Regulator's assistance under S.12B. The Regulator may also be approached to commence conciliation or arbitration after negotiations are deemed to be in dispute.

Material change of circumstances - S.36 is still the means of addressing issues related to **Clause 6(4)(k)** - a "**material change in circumstance**". It allows the Regulator to revoke an arbitrated award if all parties agree. If the parties do not agree, the Regulator has the discretion to refer the matter to arbitration. In deciding whether to refer a dispute to arbitration, the Regulator has to consider if there has been "**a material change in circumstances**" since the award was made or last varied.

The Governments have not included a provision that requires the parties to negotiate the definition of "**material change in circumstance**" for inclusion in each contractual arrangement. The Governments argued that the Regime does not preclude negotiation of this condition and if there is a dispute, the normal dispute resolution processes are available. Therefore, the matter does not need explicit provisions. Parties are still free to negotiate what constitutes "**a material change in circumstances**" as part of their access negotiation.

Dispute trigger - S.13(b) nominates no specific timeframe after which the access seeker can have its proposal referred to arbitration. However, 12B now allows the Regulator to intervene at any time in the negotiation period. In support, S.14 allows the access seeker to request the Regulator to refer the matter to conciliation or arbitration.

The Council considers that a Regulator ensuring compliance with a Regime certified under Part IIIA, will ensure that the timeframes contribute to a framework that moves quickly towards agreement and so does not deter access.

Lengthy negotiations increase costs for all parties. Access seekers who anticipate lengthy negotiations would be deterred from seeking access. Should such practices become evident, the Governments argue the Regulator is able to intervene to rectify the situation. Given the proposed Ministerial Review after three years of operations and the

Regulator's powers and functions, the Council considers that there are sufficient opportunities to develop and review trigger points for dispute resolution.

3 Competitive neutrality

The Regime contained no commitment to separate the areas of the access provider that would be dealing with above and below rail business. The Regulator had not been assigned the task of defining ringfencing arrangements and so it could not be assumed to have sufficient powers to deal with this issue. A number of submissions to the draft recommendation noted the ease with which access seeker information could inadvertently pass to a person with a conflict of interest. The Governments agreed to amend (underlined) S.12A:

12A. ***(****1) Information obtained under this Division that—*

(a) could affect the competitive position of an access seeker or a respondent; or

(b) is commercially valuable or sensitive for some other reason,

is to be regarded as confidential information.

(2) A person who obtains confidential information under this Division must not disclose that information unless—

(a) the disclosure is reasonably required for the purposes of this Code;

(b) the disclosure is made with the consent of the person who supplied the information;

(c) the disclosure is required or allowed by law;

(d) the disclosure is required by a court or tribunal constituted by law; or

(e) the disclosure is in prescribed circumstances.

Penalty: $10 000.

(3) A person who obtains confidential information under this Division must not (unless authorised by the person who supplied the information) –

(a) disclose the information to an unauthorised person; or

(b) use (or attempt to use) the information for a purpose which is not authorised or contemplated by this Code.

Penalty: $10 000.

(4) Subclauses (1) ,(2) and (3) do not prevent or restrict the disclosure of information to the regulator and the regulator may in any event disclose confidential information if the regulator is of the opinion that the public benefit in making the disclosure outweighs any detriment that might be suffered by a person in consequence of the disclosure.

(5) A person who obtains confidential information under this Division must not use the information for the purpose of securing an advantage for himself or herself or for some other person in competition to the person who provided the information.

Penalty: $100 000.

(6) The access provider must, in connection with the operation of this clause, develop and maintain policies to ensure that confidential information obtained by the access provider under this Division is not:

(a) used in any unauthorised way of for an unauthorised purpose; or

(b) provided to an unauthorised person.

(7) The access provider must provide a copy of a policy that applies under subclause (6) to the regulator, and to any other person who requests a copy from the access provider.

(8) In this clause –

"unauthorised person" means a person who is directly involved, on behalf of the access provider, in the promotion or marketing of freight services or passenger services but does not include a person whose involvement is limited to –
(a) strategic decision making;
(b) performing general supervisory or executive functions; or
(c) providing technical, administrative, accounting, service or other support functions.

S.12A now takes a more stringent approach and structures a series of penalties for disclosing and misusing confidential information.

S.12A(5) imposes a penalty of $100,000 on a person who uses confidential information for commercial gain. At the time the draft recommendation was issued, S.12A provided for a penalty of $10,000 for any party that misused any commercially sensitive information. In its submissions to the draft recommendation NRC requested:

> Penalties sufficiently large to act as a genuine deterrent. The penalty specified in s.12A of the AustralAsia Railway (Third Party Access) Act 1999 ($10,000), does not seem sufficient when contrasted to the scale of financial loss to which an incumbent operator would be exposed by potential competition. For a contract valued at say $2 million per year revenue (not a large contract) with a modest contribution margin (say 15%), the risk of a fine of only $10,000 (if detected) for mis-using information is not in proportion to the much larger profit placed at risk.

In response, the Governments agreed to increase the penalty for attempting to gain commercially from the misuse of confidential information to $100,000 and nominate further offences.

S.12A(2) now imposes a penalty of $10,000 on any person who discloses confidential information outside specified circumstances.

S.12A(3) imposes a penalty of $10,000 on any person who discloses confidential information to an "unauthorised person" – defined in S.12A(8) as a person directly involved in marketing the access provider's above rail business but specifically excluding persons who are limited to non marketing functions.

The Council was at first concerned that these exemptions appeared too broad. However, the Governments argued that the access provider's staff numbers were likely to be small, and a more stringent range of exemptions or structural definition could impose unsupportable costs on the access provider.

These latter penalties were set at $10,000 rather than $100,000 as the Governments argued that offences outside misuse of information could be inadvertent and so should receive a lesser penalty. A person who came by such information and then used it for commercial benefit should attract the higher penalty.

The Council considered that this could prove a sufficient deterrent but would recommend that this be reviewed by the Ministerial review scheduled to occur after three years of operations.

Imposition of these penalties requires court action. However, S.s 42 and 43 provide for the Regulator to bring such court action. Hence it is not the sole responsibility of the access seeker to take action to gain redress for abuse of its confidential information.

S.12A(6) and (7) requires the access provider to develop policies indicating how it will handle confidential information to avoid breach of these requirements.

Conclusion

The Council considers that the negotiation framework satisfies ***Clauses 6(4)(a)-(c), 6(4)(e), 6(4)(k), 6(4)(m)*** *and* ***6(4)(n).***

3 TERMS AND CONDITIONS

3.1 PRICING

The Regime includes two approaches:

1. "**sustainable competitive"** pricing; and
2. "**floor/ceiling**" pricing.

These approaches have been significantly changed since lodgement. These changes are detailed in the following assessment.

A summary of the current pricing system is provided below in both diagram and dot point form:

- On receipt of an access proposal, a freight service will be tested to see if it meets the **"sustainable competitive"** pricing criteria. These criteria have been significantly tightened.

- If the rail service meets these criteria, a formula, using the price of a competing non rail freight as its benchmark, will determine the total freight price. This will be adjusted to ensure comparative integrity – for instance deductions necessary to reflect the additional transport costs required to deliver the freight "door to door". From this benchmark is deducted the above rail avoidable costs of the incumbent rail provider, to determine the access price payable. This price must lie between a floor/ceiling band, calculated on the basis of forward looking efficient costs.

- If the service does not meet the **"sustainable competitive"** criteria, it will be priced under a "**floor/ceiling"** approach, based on the forward looking efficient costs of the infrastructure necessary to provide the service. Passenger services will always be priced under the floor/ceiling approach.

- Competitive neutrality is taken into account explicitly in the "**floor/ceiling**" approach. Given that the "**sustainable competitive**" approach should only capture

those services under effective competition, it allows entry only on the basis of relative efficiency of above rail operations. It therefore can take competitive neutrality principles into account as it encourages entry by the most efficient operator rather than the operator with an affiliation to the access provider.

- A review to test for monopoly rents is held periodically (first after 10 years and then after each successive 5 years). In that review all revenues (relating to the assets used to provide the services priced under the "**floor/ceiling**" approach) are totalled and compared against the efficient stand alone costs of the assets required to deliver the "**floor/ceiling**" services, to test for monopoly rents. If monopoly rents are found, the remedy (of reducing prices for the next period to remove anticipated monopoly rents for that period) will only be applied to the prices of the "**floor/ceiling**" services. Competition is considered sufficient to constrain the ability of prices to include monopoly rents under the "**sustainable competitive**" approach.

- A public review of the whole Regime by the Ministers, assisted by the Regulator, is scheduled to occur three years after operations commence. This review should assess the operation of both pricing approaches as well as previewing how likely it is that the ceiling will be breached by the "**floor/ceiling**" revenues, in combination with the "**sustainable competitive**" revenues. This review should provide an opportunity to make the changes necessary to ensure the continuing effectiveness of the Regime. It should also provide the Regulator with sufficient information to adjust prices going forward, in anticipation of the 10 year review or provide sufficient information to request a change in that review timetable.

Pricing under the Regime

Access seeker identifies an interest in a particular service

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Access provider considers whether this service fits the "**sustainable competitive**" criteria – is it under the "**effective constraint**" of a non-rail service?

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Approach 1. AP = $CRLP_{AB}$ – IC_{AR}

If **yes,** the **access provider** determines the below rail access price by:

CRLPAB - setting this competitive benchmark based on the price of the non rail substitute service.

ICAR -estimating and deducting from the benchmark, **CRLPAB,** the avoidable above rail costs that are not incurred by the incumbent if it did not provide the service.

AP – setting the residual as the access price – it represents the most an access provider could charge for the below rail service while still allowing those operators more efficient than the incumbent to enter the market and compete with the non rail service.

Within the band- determining if the residual is equal to or exceeds the avoidable cost **floor** but is less than the stand alone cost **ceiling** for that below rail service, based on forward looking efficient costs (with capital costs adjusted where appropriate for the cash and asset subsidies)**.**

Competitive Neutrality – The approach allows entry on the basis of relative efficiency of above rail operations. It therefore implicitly takes competitive neutrality principles into account during its operations.

Approach 2. Floor/ceiling

If **no,** the **access provider** determines the below rail access price by:

Floor - assigning the avoidable costs of that service as the **floor**(as in the final step of Approach 1) based on forward looking efficient costs.

Ceiling – determining the relevant **ceiling** for the assets used, based on forward looking efficient costs (with capital costs adjusted where appropriate for the cash and asset subsidies). The relevant price ceiling cumulatively takes into account the contribution to capital costs made by other access seekers using those same assets by deducting from that ceiling all revenues (both avoidable and fixed cost contributions**)** received as at the date this price is set.

Access price- An access price is then negotiated between this floor and ceiling.

Competitive Neutrality – An arbitrator can take account of prices charged to other users including the access provider's above rail operations. However, it should consider the efficiency effects of any common or differential pricing.

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Pricing Review.

After 3 years of operations, the Ministers, assisted by the Regulator will undertake a comprehensive review of the operation of the Regime. This review will include all aspects of the pricing approaches.

After 10 years of operations, the Regulator tests for monopoly rents against the assets used by the group priced under the "**floor/ceiling**" approach set by S.50 by:

- setting the stand alone cost benchmark for the infrastructure used by the group, based on efficient costs;
- deducting the revenues received from all users of the relevant assets from the stand alone cost benchmark.

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If the result is **positive**

- the access provider and/or the Regulator must implement a plan that ensures that price reductions for the "**floor/ceiling**" group anticipate that there will be no excesses in the following period. No price reductions are made for the "**sustainable competitive**" group.

If the result is **zero, or negative**

- the access provider need take no further action

3.1.1 General issues

Competitive markets drive firms to offer prices that reflect the lowest costs they can achieve. In natural monopoly markets, competition is not available to drive costs down to this level. Part IIIA proposes that access Regimes should substitute for competition in markets featuring a natural monopoly supplier providing essential services to potentially competitive upstream and downstream activities. To do this, access Regimes need to contain mechanisms that can replicate competitive market outcomes, including those for pricing, while taking into account the characteristics of the monopoly infrastructure.

Natural monopoly infrastructure is often characterised by a high volume of available capacity relative to initial demand - suppliers often operate with significant spare capacity in their early years of operations. The high capital costs and long asset life - characteristics of such infrastructure - commonly mean that access providers face declining unit costs as demand gathers pace. Setting prices to average costs may result in prices too high to encourage access and result in increasing unit costs as demand further declines. However, setting prices to marginal costs may result in prices that are too low to secure the viability of the access provider.

Pricing approaches for natural monopoly services generally recognise these conditions. At a total revenue level, they commonly aim to recover no more than the long term efficient costs attributable to the services demanded. At an individual pricing level, they aim to recover all those costs directly attributable to the consumer, as well as a proportion of common costs. To preserve economic efficiency, the proportion of common costs charged to each consumer needs to cause little change in the demand of that consumer – that is it should correctly estimate the consumer's "**ability to pay**".

Estimating this margin above direct costs can create a secondary problem for revenues – it can allow total revenues to exceed the efficient costs of supply. A group of customers may face prices that include too large a proportion of common costs. Their combined revenues may then exceed the long term efficient cost benchmark – the access provider would then make monopoly profits. To prevent this outcome, a natural monopoly under regulatory control is commonly subjected to a total revenue constraint.

Relevant CPA criteria

Clause 6(4)(a)-(c) – negotiation framework, terms and conditions should facilitate and not preclude efficient access.

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Clause 6(4)(f) - differential pricing should be permitted.

Access to a service for persons seeking access need not be on exactly the same terms and conditions.

Clause 6(4)(i) – conditions the arbitrator (and hence the negotiation) should take into account. Arbitration should support negotiation.

In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;
(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;
(iv) the interests of all persons holding contracts for use of the facility;
(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;
(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;
(vii) the economically efficient operation of the facility; and
(viii) the benefit to the public from having competitive markets.

Clause 6(4)(m) – access provider should not hinder access

The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

Clause 6(4)(n) – accounting separation of businesses

Separate accounting arrangements should be required for the elements of a business which are covered by the access regime

The Council considers that the pricing approach taken in arbitration will strongly influence the approach taken in negotiation. **Clause 6(4)(i)** is mindful that prices need to take account of the facility owner's legitimate business interests, but at the same time, prices should be set, in the public interest, to reflect those that could be expected if the market was competitive. Such prices should lead to the economically efficient operation of the facility.

With regard to **Clause 6(4)(a)-(c)**, the Council considers that the Regime should not constrain or deter the parties from negotiating prices coincident with outcomes anticipated in arbitration. While containing a robust arbitration mechanism, the Regime should minimise the need to use that mechanism, clearly placing negotiations within the boundaries of anticipated arbitration outcomes.

While the Regime need not require that all prices be the same (as required by **Clause 6(4)(f)**), the use of differential pricing should not hinder access (and so comply with **Clauses 6(4)(a)-(b) and (m)).** For instance, an unaffiliated rail operator should not face prices that are substantially higher than the access provider's affiliated rail operator for the same or similar services.

The appropriate separation of accounts, as required by **Clause 6(4)(n)**, supports the application of competitive neutrality as well as efficient pricing by:

- ensuring only those costs attributable to the below line operations are used to determine "**floor/ceiling**" parameters;
- that above rail costs are set appropriately in the above rail deduction required in the "**sustainable competitive**" approach; and
- assisting in the verification of prices and application of competitive neutrality principles.

Ensuring that this separation is appropriate is an important function of the Regulator.

On application, the Regime contained a range of problems that the Council and participants considered were inconsistent with these criteria. The Governments have since made many changes to the pricing approaches.

The two pricing approaches are detailed below, after a discussion of some general pricing issues such as using efficient costs in price calculations, competitive neutrality between affiliated and unaffiliated operators, the treatment of cash and asset subsidies and the inclusion of the affiliated operator's above rail revenues in the calculations of recovered costs.

A) Costs should be efficient

On application, the pricing principles did not necessarily require the use of efficient costs to establish parameters - actual costs and mandated formulas resulting in a cap that doubled average costs could be used. As noted by NRC, a rail price cap of twice average (below-rail) costs could allow for the collection of monopoly rents.

The Governments argued that access seekers priced under the "**sustainable competitive**" pricing approach needed no verification that efficient costs had been used. The competitive price benchmark was by definition, an efficient price. The Council considered that this would only be the case if the benchmark and deductions were set appropriately and was concerned that the definitions and cost calculations implementing this approach may not deliver appropriate benchmarks, above rail deductions and, consequently, access prices.

With regard to the second approach, the Council considered that the "**floor/ceiling"** parameters would need to be based on efficient costs to ensure that the appropriate boundaries are set.

Assessment of the NT/SA Governments' response

The proposed definitions and cost calculations implementing the "**sustainable competitive**" approach can now set more appropriate benchmarks, deductions and access prices (see **"sustainable competitive"** pricing approach). Prices under this approach will need to occur within a floor/ceiling band. The Regulator must now develop guidelines to guide the operation of the "**floor/ceiling**" approach, using efficient forward looking costs.

At the draft recommendation, the Regime prescribed that a "**depreciated optimised replacement cost**" (DORC) methodology be used to value assets. The Council had asked that the Regime allow the Regulator full discretion to take account of the cash and asset subsidies (provided by the Commonwealth, State and Territory Governments) in any element of the capital costs it considered appropriate. The Council was concerned that mandating a DORC valuation could unreasonably limit the Regulator's discretion. The Governments have now made amendments that meet the Council's concerns on this issue (more fully discussed below under Cash and Asset subsidies). While DORC is still the prescribed valuation methodology, its use has been qualified in two ways:

- the Regime allows the Regulator to make adjustments to this valuation for the cash and asset subsidies; and
- such adjustments should not prevent the access provider from making an appropriate return on the capital it has invested.

Conclusion

The Council's concludes that the costs the Regime proposes to use as a basis for calculating prices can reflect the efficient costs of supply.

B) Stand Alone Cost Units

A fundamental issue is the establishment of the appropriate cost units used for cost calculations. In its review of the NSW Rail Access Regime, IPART noted the implications of differing approaches to track segmentation.

> Sectors which are too small increase the proportion of costs avoided if operators' cease services. Conversely, Sectors which are very large result in very few costs being avoidable for any given traffic. Similarly, too small a line Sector may increase the subjectivity in allocating common costs. The optimal size of each Sector needs to be considered in light of traffic mix, usual routes and density. The NSW Network was segmented into 239 Sectors. Sectors averaged 36km in route length with a shorter average length in the Hunter Valley of 14km.

The Council's assessment

The AustralAsia Railway is yet to be fully constructed. Cost units are yet to be developed. Yet how these units are set is an important issue in achieving efficient costing. The Council considers that the Regulator will need to establish the stand alone units and the assets that comprise these units (taking into account the requirement that the Regime cover only those assets that meet the criteria contained in **Clause 6(3))** before it can commence regulating prices.

The Ministerial review after three years of operations, will provide a forum to assess this issue, in conjunction with other aspects of the pricing approaches. For instance, adjustment provisions for the cash and asset subsidies in S.2(8)(b) of the Pricing Schedule, require that any adjustment be "**pro rated**" over the below rail infrastructure. This matter will need to be considered in the development of cost units.

Conclusion

The Council concludes that the Regulator has the ability to ensure that the stand alone units reflect the efficient costs of supply of relevant services.

C) Competitive neutrality in pricing

Where ownership characteristics give one party an advantage over those it competes with, mechanisms in the Regime must ensure that these advantages are neutralised. These mechanisms can include increased transparency and/or regulation over areas likely to provide an advantage. Regulation is needed as the access provider has the incentive to charge unaffiliated operators a higher proportion of common costs than the affiliated operator. This would reduce the competitiveness of unaffiliated operators, deter their access and so constrain the development of competitive pressures on the affiliated operator.

