



# Review of rail guidelines for Tarcoola-Darwin Railway

DRAFT DECISION

April 2019

### Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this paper. Written comments should be provided by **Friday, 17 May 2019**.

It is the Commission's policy to make all submissions publicly available via its website ([www.escosa.sa.gov.au](http://www.escosa.sa.gov.au)), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to publish any submission based on length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to: **2019 Review of rail guidelines for Tarcoola-Darwin Railway**

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## Glossary of terms

Above-Rail	Rolling stock such as locomotives, carriages and wagons.
Act	AustralAsia Railway (Third Party Access) Act 1999.
Access Contract	A contractual agreement between an <b>Above-Rail Operator</b> and the <b>Access Provider</b> regarding Access to the <b>Tarcoola-Darwin Railway</b> .
Access Price	The price of third party access to <b>Below-Rail Infrastructure</b> , provided by the <b>Access Provider</b> .
Access Provider	A party providing, or able to provide, <b>Railway Infrastructure Services</b> – sometimes referred to as a <b>Below-Rail</b> operator.
Access Regime	The regime to allow <b>Third Party Operators</b> access to <b>Railway Infrastructure</b> on the <b>Tarcoola-Darwin Railway</b> , under the <b>Code</b> .
Access Seeker	<b>An Above-Rail Operator</b> seeking access to the <b>Services</b> provided by the <b>Railway</b> .
Below-Rail	Refers to operations involving track management, including the track and associated infrastructure required to operate it.
Code	The AustralAsia Railway (Third Party Access) Code, which is contained as a Schedule to the AustralAsia Railway (Third Party Access) Act 1999 (SA) and the AustralAsia Railway (Third Party Access) Act 1999 (NT), which specifies the terms and conditions of Access for <b>Third Party Operators</b> to the <b>Tarcoola-Darwin Railway</b> .
Commission	Essential Services Commission, established under the Essential Services Commission Act 2002.
DORC	Depreciated Optimised Replacement Cost – a methodology for the valuation of assets.
GWAN	Genesee & Wyoming Australia (North) Pty Ltd, a wholly owned subsidiary of Genesee & Wyoming Inc.
MCA-NTD	Minerals Council of Australia (Northern Territory Division).
Pricing Schedule	The Schedule to the <b>Code</b> setting out the access pricing principles to be followed by the arbitrator.
Railway Infrastructure	Facilities necessary for the operation or use of the railway, including signalling and control systems as well as railway track, but not Rolling Stock.
Services	Trains run by an <b>Above-Rail</b> operator using the <b>Tarcoola-Darwin Railway</b> , which provides freight or passenger services including work Trains.
Tarcoola-Darwin Railway	The railway to which the <b>Code</b> applies, being the whole of the railway from (a point near) Tarcoola to its end in Darwin (in the Port of Darwin).

Third Party Operators	<b>Above-Rail</b> operators who are not related to or affiliated with the <b>Access Provider</b> .
Vertical Integration	Where the owner of the <b>Below-Rail Railway Infrastructure</b> is also a provider of <b>Above-Rail</b> operations.

# 1 Executive summary

The Essential Services Commission (**Commission**) is reviewing the Guidelines for the **Tarcoola-Darwin Railway** pursuant to clause 45A(1) of the AustralAsia Railway ('Third Party Access') Code (**Code**), a Schedule to the AustralAsia Railway (Third Party Access) Act 1999 (**Act**) (SA) and the AustralAsia Railway (Third Party Access) Act 1999 (NT). The previous review of the Guidelines took place in 2008.

The intent of the review is that the Guidelines issued by the Commission assist commercial negotiation of railway access, are up-to-date and relevant for existing and prospective railway users, and do not impose undue regulatory costs. While neither the Code nor the Act contain listed objectives or an objects clause, the intent of the review is consistent with the overall goals of access regulation under Part IIIA of the Competition and Consumer Act 2010 (Cth); that is, to help to ensure the efficient use of and investment in infrastructure and promote competition in activities that rely on the use of infrastructure services.

Following a period of consultation with stakeholders and consideration of submissions, the Commission has not identified the need for major changes to the Guidelines; draft amendments are of limited scope and are not expected to materially impact on the operations of the Tarcoola-Darwin Railway. The proposed amendments relate, among other things, to reporting timeframes and procedures, and improving readability.

The Commission also sees value in the Access Provider publishing reference prices, or the formula (or principles) for calculating them, on its website.