Certification issues

The original Regime did not explicitly cater for competitive neutrality principles in pricing. To the contrary, S.24 allowed for significant differences in pricing, including the negotiation of prices outside the nominated parameters.

ARTC expressed concerns that S.24 allowed prices to be set outside the pricing principles. It considered this undermined the intent of a Regime under Part IIIA, in so far as, it allowed the access provider to collect monopoly rent, cross-subsidise parts of the network and differentially price in a way that may selectively deter access.

NRC stated that, issues relating to differential pricing across operators were crucial for the effectiveness of the Regime, particularly given that the access provider would be a competitor in the above rail market. All operators expressed strong concerns at the ability of the access provider to differentially price across operators. The submissions did not raise concerns about differentially pricing across product markets, as long as all operators were treated equally.

ARTC supported the approach in the Regime proposed for Queensland Rail that explicitly stated how competitive neutrality principles would be addressed.

The NT/SA Governments' response

The Governments argued that the "**sustainable competitive**" approach to pricing did not require any additional mechanisms to ensure competitive neutrality principles were applied. They argued that the approach implicitly practised these principles – it used a formula in a consistent way that favoured only those operators more efficient than the benchmark operator. They therefore considered changes need only be made to the "**floor/ceiling**" approach. The Governments agreed to delete S.24.

The Governments also agreed to include a new provision to cover competitive neutrality in pricing under the "**floor/ceiling**" approach:

> *Pricing Schedule 2(5)*
>
> *The arbitrator must, in determining a price under this section, have regard to economic efficiency taking into account the prices being charged by the access provider to access holders for the same or similar services (including, if the access provider, a related body corporate or an associate has conducted the same or similar services on the railway, the actual prices charged in relation to those services).*

The Council's assessment

The Council considers that the "**sustainable competitive**" approach should determine prices using common factors and allocate timepaths according to the relative efficiency of operators rather than their degree of affiliation with the access provider.

Under the "**floor/ceiling**" approach, the Arbitrator is directed to take economic efficiency into account when considering matters related to differential pricing. This should impose competitive neutrality principles in a way that does not diminish efficiency.

Additionally, the Ministers must now review the Regime after 3 years of operations. General provisions (S.45A) allow the Regulator to develop and publish guidelines related to costs and to verify that a negotiated outcome complies with the Regime (S.12B) - in this case to verify if the price is competitive relative to those charged to other operators providing the same service.

Conclusion

The Council considers that competitive neutrality principles can be taken into account in the pricing approaches.

D) Inclusion of the access provider's above rail revenues in cost recovery calculations

The NT/SA Regime – as initially submitted

In a number of areas of pricing, the level of costs recovered from access holders is measured against the level that a competitive market would allow an efficient access provider to recover. The existence of an excess of recovered revenues over those a competitive market would allow is likely to trigger remedial action. Hence, the accurate measurement of each of these values is critical to ensure remedial action is triggered at the appropriate time.

Some cost recovery calculations were to be based on the revenues from "**access holders**". The initial definition of "**access holder**" under S.3 was:

> *... a person who has a right of access to railway infrastructure facilities.*

This definition did not explicitly include the access provider's above rail operator. If these revenues were not included, revenue calculations would not result in accurate values - they would be too low.

NT/SA Governments' response

S.3 of the Regime now defines "**access holder**" as:

> *... a person who has a right of access to railway infrastructure facilities and includes the access provider if or when the access provider is providing a freight service or a passenger service by means of the railway;*

Conclusion

The Council considers this amendment addresses its concerns.

E) Treatment of the cash and asset subsidies

In its draft recommendation the Council indicated concern that the Regulator could be constrained in its consideration of the effects on capital costs of the Governments' cash and asset subsidies[6] if the Regime precluded the Regulator from making adjustments to the asset valuation.

The Council considered that it had too little detail of the returns anticipated by Governments (in terms public benefits and residual asset values) from these subsidies to establish their values to the Governments and access provider and their resulting effects on the individual capital cost elements. It considered that the powers of the Regulator and the time available to it prior to the commencement of operations would make it more able to analyse the necessary information and make any appropriate adjustments. Given the complexity of the arrangements, the Council did not wish to prescribe how the Regulator should perform this task. The Council wished to allow the Regulator full

[6] The Governments of the Northern Territory and the Commonwealth have undertaken to contribute $165M each. The Government of South Australia has undertaken to contribute $150M. The Commonwealth Government has also undertaken to lease to the access provider the line from Tarcoola to Alice Springs (estimated to equate to $500M) at a minimal rent.

discretion to take the effects of the subsidies through any capital cost components the Regulator considered appropriate.

The Governments wished to constrain the Regulator to take the effects only through the rate of return calculation. They considered this could be achieved by prescribing the asset valuation methodology as "**depreciated optimised replacement costs**" (DORC). The Governments considered that mandating DORC, while leaving the rate of return open for the Regulator to determine, established a level of certainty on expected revenues that the access provider (and its financiers) could accept.

Submissions to the Council's draft recommendation indicated significant disquiet regarding this matter. They considered that in mandating a DORC valuation, the access provider could set prices to a ceiling that included a rate of return on the capital invested by both the access provider and the Governments. FreightCorp (second submission) considered that:

> ... this is a flawed approach setting a dangerous precedent for future regulatory regimes. ... It is ... unclear how the NT/SA Governments' approach will lower risk for the financiers unless the rate of return was discounted by less than an amount to offset the inflated asset base. Indeed the proposition appears "prima facie" as disingenuous and an attempt to disguise the issue of including gifted assets.

In an attachment to NRC's (second) submission its consultant, Meyrick & Associates, stated that:

> ... the substantial government contribution indicates a belief that, if a commercial rate of return were to be required on all of the contributed capital, the project would not be financially viable. This is implicit in the Prime Minister's statement that 'the three governments have agreed to commit sufficient funds to enable the project to go ahead'. ... It seems reasonable to infer that the governments concerned decided to provide the subsidy in a deliberate attempt to produce a transport outcome that differs from that which would result if the process was left entirely to market forces.

Meyrick and Associates further stated their view that the Governments' decision to contribute capital implies a prediction that the project lacked commercial viability. Meyrick and Associates considered that pricing on an asset base that did not adjust for the cash and asset subsidies would price too high, lower demand and destroy the benefits (flow on regional development, economic effects from growing rail traffic and creating competitive pressure on current non rail transport modes) that the subsidies hoped to obtain. The Council saw merit in these arguments.

A number of submissions also noted the contrasting risk conditions of the established track from Tarcoola to Alice Springs and the yet to be constructed track from Alice Springs to Darwin. ARTC noted that the arguments for special treatment, given the "**greenfield**" nature of the project, did not apply to the track from Tarcoola to Alice Springs. Current operators, such as Great Southern Railways and NRC, were concerned that a DORC approach to valuing this line could justify a significant rise in prices, destabilising current businesses. They also considered that this would not reflect the cost nor risk to the investor as it had been protected from a high proportion of capital costs by the subsidies and a high proportion of operational risk by the services already established on this line.

Views of consultants that assisted the Council's assessment

Following the draft recommendation, the Council sought further advice on this issue. It obtained the assistance of Professor Joshua Gans, from the Melbourne Business School together with its consultant, Professor Henry Ergas. The Governments sought the assistance of Professor Bob Officer also from the Melbourne Business School.

Although the consultants took varying perspectives on the questions raised, the common thread was that the cash and asset subsidies needed to be accounted for in some way to avoid counting returns twice.

Professor Officer recommended that if DORC was adopted, the equivalent value of the community services the cash and asset subsidies were designed to produce must be taken through revenues to avoid double counting.

Professor Gans looked at why the Governments (on behalf of the access provider) and the potential access seekers, took such strongly opposing views:

> The basic trade-off arises because regulated access prices determine the division of economic surplus between rail providers and rail access seekers. Hence, by adjusting asset value for government contributions, access prices will be lower; conferring benefits on seekers at the expense of providers. From an economic efficiency perspective, this division has meaning because it influences the investment incentives of each party. And these forces lie at the heart of the differing views in this debate.

While recognising the reasons for the strongly opposing positions of the Governments and the access seekers, the Council has the specific role of ensuring efficient use of natural monopoly infrastructure. Pricing should be structured so that the access provider received an appropriate return on the capital it invests, while ensuring that bypass construction is not encouraged and competition is promoted in related markets. Critical to setting prices that achieve these goals are the capital cost settings.

As Professor Gans noted, prices set too high would reduce the identified public benefits of the project – the objective of the cash and asset subsidies:

> ... In particular, it would appear to me that the Governments are subsidising one type of investment – rail provision – but not choosing to have the subsidy flow to other complementary investments. However, the encouragement of these investments is part of the stated external benefit from the infrastructure provision. Hence, to value assets in a way that ignores the subsidised component is to distort long-term resource allocation in the economy. ... In the end, there is too much rail investment relative to the level of complementary investment.

Professor Gans concluded that, to reduce regulatory risk, the methodology for adjusting for the cash and asset subsidies should be agreed before certification, assuming time allowed.

Professor Ergas remained strongly of the view that the Regulator should have full discretion to take the cash and asset subsidies into account through the capital costs.

He estimated that to meet basic fiscal and competitive neutrality benchmarks, the returns on the Governments' investments must at least equal the opportunity cost of the

subsidies (at a minimum the risk-free rate). He noted an ancillary effect: that the subsidies reduced the risks, and therefore the costs, faced by private investors:

> (1) The required return on public sector investment will, subject to a set of important conditions which seem to hold here, approximate the risk-free rate; and
> (2) Where public investment serves to insure the returns available to other types of funding, as seems to be the case here, the return required to obtain those other types of funding will be lower than it would otherwise have been.

Professor Ergas considered that each of these effects could be quantified if the appropriate information (including the cash equivalent of the assets transferred, the exact conditions attached to the resulting claims, and the best available estimates of the project's income stream) was available. However, he considered that given the volume and complexity of the information required and the need for simultaneous assessment of a range of issues, the task was best left to an "**expert finder of fact**" - the Regulator. In fact, Professor Ergas saw some danger in excluding the Regulator from considering all these issues contemporaneously:

> Precluding the regulator from considering these issues would likely result in a WACC that did not reflect the opportunity cost of capital. This would distort ceiling prices for the project's services, and to the extent to which these prices were relevant, could reduce efficiency in the use of those services. The Governments' view that they, rather than the regulator, should determine the required return on the financing provided may therefore result in conflicts with the efficiency objectives of the Competition Principles Agreement, as well as implying that Governments, when they invest, ought to be treated differently from their private sector counterparts.

Professor Ergas also disagreed with the Governments in their claim that excluding the Governments' contribution from earning a rate of return for private investors would result in the project not going ahead. He noted that there were special provisions in the Regime to ensure that ex ante risks were taken into account:

> They effectively suggest that such an exclusion would lead to regulated returns below those required to bring forth investment. This seems difficult to accept. The regime requires the regulator to determine a rate of return that in an ex ante sense would have induced the investors to bear the risks involved in the project. The Governments' must therefore be assuming that the regulator will act in breach of the regime (and do so in the direction of providing a lower, rather than higher return).

With regard to guaranteeing the access provider certainty through mandating a DORC (or ODRC) valuation methodology Professor Ergas considered that:

> There are nonetheless a range of interpretations of the ODRC concept[7], with differing interpretations being capable of yielding substantially different results[8]. It is therefore questionable, as a practical matter, whether specification of ODRC would materially reduce uncertainty.

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[7] There is, for example, no agreement as to the proper determination of depreciation in an ODRC system nor more generally of the articulation between the income statement and the balance sheet under ODRC.

[8] For example, the ODRC approach set out by the ACCC in its Guidelines on transmission regulation do not seem to allow depreciation provisions that include the change in the present value of O&M as between the existing and optimised plant. This can have a very substantial effect on project cash flows.

A note on asset valuation methodologies

Accepted approaches to asset valuation are commonly divided into two main groups:

1. *Value based* approaches that use the income the assets could generate from either revenue or sale as the basis for valuation.
2. *Cost based* approaches that look to the cost of reproducing the service potential of the assets in place.

A hybrid approach considers both value and costs.

Value based (economic value)	**Cost based**	**Hybrid**
Net present value: equates to future predicted income, discounted at a rate to reflect the risk of achieving this income. **Net realisable value**: current market price	**Historical cost:** equates to purchase costs. Can be adjusted for inflation and depreciation to make more relevant in a current context. **Reproduction cost:** the costs of reproducing the existing plant using the same technology and scale. **Replacement cost:** the current cost of replacing assets able to provide equivalent services in terms of quality and quantity. Depreciation can adjust for loss of service potential in terms of asset life. Optimisation can adjust for excess assets.	**Deprival value:** the predicted loss from being deprived of the benefits derived from the assets. **Optimised Deprival Value** (ODV): the lesser of Depreciated Optimised Replacement Cost (DORC) and Economic Value (EV).

Source: QCA, *Queensland Rail – Draft Undertaking Asset Valuation, Depreciation and Rate of Return*, p. 5.

Each approach has its limitations. The problem with the *net present value* approach in monopoly markets is one of circularity. Monopolists are able to set prices with market power. These prices then influence future income and the discount rate, and so, the asset value. While *historical cost* demands fewer subjective judgements, it loses meaning over time as current values increase relative to historic values and technology changes. *Replacement cost* uses a current value base. However, it involves greater subjectivity and can prove costly if verification of these judgements is required.

The replacement cost base estimates the current cost of assets that can provide similar service potential to those in place. This does not necessarily preclude purchasing already constructed assets from the market place, allowing an element of market value to intrude in the valuation.

The magnitude of a replacement cost valuation generally reduces through the adjustments made to reflect depreciation and optimisation. Deducting for depreciation reduces this base to reflect the existing asset's remaining economic life. Optimisation allows further reductions attributable to the ability of the replacement asset to achieve the service potential demanded at lower cost due to a different configuration or better technology.

The Council's consideration of consultant's advice

The Council notes the CSO approach recommended by Professor Officer but also notes that the Regime would need to be restructured to incorporate this approach. Given that the Governments had emphasised the need to conclude the certification process as soon as possible, the Council constrained its assessment to taking the effects of the cash and asset subsidies only through capital costs – a mechanism that had already been progressed with the Governments.

The Council notes that under a DORC approach, the magnitude of a replacement cost valuation generally reduces through the adjustments made to reflect depreciation and optimisation. However, it is advised by Professor Ergas that the theory of regulatory asset valuation is an evolving science and that the approaches taken to DORC have and will continue to differ. He considered that there were risks in prescribing a DORC for such a long period. Evolution of its development could make it inappropriate in this application over time. He also considered that, given the range of interpretations of DORC, the Governments could not be certain that they would achieve the outcome they anticipated – mandating a DORC valuation may not give the Governments the certainty they desired. Professor Ergas also considered that application of commonly used rate of return mechanisms may not be capable of handling all the effects of the cash and asset subsidies and that some of these effects may need to be taken through the valuation.

After consideration, the Council concluded it was prepared to accept the mandating of DORC on condition that the Regime specified that its application in this context should take account of the cash and asset subsidies granted by the State and Federal Governments. To provide the access provider with more certainty, the Council was willing to constrain the downside risk of any adjustments made to the valuation. It would require that the valuation be adjusted by no more than allowed the access provider an appropriate return on the capital it invested, in accordance with criterion **6(4)(i)(i)** of the CPA (requires that the arbitrator take into account *"the owner's legitimate business interests and investment in the facility"* when arbitrating disputes).

NT/SA Governments' response

The Governments now propose that the cash and asset subsidies be taken into account in the Regime's "**floor and ceiling**" applications as set out in S.2 and S.3 of the Pricing Schedule.

For the ceiling price, the amendments read:

> *S.2(7) The guidelines* [to be developed by the Regulator] *must –*
>
> *(a) subject to subsection (8), adopt an approach for valuing capital assets which reflects the Depreciated Optimised Replacement Cost for those assets;*
> *(b) provide guidance on the timeframes within which the regulator considers costs could be avoided; and*
> *(c) in relation to a return on assets, have regard to —*
>
> *(i) the appropriate risk premium associated with the construction, development and operation of the railway infrastructure facilities, based on both of the following:*
> *(A) the expected risks prevailing as at the date of commencement of construction of the railway by the access provider; and*

(B) in respect of any expansion or extension of the railway after the date of commencement of construction of the railway by the access provider—the expected risks prevailing as at the date of the commencement of construction of that expansion or extension; and

(ii) the relevant financial market rates (including the risk free rate for return on investments and the rate of inflation);

(and may include other provisions considered appropriate by the regulator).

(8) The guidelines may, if the regulator thinks it appropriate to do so, allow an adjustment to the Depreciated Optimised Replacement Cost valuation of capital assets under subsection (7)(a) on account of government-contributed assets and other government financial assistance after taking into account any associated liabilities assumed by the access provider, subject to the qualifications that any such adjustment:

(a) must not, when used in calculating the ceiling prices specified in sections 1(4) and 2(2), prevent the access provider earning a reasonable risk-adjusted return on the capital invested in the railway (disregarding government-contributed assets and other government financial assistance); and

(b) must be made on a pro rated basis over the entirety of the capital assets comprising the railway infrastructure facilities.

These words are repeated in the definition of floor costs at S.3(4) of the Pricing Schedule.

The Council's assessment of the NT/SA Governments' response

While requiring the Regulator to adopt a DORC in S.2(7) and S.3(4), the guidelines allow for an adjustment to the DORC valuation to reflect the cash and asset subsidies in S.2(8) and S.3(5), as long as the access provider is not prevented from earning a reasonable return on the capital it invests - S.2(8)(a) and S3(5)(a).

The Council was keen to ensure that the Regulator considered the subsidies adjustment issue. The Governments have assured the Council that S.2(8) and S.3(5) should be interpreted as requiring the Regulator to consider adjusting the DORC valuations (the option must be included in the guidelines) and not as giving the Regulator the discretion to include or exclude the issue from its guidelines.

The Council was concerned that S.2(8)(a) and S.3(5)(a) were somewhat ambiguous. The words *"disregarding the government contributed assets"* might be misconstrued. The Governments stated that these sections were intended to net out the cash and asset subsidies from the capital cost benchmark. This would result in a reference benchmark for the calculation of the access provider's rate of return of only the capital the access provider had invested.

S.2(8)(b) and S.3(5)(b) requires that the adjustment for the subsidies be pro rated over all the assets comprising the rail line. The Governments argued that this would avoid disparities in prices across sections of track and the consequent distortions. For instance, if the Regulator substantially reduced the DORC value of the line from Tarcoola to Alice Springs to correspond with the price at which the assets were obtained, the prices for

travel on that piece of track may be significantly below those on the track from Alice Springs to Darwin. As noted under "**3.1.1B) Stand alone unit costs**" above, the Regulator will need to take this matter into account in setting its stand alone units. It will also need to take this issue into account when setting price and revenue ceilings.

Following clarification of these issues, the Council considered that the amended sections, in the main, paralleled the position it had reached.

Conclusion

The Council considers that the Regime's treatment of the cash and asset subsidies can produce prices that will comply with the relevant ***Clause 6*** *criteria.*

3.1.2 Approach 1 - Sustainable competitive pricing

This is an adaptation of the "**efficient component pricing rule**" (**ECPR**) approach. **ECPR** has featured in a number of regulatory decisions over past years, including those to do with the telecommunications industries. It assumes that the access provider conducts downstream services and so has sufficient information to set a total price for the bottleneck service plus the downstream service. From this total it deducts the costs it avoids by not providing the downstream service. The residual price is then offered to any access seeker. Those that find it attractive must be more efficient than the access provider. The access provider receives the same return whether it provides the service to itself or to any other access seeker and therefore, should be indifferent as to whether it or a competitor provides the service.

While based on **ECPR**, the "**sustainable competitive**" approach varies in as much as the total cost benchmark does not represent the combined costs of the access provider. It represents the price of a substitute service provided by a competitive non-rail mode of transport. The Regime provides for some adjustment of these prices to ensure the integrity of the comparative exercise.