## 1.1 Background

The Code is established to facilitate commercial negotiation for access by **Third Party Operators** to the Tarcoola-Darwin Railway. The Commission's role as Regulator under the Code is to facilitate access negotiations and conciliate access disputes, monitor reporting and compliance with the Code, conduct periodic reviews such as reviews of revenues, and develop and maintain guidelines.

The Guidelines under review are:

- ▶ Guideline No 1 – Access Provider Reference Pricing and Service Policies
- ▶ Guideline No 2 – Arbitrator Pricing Requirements, and
- ▶ Guideline No 3 – Regulatory Information Requirements.

The review is not considering Guideline No 4 – Compliance Systems and Reporting. Instead, this Guideline will be reviewed as part of the Commission's broader review of compliance and monitoring later in 2019. This will allow for greater alignment of compliance requirements across regulated industries in South Australia.

## 1.2 Proposed amendments to the Guidelines

The Commission proposes to:

- ▶ retain guidance on floor and ceiling price principles, incremental cost, and the financial market rates to be used in rate of return of return calculations, all for consideration in the case of arbitration
- ▶ retain guidance on regulatory information requirements, and
- ▶ make minor modifications, updates and clarifications to the Guidelines.

The format of the Guidelines is also planned to be updated in line with the approach used by the Commission in other regulated sectors. Proposed amendments will be highlighted in the draft versions released.

### **1.3 Next steps**

The Commission invites written submissions on all aspects of this Draft Decision by 17 May 2019. To facilitate the provision of submissions or address any queries, the Commission would be pleased to meet with stakeholders for a briefing upon request.

The Commission intends to release a Final Decision with Final Guidelines in July 2019.

## 2 The review

### 2.1 Purpose of Guidelines and review

The AustralAsia Railway (Third Party Access) Code (**Code**) is a Schedule to the AustralAsia Railway (Third Party Access) Act 1999 (SA) and the AustralAsia Railway (Third Party Access) Act 1999 (NT) (**Act**).<sup>1</sup> The Code sets out a negotiate-arbitrate framework for access to specified infrastructure services provided by the operator of the **Tarcoola-Darwin Railway**.<sup>2</sup> The Code appoints the Essential Services Commission (**Commission**) as the Regulator of third party access to those services in both South Australia and the Northern Territory.

The Commission has issued four Guidelines for the Tarcoola-Darwin Railway, pursuant to the Code. Those Guidelines are:

- ▶ Guideline No. 1 – Access Provider Reference Pricing and Service Policies<sup>3</sup>
- ▶ Guideline No. 2 – Arbitrator Pricing Requirements<sup>4</sup>
- ▶ Guideline No. 3 – Regulatory Information Requirements,<sup>5</sup> and
- ▶ Guideline No. 4 – Compliance Systems and Reporting.<sup>6</sup>

Clause 45A of the Code empowers the Commission to vary or revoke guidelines developed and published under the Code, or develop and publish new or substitute guidelines (Appendix B). The purpose of this review is to ensure that those Guidelines continue to assist commercial negotiation of railway access, are up-to-date and relevant for existing and prospective railway users, and do not impose undue regulatory costs. The Guidelines were last reviewed in 2008.<sup>7</sup>

The Code and the Act do not set out specific objectives or contain an objects clause which might govern the conduct of this review. Nonetheless, the scope and purpose of the review is consistent with the general intent of clause 6 of the Competition Principles Agreement; that is, to identify the type of infrastructure services that should be subject to access regulation and to establish principles that the regulatory framework should embody.<sup>8</sup> It is also consistent with objectives of access regulation under Part IIIA of the Competition and Consumer Act 2010 (Cth): to promote the efficient use of and investment in infrastructure and promote competition in activities that rely on the use of infrastructure services.<sup>9</sup>

#### 2.1.1 Guideline No 1

Guideline No 1 is published to fulfil the requirements of clauses 9(1) (e) and 9(3) of the Code. In practice, the Guideline sets out matters of procedure relating to the provision of information by an **Access Provider** to an **Access Seeker** on rail track utilisation, time path allocation and service standards. The distinguishing feature of the Guideline is that it addresses the process involved in the request of **Access Prices** for reference purposes.

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<sup>1</sup> The Code is available at <http://bit.ly/AustRailway3rdPartyAccessAct>.

<sup>2</sup> See Appendix A for a short summary of the Tarcoola-Darwin Railway.