This pricing approach was defined by the following formula:

$$AP = CRLP_{AB} - IC_{AR}$$

Where –

AP	is the access price;
$CRLP_{AB}$	is the sustainable competitive or the maximum price that could be charged for above and below rail services given that it equals the comparable freight service provided by another transport mode;
IC_{AR}	is the cost of the above-rail service component for the service.

A) Overall concerns on the approach

Most submissions expressed strong resistance to the inclusion of this approach in the Regime.

A large number of amendments were made before the draft recommendation was published. These were a response to the concerns expressed in the round of submissions

to the Council's issues paper. However, submissions to the draft recommendation still did not consider these amendments sufficient to allay their many and varied concerns.

For instance:

- the Department of Transport and Regional Services considered the approach would not allow ARTC to conduct its "**one stop shop**" function;

- NRC considered that the costs that the approach would impose on the negotiation process would exceed the purported benefits to the access provider from pricing certainty;

- FreightCorp considered that there were a range of ways the formula could be manipulated to determine an excessive price and foresaw the approach precipitating much disputation.

NT/SA Governments' response

S.50 now proposes that the Ministers will conduct a comprehensive public review of the Regime, including the pricing approaches, after three years of operations. The Ministers will seek the support of the Regulator in investigating and analysing issues raised by interested parties operating under the Regime. This investigation will need to include those areas flagged in this recommendation if they prove problematic during the first few years of the Regime's operation. The ensuing report must be tabled in the respective Parliaments of the Ministers.

The Council's assessment

The concerns of interested parties fell into two groupings both related to the perceived complexity of the approach:

1. The complexity opened the approach to abuse, encouraging disputes and increasing negotiation costs.

2. The complexity made the approach impractical. It would prove so cumbersome and costly to go through the necessary steps, that access seekers would be deterred from entry.

Amendments to address the first group of concerns prior to the draft recommendation primarily related to the powers and functions of the independent Regulator, particularly provided by S.12B (which allows it to verify that the outcomes fulfil the approach's requirements). Subsequent to the draft recommendation, the Governments amended S.50 to include a comprehensive public Ministerial review after three years of operations. The Council considers that these provisions should be sufficient to remove any abuse.

With regard to the second group of concerns, with the valuable assistance of Toll Holdings, the Council undertook an exercise to satisfy itself that the approach was indeed practical. This is discussed in the following box.

Practicality of the "sustainable competitive" approach

The Council used a linked spreadsheet model of the road and rail costs for calculating the access price using the "**sustainable competitive approach**" formula. The cost characteristics and main assumptions used in the model are outlined in Annexure 2.

In its base case model, the resulting rail access price was of between 0.25 and 0.30 c/gtk. This is within the range of access prices charged by other access providers for general rail freight.

This model demonstrated that the rule could be used because:
– road benchmark prices were available;
- road benchmark prices could be adjusted to ensure comparable integrity with like rail services;
- above rail costs could be calculated and deducted from the benchmark; and
- the resulting rail access price was within the range of access prices charged by other access providers.

To give some meaning to the results, the Council then varied some assumptions to test the sensitivity of the model. The assumptions varied were the number of trains, the volume of freight and the length of trains. The results are quite sensitive to varying the assumptions such as the number and frequency of journeys, the actual origin and final destination of the freight, the nature of the freight, the ability to back load from Darwin on the journey south, and the technology used in the rail journey.

The Council concludes that, although sensitive to changes in fundamental values, the exercise has given it confidence that the approach could be practised.

In coming to this decision the Council considered the Governments' original arguments for the use of this approach – it was included in this Regime because of the perceived certainty it provided in securing prices, and hence revenues, for the low volumes projected for this marginal "**greenfields**" project. The Council concludes that the exercise's scenarios that generated high prices are unlikely, given that they require volumes of freight far above those that are projected. Additionally, if high scale efficiencies through large volumes were achieved, given rail's advantage over road in such circumstances, it is unlikely that the non rail service could still be constraining the price of the rail service – the service would fail the benchmark test for this approach and so would be priced under the "**floor/ceiling**" approach.

Therefore, the Council considers that, while price outcomes from this approach will vary according to individual freight characteristics, the base case provides a useful benchmark for a range of freights. Notwithstanding, the Council takes considerable comfort that the application of this approach will be reviewed in the Ministerial review scheduled to occur three years after operations commence.

Conclusion

The Council considers that this approach can produce access prices that comply with the relevant ***Clause 6*** *criteria.*

B) Elements of the approach

The obvious issues determining the effectiveness of this approach go to its construction and the specification of the two determinants to the access price - $CRLP_{AB}$ and IC_{AR}. If either is set inappropriately, rail operators more efficient than the access provider may not gain access.

B1) $CRLP_{AB}$

The principal issues relating to how $CRLP_{AB}$ is set are:

- Construction of the threshold criteria, that determine what services come under this approach; and
- The integrity of the variations allowed to $CRLP_{AB}$ established by the benchmark non rail service.

The NT/SA Regime – as initially submitted

The Regime on application gave the following threshold criteria:

> *A sustainable competitive price will exist where it can be demonstrated that –*
>
> *(a) there are no regulatory, technical or other practical impediments to transport of the freight by an alternative mode or combination of modes; and*
>
> *(b) the lowest cost of transporting the freight by an alternative mode is less than the stand alone cost of transporting the freight over the relevant part of the railway, which costs are to be calculated on the following basis:*
>
> *(i) the costs associated with the operation of the railway infrastructure are to be limited to that portion of the railway infrastructure as is needed to satisfy the requirements of the access seeker (the "relevant infrastructure") and are to be calculated assuming the access seeker is the sole user of the infrastructure; and*
>
> *(ii) the stand alone costs are to include operating costs, being the on-going operational costs of the relevant infrastructure, including the labour and material costs that are causally related to the operation and maintenance of the relevant infrastructure and capital costs which include depreciation and a rate of return, based on the written down replacement cost of the relevant infrastructure and a nominal (after tax) rate of return on assets of 18%, where the tax rate to be applied is the corporate tax rate prevailing at the time or arbitration.*

The Regime allowed the following adjustments to the price of the benchmark service once it was judged to have passed the test:

$CRLP_{AB}$ is the competitive rail-linehaul price, being the maximum competitive price that the access provider could charge for the transport of freight between one point (point A) and another point (point B) on the railway having regard to –

(a) the prices charged for transporting the same or similar freight on the railway, taking into account, and where appropriate removing the effect of, any differences in –

(i) the type and volume of freight product involved;

(ii) cost or service characteristics (such as the time for delivery of the freight, rolling stock axle loadings, train length and train speed);

(iii) contractual terms (such as the duration and frequency of the access contract and whether the contract involves a take-or-pay obligation for specific volume of freight or some other risk allocation arrangement);

(iv) the time during which access to the railway is required and the available capacity of the railway to accommodate the proposed freight service and all other freight and passenger services of other users of the railway at that time; and

(v) the amount of freight and the prices charged in each direction; and

(b) the price charged for alternative modes of transporting the same or similar freight (for example, by road, sea, air or some other mode of transport or a combination of such means), which price must be sustainable in the long-run and allow for a replacement of capital and a normal commercial return (being a return that is consistent with the return in the market for investments of similar risk) and taking into account, and where appropriate removing the effect of, any differences in –

(i) any additional handling or transportation costs required in order to compare the total price of delivering the relevant freight product from the linehaul point of pick-up (of the alternative mode of transport) to the final linehaul point of delivery of the freight product, when compared to transporting the freight product from the linehaul point of pick-up to the final linehaul point of delivery via the relevant section of the railway between point A and point B;

(ii) the type of freight product involved, including its handling characteristics and the volumes of the freight product to be hauled and the contributions, if any, required to upgrade necessary infrastructure;

(iii) the amount of freight and the prices charged in each direction;

Certification issues

The Council was concerned that this approach did not impose a tight enough test to isolate and price only those services under effective competition. It appeared to allow the benchmark to be set by the highest price from a range of rail and non rail services and then allow a number of arbitrary adjustments to be made.

The benchmark price, $CRLP_{AB}$, needed to be less than the stand alone rail costs of supplying the above and below rail service. But the ceiling included components that could calculate these costs too high.

The combination of these two factors did not give confidence that services firstly, would be appropriately categorised, and secondly, would be priced against the appropriate competitive benchmark.

NT/SA Governments' response

The Regime now provides the following threshold criteria in S.1(2) of the Pricing Schedule:

> *(2) A sustainable competitive price will exist in relation to the transportation of a particular type of freight where it can be demonstrated that –*
>
> *(a) there are no regulatory, technical or other practical impediments to transport of the freight by a mode of transport other than the railway or combination of such alternative modes; and*
>
> *(b) the availability or potential availability of modes of transport other than the railway is an effective constraint on the price of transporting such freight on the railway having regard to the following factors:*
>
> *(i) the number and size of participants in the market;*
> *(ii) the type and volume of freight involved and any unequal backhaul loadings;*
> *(iii) whether there are any regulatory, technical or other practical barriers to entry;*
> *(iv) the extent of product differentiation in the market, including the differences in the ancillary services and convenience offered by different modes of transport;*
> *(v) the dynamic characteristics of the market including any fluctuations in demand for transportation services;*
> *(vi) the costs and service characteristics of transporting freight by different modes of transport (including the time for delivery of the freight, rail rolling stock or other vehicle axle loadings, length and speed of trains, and any infrastructure upgrade requirements);*
> *(vii) contractual terms (such as duration and frequency of service, whether for a specific volume or at call);*
> *(viii) congestion and bottleneck inefficiencies caused by constraining points on the road, railway or other relevant infrastructure;*
> *(ix) the safety requirements the different modes of transport are required to meet;*
> *(x) the direct and indirect costs of environmental impacts of the different modes of transport; and*
> *(xi) any other relevant matters.*
>
> *(3) Where there is a sustainable competitive price, the access price (AP) payable to the access provider by an access seeker for the railway infrastructure service will be a price determined by the arbitrator which is–*
>
> *(a) not more than the ceiling price for the provision of the railway infrastructure service (see subsection (4)); and*

(b) not less than the floor price for the provision of the railway infrastructure service (see subsection (5)),

but subject to these qualifications the price so determined will be calculated in accordance with subsection (6).

(4) The ceiling price is to be an amount equal to the costs associated with the operation of the required railway infrastructure needed by the access seeker for the provision of the freight service involving the transportation of freight on the railway between one point (point A) and another point (point B), calculated assuming the access seeker is the sole user of that required railway infrastructure and calculated in a manner consistent with section 2(2)(d) and (7)(a).

(5) The floor price is to be calculated in accordance with section 3.

(6) Subject to subsections (4) and (5), the access price payable where there is a sustainable competitive price is to be an amount calculated in accordance with the following formula:

$$AP = CRLP_{AB} - IC_{AR}$$

Where –

AP is the access price payable by the access seeker to the access provider for the railway infrastructure service used by the access seeker to provide a freight service to its customers involving the transportation of freight on the railway between one point (point A) and another point (point B);

$CRLP_{AB}$ is the competitive rail-linehaul price, being the maximum competitive price that the access provider could charge for the transport of freight between one point (point A) and another point (point B) on the railway having regard to the nature of the railway infrastructure service being sought and –

(a) the prices charged (on the basis of long term efficient costs of supply) for transporting on the railway the same or similar freight where some other mode of transport (or a combination of modes) provide an effective constraint on prices, taking into account, and where appropriate removing the effect of, any differences in –

(i) the type and volume of freight product involved;

(ii) cost or service characteristics (such as the time for delivery of the freight, rolling stock axle loadings, train length and train speed);

(iii) contractual terms (such as the duration and frequency of the access contract and whether the contract involves a take-or-pay obligation for specific volumes of freight or some other risk allocation arrangement);

(iv) the amount of freight and the prices charged in each direction; and

(v) the origin and the ultimate destination of the freight; and

(b) the prices charged (on the basis of long term efficient costs of supply) for the use of alternative modes of transport (for example, by road, sea, air or some other mode of transport or a combination of such means) for transporting the same or similar freight taking into account, and where appropriate removing the effect of, any differences in –

(i) any additional handling or transportation costs required in order to compare the total price of delivering the relevant freight product from the linehaul point of pick-up (of the alternative mode of transport) to the final linehaul point of delivery of the freight product, when compared to transporting the freight product from the linehaul point of pick-up to the final linehaul point of delivery via the relevant section of the railway between point A and point B;

(ii) the type of freight product involved, including its handling characteristics and the volumes of the freight product to be hauled and the contributions, if any, required to upgrade necessary infrastructure;

(iii) contractual terms (such as the duration and frequency of the service relating to the delivery of freight and whether the contract for the delivery of freight involves a take-or-pay obligation for specific volumes of freight or some other risk allocation arrangement);

(iv) the amount of freight and the prices charged in each direction; and

(v) the origin and ultimate destination of the freight;

The Council's assessment

Under S.1(2) of the Pricing Schedule, the "**effective constraint**" must relate to a competitive non rail service. The price of the non rail service (adjusted by factors S.1(2)(b)(i)-(xi)), are now used to set $CRLP_{AB}$.

This approach turns on the definition of an "**effective constraint**" in S.1(2)(b) of the Schedule. This is given in the definitions under S.3 of the Regime:

> *(4) For the purposes of the pricing principles, an effective constraint will be taken to exist when it is likely that a supplier (or the threat of entry by a potential supplier) of transportation services by a mode other than rail (supplier A) will prevent another supplier of the same or similar transportation services by rail (supplier B) from sustaining prices materially above supplier B's long term efficient costs of supply without offering materially more in return.*

This "**effective constraint**" definition ensures that the relationship between the rail service and its non-rail substitute is tight. A non-rail service that fits this definition of a competitive substitute must be able to keep rail prices close to their long term efficient costs. S.1(6)(b) of the Pricing Schedule requires that non-rail services demonstrate another factor – that the prices they charge are also kept at their long term efficient costs. Hence each service must constrain the price of the other.

Under S.12B, an access seeker may call on the Regulator for its direction as to whether the access provider can demonstrate that the benchmark non-rail service imposes an "**effective constraint**" and that the adjustments made to this benchmark are warranted.

FreightCorp (second submission) argued strongly that these adjusting factors were still too expansive:

> ... the proposed detail for the setting of the Competitive Rail-Linehaul Price (CRLP$_{AB}$) lists ten factors against which the price needs to be judged and potentially adjusted, and an eleventh factor which is "any other relevant matters". This appears to allow for great subjectivity and variability in the calculation of a sustainable competitive price. Operators will be relying heavily on the regulator to bring uniformity of outcomes to the pricing process.

FreightCorp had particular concerns over two of the adjustment factors. The first was the adjustment for the volume of freight products. FreightCorp argued that if this was misused by the infrastructure owner it would entrench the competitive position of the largest volume operator on the network, as it would allow access prices to be pitched to favour larger volumes. FreightCorp also considered that this factor would move volume risk to operators – a risk that it contended was more ably handled by the infrastructure owner. FreightCorp recommends that the reference to **"the type and volume of freight product involved"** be removed.

The Council was concerned at the expansiveness allowed by these adjustment factors. These concerns were somewhat relieved by the Regulator's array of functions in implementing this approach. This work should be further supported by the Minister's comprehensive public review of the Regime after three years of operations. The implementation of the "**sustainable competitive**" approach, together with the effectiveness of each of its elements, will no doubt comprise a large component of this review.

CRLP$_{AB}$ is no longer tested to ensure it comes in under the total price of the stand alone freight service. Instead the **Access Price** is tested to see if it falls between the floor and ceiling for the below rail service, based on efficient forward looking stand alone costs.

The Council now considers that the calculation of capital costs in the floor/ceiling approach below, provides the Regulator with sufficient discretion to take the cash and asset subsidies provided by the Commonwealth, State and Territory Governments, into account when determining the approaches to the floor and ceiling settings. This should allow these parameters to be set appropriately, thus ensuring the test is effective.

Conclusion

The Council considers that the framework for developing CRLP$_{AB}$, can result in an appropriate benchmark price.

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B2) ICAR - the incremental cost deduction

IC_{AR} represents the costs of the above rail service provided by a current operator. It is deducted from the benchmark price set by the non-rail substitute - $CRLP_{AB}$. The residual represents the most the access provider could charge for the below rail service and allow a new rail operator, more efficient than the current rail operator (represented by IC_{AR}), to enter and compete with rail and non-rail substitute services.

The NT/SA Regime – as initially submitted

At application the deduction that represented the above rail costs of supply was defined as:

> *IC_{AR} is the incremental cost (above-rail) of providing the relevant freight service involving the transport of freight between point A and point B on the railway of whichever of the following entities that conducts freight services:*
>
> *(a) the access provider;*
> *(b) if the access provider does not conduct freight services, a related body corporate or an associate of the access provider;*
> *(c) if neither the access provider nor a related body corporate or an associate of the access provider conduct freight services, an efficient operator of freight services,*
>
> *(the relevant entity being referred to as the "designated service provider"), such costs to be calculated having regard to –*
>
> *(d) the total above-rail incremental costs, being the costs the designated service provider will avoid if it did not provide the freight service;*
>
> *(e) where the period of the access contract requested by the access seeker to enable it to deliver freight services is of less than 5 years duration (a "short-term access contract") then the incremental costs (above-rail) will include –*
>
> *(i) the operating costs, being the on-going operational costs of providing the freight service, including the labour and material costs that are causally related to the provision of the freight service, including –*
> *- train crew labour costs;*
> *- rolling stock maintenance costs;*
> *- fuel costs; and*
> *- terminal handling costs; and*
>
> *(ii) no allowance for capital costs; and*
>
> *(f) where the period of the access contract requested by the access seeker to enable it to deliver freight services is of 5 or more years duration (a "long-term access contract") then the incremental costs (above-rail) will include –*
>
> *(i) the operating costs, being the on-going operational costs of providing the freight service, including the labour and material costs that are causally related to the provision of the freight service, including*
> *- train crew labour costs;*
> *- rollingstock maintenance costs;*
> *- fuel costs; and*
> *- terminal handling costs; and*

(ii) an allowance for capital costs, which are to be calculated on the basis of the historical costs of the relevant above-rail assets of the designated service provider where they exist or otherwise the acquisition cost of the relevant above-rail assets (which may not be new assets), comprising
- depreciation on a straight line basis calculated over the useful economic life of the assets; and

- a return on the assets calculated at a rate equal to the 10 year Commonwealth bond rate plus 2%.

Certification issues

1 Costs to be used

The standard application of the ECPR would only use the access provider's above rail costs to calculate $IC_{AR.}$. This adaptation had 3 cost options:

(a) the costs of the access provider;
or, if it does not provide above rail services:
(b) the costs of an operator affiliated to the access provider,
or if it does not provide rail services;
(c) the costs of an efficient operator.

The Council was concerned that the inclusion of (c) did not reflect the principles of ECPR because:

- ECPR was designed to compensate the access provider for its services displaced by more efficient non affiliated operators. When the access provider's services are not displaced (as would be the case in (c)) compensation is not necessary and the service could be priced under the "**floor/ceiling**" approach; and

- The notion of efficiency is ongoing. The most efficient operator on the railway (who may not be operating at a good industry practice level) is the current operator but if a new lower cost operator enters the market, it becomes the most efficient operator, and so on. It is the ongoing drive to increase efficiency that is the objective of this rule and its consequent formula. Substituting a moving "**global best practice**" benchmark will not reflect the actual inefficiencies on this particular railway. Best practice might relate to a high volume rail line and may result in prices that are too high to facilitate entry on this rail line.

2 Differing deductions depending on contractual period

Sub section (e) required a lower deduction (and hence a higher residual price) when the contractual period was less than 5 years. It achieved this by not allowing the deduction to include capital costs. Sub section (f) allowed the deduction to include capital costs when the contractual period was over 5 years.