<sup>3</sup> See Guideline No 1, available at <http://bit.ly/RailIndustryGuidelineNo1>.

<sup>4</sup> See Guideline No 2, available at <http://bit.ly/RailIndustryGuidelineNo2>.

<sup>5</sup> See Guideline No 3, available at <http://bit.ly/RailIndustryGuidelineNo3>.

<sup>6</sup> See Guideline No 4, available at <http://bit.ly/RailIndustryGuidelineNo4>.

<sup>7</sup> See Commission, 'AustralAsia Railway (Third Party Access) Code: Guideline Review', Final Decision, 2008, pp.1-30, available at <http://bit.ly/ThirdPartyAccessGuidelineReview-Final>.

<sup>8</sup> See COAG Competition Principles Agreement, 11 April 1995, available at

<https://www.coag.gov.au/sites/default/files/agreements/competition-principles-agreement-amended-2007.pdf>.

<sup>9</sup> See National Competition Council, 'Declaration of Services: A Guide to Part IIIA of the Competition and Consumer Act 2010 (Cth)', April 2018, p.11, available at [http://ncc.gov.au/images/uploads/NCC\\_Declaration\\_Guide\\_-\\_Version\\_6\\_-\\_April\\_2018.pdf](http://ncc.gov.au/images/uploads/NCC_Declaration_Guide_-_Version_6_-_April_2018.pdf).

### 2.1.2 Guideline No 2

In the event of an access dispute, the Code requires an Arbitrator to determine an Access Price payable to the Access Provider by an Access Seeker. The Arbitrator is obliged to apply particular principles and methods in accordance with the Code. Guideline No 2 is published to inform these requirements. In practice, Guideline No 2 outlines principles to be considered in calculating rates of return, incremental cost, and floor and ceiling prices for **Railway Infrastructure Services**.<sup>10</sup>

### 2.1.3 Guideline No 3

Under clauses 39(1) and 46 of the Code, an Access Provider is obliged to report certain information to the Regulator. Guideline No 3 outlines the information that the Access Provider is required to keep, prepare and report to the Commission to fulfil requirements under the Code. This includes information on the separation of accounts and records and for periodic reviews of revenue.

### 2.1.4 Guideline No 4

Clauses 5 and 46(2) of the Code along with section 8 of the Essential Services Commission Act 2002 (SA) enable the Commission to issue a compliance guideline to fulfil its function to monitor and enforce compliance with the Code. Guideline No 4 sets out processes of the reporting of compliance by an Access Provider.

## 2.2 Scope of review

This review is not examining the Code or the Act. Rather, it is focussed on the Guidelines. The focus is consistent with clause 45A(1) of the Code, where the Regulator may vary or revoke guidelines developed and published under the Code, or develop and publish new or substitute guidelines (see Appendix B).

Of the four, the review only covers Guidelines No 1, No 2 and No 3. Guideline No 4 will be considered as part of the Commission's broader review of its Regulatory and Compliance Framework later in 2019; this will allow for greater alignment of compliance requirements across industries regulated by the Commission in South Australia.<sup>11</sup>

Clause 45A(2) of the Code states that, in developing or varying Guidelines, the Regulator should take into account interface issues that may arise under the **Access Regime**. Interface issues could involve the South Australian intrastate railway and the interstate railway. However, while interface issues are within scope of the review, the Commission has not received any complaints or otherwise been made or become aware of any material interface issues that should be addressed by changes to Guideline No 1, No 2 or No 3. The Commission remains open to submissions raising any such concerns during consultation on this Draft Decision.

## 2.3 Process of review

In undertaking the review the Commission has been informed by:

- ▶ submissions from stakeholders
- ▶ its analysis of the economic conditions on the Tarcoola-Darwin Railway

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<sup>10</sup> See Pricing Schedule, Division 1, clauses 6(f), (7)(a) and (7)(b)); Pricing Schedule, Division 2, clauses (2)(d)(iii), (6), (7), (8); and Pricing Schedule, Division 3, clauses (3), (4), (5)).

<sup>11</sup> The same approach for compliance guidelines was taken in the 2019 Review of the South Australian Rail Access Regime Information Kit. See Commission, '2019 Review of the South Australian Rail Access Regime Information Kit, draft decision, March 2019, p. 4.

- ▶ knowledge gained from its role as the regulator of the Code, and
- ▶ regulatory practice in other parts of Australia.