3 Capital costs unverified and inconsistent when allowed

Capital costs were not verified to represent efficient costs. Additionally, the approach to calculating capital costs differed from that used in other parts of the regime (particularly regarding the rate of return).

4 Overhead costs

These were not included in the deduction.

NT/SA Governments' response

IC_{AR} is now defined as follows:

> *IC_{AR} is the incremental cost (above-rail) of providing the relevant freight service (including, if the relevant freight service is not provided, an estimate of that cost) involving the transport of freight between point A and point B on the railway of whichever of the following entities that conducts freight services:*
>
> *(a) the access provider;*
> *(b) if the access provider does not conduct freight services, a related body corporate or an associate of the access provider;*
> *(c) if neither the access provider nor a related body corporate or an associate of the access provider conduct any freight services, an operator of freight services operating in accordance with good railway industry practice,*
>
> *(the relevant entity being referred to as the "designated service provider"), such costs to be calculated having regard to the total above-rail incremental costs, being the costs the designated service provider would avoid if it did not provide the freight service, including—*
>
> *(d) operating costs, being the on-going operational costs of providing the freight service, including the labour and material costs that are causally related to the provision of the freight service, including*
> *– train crew labour costs;*
> *– rollingstock maintenance costs;*
> *– fuel costs; and*
> *– terminal handling costs;*
>
> *(e) administrative costs; and*
>
> *(f) an appropriate allowance for capital costs, which reflects the opportunity costs of the relevant above-rail assets of the designated service provider where they exist or otherwise the acquisition cost of the relevant above-rail assets (which may not be new assets), comprising both depreciation and return on assets, determined in accordance with guidelines developed and published by the regulator.*
>
> *(7) The guidelines referred to in paragraph (f) above must—*
> *(a) adopt an approach for valuing capital assets; and*
> *(b) provide guidance on the timeframes within which the regulator considers costs could be avoided,*
> *(and may include other provisions considered appropriate by the regulator).*

The Council's assessment

1 Costs to be used

Option (c) has not been deleted. However, *"an efficient operator of freight services"* has been replaced with the *"an operator of freight services operating in accordance with good railway industry practice"*. This change allows the deduction to be estimated on the basis of relevant industry performance. The Governments advise that the only time this approach would be applied is if the access provider chooses not to offer above rail services. This is a further issue for the Regulator to assess and incorporate into its guidelines.

The Governments added the words *"(including, if the relevant freight service is not provided, an estimate of that cost)"* in the introduction to make it clear that where the relevant service was not already provided, the deduction could be based on estimates of the costs of like services. This is another matter that can be developed further by the Regulator and reviewed by the Ministers in the public review of the Regime.

2 Differing deductions depending on contractual period

Sub section (f) no longer differentiates between short and long term access seekers. However, FreightCorp (second submission) considers this approach can still be effected:

> The regime originally submitted required a lower deduction for the ICAR (and hence a higher residual price) when the contract was less than 5 years duration. While this is no longer the case the CRLPAB still allows for variation based on the length of the contract period resulting in the same ability to manipulate the resulting access price.

This is another matter that can be developed further by the Regulator in its guidelines, particularly between short and long term costs. If problems arise, they can be addressed by the Ministers in the public review of the Regime.

3 Capital costs unverified when allowed

Sub section (f) allows the deduction to include capital costs on an opportunity cost basis as determined by the Regulator's published guidelines.

This is another matter that will be developed further by the Regulator and reviewed by the Ministers in the public review of the Regime after three years of operations.

S.1(7)(a) requires the Regulator's guidelines to adopt an approach for valuing assets. This gives the Regulator the opportunity to ensure that this deduction is constructed to maintain the integrity of the ECPR approach.

4 Administrative costs

These are now included in the deduction.

Conclusion

The Council considers that the framework for developing ICAR, can result in an appropriate above rail deduction.

C) The floor price test – common to both price approaches

A floor price in an access regime should recover all costs that could be avoided if the service was not provided. Unless avoidable costs are recovered, the access provider will be forced to either absorb these costs or recoup them from other operators through cross subsidies. Effective regimes are required to avoid these two outcomes and set avoidable costs as a minimum price.

The NT/SA Regime – as initially submitted

Under the original Regime, the freight services 'price floor was defined as:

The access price (AP) must not be less than the economic cost of providing the service, and accordingly the access price calculated in accordance with section 1 or section 2 (as the case may be) must not be less than a floor price calculated in accordance with the following formula:

$$AP = IC_{BR} + R$$

where –

AP *is the access price ...;*

IC_{BR} *is the incremental costs (below-rail) of the access provider, being the additional costs incurred by the access provider of providing access to the railway for the access seeker to deliver the relevant freight service involving the transport of freight between point A and point B on the railway having regard to –*

(a) *the total below-rail service long-run incremental cost, being the costs the access provider will avoid in the long-term if it did not provide the freight service;*

(b) *the period of time over which the long-run costs are to be measured is to be sufficient so as to enable all necessary investments in the railway infrastructure to be replaced;*

(c) *the incremental costs are to include operating costs, being the on-going operational costs of providing the railway infrastructure service, including the labour and material costs that are causally related to the operation and maintenance of the railway infrastructure service;*

(d) *the incremental costs are also to include capital costs, calculated on a long-term basis to account for the replacement of assets being brought forward by the operation of the freight service (such as wear and tear of the track); and*

R *is a reasonable contribution to below-rail common costs and capital charges having regard to the access provider's original investment in the railway (including outstanding debt obligations).*

It should also be noted that S.24 allowed the access provider to sell services below this floor price test.

Certification issues

The Council's principle concerns were:

1. **"Additional" rather than "avoidable" cost concept**

The Council's pricing consultant, Professor Ergas, considered the use of "**additional**" costs in a floor price definition led to ambiguity. The Council requested that the definition be pitched in terms of "**avoidable**" rather than "**additional**" costs. This better describes this floor concept as those costs that would not be incurred if the service was not provided.

2. The inclusion of long term costs

The floor was constructed from a long term perspective and so included a range of costs that would not be avoided if the service was not provided. The Council asked for the deletion of the explicit reference to long term costs.

The Council also asked that, where capital costs were involved, the Regulator be given full discretion to take the Governments 'cash and asset subsidies into account.

3. **No efficient cost requirement**

There was no explicit requirement that these costs represent efficient forward looking costs.

4. **Pricing below the floor**

S.24 allowed the access provider to price below avoidable costs, thus presenting the access provider with the need to absorb losses or include cross subsidies in other prices.

5. **Administrative costs**

These were not included.

NT/SA Governments 'response

The Regime now contains the following floor definition in the Pricing Schedule:

> *3(1) The access price must not be less than the economic cost of providing the railway infrastructure service, and accordingly the access price calculated in accordance with section 1 or section 2 (as the case may be) must not be less (but may be greater) than an amount which is equal to the avoidable costs (below-rail) associated with the access provider providing access to the required railway infrastructure for the access seeker to deliver the relevant freight service involving the transport of freight between point A and point B on the railway , being:*
>
> *(a) labour and material costs which vary directly with the usage of the access seeker (including major periodic maintenance);*
> *(b) administrative costs which vary directly with the usage of the access seeker; and*
> *(c) capital costs which vary directly with the usage of the access seeker, including the costs of replacing the required railway infrastructure assets being brought forward by the operation of the freight service (such as wear and tear of the track).*
> *(2) The costs to be applied in subsection (1) must be forward-looking and efficient.*
>
> *(3) The regulator must develop and publish guidelines in connection with the operation of this section.*
>
> *(4) The guidelines must—*
>
> *(a) subject to subsection (5) adopt an approach for valuing capital assets which reflects the Depreciated Optimised Replacement Cost of those assets; and*
> *(b) provide guidance on the timeframes within which the regulator considers costs could be avoided,*
> *(c) in relation to a return on assets, have regard to —*
>
> *(i) the appropriate risk premium associated with the construction, development and operation of the railway infrastructure facilities, based on both of the following:*

(A) the expected risks prevailing as at the date of commencement of construction of the railway by the access provider; and

(B) in respect of any expansion or extension of the railway after the date of commencement of construction of the railway by the access provider—the expected risks prevailing as at the date of the commencement of construction of that expansion or extension; and

(ii) the relevant financial market rates (including the risk free rate for return on investments and the rate of inflation);

(and may include other provisions considered appropriate by the regulator).

(5) The guidelines may, if the regulator thinks it appropriate to do so, allow an adjustment to the Depreciated Optimised Replacement Cost valuation of capital assets under subsection (4)(a) on account of government-contributed assets and other government financial assistance after taking into account any associated liabilities assumed by the access provider, subject to the qualifications that any such adjustment:

(a) must not, when used in calculating the floor prices specified in sections 1(5) and 2(4), prevent the access provider earning a reasonable risk-adjusted return on the capital invested in the railway (disregarding government-contributed assets and other government financial assistance); and

(b) must be made on a pro rated basis over the entirety of the capital assets comprising the railway infrastructure facilities.

The Council's assessment

1. "Avoidable" costs

The definition is now cast to capture "**avoidable**" rather than "**additional**" costs.

2. **Long term costs**

The definition now excludes explicit reference to long term costs. These costs should only be attributable to the avoidable usage of the access seeker. This qualifies costs (such as capital costs) that would generally be considered long term.

Any relevant capital costs are to be calculated on assets valued on a "**depreciated optimised replacement cost**" (DORC) basis, adjusted where appropriate for the cash and asset subsidies provided by Governments. Such adjustment will not be so great as to preclude the access provider from earning an appropriate return on the capital it has invested.

The Regulator's guidelines will now determine how this methodology, together with other aspects of this approach to the floor, are to be implemented. The Regulator's guidelines will also determine the timeframe in which avoidable costs will be considered. The Ministerial review (S.50) will now provide a testing ground to ensure that this approach has been applied appropriately.

3. **Efficient costs**

Costs are now explicitly required to represent forward-looking and efficient costs.

4. **Pricing below the floor**

S.24 is to be deleted. Therefore, the Regime no longer explicitly provides for pricing below the floor.

5. **Administrative costs**
The definition now includes administrative costs.

Conclusion
The Council considers that the framework for developing floor price calculations can produce appropriate floor prices for both pricing approaches.

3.1.3 Approach 2 - Floor/ceiling pricing
If services do not meet the "**sustainable competitive**" conditions, prices are negotiated within an avoidable cost floor and a stand alone cost ceiling. The floor to be used in this approach is outlined above. The following sections discuss the ceiling test.

The NT/SA Regime – as initially submitted
At application, the Regime's ceiling test was:

$$AP = RPC_{AB}$$

Where –

AP *is the access price ... ; and*

RPC_{AB} *is the rail price cap, being an amount equal to 2 times the average (below-rail) costs of the railway infrastructure facilities used in the provision of the freight service involving the transportation of freight on the railway between one point (point A) and another point (point B), which costs are to be calculated on the following basis:*

(a) *the costs associated with the operation of the railway infrastructure are to be limited to that portion of the railway infrastructure as is needed to satisfy the requirements of the access seeker (the "relevant infrastructure");*

(b) *the average (below-rail) costs, being the on-going costs of the relevant infrastructure, including the labour and material costs that are causally related to the relevant infrastructure, including –*

(i) labour and material costs associated with the operation and maintenance of the relevant infrastructure;

(ii) an appropriate allocation of administrative costs,

(iii) an appropriate allocation of capital charges including depreciation and a return on assets, based on the written down replacement cost of the relevant infrastructure and a nominal (after tax) rate of return on assets of 18%, where the tax rate to be applied is the corporate tax rate prevailing at the time of arbitration, which costs are to be apportioned across all users of the railway infrastructure facilities based on relative usage of those facilities.

Certification issues

1. Price equal to twice average costs

The Council and many participants (NRC, FreightCorp, Toll, SCT) were concerned that the price could go as high as twice the below rail average costs. FreightCorp noted that:

> No justification is provided as to why the average below rail costs should be doubled, nor is any clear indication given as to how the costs "are to be apportioned across all users of the railway infrastructure facilities based on relative usage of those facilities".

The Council also noted that S.24 allowed prices to be outside the pricing principles. This could allow them to rise above twice average costs.

2. Capital costs

This Regime prescribed that capital costs be determined valuing assets on a written down replacement cost basis and using a nominal (after tax) rate of return on assets of 18 per cent - the prevailing corporate tax rate was to be applied.

Given recent regulatory decisions, a nominal (after tax) rate of return on assets of 18%, where the tax rate to be applied is the corporate tax rate, seems high. NRC noted that:

> The rate of return ... is excessive, and no rationale for it is provided by the Applicants. It is very far from the 8 percent recommended by IPART for the Rail Access Corporation of NSW. It is acknowledged that the circumstances may differ, but the margin of difference between 8% and 18% is so large that some analysis and discussion in defence of the much higher figure is required. There should also be a process in the Code for periodic review of the rate.

Additionally, the rate is specified in "**nominal**" terms. Given that the approach to valuation already takes inflation into account, it is likely that this rate should be in "**real**" terms.

3. Efficient Costs

There was no requirement that costs represent efficient forward looking costs.

NT/SA Governments' response

NT/SA Governments have proposed the following amendment under S.2 of the Pricing Schedule:

> *(1) Where there is not a sustainable competitive price, the access price payable to the access provider by an access seeker for a railway infrastructure service that is provided to enable the access seeker to deliver a freight service will be a reasonable price determined by the arbitrator which is -*
>
> *(a) not more than the ceiling price for the provision of the railway infrastructure service (see subsection (2)); and*
>
> *(b) not less than the floor price for the provision of the railway infrastructure service (see subsection (4)),*
>
> *and the price so determined must take into account the matters set out in clause 21 of this Code.*

(2) The ceiling price is to be an amount equal to whichever is the lesser of:

(a) the costs associated with the operation of the required railway infrastructure needed by the access seeker for the provision of the freight service involving the transportation of freight on the railway between one point (point A) and another point (point B), calculated assuming the access seeker is the sole user of that required railway infrastructure; and

(b) the costs associated with the operation of the required railway infrastructure needed by the access seeker for the provision of the freight service involving the transportation of freight on the railway between one point (point A) and another point (point B), less an amount determined by the arbitrator to be the aggregate of–

(i) the avoidable costs attributable to the usage of that required railway infrastructure by all other access holders; and
(ii) a reasonable contribution to the fixed costs of that required railway infrastructure ("R") from all other access holders using that required railway infrastructure,

where—

(c) R is to be an amount which is not greater than the amount, if any, by which revenues of the access provider attributable to access holders' (other than the access seeker's) usage of the required railway infrastructure required by those access holders exceeds the avoidable costs attributable to those access holders' usage of that required railway infrastructure; and

(d) the costs are to be on-going costs that are causally related to the relevant required railway infrastructure, including -

(i) labour and material costs associated with the operation and maintenance of the required railway infrastructure (including major periodic maintenance);
(ii) an appropriate allocation of administrative costs;
(iii) an appropriate allocation of capital costs, including both depreciation and a return on assets, determined in accordance with guidelines developed and published by the regulator.

(3) The costs to be applied in subsection (2) must be forward-looking and efficient.

(4) The floor price is to be calculated in accordance with section 3.

(5) The arbitrator must, in determining a price under this section, have regard to economic efficiency taking into account the prices being charged by the access provider to access holders for the same or similar services (including, if the access provider, a related body corporate or an associate has conducted the same or similar services on the railway, the actual prices charged in relation to those services).

(6) The regulator must develop and publish guidelines in connection with the operation of this section (in addition to the guidelines specifically required under subsection (2)(d)(iii)).

(7) The guidelines must –

(a) subject to subsection (8), adopt an approach for valuing capital assets which reflects the Depreciated Optimised Replacement Cost for those assets;

(b) provide guidance on the timeframes within which the regulator considers costs could be avoided; and

(c) in relation to a return on assets, have regard to —

(i) the appropriate risk premium associated with the construction, development and operation of the railway infrastructure facilities, based on both of the following:

(A) the expected risks prevailing as at the date of commencement of construction of the railway by the access provider; and

(B) in respect of any expansion or extension of the railway after the date of commencement of construction of the railway by the access provider— the expected risks prevailing as at the date of the commencement of construction of that expansion or extension; and

(ii) the relevant financial market rates (including the risk free rate for return on investments and the rate of inflation);

(and may include other provisions considered appropriate by the regulator).

(8) The guidelines may, if the regulator thinks it appropriate to do so, allow an adjustment to the Depreciated Optimised Replacement Cost valuation of capital assets under subsection (7)(a) on account of government-contributed assets and other government financial assistance after taking into account any associated liabilities assumed by the access provider, subject to the qualifications that any such adjustment:

(a) must not, when used in calculating the ceiling prices specified in sections 1(4) and 2(2), prevent the access provider earning a reasonable risk-adjusted return on the capital invested in the railway (disregarding government-contributed assets and other government financial assistance); and

(b) must be made on a pro rated basis over the entirety of the capital assets comprising the railway infrastructure facilities.

The Council's assessment

The construction of the ceiling has changed. The following steps through the calculation the proposed price ceiling:

- Calculation of an individual ceiling price starts with the calculation of the stand alone costs of the required assets, for providing the current range of services as well as the one proposed, based on efficient forward looking costs;

- These stand alone costs are then reduced by the avoidable costs of all other users, including the access provider's above rail operator and those priced under the "**sustainable competitive**" approach;

- A further reduction, representing "**a reasonable contribution to the fixed costs**" received from all other users of the relevant assets, is then made;

- The residual establishes the highest contribution the access seeker could make; and

- The access price is then negotiated between this ceiling and the avoidable cost floor.

While this approach reduces the ceiling applicable to access seekers, according to their order of application, this should not prove too large a problem, given that this process

determines a ceiling rather than a price and that the Regulator has the ability to adjust prices to accommodate, among other things, competitive neutrality principles.

The Council considers that the following amendments have addressed its concerns on explicit issues:

1. **Prices outside the Regime**
S.24 has been deleted.

2. Capital costs
Capital costs are now to be defined by guidelines published by the Regulator. These are required to reflect forward-looking and efficient costs.

The Council had asked that, where capital costs were involved, the Regulator be given full discretion to take into account the Governments 'cash and asset subsidies through its choice of capital cost elements. The Regime prescribes the use of the DORC approach to valuation, but now specifically allows for its adjustment for the cash and asset subsidies as long as it does not prevent the access seeker from achieving an appropriate return on the capital it invests. The rate of return may also be adjusted for the effects of these subsidies. The approach can be tested in the Ministerial review, scheduled to occur 3 years after operations commence.

3. Efficient Costs
Costs must now represent efficient forward looking costs.

Conclusion

The Council considers that the framework now allows the ceiling parameters to be set appropriately.

A) Passenger services

The NT/SA Regime – as initially submitted

Passenger services were to be priced under a floor/ceiling approach:

> *(1) The access price (AP) payable to the access provider by an access seeker for a railway infrastructure service that is provided to enable the access seeker to deliver a passenger service will be a price determined by the arbitrator which is –*
>
> *(a) not more than the ceiling price for the provision of the railway infrastructure service; and*
>
> *(b) not less than the floor price for the provision of the railway infrastructure service.*
>
> *(2) The ceiling price is to be determined by the arbitrator reflecting the highest price that could fairly be asked by the access provider for the provision of the railway infrastructure service having regard to the principles used to calculate the access price set out in section 2 above [no sustainable price approach].*

(3) The floor price for the provision of railway infrastructure services is to be determined by the arbitrator reflecting the lowest price at which the access provider could provide the railway infrastructure service without incurring a loss, having regard to the principles set out in section 3. [freight floor price test]

Certification issues

Although it used a "**floor/ceiling**" approach, the pricing for passenger services contained different elements to that for freight.

The Council considered that the floor and ceiling price tests for both freight and passenger services should be consistent and reflect efficient forward looking costs.