The users of the Tarcoola-Darwin Railway are well placed to comment on the Guidelines. Those users include the Access Provider and rail transport companies (both of which must be accredited by the National Rail Safety Regulator). Upstream users of the Tarcoola-Darwin Railway, such as mining companies, are also likely to have an interest in the Guidelines, as service levels and the cost of transport can influence mining investment decisions and demand for railway services.<sup>12</sup>

To date, the Commission has received submissions to this review from the following parties:

- ▶ Genesee and Wyoming Australia (**GWA**), a joint-venture of Genesee and Wyoming Inc. and Macquarie Infrastructure and Real Assets. It is a rail freight company with **Above-Rail** assets (rolling stock such as locomotives, carriages and wagons) and **Below-Rail** assets (track and associated infrastructure required to operate it). Its related entity, GWA (North) Pty Ltd (**GWAN**) is the current concession-holder for the Below-Rail assets of the Tarcoola-Darwin Railway, while GWA operates most trains on that line<sup>13</sup>
- ▶ Pacific National, a rail freight company operating Above-Rail Services in parts of Australia,<sup>14</sup> and
- ▶ the Minerals Council of Australia – Northern Territory Division (**MCA-NTD**), an industry group that represents resources companies in the Northern Territory.<sup>15</sup>

The issues raised in submissions were carefully considered in preparing this Draft Decision. Where relevant, certain arguments and submissions have been mentioned in the text of this Draft Decision, either by direct quotation or by reference to themes or arguments, to assist stakeholders to understand the proposed positions that have been reached. A failure to reference an argument or submission does not mean that it has not been considered by the Commission in arriving at its draft conclusions.

## 2.4 Context for review

### 2.4.1 Economic conditions on the Railway

Freight services on the Tarcoola-Darwin Railway are operated solely by GWA<sup>16</sup> and are made up of bulk and non-bulk freight.<sup>17</sup> Previous analysis has found that, while bulk freight does not face competitive pressures from road transport, due to the large weight and quantities involved, non-bulk containerised freight does.<sup>18</sup>

Total freight services on the Tarcoola-Darwin Railway have declined over the past five years, with the volume of haulage in calendar year 2017 below the average over that five-year period (Table 1). The decline follows a period up until around 2013 in which the volume of freight gradually increased.

<sup>12</sup> See, for example, Minerals Council of Australia – Northern Territory Division (MCA-NTD), 'Submission on the 2017 ESCOSA Review of Guidelines for the Access regime for the Tarcoola-Darwin Railway', 24 February 2017, p. 3, available at <http://bit.ly/RailGuidelinesSubmission-MineralCouncil>.

<sup>13</sup> See GWA, 'Submission on Review of Regulatory Guidelines', 24 February 2017, available at <http://bit.ly/RailGuidelinesSubmission-GWA>.

<sup>14</sup> See Pacific National, Submission to the Review of Rail Guidelines, February 2017, p. 3, available at <http://bit.ly/RailGuidelinesSubmission-PacificNational>.

<sup>15</sup> See MCA-NTD, pp.1-3.

<sup>16</sup> See Department of Infrastructure, Regional Development and Cities, 'Statistical report: Trainline 6', 2018, p. 79, available at [https://bitre.gov.au/publications/2018/files/train\\_006.pdf](https://bitre.gov.au/publications/2018/files/train_006.pdf).

<sup>17</sup> See GWA, p. 7.

<sup>18</sup> See Commission, 'Tarcoola-Darwin Railway: Ten year revenue review', Final report, 2009, pp.16-20, available at <http://bit.ly/TenYearRevenue-FinalReview2009>, and GWA, p. 7.

That decline reflects a fall in the volume of haulage of goods for which no sustainable competitive price exists,<sup>19</sup> likely in part due to some mine closures,<sup>20</sup> while the volume of haulage of goods where a sustainable competitive price exists has been largely unchanged. Alongside this, other indicators of railway utilisation have remained relatively low. For instance, data on average dwell times in 2018 – a partial indicator of utilisation (ie higher dwell times can indicate more traffic and time spent in passing loops) – were lower on the Tarcoola-Darwin line compared with other freight routes on the east-west corridor (Figure 1).<sup>21</sup>

Table 1: Indicators of demand and utilisation on the Tarcoola-Darwin Railway<sup>22</sup>

	2006	2010	2014	2017
Annual freight (billion gtps)				
<i>Total</i>	2.7	6.1	5.8	4.7
<i>Sustainable</i>	2.6	2.9	3.6	3.4
<i>Non-sustainable</i>	0.1	3.2	2.3	1.3
Weekly intermodal services (no.) <sup>23</sup>	N/A	6	6	6
Average dwell time (%) <sup>24,25</sup>	N/A	15.5	11	14.5

<sup>19</sup> For reporting purposes, freight services are categorised by GWA into those where a sustainable competitive price exists and those where it doesn't.