The Council's assessment of the NT/SA Governments' response

Passenger services will now be priced consistent with the floor/ceiling approach for freight. Therefore, the Council's comments regarding these approaches are equally valid for the approach to passenger pricing.

Conclusion

The Council considers that the framework now allows the floor and ceiling parameters to be set appropriately.

Conclusion on the two pricing approaches

The Council also considers that the elements that comprise the two pricing approaches are now set so that they meet the requirements of ***Clauses 6(4)(a)-(c), 6(4)(f), 6(4)(i), 6(4)(m) and 6(4)(n).***

3.1.4 Monopoly Rent Test

When regulating natural monopolies it is common to test their total revenues to see if their pricing practices have allowed them to earn monopoly rents. As previously discussed, due to the scale characteristics of natural monopoly infrastructure (where demand can be well short of available capacity for a significant proportion of the asset's life), pricing needs to be above marginal cost for some services to ensure recovery of avoidable and fixed costs. The common pricing practice for natural monopoly service providers is to set the price for an individual service at avoidable costs, plus a margin to contribute to common costs.

Under this Regime, this margin is set either by competitive constraints ("**sustainable competitive**" approach) or an estimate of the customer's "**ability to pay**" (**floor/ceiling** approach). While effective competition should constrain monopoly rents in the "**sustainable competitive**" approach, where competition does not prevail (for services priced under the floor/ceiling approach) estimates of "**ability to pay**" provide an opportunity to collect monopoly rents.

Certification issues

The original Regime did not include a test for monopoly rents for the "**floor/ceiling**" approach. Given the high ceiling price, the lack of a test for monopoly rents was a concern for participants (for example, FreightCorp, NRC, ARTC) and the Council.

> FreightCorp notes that there is no mechanism incorporated for adjustment to prices if the ceiling is breached. The recent IPART review of the NSW Rail Access Regime has suggested that there should be such a mechanism to recompense users for over recovery by the infrastructure owner.

Additionally, the Council was concerned that the criteria used, to establish if a service was under effective competitive pressure, were too loose – price benchmarks could be set by non rail services that exert very little competitive pressure on the rail service. This could allow the access provider to draw monopoly revenues from the services priced under the "**sustainable competitive"** approach's prices.

The NT/SA Governments' response

S.50 of the Regime now tests for monopoly rents in the "**floor/ceiling**" approach, taking into account revenues from the "**sustainable competitive**" approach that are relevant for the infrastructure used by the total "**floor/ceiling**" group of customers, including the revenue from the infrastructure owner's above rail activities:

> *S.50(4) The regulator must, at the intervals referred to in subclause (10), review the revenues paid or payable by access holders to the access provider for railway infrastructure services where no sustainable competitive prices exist ("relevant revenues"), being revenues derived under either:*
>
> *(a) awards by arbitrators to the extent the awards involve the application of section 2 of the pricing principles; or*
>
> *(b) access contracts to the extent that the regulator considers sustainable competitive prices did not or do not exist in relation to the transportation of the freight the subject of those access contracts,*
>
> *and determine whether the relevant revenues paid or payable by such access holders (the "relevant access holders") for those railway infrastructure services are excessive having regard to the factors referred to in subclause (5).*
>
> *(5) In determining whether the relevant revenues are excessive the regulator must have regard to the following:*
>
> *(a) the relevant revenues are to be measured against the costs associated with the required railway infrastructure required by the relevant access holders including an appropriate commercial return on the required railway infrastructure used by the relevant access holders in the circumstances referred to in subclause (4) (the "relevant required railway infrastructure");*
>
> *(b) the investment in all of the railway infrastructure facilities by the access provider or any other person and all of the revenues earned by the access provider from the provision of railway infrastructure services including, if the access provider, a related body corporate or an associate has conducted transportation services on the railway, revenues at market rates in relation to those services;*

(c) an appropriate commercial return on the relevant required railway infrastructure, determined having regard to—

(i) the appropriate risk premium associated with the construction, development and operation of the railway infrastructure facilities, based on both of the following:

(A) the expected risks prevailing as at the date of commencement of construction of the railway by the access provider; and

(B) in respect of any expansion or extension of the railway after the date of commencement of construction of the railway by the access provider—the expected risks prevailing as at the date of the commencement of construction of that expansion or extension; and

(ii) the relevant financial market rates (including the risk free rate for return on investments and the rate of inflation) prevailing at the time of the regulator's review;

(d) when comparing the relevant revenues to the costs under paragraph (a), the regulator must subtract from those costs an amount determined by the regulator to be the aggregate of–

(i) the avoidable costs attributable to the usage of the relevant required railway infrastructure by all other access holders (being avoidable costs of the kind referred to in section 3 of the pricing principles); and
(ii) a reasonable contribution to fixed costs of the relevant required railway infrastructure ("R") from all other access holders using that required railway infrastructure, where R has the same meaning as in section 2(2)(c) of the pricing principles.

(6) The costs to be applied under subclause (5) must be efficient.

(7) For the purposes of determining expected risks under subclause (5)(c)(i), the regulator must have regard to information provided by the access provider with respect to the contents of any financing plan of the access provider.

(8) If the regulator determines that revenues are excessive under subclause (4)—

(a) the regulator must promptly give the access provider written notice of the regulator's determination, including the reasons for his or her determination;

(b) within 2 months of receiving the regulator's determination under paragraph (a), the access provider must prepare and submit to the regulator for approval a plan under which the access provider will reduce future relevant revenues so that such revenues are not excessive (having regard to the matters referred to in subclause (5)), when measured over the next regulatory review period (the "remedial plan");

(c) the regulator will consider the remedial plan submitted to it with a view to reaching agreement with the access provider on the terms which are acceptable to the regulator for the remedial plan;

(d) if the regulator and the access provider agree on the terms of a remedial plan, the access provider must implement that plan;

(e) if the regulator and the access provider are unable to reach agreement on a remedial plan that is acceptable to the regulator within 1 month of receiving the remedial plan, the regulator must make a determination under subclause (9) and the access provider must observe the terms of that determination.

(9) If subclause (8)(e) applies, the regulator will make a determination to regulate prices, and/or to establish conditions relating to prices or price fixing factors in relation to the future provision of railway infrastructure services in any manner the regulator considers appropriate, including -

(a) fixing a price or the rate of increase or decrease in a price;
(b) fixing a maximum price or rate of increase or decrease in a maximum price;
(c) fixing an average price for specified railway infrastructure services or an average rate of increase or decrease in an average price;
(d) specifying pricing policies or principles;
(e) fixing a maximum revenue in relation to railway infrastructure services,

provided the effect of the determination is limited to reducing revenues of the type referred to in paragraphs (a) and (b) of subclause (4) derived from railway infrastructure services so that the total of such revenues so derived do not result in excessive revenues (having regard to the matters referred to in subclause (5)), when measured over the next regulatory review period.

(10) The regulator's reviews under subclause (4) are to be conducted in relation to the following periods -

(a) the first review must be in respect of the period ending on 30 June in the 10th year of operations of the railway;

(b) the second review must be in respect of the 5 year period commencing immediately after the end of the period of the first review; and

(c) the third and subsequent reviews must be in respect of successive 5 year periods.

The Council's assessment

The box below illustrates how the monopoly review will work.

Monopoly rent test

The mechanism requires the establishment of two distinct values - the **"relevant revenues"** and the "**monopoly revenue limit"**.

"**Relevant revenues**" - are simply all those revenues collected from the access holders priced under the "**floor/ceiling**" approach. At the time of review, the Regulator has the power to determine if some services have been incorrectly categorised or need to be counted in one group for part of the period and the other for the remainder of the period.

Monopoly revenue limit - the efficient costs of the supply of the floor/ceiling group of services is then calculated. From these costs are deducted all revenues received from all access holders (including an imputed contribution from the affiliated operator) pertinent to the group of assets used to deliver the "**floor/ceiling**" services.

This residual establishes the "**monopoly revenue limit**". It represents the maximum revenue that could be received from the "**floor/ceiling**" group before the "**stand alone cost**" benchmark was breached.

Remedy - If there remains a positive number after taking the "**relevant revenues**" from the "**monopoly revenue limit**", the access provider must develop a remedy to be approved by the Regulator and implemented over the following period. The remedy will put in place prices for services priced under the "**floor/ceiling**" approach that would anticipate no monopoly rent in the next period.

The first review period would be after 10 years of operations. Thereafter a review would occur after each successive 5 years of operations. The remedies would go forward after the first 10 years of operations, over each of the successive 5 year periods.

1. No test for "sustainable competitive" approach

The mechanism does not subject the revenues from the "**sustainable competitive**" approach to a direct monopoly rent test. While revenues from this group are taken into account when services for this group are provided by infrastructure also used by the revenues that are tested – those from **"floor/ceiling"** services – revenues from the "**sustainable competitive**" are not subjected to any remedy. Some "**sustainable competitive**" revenues may not be tested if their services are delivered by infrastructure that does not provide any "**floor/ceiling**" services.

The Governments argued that if services were under "**effective competitive**" constraint, there would be no possibility of monopoly pricing. Therefore, revenues from the "**sustainable competitive**" approach would not need to be tested. The Council was initially concerned that the threshold criteria was too loose and would allow services not under effective competition to be priced under this approach. However, now that the Governments have redefined "**effective constraint**" to (under definitions in S.3):

> *(4) For the purposes of the pricing principles, an effective constraint will be taken to exist when it is likely that a supplier (or the threat of entry by a potential supplier) of transportation services by a mode other than rail (supplier A) will prevent another supplier of the same or similar transportation services by rail (supplier B) from sustaining prices materially above supplier B's long term efficient costs of supply without offering materially more in return.*

Coupled with the following sub sections of the Pricing Schedule:

> *1.(6) (a) the prices charged (on the basis of long term efficient costs of supply) for transporting on the railway the same or similar freight where some other mode of transport (or a combination of modes) provide an effective constraint on prices, taking into account, and where appropriate removing the effect of, any differences in –*
>
> ....
>
> *1.(6) (b) the prices charged (on the basis of long term efficient costs of supply) for the use of alternative modes of transport (for example, by road, sea, air or some other mode of transport or a combination of such means) for transporting the same or similar freight taking into account, and where appropriate removing the effect of, any differences in -*

the Council is more confident that the threshold test is appropriate.

These prices must lie between a stand alone floor and ceiling, calculated on an efficient forward looking cost basis. Now that the cash and asset subsidies can be taken into account in the calculation of capital costs, the Council is confident that the appropriate floor and ceiling parameters can be set.

2. The ceiling used to establish the "monopoly revenue limit"

This ceiling, specific to the S.50 test, must be established using relevant efficient costs. However, the provisions allow that factors may be taken into consideration that are not necessarily included in the ceiling established for the "**floor/ceiling**" approach in S.2 of the Schedule. For instance, S.50(5)(b) allows the Regulator to have regard for *"the investment of the access provider, and others, in the whole of the infrastructure"* when considering the S.50 test.

The Governments consider that over time, access seekers may make investments but that this consideration does not go to the cash and asset subsidies provided by the Governments.

The Council notes that **Clause 6(4)(i)(i)** of the CPA requires that the arbitrator take into account *"the owner's legitimate business interest and investment in the facility"*. The Council has ensured that this criterion can be complied with in the setting of floor and ceiling parameters in other areas of the Regime. The Council considers that the parameters in the S.50 test can be applied in a way that is consistent with the floor and ceiling parameters in other areas of the Regime.

3. The remedy

If any periodic review (after first 10 years of operations and each following 5 years of operations) identifies an excess, prices of the "**sustainable competitive**" services, using the assets that also provide "**floor/ceiling**" services, will stand. Prices for the "**floor/ceiling**" services will be reduced to ensure that the anticipated revenues from all users ("**floor/ceiling**" and "**sustainable competitive**") of these assets over the following five year period will not together produce monopoly rents.

S.50 now also provides for a comprehensive review of all elements of the Regime after three years of operations. It is envisaged that information from this review will allow the Regulator to assess how the "**sustainable competitive**" approach is operating and how likely it is that revenues from the "**floor/ceiling**" approach, in combination with those from the "**sustainable competitive**" approach, will breach the ceiling. It will also allow

the Regulator the information necessary to adapt its approach, going forward, if it deems this necessary.

Conclusion

The Council considers that the framework now provides a mechanism to test for monopoly rents.

3.1.5 New Investment

Relevant CPA criteria

Clause 6(4)(a)-(c) - negotiation framework, terms and conditions should not preclude access.

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Clause 6(4)(i) – conditions the arbitrator (and hence the negotiation) should take into account. Arbitration should support negotiation

In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

Clause 6(4)(j) - conditions the arbitrator (and hence the negotiation) should take into account when considering issues of new investment.

The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:

(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

As with other prices, the Council considers that the pricing approach taken with regard to arbitrations of new investment disputes should establish the guidelines for prices in negotiation. It considers that **Clause 6(4)(i)** anticipates that prices will be set, in the public interest, to reflect those that could be expected in a competitive market and that such prices would lead to the economically efficient operation of the facility. While also mindful that such prices need to take account of the facility owner's legitimate business

interests, **Clause 6(4)(i)** relates such considerations to the returns available in a competitive market.

Clause 6(4)(j) acknowledges that an access provider may be required to *"extend or permit extension"* of infrastructure to satisfy the needs of an access seeker, but that the investment must be in the commercial interests of the access provider.

With regard to **Clause 6(4)(a)-(c),** the Council considers that the Regime should not constrain or deter the parties from negotiating prices that would coincide with outcomes anticipated in arbitration. In the context of new investment, the Council would expect that the access provider would favourably consider expansions or extensions that were commercially viable.

Certification issues

1. Deviation from Clause 6(4)(i).

S.21 set out the matters an Arbitrator should take into account in any arbitration. These matters were an adaptation and expansion of those included in **Clause 6(4)(i)** of the CPA**.** The most significant addition was the requirement that an Arbitrator take into account:

> *(b) the high initial capital cost of the railway infrastructure facilities (including the cost of the rail corridor), the high degree of economic risk of the project, and the need for a fair return on the access provider's investment having regard to those costs and that risk;*

The Council was concerned that the addition to **Clause 6(4)(i)** contained in S.21(b), may allow pricing above that anticipated in a competitive market, if not applied consistent with the intent of **Clause 6(4)(i)**. Application outside this intent would breach **Clause 6(4)(a)-(c).**

ARTC argued that **Clause 6(4)(i)** already took into account project risks – further prescription on these risks was therefore redundant. The Council agreed that **Clause 6(4)(i)** together with **Clause 6(4)(j)** adequately ensured that any new investment did not compromise the business interests of the access provider.

2. Restrictions on arbitrator

S.20(1)(a) placed restrictions on the arbitrator when deciding matters related to new investment. An arbitration award could not:

> *i) delay the construction of the railway or any part of the railway;*
> *(ii) add to the cost of construction of the railway; or*
> *(iii) have the effect of requiring the access provider to bear any of the capital cost of any addition or extension to the railway infrastructure facilities, unless the access provider agrees; ...*

This section precluded the Arbitrator from requiring the access provider to bear the cost of any new investment, even if it complied with **Clause 6(4)(j)** and was commercially viable and where investment by the access provider would be the most efficient outcome.

The Council considered that the constraints imposed on new investment were too broad. They could allow the access provider to refuse proposals, that required extensions or

expansions, at its discretion. FreightCorp agreed with this view. ARTC considered that the constraints could constitute *"**hindering access**"* and so breach **Clause 6(4)(m)**.

3. Expansions and extensions

The Council considers that the term *"**extension**"* includes both:

- expansion of capacity; and
- extension of geographical range of a facility or allowing interconnection with another facility. The latter would mean that a business seeking geographic extensions to an existing facility could undertake the necessary construction work itself and gain access to the owner's infrastructure through interconnection – that is, the extension would not need to be undertaken by the service provider.

S.20 did not clearly commit to consider new investment in terms of both expansion of capacity and extension of geographical range of a facility.

The Council's assessment of the NT/SA Governments' response

1. Deviation from Clause 6(4)(i)

The amended Regime has modified its requirements on the Arbitrator with regard to new investment. S.21(2) now requires that S.21(1)(b) be applied in a manner not inconsistent with **Clause 6(4)(i)**. This, together with the operations of the Regulator, should allow appropriate pricing.

2. Restrictions on arbitrator

S.20 includes provisions that preclude the Arbitrator from making an award that requires the access provider to bear any of the capital costs of expansion or extension

> *S.20(1) The arbitrator cannot –*
>
> *(a) make an award that would –*
>
> *(i) delay the construction of the railway or any part of the railway;*
> *(ii) add to the cost of construction of the railway; or*
> *(iii) have the effect of requiring the access provider to bear any of the capital cost of any expansion or extension of the railway infrastructure* facilities,
>
> *unless the access provider agrees; or*

However, S.20(3) allows for exceptions which are similar to the **Clause 6(4)(j)** provisions.

> *(3) Despite subclause (1), the arbitrator may make an award that would have the effect of requiring the access provider to expand or extend the railway infrastructure facilities, or to permit an expansion or extension of the railway infrastructure facilities, if—*
>
> *(a) the expansion or extension is technically and economically feasible and consistent with the safe and reliable operation of the railway infrastructure facilities;*
> *(b) the access provider's legitimate business interests in the railway infrastructure facilities are protected; and*

(c) the terms and conditions on which access is to be permitted are reasonable taking into account the costs to be borne by the parties and the economic benefits to the parties resulting from the expansion or extension.

S.20(4) qualifies **Clause 6(4)(j)** in that it defines "**business interests**" as:

(4) For the purposes of subclause (3)(b), it will be considered not to be in the access provider's legitimate business interests to require the access provider to take action that would—

(a) result in a breach of—

(i) a reasonable financial or other covenant or commitment given by the access provider to a third party; or

(ii) a reasonable security obligation of the access provider to a third party; or

(b) result in the access provider having to assume an unreasonable financial, business or other risk, liability or detriment associated with the cost of the expansion or extension.

While this qualification opens up a range of circumstances where the access provider need not be required to extend or expand the facilities, the introduction of an independent Regulator with extensive powers to intervene in negotiations, gives the Council confidence that this qualification will not be abused. Additionally, S.50 now provides for a public comprehensive Ministerial review of the Regime after three years of operations. Any problems with this approach would be aired in this review.

S.20(5) requires that the financial arrangements not be structured with the intent of hindering access.

(5) However, subclause (4)(a) does not apply if it is found that the financial or other covenant or commitment was given, or the security obligation was undertaken, (as the case may be) by the access provider for the purpose of preventing or hindering access to a railway infrastructure service.

The Council considers that S.20 now allows for the intent of **Clause 6(4)(i)** and **(j)** to be effected.

3. Expansions and extensions

S.20 now allows for both extension and expansion.

Conclusion

*The Council considers that the provisions covering new investment satisfy **Clauses 6(4)(a)–(c), 6(4)(i) and 6(4)(j)**.*

3.2 NON PRICE TERMS AND CONDITIONS

3.2.1 Safety accreditation

Relevant CPA criteria

Clause 6(4)(a)-(c) - negotiation framework, terms and conditions should not preclude access.

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Safety accreditation refers to the regulatory framework and practices associated with a rail operator gaining approval to use the rail line services. A number of recent reviews of the rail industry[9] have asserted that safety accreditation practices across states are overly bureaucratic and increase the costs of access.

While not strictly an element of negotiation, safety accreditation, like other regulatory processes, can be practiced in a way that deters access. When tested against **Clause 6(4)(a)-(c**), regulatory services related to safety should be delivered at least cost and not deter entry for reasons other than safety.

Certification issues

Operators argued that in spite of national agreements, accreditation in one State would not necessarily allow abridged accreditation in another. As rail systems developed with a State focus, States developed practices in isolation from each other. These consequently required operators to traverse inconsistent processes and meet differing standards to gain and maintain accreditation in each State. This resulted in costs that were higher than necessary.

Most of the AustralAsia Railway is yet to be constructed and therefore a review of accreditation practices is not possible. However, under the Regime, safe use of facilities is covered by mirror legislation - the *Northern Territory Rail Safety Act 1998* and *Rail Safety* Act 1996 (SA).

FreightCorp indicated no particular problems gaining accreditation under the SA accreditation process – the process that should apply to the new infrastructure. However, FreightCorp did make the general comment that unless its current SA accreditation covered its operations on the AustralAsia Railway, it would incur costs that could be considered unnecessary.

The Council's assessment

The Council is aware of the Independent Pricing and Regulatory Tribunal's (IPART) conclusion, in its recent review of Rail Safety Accreditation Costs in NSW, that pricing

[9] Including those of the Productivity Commission, House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform and the Smorgon Taskforce.

for safety accreditation should be risk based and uniform across States to achieve maximum pricing efficiencies. As a national uniform approach to pricing is yet to be developed, the Council is unable to consider changes consistent with the IPART's recommendations.

The Acts adopt the Australian Rail Safety Standard and contain safety accreditation regimes together with mechanisms for mutual recognition of accreditation between jurisdictions. Participants foresaw no particular problems with this approach.

Under S.41 the Regulator must, on request, report to the Ministers on the functioning of the Regime. The Regulator may use this avenue to report on inefficient or inappropriate practices being applied in the course of safety accreditation. S.50 now requires a comprehensive public Ministerial review of the Regime after three years of operations. This issue can be considered in this review.

Conclusion

The Council considers that the Regime's provisions for safety accreditation satisfy ***Clause 6(4)(a)–(c)****.*

3.2.2 Timepath management

Relevant CPA criteria

Clause 6(4)(a)-(c) - negotiation framework, terms and conditions should not preclude access.

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Clause 6(4)(i) - conditions the arbitrator (and hence the negotiation) should take into account. Arbitration should support negotiation.

In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

Clause 6(4)(l) – requires compensation of an access holder for any transfer of rights

The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

Timepath management involves a range of matters but includes:

- the access provider's general allocation policies;
- its approach to day-to-day management matters; and
- its policy to transfers or reallocations of timepaths between rail operators.

Timepath management significantly influences the quality of service provided and passed on to final customers and therefore is important in influencing the relative competitiveness between rail operators and between rail and non-rail transport. For instance, persistent delays will undermine customer confidence in that operator's ability to travel within the advertised time. If delays occur across all operators then only the relative competitiveness between rail and non-rail transport will be affected. However, if only some rail operators are delayed, those operators' costs will increase, changing their competitiveness relative to those operators not experiencing delays. As timepath management is in the hands of the access provider, it has important implications for competitive neutrality principles - the access provider has an incentive to give its own operator a competitive edge.

To meet **Clause 6(4)(a)-(c)**, the Council considers that timepath management should be effected in a way that reflects competitive neutrality principles that coincide with the quality of service negotiated and does not deter access.

The Regime's dispute resolution processes can resolve disputes over timepath issues. Therefore, the provisions of **Clause 6(4)(i)** should direct the Arbitrator to take the interests of all affected parties into account, while mindful of the benefits of efficient capacity utilisation and cost recovery.

Clause 6(4)(l) relates to how timepath management deals with the rights of existing access holders. It requires that these holders be appropriately compensated for any loss of rights.

Certification Issues

1. No timepath management policies

Submissions (NRC, ARTC, FreightCorp, Toll) noted that timepath and service quality matters were not explicitly addressed by the Regime. NRC and FreightCorp indicated that timepath management went to the heart of access, competitive neutrality and quality of service matters.

Freightcorp noted:

> As a general comment, the allocation of train paths is fraught with difficulty in any jurisdiction. ... It must be recognised that capacity in a rail system is quite different from that in a gas pipeline or electricity grid. What matters acutely are the origin, destination and other parameters of the train. This can be contrasted with the capacity of a pipeline where the guiding principle is whether additional product can be added to the network at a particular time. It is immaterial which product exits the network at which location so long as the quantity is appropriate (eg the petajoules of gas). As these products are homogeneous, the particular molecules of gas do not matter. With rail it is crucial that each particular product which enters the network exits the network at a particular point. This requirement leads to a fundamentally different outcome for the allocation of capacity.

At the draft recommendation, the Regime did not require the Regulator to develop guidelines on service quality and day-to-day timepath management. ARTC and FreightCorp (second submissions) expressed concerns that these vital elements of service delivery were excluded from such preliminary attention.

2. Arbitration too costly for timepath disputes

FreightCorp considered that as time sensitive disputes could occur over minor issues, such as day-to-day timepath management, arbitration could prove too costly and too prolonged relative to the issue. ARTC noted that there is a multitude of ways a track owner could deter access through network control practices. FreightCorp considered timepath matters would be better managed by an independent regulator.

3. Access seeker to negotiate directly with existing access holders

The Council noted that S.10 and S.11 required the access seeker to negotiate directly with each access holder with a right that might be affected by the access seeker's proposal. S.20 followed on to address **Clause 6(4)(l)** by guiding the arbitrator on the need for compensation for existing access holders.

The need for compensation was mitigated by S.20(2)(b), which allowed an arbitrator to make an award against the rights of an existing access holder if the access seeker's requirements could not be met from an alternative source and the access holder's entitlement exceeded its needs:

> *... and there is no reasonable likelihood that the access holder will need to use the excess entitlement;*

The Council considered that the way these rights were initially allocated and defined would prove crucial to the efficiency of this approach. FreightCorp claimed that the current solution of grandfathering the rights of incumbents worked against new entry and so competition – a situation exacerbated when the infrastructure owner was also a train operator.

The Council's assessment of the NT/SA Governments' response

1. No timepath management policies

S.9 now requires the access provider to give access seekers information on service quality, day-to-day timepath management, timepath allocation and reallocation policies. These are to be developed and maintained in accordance with guidelines prepared by the Regulator.

The Regulator will now establish these guidelines, through public processes, prior to commencement of operations. These should address matters concerning competitive neutrality, initial allocations and any other matters raised in the public consultation processes, allowed for in the development of such guidelines, under S.8. For instance, the Regulator may consider it necessary that it assist the Arbitrator in interpreting S.20(2)(b) by giving guidance on what constitutes an entitlement that covers the access holder's *"current and foreseeable needs"*.

At the draft recommendation, the Regime did not require the Regulator to develop guidelines on service quality and day-to-day timepath management. Submissions to this draft expressed concerns at this omission. As a consequence, the Governments agreed

to include a requirement (S.9) that the Regulator must also develop guidelines for these elements of rail management.

2. Arbitration too costly for timepath disputes

Under S.12B, the Regulator can now be asked to intervene in any negotiation matter. This allows the access seeker to check aspects negotiated with the access provider, including those relating to timepath and service quality matters. The Regulator can assure the access seeker that the elements it has negotiated comply with the Regime or direct the access provider to modify its offer to comply with the Regime.

S.12B also allows the Regulator to impose penalties for non compliance with its directions. S.15 allows the parties to engage the Regulator as a Conciliator on matters in dispute. This provides several avenues to low cost dispute resolution. However, the option of full arbitration remains open if these fail.

3. Access seeker to negotiate directly with existing access holder

Given that the Regulator will now need to develop reallocation guidelines, it may also consider it appropriate to provide guidance to the access seeker and an existing access holder on matters related to their negotiations over reallocating existing rights.

This negotiation is subject to the general negotiation framework and dispute resolution processes.

Conclusion

The Council considers the provisions for timepath management satisfy ***Clauses 6(4)(a)–(c), 6(4)(i) and (6(4)(l).***

4 DISPUTE RESOLUTION AND ENFORCEMENT

Relevant CPA criteria

Clause 6(4)(a)-(c) - negotiation framework, terms and conditions should not preclude access. Arbitration should support negotiation

A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

Clause 6(4)(g) – requirement to appoint independent arbitrator

Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

Clause 6(4)(h) – arbitrations binding, but appeal rights preserved

The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

Clause 6(4)(i) - conditions the arbitrator (and hence the negotiation) should take into account.

In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;
(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;
(iv) the interests of all persons holding contracts for use of the facility;
(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;
(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;
(vii) the economically efficient operation of the facility; and
(viii) the benefit to the public from having competitive markets.

Clause 6(4)(n) – accounting separation of businesses

Separate accounting arrangements should be required for the elements of a business which are covered by the access regime

Clause 6(4)(o) – arbitrator needs access to access provider's financial information

The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

A Regime must contain independent dispute resolution and enforcement processes. Independence from the parties is primary to guarantee that the Regime will be effected without favour. **Clause 6(4)(g)** is primarily concerned with the independence of the dispute resolution managers. It also covers dispute resolution funding by the parties.

The expectation that the elements of the Regime will ultimately be implemented in accordance with the CPA principles, gives the access provider the incentive to comply with the Regime in the negotiation process. The expectation that it will be granted access on the terms and conditions provided by the Regime, encourages the access seeker to pursue access. The time and cost required to ensure enforcement of the Regime, qualifies the effectiveness of the dispute resolution and enforcement processes. Processes that are costly to exercise are likely to be less effective in both constraining the access provider to negotiate within the terms of the Regime and providing the access seeker with sufficient confidence to seek access.

Submissions to a number of the Council's processes have indicated that operators consider arbitration a costly exercise. They stated that they would use arbitration only when outcomes were likely to provide benefits above arbitration costs – meaning that less significant matters would go unchallenged. If an access provider anticipates that a range of relatively low valued matters will go unchallenged it has no incentive to offer efficient outcomes on these matters. Therefore, accessibility to dispute resolution, as well as its anticipated effectiveness, are issues for **Clause 6(4)(a)–(c**). The Council considers that a Regime will be more effective if it contains a relatively informal, low cost dispute resolution process as well as full arbitration.

Clause 6(4)(h) requires that while the decisions of the dispute resolution body need to be enforceable, existing legislative rights of appeal should be preserved.

Clause 6(4)(i) requires that the dispute resolution managers take the matters listed under this clause into account when resolving disputes and effect them with the intent of Part IIIA.

Clause 6(4)(n) allows the Arbitrator to establish prices based on the appropriate costs for above and below rail calculations.

Clause 6(4)(o) requires Regimes to contain provisions enabling the dispute resolution body and any other relevant body (for example, the Regulator) to obtain financial information pertaining to the service.

Certification issues

1. Independence and the role of Regulator in the Regime

In the original Regime, S.5 acknowledged that the Regulator was subject to the control and direction of the two Ministers on some matters. However, S.5 also stated that no Ministerial direction could be given in relation to the Regulator's role in dispute resolution. The Council did not consider the Regulator enjoyed complete independence. As such there was a question as to whether it met **Clause 6(4)(g)** and so could take a significant role in the Regime.

The Regime gave the Regulator several functions including providing conciliation services and being responsible under S.16 for appointing an Arbitrator from a list it compiled of suitably qualified prospective Arbitrators. This appeared to provide it with too significant a role for its level of perceived independence.

2. Low cost dispute resolution

The original Regime allowed the Regulator to provide conciliation services and refer disputes to full arbitration when requested. Conciliation offered a lower cost mechanism than full arbitration. However, the Regulator was not fully independent and this raised a question over the effectiveness of conciliation.

FreightCorp reiterated its view that dispute resolution through arbitration was too costly an option for most disputes. It considered that the lack of a low cost dispute resolution processes would seriously deter access and expressed a preference for the inclusion of an independent regulator able to deal with all disputes at a preliminary level. It considered the Regime was constructed in a way that was likely to precipitate disputes. For instance, FreightCorp considered that the complexity of the pricing approaches and the fact that the access provider would also operate rail services would give it reason to question elements of any offer.

3. Restraint on reapplication by access seeker

Under S.35(2) of the original Regime, an award took effect 21 days after it was determined by the Arbitrator, unless the access seeker elected not to be bound by the award. In this case, the access seeker was precluded from making another access proposal for 2 years (unless otherwise authorised by the regulator). Arguably this would result in that access seeker being precluded from making a proposal for a service unlike that considered under arbitration.

The Council considered this restriction too general and that it may unnecessarily inhibit access.

4. Strength of processes

The lack of a fully independent Regulator left the responsibility for dispute resolution primarily with the Arbitrator. The Council had concerns that, as the Arbitrator was

unlikely to be the same across arbitrations, the Regime would have difficulty producing consistent and timely results at arbitration. This could deter access and so raised issues under **Clause 6(4)(a)-(c).**

5 Division of costs

S.34 required that the costs of arbitration be equally divided between the parties unless otherwise determined by the Arbitrator. It also provided that the access seeker bears the costs if the access seeker terminated or elected not to be bound by an arbitration.

6 Enforcement

Unless the access seeker chose not to be bound, S.35 required that the Arbitrator's award bind the parties. Under S.36, a Regulator could vary or revoke an award if the parties agreed. If the parties were unable to agree, the Regulator could refer the dispute to arbitration. If the Regulator considered there was insufficient reason for varying the award it need not refer the dispute to arbitration. The lack of independence of the Regulator made its involvement an issue.

Where a party fails to comply with an order of an Arbitrator, S. 36 allowed the Arbitrator to ensure enforcement by certifying the failure to the Court that then may inquire into the case.

S.37 combined with S.36 to address the enforcement issues raised by **Clause 6(4)(h).** They provided for a right of appeal to the Supreme Court on questions of law from an award or a decision not to make an award. On an appeal, the Supreme Court could:

- vary or revoke the award or decision;
- make an award or decision that should have been made in the first instance;
- remit the matter to the Arbitrator for the further consideration; and/or
- make incidental or ancillary orders, including orders for costs.

Unless decided by the Supreme Court, an appeal to the Supreme Court does not suspend the operation of an award.

Outside the matters of the Regulator's independence, the Regime raised no significant concerns with regard to **Clause 6(4)(h)**.

7 Regulator/Arbitrator to take into account matters outside 6(4)(i)

S.21. included a number of variations on **Clause 6(4)(i):**

> *(1) The arbitrator must take the following matters into account in making an award:*
>
> *(a) the legitimate business interests of the access provider, and the access provider's investment in the railway generally;*
>
> *(b) the high initial capital cost of the railway infrastructure facilities (including the cost of the rail corridor), the high degree of economic risk of the project, and the need for a fair return on the access provider's investment having regard to those costs and that risk;*
>
> *(c) the cost to the access provider of providing access, including any costs of extending the railway infrastructure facilities, but not costs*

associated with losses arising from increased competition in upstream or downstream markets;

(d) the public interest, including the public interest in having competition in markets;

(e) the interests of all access holders and other persons who have rights to use the railway infrastructure facilities, including all firm and binding contractual obligations;

(f) the pricing principles;

(g) the economic value to the access provider of extensions to the railway infrastructure facilities, the cost of which is borne by someone else, and any additional investment that the access seeker or access provider has agreed to undertake;

(h) the operational and technical requirements necessary for the safe and reliable operation of the railway infrastructure facilities;

(i) the economically efficient operation of the railway infrastructure facilities.

(2) The arbitrator may take into account any other matters, not inconsistent with the matters referred to in subclause (1), that the arbitrator thinks are relevant.

The main difference to **Clause 6(4)(i)** is the addition of S.21(b) which required the arbitrator to take into account the high initial capital cost and risk of the facilities. It also reminded the Arbitrator that the access provider needed a return commensurate with this cost and risk.

Submissions argued that this was a risky project, they also noted that the access provider should take a commercial approach and only undertake construction if it considered normal commercial returns would compensate it for its investment. If this were not the case, the access provider could achieve better returns in an alternative investment and should make that decision. Submissions also argued that if the access provider decided to go ahead with the project, operators should only expect to pay prices that reflect returns that could be expected in a competitive market. In addition, the capital requirements and risk on capital invested were significantly ameliorated by the peppercorn rental for the lease of the current assets (Tarcoola to Alice Springs line) and the capital grants to be provided by the Commonwealth, Territory and State Governments.

The Council and participants considered that issues of risk were already taken into account in **Clause 6(4)(i)** and that no additions were necessary.

S.21(d) features a variation of **Clause 6(4)(i)(viii).** Sub section (d) moves the focus from the public benefits that are afforded from competitive markets, to the benefit of having *"competition in markets"*. The Council considers that the benefits outlined in **Clause 6(4)(i)(viii)** relate to the benefits afforded to consumers from prices determined in competitive markets compared with markets where suppliers have market power. The Council considers that this variation does not cloud the intended interpretation of this criterion.

S.21(f) requires that the Arbitrator take account of the pricing principles. This is not included in **Clause 6(4)(i),** however the Council would only recommend a Regime it contained pricing principles consistent with **Clause 6(4)(i)(viii).** It therefore did not consider that the inclusion of S.21(f) was a concern.

8 Access to financial records

S.39 looked to address the requirements of **Clause 6(4)(o).** It gave the Regulator the power to obtain information from the access provider:

> *S.39(1) The regulator may, by written notice to the access provider, require the access provider to provide to the regulator, within a period stated in the notice or at stated intervals, specified information or copies of specified documents related to –*
>
> *(a) the provision of railway infrastructure services to which this Code applies; and*
>
> *(b) any other activity in relation to the railway engaged in by the access provider or a related body corporate or an associate of the access provider.*
>
> *(2) without limiting subclause (1), the information and documents that may be required extend to financial information and documents relating to the access provider's own use of railway infrastructure facilities.*
>
> *(3) A person must not, without reasonable excuse, contravene or fail to comply with a notice under this clause.*
>
> *Penalty: $100,000 and $10,000 for each day during which the offence continues.*

The Council's assessment of the NT/SA Governments' response

1. Independence and role in regime

S.5 now appoints the SA Independent Industry Regulator, established under the *Independent Industry Regulator Act 1999*, as the Regime's Regulator. The legislation indicates it has the independence and will have access to sufficient expertise to carry out its responsibilities. Now that the Regulator is independent it can take a broader role in ensuring compliance with the Regime.

2 Low Cost dispute resolution

When disputes arise, parties now have a choice of three options:

1. S.12B allows the Regulator to give directions to the parties, during the negotiation phase, regarding the compliance of elements of the negotiated outcome with the Regime.
2. S.15(1)(a) allows the Regulator to conciliate in areas of dispute if the parties agree.
3. S.15(1)(b) allows, upon request, the Regulator to appoint an arbitrator.

These options increase in formality and cost respectively. The Council considers this approach, together with the appointment of an independent Regulator, addresses its concerns.

3 Restraint on access seeker

S.35 allows more latitude for an access seeker, who chooses not to be bound by an arbitration award, to make further proposals. It now states that:

> *(5) If the access seeker elects not to be bound by an award, the award is rescinded.*
>
> *(6) If—*
>
> *(a) an award is rescinded under subclause (5); and*
> *(b) the access seeker who elected not to be bound by the award makes a new access proposal under this Code,*
>
> *the regulator may, on application by the access provider, determine that the new access proposal should not proceed if, in the opinion of the regulator—*
>
> *(c) in a case where the new access proposal is the same as, or similar to, the access proposal in relation to which the award was made—the access seeker is acting unreasonably in view of the period of time between the rescission of the award and the making of the new access proposal;*
>
> *(d) the access seeker has not acted, or is not acting, in good faith; or*
>
> *(e) there is some other good reason why the new access proposal should not proceed.*
>
> *(7) A determination of the regulator under subclause (6) will have effect according to its terms*

If the Regulator considers it appropriate, any new proposal from an access seeker, that refuses to be bound by an arbitration, must now be considered by the access provider.

4 Strength of processes

The arbitration process has not changed significantly. However, the insertion of an independent Regulator with more extensive powers and functions, will substantially reduce the number of matters flowing through to arbitration - for instance, the Regulator's guidelines assisting the determination of prices and timepath policies. The powers and functions of both the Regulator and Arbitrator are listed in the following table.

The Regulator's participation in each of the three dispute resolution options will also reduce arbitrations. S.12B gives the Regulator the role of initial verifier – the Regulator will keep sufficient information to enable it to verify that negotiated terms or conditions comply with the Regime. The parties can take any issue to the Regulator to check for its compliance with the Regime or to trigger an action by the Regulator to ensure a party acts within the Regime.

S.15 provides the option of conciliation before the arbitration process commences.

If conciliation is inappropriate or unsuccessful, the Regulator appoints a suitable and independent arbitrator. However, it remains ready to provide the Arbitrator with any guidance, expertise or information that would assist in its determinations.

5 Division of costs

Where previously S.34 set the equal division of costs as the norm, it now makes no mention of equal division, allowing the Arbitrator to apportion arbitration costs, including each party's reasonable costs and expenses. It still requires the access seeker to bear all the costs of arbitration if it elects not to be bound by an award.

The Council did not consider that this posed any substantial concerns and did not receive any further comment in submissions on the draft recommendation.

6 Enforcement

The inclusion of an independent Regulator meets the Council's previous concerns regarding the Regulator's involvement in the enforcement processes.

7 Arbitrator to take into account matters outside 6(4)(i)

At the time of the draft recommendation, S.21(2) required that S.21(b) to be applied consistent with **Clause 6(4)(i).** FreightCorp (second submission) still considered that the use of subjective terms such as "**high**" initial capital cost and "**high**" risk in this sub section, could be interpreted by the arbitrator as a direction to consider this project as having unique risks, higher than those for other similar projects. It was FreightCorp's contention that the subjective words should be removed from this sub section.

The Governments agreed to delete the word "**high**" twice from sub section 21(b) which now reads:

> *the initial capital cost of the railway infrastructure facilities (including the cost of the rail corridor), the degree of economic risk of the project, and the need for a fair return on the access provider's investment having regard to those costs and that risk;*

The Regulator now has a number of functions that should assist in this outcome. Calculations of capital costs (that would reflect considerations of risk) must use methodologies developed by the Regulator, in accordance with efficient costs, through public processes.

8 Access to financial records

The regime provides the Regulator with sufficient powers to obtain any relevant financial and accounting information within a reasonable time. The Regulator's ability to direct the access provider to provide information under S.39 is now strengthened by its broader powers and independence.

S.46(2)(c) now explicitly requires that the access provider's accounts and records be kept to ensure that sufficient information is available to apply the pricing principles. While it is not clear that the Regulator can direct the access provider to structure its accounts in a fashion that will provide it with the information it requires, it can require that certain information be provided. The access provider will need to set up its accounts so that it can meet these requirements.

Conclusion

The Council considers that the dispute resolution processes satisfy ***Clauses 6(4)(a)-(c), 6(4)(g) 6(4)(h), 6(4)(i), 6(4)(n)*** *and* ***6(4)(o).***

Table 4 Powers and functions of the Arbitrator and Regulator

Arbitrator
Make persons a party S.17(d) allows the Arbitrator to make any person with sufficient interest a party to an arbitration.
Award S.19 - must make a written award with reasons - may, among other things and subject to S.20, require the access provider to expand or extend the facility - must give a draft award to the parties and the regulator S.21 must take into account matters not inconsistent 6(4)(i) S.22 – gives discretion to terminate without making an award after giving parties and regulator reasons
New investment S20 - conditional award on new investment but in the end must comply with 6(4)(j)
Particular powers S.28 (1) has broad discretion to manage the arbitration S.19-32 - fine a person acting in a way that would constitute contempt of court Penalty: $50,000. - fine a person acting contravening an order to keep information confidential Penalty: $50,000. - fine a person failing to present as a witness Penalty: $50,000. - fine a person failing to give information Penalty: $50,000. - fine a person for intimidation Penalty: $100,000. S.33 – decide on confidential information S.34- decide on costs but direction that if the access seeker terminates or elects not to be bound by an award, the access seeker must bear all costs
Appeal to Supreme Court on question of law S.37 – the only avenue of appeal on an award is through the Supreme Court on a question of law. Unless the Court decides, an appeal does not suspend the operations of an award.
Can request information S. 40(b) can request information from the regulator in the course of an arbitration.
Enforcement of arbitrator's requirements S. 44 - the arbitrator may advise failure to comply with an award to the Supreme Court.
Pricing Schedule – The Arbitrator must follow the pricing principles in any arbitration.
Regulator
Public consultation S.8 - Requires the regulator to undertake a public consultation process when undertaking a S.50 review or is considering the adoption of a guideline, or a variation to a guideline
Cost information S.9(e) – develop and publish guidelines to be followed by the access provider when it provides information to access seekers on prices and costs
Time-path allocation S.9.(3) – develop and publish guidelines for the access provider's policies on time-path allocation and reallocation policies
Regulator obtains information S.10(a)(i) – receive within 21 days from the access provider, written notice of any access proposal
Regulator can release information S.12A(3) – allows the regulator to disclose confidential information from access proposals for the public benefit
Test the access provider's proposal S.12B – allows the Regulator to give advice or directions with respect to any negotiation matter – first step in dispute resolution process. Also allows Regulator to impose penalties for non compliance with directions

Table 4 Powers and functions of the Arbitrator and Regulator ..cont.

Conciliate and manage arbitration S.14/15 – conciliate or appoint an arbitrator to resolve a dispute S.16 – must keep a list of suitably qualified arbitrators S.35 – notify the access seeker that an arbitration award has been rejected and decide if a subsequent proposal from that access seeker is for a similar or dissimilar service S.36 – allows the regulator to vary or revoke an award if all parties agree or refer to arbitration if there is no agreement S.47 – remove the arbitrator under certain circumstances
Assist arbitrator S.17 - may participate in an arbitration to provide or call for evidence, give expert advice
Publish arbitration outcomes S.19 – allows the regulator to disclose confidential information from arbitrations for the public benefit
Information from access provider S.39 - may require the access provider to provide specified information or documents related to any matter but including the access provider's own use of railway infrastructure facilities and financial information
Disclose confidential information S.40 – allows the regulator to disclose confidential information obtained in the course of monitoring the Code for the public benefit
General report to Ministers S.41 requires the regulator to report to Ministers on the provision of railway infrastructure services, including costs and any aspect of the Code's operations
Enforcement S.42 – allows the regulator to take out an injunction through the Supreme Court to restrain behaviour that contravenes the Code
Vary or develop guidelines S. 45A - may vary or revoke guidelines or publish new or substitute guidelines
Account segregation S.46 – the access provider must keep its accounts and records in accordance with any guidelines published by the Regulator
Reviews S.50 – prepare reports necessary for any Ministerial review of the Code. The first is scheduled for 3 years after operations commence. Review the "relevant revenues" against costs – monopoly rent test
Pricing principles Determine capital costs guidelines for ICar deduction. Determine capital costs guidelines for ceiling price test, taking into account the cash and asset subsidies. General provisions to publish guidelines to facilitate operation of pricing approaches

5 CROSS BORDER ISSUES

Relevant CPA criteria

Clause 6(2) – concordance with arrangements covering outside services

The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:

(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or

(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

Clause 6(4)(p) – concordance when more than one set of arrangements cover the same service

Where more than one State or Territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

Clause 6(2) raises issues relating to services provided by a facility that significantly influences the services provided in another jurisdiction.

Clause 6(4)(p) deals with the consistency of access arrangements, where more than one set of arrangements applies to a service.

While **Clauses 6(2) and 6(4)(p)** deal with some common issues, the scope of **Clause 6(4)(p)** is more focussed on the consistency of Regimes, rather than the more general approach of **Clause 6(2)** which can be triggered by the influence of the Regime, and the facility it covers, on services provided outside its coverage.

The Regime – as initially submitted

The NT/SA Governments argued in their application that the Regime complies with **Clauses 6(2)** and **6(4)(p)** because:

> The Railway is situated in both South Australia and the Northern Territory, and the Access Code will apply equally to Railway Infrastructure Services provided by means of the Railway in both jurisdictions. …the Access Code adopts a single set of rules for regulating access arrangements regardless of whether the services are provided in one or other or both jurisdictions - for instance the Ministers will jointly appoint one Regulator so the Access Provider, Access Seekers and Access Holders will have one point of statutory contact for both jurisdictions.
>
> Users of the Railway will need to enter into appropriate access arrangements with the owners/operators of other relevant sections of the interstate railway network in Australia to the extent that they interconnect with the Railway at Tarcoola. The need to negotiate those arrangements will apply equally to the owner/operator of the Railway and to third party access seekers who obtain a right to use the Railway.
>
> In the circumstances (of a single access regime applying to the Railway north of Tarcoola and that whatever access arrangements and interfacing arrangements are required south of Tarcoola will apply equally to all Railway users) no substantial difficulties should arise from the proposed access regime and the fact that the Railway is situated in more than one jurisdiction.

The Governments have endeavoured to address **Clause 6(4)(p)** issues by establishing mirror legislation in each state to cover the elements of the Regime. Mechanisms within the Regime, including the regulatory and arbitration arrangements, are universally applied across all services on the tracks in both states. The pricing approaches are not dependent on location but on the competitive conditions relative to each service.

Certification Issues

The Regime addressed **Clause 6(4)(p)** by establishing consistent Regimes through mirror legislation in both States. The Council considered there were no further issues with regard to this criterion. This left a number of issues regarding **Clause 6(2).**

1. No specific provisions to allow for national arrangements

As NRC noted, it is likely that most of the freight transported along the AustralAsia Railway will originate or terminate somewhere beyond Tarcoola:

> Any person wishing to operate a rail service on this railway must obtain access both to this infrastructure and also other infrastructure owned by the ARTC [Australian Rail Track Corporation] and (depending on the corridors used) also other track owners

> (RAC of NSW, Westrail and Queensland Rail). There is no significant demand for service on this line that does not also require the use of services provided by one or more of these other organisations in South Australia, Victoria, New South Wales and Queensland.

Submissions stressed the importance of a co-ordinated approach to interstate rail services. Toll Transport argued that the access framework could only benefit from consistency with the national framework:

> Toll acknowledges that the greenfields nature of this project will impact upon certain aspects of how access should be regulated and the terms and conditions of that access. However, any differences should be as limited as possible and the framework should be consistent with a national framework.

Currently there is an intergovernmental agreement that covers, among other things, the arrangements for access to interstate rail services. The agreement provides for operators to be able to access the national network, from capital city to capital city, through a single point of entry, ARTC. Of the two jurisdictions, only South Australia is a signatory to this agreement. Even so, its relevance to this project could be limited. The agreement expires 30 June 2003 and there is no clear commitment to extend the agreement beyond that date. Therefore, it is unclear what national arrangements will be in place when the AustralAsia Railway begins operations in or around 2003. Up until then, the existing line from Tarcoola to Alice Springs is likely to be administered by ARTC's access arrangements.

Submissions to the Council's draft recommendation strongly criticised the Regime for its lack of provision for future national arrangements, even if these arrangements remain largely unspecified. They considered this lack of provision contrary to the requirements imposed on other Regimes and potentially deleterious to the continued development of a national approach. In its submission, ARTC (second submission) stated that:

> The applicants have stated several times that the notion of a single national regime (applying to all rail infrastructure) a 'high ideal'. This may or may not be true. More likely might be a single access regime applicable to all movements on the interstate network. This outcome is still more desirable than the situation currently in place and remaining interfaces can be managed as occurs in some states now. Where a state based regime excludes interstate movements (but not the network), it is desirable that that regime be consistent with any national regime (given both regimes will apply on the one section of track). Where a state based regime includes interstate movements, as is the case here and in NSW only, it is most important that that regime be consistent with any national regime. It is one of the goals on the NCC to ensure that this is the case. ... ARTC has previously applauded the exclusion by WA of interstate services from its regime, and the NCC recommendation to certify the NSW regime until 31 December 2000, so that it can be reviewed in the context of the national regime.

2. Sustainable competitive pricing approach

Interested parties envisaged that the sustainable competitive pricing approach would be difficult to integrate with the pricing approaches of other Regimes. FreightCorp (second submission) considered the approach inconsistent with other Regimes and likely to cause integration problems. ARTC (second submission) considered that the approach required

a large number of preliminary steps, based on very specific information. The level of detail required may not always be available to ARTC, particularly when it negotiated to buy blocks of access to onsell:

> ... ARTC has only limited knowledge of the prices of modes competing against access seekers. ... This is one reason why ARTC believes that an auctioning approach to pricing represents an efficient solution once competitive neutrality between access seekers has been achieved.

The Commonwealth Department of Transport and Regional Services (second submission) stated that this approach could stop ARTC using this track:

> The ARTC is currently negotiating wholesale access agreements with Queensland, NSW and Western Australia. While the details of those agreements are still to be finalised, it is envisaged that these arrangements would entail jurisdictions making blocks of capacity available to the ARTC to sell to interstate operators under its own arrangements. It is understood that while the NT/SA Regime would not preclude the ARTC from purchasing access on behalf of other above rail operators, the pricing structure would seem to preclude the ARTC from pre-purchasing blocks of access without first identifying an operator and the nature of the operation to determine which pricing structure should be applied to the access seeker.

FreightCorp and ARTC (second submissions) agreed with the Department. They suggested that if the approach, and the long period of certification, was accepted, the Council should require a review of its effectiveness in the early years of the Regime's operations.

NRC (second submission) agreed that to ensure consistency the elements of the Regime should appear consistent to those of Regimes currently in place and that consistency tested in an early review. NRC noted the window of opportunity now available to link all Regimes with a common review date:

> If the SA-NT regime as now proposed is certified, this opportunity will be lost for at least 10 years (the first required review in the SA-NT regime), and probably for 30 years.

The Council's consideration of the NT/SA Governments' response

1. No specific provisions to allow for national arrangements

A number of changes have now been made to accommodate issues that may arise due to the Regime's interaction with operations outside its coverage.

a) Definition of what is an interface issue

Firstly, under its definitions, the Regime picks up what service issues will be considered to have an "**interface**" dimension.

The Regime does this by defining both the relevant Regime and service issues:

> *"corresponding access regime" means-*
> *(a)*
>
> *(i) in respect of a service that is declared under Part IIIA of the Trade Practices Act 1974 of the Commonwealth, Part IIIA of that Act; or*

(ii) an access regime in respect of which there is a decision in force by the Commonwealth Minister under section 44N of the Trade Practices Act 1974 of the Commonwealth that the regime is an effective access regime;

(iii) an arrangement under an undertaking in operation under section 44ZZA of the Trade Practices Act 1974 of the Commonwealth; or

(iv) a code accepted by the Australian Competition and Consumer Commission under section 44ZZAA of the Trade Practices Act 1974 of the Commonwealth,

if and only to the extent that the regime allows for the resolution of interface issues arising under two or more railway access regimes; or

(b) a law, code, instrument or arrangement declared by the Northern Territory Minister and the South Australian Minister jointly, by notice in the Gazette, to be a corresponding access regime for the purposes of this definition;

While the services themselves are defined as:

"interface issues" - these are issues which directly affect two or more railways (including the railway to which this Code applies) and which relate to operating a freight service or a passenger service by means of such railways;

The Council was concerned to ensure that the use of the word "**operating**" did not preclude pricing issues. The Governments assured the Council that this was not the case. On the contrary, the Governments considered the word "**operating**" sufficiently expansive to embrace all potential issues, including pricing.

Having isolated the service issues that will be considered, there remains the specification of how these will handled by the Regime in negotiation of both terms and conditions and in arbitrations.

b) Negotation matters

The Regime now requires that the Regulator consider interface issues when it develops any guidelines. S.45A(2) now reads:

The regulator should, in preparing (or varying) guidelines under this Code, take into account interface issues that may arise under any corresponding access regime (insofar as this may be relevant and insofar as this is consistent with, and not in derogation of the operation of, the other provisions of this Code).

The Governments argued that this incorporates a requirement that all relevant issues are taken into account. The Council was concerned to ensure that all aspects of the Regime could be considered if they raised interface issues. This was necessary to comply with **Clause 6(2)**. The Governments agreed that when the Regulator develops all guidelines, including those for the pricing approaches, it should consider interface issues, as long as the fundamentals of this Regime are not over ruled by approaches in other Regimes.

c) Arbitration matters

The Regime has now incorporated particular provisions to cope with arbitrations over interface issues. S.21 directs the arbitrator on the matters to be taken into account when undertaking arbitrations. The Governments have now added an additional sub section

that requires the arbitrator to consider the need for efficient access when arbitrating interface issues:

> *S.21(ea) in relation to an interface issue involving a corresponding access regime – the interests of the access seeker in having efficient access to the railway;*

A provision has been added to S.16 to deal with situations where the Regulator needs to appoint an Arbitrator to arbitrate an interface issue.

> *S.16(4) If it appears to the regulator-*
> *(a) that a dispute includes, or may include, an interface issue; and*
> *(b) that the access seeker is, or may be, involved in a dispute under a corresponding access regime,*
>
> *then the regulator should, in making an appointment under this clause, endeavour to appoint a person who can also act under the corresponding access regime.*
>
> *(5) If the regulator is unable to appoint a person under subclause (4) who is able to act under a corresponding access regime, the person appointed under this clause to act as an arbitrator must, in respect of any interface issues involved in a dispute, endeavour to consult with any person appointed to act as an arbitrator under the corresponding access regime.*

The Regime now provides considerable flexibility to accommodate the arbitrators of "**corresponding regimes**" on interstate services.

The Australian Competition and Consumer Commission (ACCC) has raised with the Council a number of issues it considers are not fully addressed by the arrangements:

- there are no heads of power for the ACCC to undertake an arbitration role ;
- it is not clear how the ACCC will be constituted to undertake this role;
- it is not clear that the functions of the state regulator and the arbitration role of the ACCC will be consistent; and
- difficulties of a technical and opeational nature are likely to arise if an organisation, such as the ACCC, is one of a panel of arbitrators in a dispute.

Given that the ACCC will be the likely Arbitrator under the national arrangements currently being developed by ARTC, the Council considers ACCC participation is important. However, it concludes that the refinement of the general arrangements included in this Regime to accommodate the particular requirements of the ACCC should be negotiated by the ACCC and the Governments directly. The Governments considered that these matters could be addressed in the period before operations commenced. This issue can be reviewed by the Ministerial review after three years of operations.

The Council understands that the Regime can accommodate the ACCC's participation as an arbitrator, once the specific requirements are put in place. It also notes that the arrangements are broad enough to accommodate other "corresponding regimes" and their arbitrators as and when they become relevant.

2. Sustainable competitive pricing approach

a) Ability of approach to integrate with other Regimes

The Regime now includes pricing approaches set within the more conventional floor and ceiling parameters (see schedule to the Code and the discussion on pricing) included in the rail regimes of other States. Notwithstanding, the "**sustainable competitive**" approach still embodies a less conventional approach to establishing rail prices within that band and the Council welcomes the Ministerial review proposed in S.50, where this issue can be canvassed in light of operational experience.

b) Ability of ARTC to conduct a "one stop shop"

S.3(3) of the definitions is now amended to note that an access seeker includes ***"a reference to a person seeking access on behalf of another person or other persons"***. This amendment ensures that wholesalers, such as the ARTC, can onsell access arrangements negotiated under the Regime.

In response to the Commonwealth Department of Transport and Regional Services and ARTC's argument that this pricing approach precludes ARTC from pre-purchasing blocks of access, the Governments argue that as only a minimum of detail is required to complete negotiations, blocks could be pre-purchased. They envisage that freight categories would be few and based only on whether the cargo was containerised, bulk, refrigerated or dry. Further, they expect that price differentials for different non bulk services are likely to be low. Therefore, it will be possible to purchase blocks of generic timepaths for trains carrying any combination of non bulk freight.

The Governments amended the Regime to make it clear that negotiation and arbitration of blocks of timepaths are covered. An addition was made to S.10 to ensure that the ARTC's needs could be accommodated:

> *S.10(2a) An access proposal may involve:*
>
> *(a) a proposal relating to one or more freight services or passenger services and one or more time paths for such services; and*
>
> *(b) a person other than the access seeker who will ultimately require the railway infrastructure services which are the subject of the access request.*

The Council will again rely on the S.50 public Ministerial review, after three years of operations, to test these issues.

Conclusion

The Council considers that the Regime now satisfies ***Clauses 6(2) and 6(4)(p)***.

6 DURATION OF CERTIFICATION

Under Section 44M(5) of the TPA, the Council must recommend the period for which any certification should be in force.

The Council adopts a flexible approach in recommending a certification period. In doing so, it considers the views put by the applicant and other interested parties. One consideration is the need of infrastructure owners for regulatory certainty, especially when developing new infrastructure.

The NT/SA Regime – as initially submitted

The Governments requested that the Regime be certified for a minimum of 30 years. They argued that:

> The commercial viability of the Project is sensitive to movements in both revenues and costs (including capital as well as recurrent costs such as debt servicing costs). In that regard, the viability of the Project will be enhanced by an ability to access the most appropriate equity and debt financing products. One expected method of financing the Project, ... will be the use of capital market products (such as indexed linked bonds with the possibility for repayment periods exceeding 25 years, perhaps by a further 5 years). Such products are well suited to projects ... that may ... deliver a shortfall of cash flows in the early years of the project. In this situation the term of the capital market product can often be extended to up to 30 years to "top up" the cash flow shortfall from cash flows in later years. Such debt financing products are substantially more cost effective for such projects when compared to shorter term debt funding (for example bank debt). In that regard a number of "greenfields" infrastructure projects in recent years (such as toll roads) have used capital markets products with financing periods of around 30 years.
>
> A 30 year certification period is accordingly sought having regard to the likelihood of the successful consortium using capital markets products of the type described above and used in connection with numerous greenfields infrastructure projects in recent times. A certification period corresponding to the period over which the Project debt is likely to be repaid is essential in order for the finance and its repayment to be given a level of certainty regarding cash flows, particularly in the later years of the Project and the debt repayment period.

Certification Issues

Comments on the draft recommendation made it clear that, given the Regime's unique approaches and proposed duration, most interested parties were concerned that the Regime did not provide for an early review. Submissions generally argued that such a long period had the potential to entrench for its duration approaches that were in conflict with complementary regimes.

The Council's assessment

The Council noted that the project was unlikely to commence operations until 2003, reducing the operational period of a 30 year certification to 27 years. Past considerations have focussed on, among other things, relevant investment cycles. However, the resulting recommendations were all for periods substantially less than 27 years.

The Regulator's powers should allow it to adapt approaches over time. But, the Regulator is limited to developing only those guidelines specified in the Regime.

S.50 allows the Regulator to address the question of monopoly rents. But, its first review is not until after 10 years of operations (thereafter each 5 years). The remedy will not return realised rents but simply set prices going forward that anticipate no monopoly rent over the following five year periods.

The Council pressed the Governments to schedule an earlier and more comprehensive review.

The Governments agreed to include the following arrangements under S.50 for a comprehensive review of all elements of the Regime after three years operations.

> *S.50 (1) The Northern Territory Minister and South Australian Minister jointly may, at any time, review the operation of this Code but, in any case, must do so:*
>
> *(a) firstly not later than 30 June in the 3rd year of operations of the railway; and*
> *(b) secondly not later than 12 months before the expiration of the period for which the Commonwealth Minister has specified under section 44N of the Trade Practices Act 1974 of the Commonwealth that the access regime, of which this Code is a part, is to remain in force.*
>
> *(2) To enable the Ministers to perform their function under sub clause (1), the regulator must prepare such reports to the Ministers as the Ministers may require.*
>
> *(3) The Ministers must, in relation to a review under sub clause (1)(a) or (b):*
>
> *(a) (i) by notice published in a newspaper circulating generally in Australia, invite interested persons to make submissions in relation to the review within a period stated in the notice; and*
>
> *(ii) give consideration to any submissions made in response to an invitation under subparagraph (i); and*
>
> *(b) (i) in the case of the Northern Territory Minister - cause a report on the outcome of the review to be laid before the Legislative Assembly of the Northern Territory within 12 sitting days after the completion of the review; and*
>
> *(ii) in the case of the South Australian Minister - cause a report on the outcome of the review to be laid before both Houses of the South Australian Parliament within 12 sitting days after the completion of the review.*

The Council considers that this early opportunity for public participation and scrutiny of the Regime, should alleviate concerns that the Regime will be inappropriately implemented and such implementation will be maintained throughout the duration of the certification.

7 RECOMMENDATION

The Council considers that the amendments made by the Governments since application allow the Regime to now meet all the Clause 6 principles. The Council considers that the Regime should be certified for a period up to 31 December 2030.

8 SUBMISSIONS

The Council received submissions from the following participants:

To the issues paper and original application:

1. National Rail Corporation Limited
2. Department of Defence
3. Great Southern Railway
4. ARTC (Australian Rail Track Corporation Limited)
5. FreightCorp
6. Toll Holdings Limited
7. Northlink Consortium
8. Commonwealth Department of Transport and Regional Services

To its draft recommendation:

9. FreightCorp
10. Commonwealth Department of Transport and Regional Services
11. ARTC (Australian Rail Track Corporation Limited)
12. Great Southern Railway
13. Asia Pacific Transport
14. National Rail Corporation Limited

9 ABBREVIATIONS

ACT	Australian Competition Tribunal
ARTC	Australian Rail Track Corporation Ltd
CPA	Competition Principles Agreement
FreightCorp	Freight Rail Corporation
IPART	Independent Pricing and Regulatory Tribunal (NSW)
NRC	National Rail Corporation Ltd
NT	Northern Territory
SA	South Australia
SCT	Specialized Container Transport
The Council	National Competition Council
The Regime	The AustralAsia Railway Access Regime
Toll	Toll Holdings Ltd
TPA	Trade Practices Act 1974 (Commonwealth)

Annexure 1

The Regime – a snapshot

The negotiation framework – by Section
S9 The access provider must provide reasonably requested information including: . current capacity utilisation; . technical details and requirements; . time-path allocation and reallocation policies in accordance with guidelines published by the Regulator; . service quality and train management standards in accordance with guidelines published by the Regulator; and . relevant prices and costs in accordance with guidelines published by the regulator
S10. The negotiation starts with the access seeker submitting a proposal to the access provider. The access provider may, within 21 days request further information. The access provider must, within 21 days give the proposal details to the Regulator, any affected access holder and provide the affected access holder's details to the access seeker. Negotiations with ARTC are specifically provided for.
S11.All parties have a duty to negotiate in good faith.
S12 All parties must be in agreement before contracts are finalised.
S12A. No unauthorised person can be provided with confidential information. No one can misuse confidential information gained in negotiation for competitive advantage.
S12B Any party can refer a negotiation matter to the Regulator for advice or a direction. Penalties can apply if directions are not followed.
S13 An access dispute exists if: . a respondent fails to commence negotiations within 30 days of the response date (21 days after receiving a proposal); . the access seeker fails to obtain an agreement; or . all parties agree that there is no prospect of reaching agreement.
S14 An access seeker may request the Regulator to refer an access dispute to arbitration.
S17 The parties to the arbitration of an access dispute are: . the access seeker; . the access provider; . any other respondent to the access proposal; . any other person who applies in writing to be made a party and is accepted by the Arbitrator as having a sufficient interest; and . the Regulator.
S19 The Arbitrator must make a written award. Before making an award, the Arbitrator must give a draft to the parties and the Regulator and may take into account their representations on the proposed award.
S35 Unless the access seeker elects not to be bound by the award within 7 days, it becomes effective in 21 days.
S37 Appeals on questions of law regarding an award, or a decision not to make an award, lie with the Supreme Court.
S38 Penalties can be imposed on any party hindering the access of another.
S42 The Supreme Court may grant an injunction restraining a person from contravening or requiring a person to comply with this Code.
Other matters
S46 The access provider must keep the accounts and records for its rail line business separate from its other businesses. The accounts and records must comply with the Regulator's guidelines and give a true and fair view of relevant income expenditure, assets and liabilities and sufficient information to enable the pricing principles to be applied in a reasonable manner.
S48 The Code can be amended by the Ministers up to 12 months after the Code's commencement.
S49 The Ministers may prescribe matters by notice in the Gazette.
S50 The Ministers will review the Code after 3 years of operations and thereafter at any time but must review it no later than 12 months before the expiration of the certification period.
Pricing approaches – Pricing Schedule
There are two pricing approaches - the "**sustainable competitive**" pricing and the "**floor ceiling**" approach. On receipt of an access proposal, a freight service will be tested to see if it meets the "**sustainable competitive**" pricing criteria. These criteria have been significantly tightened.
If the service meets the "**sustainable competitive**" criteria, a formula, using the price of the non rail service that is "**effectively constraining**" the subject rail service becomes the benchmark total freight price (CRLPab). From this is deducted the above rail avoidable costs (of the access provider in most cases), to determine the access price - it represents the most that could be paid by an operator that will allow it to compete with both rail and non rail services. This access price must lie within the floor/ceiling band applied consistently across all below rail services under this Regime.
If the service does not meet these criteria, it will be priced under the "**floor/ceiling**" approach using the efficient forward looking stand alone costs of the infrastructure necessary to provide this service.
Passenger services will always be priced under the floor/ceiling approach.
Competitive neutrality is taken into account explicitly in the "**floor/ceiling**" approach. Application of the "**sustainable competitive**" formula should allow entry only on the basis of greater efficiency of the access seeker relative to the incumbent operator, rather than on differential below rail pricing. Given this, competitive neutrality is indirectly taken into account in the operation of the "**sustainable competitive"** approach.
S.50 A review to test for monopoly rents is held periodically (first after 10 years and then after each successive 5 years). In that review all revenues (relating to the assets used to provide the services priced under the "**floor/ceiling**" approach) are totalled and compared against the efficient stand alone costs of the assets required to deliver the "**floor/ceiling**" services, to test for monopoly rents. If monopoly rents are found, the remedy (of reducing prices for the next period to remove anticipated monopoly rents for that period) will only be applied to the prices of the **"floor/ceiling**" services. Competition is expected to constrain monopoly pricing under the "**sustainable competitive**" approach.

Arbitrator's role
Make persons a party S.17(d) allows the Arbitrator to make any person with sufficient interest a party to an arbitration.
Award S.19 - must make a written award with reasons - may, among other things and subject to S.20, require the access provider to expand or extend the facility - must give a draft award to the parties and the regulator S.21 must take into account matters not inconsistent 6(4)(i) S.22 – gives discretion to terminate without making an award after giving parties and regulator reasons
New investment S20 - conditional award on new investment but in the end must comply with 6(4)(j)
Particular powers S.28 (1) has broad discretion to manage the arbitration S.19-32 - fine a person acting in a way that would constitute contempt of court Penalty: $50,000. - fine a person acting contravening an order to keep information confidential Penalty: $50,000. - fine a person failing to present as a witness Penalty: $50,000. - fine a person failing to give information Penalty: $50,000. - fine a person for intimidation Penalty: $100,000. S.33 – decide on confidential information S.34- decide on costs but direction that if the access seeker terminates or elects not to be bound by an award, the access seeker must bear all costs
Appeal to Supreme Court on question of law S.37 – the only avenue of appeal on an award is through the Supreme Court on a question of law. Unless the Court decides, an appeal does not suspend the operations of an award.
Can request information S. 40(b) can request information from the regulator in the course of an arbitration.
Enforcement of arbitrator's requirements S. 44 - the arbitrator may advise failure to comply with an award to the Supreme Court.
Pricing Schedule – The Arbitrator must follow the pricing principles in any arbitration.
Regulator's role
Public consultation S.8 - Requires the regulator to undertake a public consultation process when undertaking a S.50 review or is considering the adoption of a guideline, or a variation to a guideline
Cost information S.9(e) – develop and publish guidelines to be followed by the access provider when it provides information to access seekers on prices and costs
Time-path allocation S.9.(3) – develop and publish guidelines for the access provider's policies on time-path allocation and reallocation policies
Regulator obtains information S.10(a)(i) – receive within 21 days from the access provider, written notice of any access proposal
Regulator can release information S.12A(3) – allows the regulator to disclose confidential information from access proposals for the public benefit
Test the access provider's proposal S.12B – allows the Regulator to give advice or directions with respect to any negotiation matter – first step in dispute resolution process. Also allows Regulator to impose penalties for non compliance with directions
Conciliate and manage arbitration S.14/15 – conciliate or appoint an arbitrator to resolve a dispute S.16 – must keep a list of suitably qualified arbitrators S.35 – notify the access seeker that an arbitration award has been rejected and decide if a subsequent proposal from that access seeker is for a similar or dissimilar service S.36 – allows the regulator to vary or revoke an award if all parties agree or refer to arbitration if there is no agreement S.47 – remove the arbitrator under certain circumstances
Assist arbitrator S.17 - may participate in an arbitration to provide or call for evidence, give expert advice
Publish arbitration outcomes S.19 – allows the regulator to disclose confidential information from arbitrations for the public benefit
Information from access provider S.39 - may require the access provider to provide specified information or documents related to any matter but including the access provider's own use of railway infrastructure facilities and financial information
Disclose confidential information S.40 – allows the regulator to disclose confidential information obtained in the course of monitoring the Code for the public benefit
General report to Ministers S.41 requires the regulator to report to Ministers on the provision of railway infrastructure services, including costs and any aspect of the Code's operations
Enforcement S.42 – allows the regulator to take out an injunction through the Supreme Court to restrain behaviour that contravenes the Code

Vary or develop guidelines S. 45A - may vary or revoke guidelines or publish new or substitute guidelines
Account segregation S.46 – the access provider must keep its accounts and records in accordance with any guidelines published by the Regulator
Reviews S.50 – prepare reports necessary for any Ministerial review of the Code. The first is scheduled for 3 years after operations commence. Review the "relevant revenues" against costs – monopoly rent test
Pricing principles Determine capital costs guidelines for ICar deduction. Determine capital costs guidelines for ceiling price test, taking into account the cash and asset subsidies. General provisions to publish guidelines to facilitate operation of pricing approaches

Annexure 2

Practicality of "sustainable competitive" pricing approach

The AustralAsia Railway Access Regime proposes an access price formula in cases where there is a competitive market between rail freight and other transport modes. The Competitive Imputation Pricing Rule (CIPR) will be used to determine in the "**sustainable competitive**" approach where, within the limits of the ceiling price (stand alone long term efficient costs) and the floor price (avoidable costs), the access price should fall.

The CIPR states that in general the access price will be the difference between the maximum competitive price an access provider could charge for the transport of freight between two points and the incremental, above rail, costs of providing the relevant freight service by the access provider.

Some submissions raised doubts about the practical application of the formula. Questions were also raised about whether the formula would result in prices significantly higher than currently in place on the Tarcoola-Alice Springs line. With this in mind, the Council sought to test the practical application of the formula and the kinds of prices it may generate.

The Council used a linked spread sheet model of the physical and financial characteristics of the rail and road options. The spreadsheets compared the costs of transporting general freight in 20 and 40 foot containers by rail and using the latest technology trailers for road. These costs include:

- linehaul costs – capital, fuel, access (where applicable), labour and operating costs;
- terminal costs – including operating and capital costs;
- container costs – including operating and capital costs;
- overheads – including IT, operations and head office expenses; and
- pick up and delivery costs for rail – including labour, fuel, operating and capital costs – to move freight between its origin/destination and the rail head.

The main assumptions of the model are set out in Table A2.1. The results obtained from this exercise are set out in Table A2.1.

Table A2.1 - Competitive Imputation Access Price: Assumptions

Train	**Road**
Physical	***Physical***
General freight in a mixture of 20 and 40 foot containers (measured in Twenty Foot Equivalent Units – TEUs) at an average of 10 t/TEU	Same volume and type of freight as on rail but in 45 foot Tautliner trailers
Above rail operates at best practice – eg double stack wagons; 4000 horse power DC locomotives	Road trains with two (between Adelaide and Pt Augusta) and three (between Pt Augusta and Darwin) trailers
For the purposes of comparison, both road and rail have been modeled on the total Adelaide – Darwin corridor as there is no market for Adelaide-Tarcoola or Tarcoola-Darwin road freight.	
Financial	***Financial***
7.5 % profit margin on costs	7.5 % profit margin on costs
Wagons and locos leased for 15 years at 10 %	Prime movers and trailers leased over five years at 9%.
New terminals required at Darwin and Adelaide. Rent charged so as to earn the developer 8.5 per cent.	
General Assumptions *Tonnage of total freight task, rail construction costs, freight growth estimates and distance for rail journey taken from the NT/SA Governments 'application for certification.* *Two-way loading* *All traffic travels the full length of the Adelaide-Darwin corridor.* *No account is taken of time of day/peak time issues, the sensitivity of the freight to time deadlines or the length of contract although the costs are computed on an annual rather than single trip basis.* *Prices are based on long term costs, including the cost of capital.* *The freight task is assumed to be on-going long term.*	

The base case modeled – that is, 360 TEU trains, using latest technology rolling stock and completing one round trip a week – suggests that access prices would be in the order of 0.25 – 0.30 c/gtk. This outcome suggests that it is possible to use the formula, and also that, based on the above set of assumptions, the CIPR can yield results which are not significantly different from the access prices currently charged by other rail infrastructure owners.

However, it is important to note that while the access price that results from the model (and assumptions used in this case) implies that the CIPR would produce reasonable outcomes, the economics of rail transport are very sensitive to a large number of variables. To give some indication of these sensitivities, the model was run varying the volume of freight, the number of trips and the train lengths. Table A2.2 gives some indication of these sensitivities.

If freight volumes are halved, the formula gives a price below the floor, regardless of whether the freight is time sensitive (ie one trip a week) or not time sensitive (ie one trip every fortnight). By comparison, if the base case assumptions are relaxed to allow the maximum efficient use of the train assets, (ie two train sets running three services a week) the volume would triple from the base case and may therefore not be achievable - the resulting access price would be just below 0.8c/gtk.

Holding the number of services and the number of train sets at this high level but halving the volume per train would result in an access price of around the 0.45c/gtk mark.

The higher volumes in these last two scenarios leads to a higher access price because they allow the train operator to use its assets very efficiently. This means that the incremental above rail costs per gtk are reduced and so the access price rises.

Other factors, such as the technology employed will have an effect on the calculated price. If, for example, single as opposed to double stacked wagons were used, the above rail costs would be significantly higher, very possibly to the point where the access price falls below the floor price.

Not all freight would necessarily travel between Adelaide and Darwin. Some might be sent between Sydney and Darwin via Broken Hill, while other freight may travel less than the full length of the line. There is no guarantee that two-way loading will be possible.

The model necessarily makes assumptions about the extra costs of pickup and delivery for the rail option, but these costs may be considerably more or in some cases much less.

Finally, there are a range of different types of freight with different densities (that is more or less than the 10t/TEU assumed) that may be transported along the rail line which may exhibit quite different cost characteristics. None of these variations have been modelled.

Overall, for some freight in sufficient volumes, application of the CIPR will result in prices that compare with other rail access charges. However, the results were not consistent and prices fell below the floor price in some examples, even when it appeared that road was a strong competitor to rail.

Table A2.2 - CIPR Modelling Results

	TEUs per Week	**Volume (TEUs per train)**	**Train Sets**	**Round Trips per week**	**Access Price (c/gtk)**
Base Case	360	360	1	1	0.25 – 0.30
Less Volume – time sensitive	180	180	1	1	<floor price
Less Volume – not time sensitive	180	360	1	0.5	<floor price
Greater volume – time sensitive	540	180	2	3	0.40 – 0.45
Maximum utilisation of train assets	1080	360	2	3	0.75 – 0.80