<sup>20</sup> See MCA-NTD (pp.14-15) for a list of some apparent mine closures in the Northern Territory between 2012 and 2016.

<sup>21</sup> Due to the distances involved, the most comparable freight route for which data are available is arguably the east-west corridor; see Commission, Ten-year revenue review, p. 20.

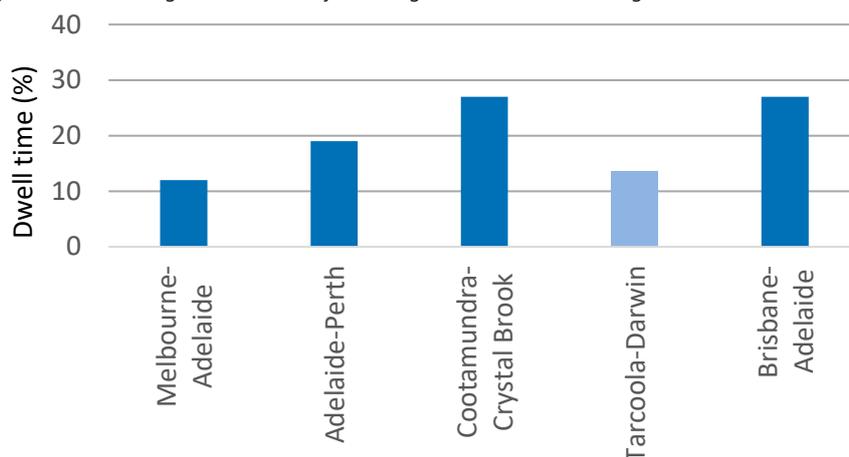
<sup>22</sup> The years included in Table 1 are selected based on data availability. 2006 and 2010 are based on financial year data, while 2014 and 2017 are based on calendar year data. Due to rounding the annual sustainable and non-sustainable freight in Table 1 may not necessarily add to the total.

<sup>23</sup> See Department of Infrastructure, Regional Development and Cities, 'Statistical report: Trainline 1', 2012, pp. 40-51, available at [https://bitre.gov.au/publications/2012/files/trainL\\_001.pdf](https://bitre.gov.au/publications/2012/files/trainL_001.pdf); Department of Infrastructure, Regional Development and Cities, 'Statistical report: Trainline 2, 2014, p. 76, available at [https://bitre.gov.au/publications/2014/files/trainline\\_002.pdf](https://bitre.gov.au/publications/2014/files/trainline_002.pdf); and Department of Infrastructure, Regional Development and Cities, Trainline 6', p. 77.

<sup>24</sup> Calculated as a simple average across both directions. Data sourced from Department of Infrastructure, Regional Development and Cities, Trainline 1, p. 51; Department of Infrastructure, Regional Development and Cities, Trainline 2, p. 76; and Department of Infrastructure, Regional Development and Cities, Trainline 6, p. 77.

<sup>25</sup> In addition to indicating utilisation, dwell time can reflect loading and unloading at freight terminals and other operational activities such as refuelling.

Figure 1: Percentage dwell time by line segment in 2018, average across both directions



Source: Department of Infrastructure, Regional Development and Cities

The outlook for haulage on the Tarcoola-Darwin Railway will likely depend much on developments in commodity prices and economic growth in South Australia and the Northern Territory. Without stronger growth or higher commodity prices that could raise end-user demand for freight services, the Tarcoola-Darwin Railway is likely to continue to face strong competition from road transport and hence may experience low utilisation on parts of the network. This outlook suggests that there is limited scope for increased demand for rail access in the short to medium term. Therefore, in an environment where access is likely to be infrequently sought, this economic context is a relevant consideration in considering the appropriate scope and content of the Guidelines, to make sure that they do assist current and future commercial negotiations for access.

## 2.4.2 Information about access pricing

Information about access pricing requirements are set out in clause 9(1)(e) of the Code and in the schedule to the Code (which sets out the access pricing principles to be followed by the Arbitrator; **Pricing Schedule**).

Clause 9(1)(e) of the Code establishes that an Access Provider must, on application from an Access Seeker, provide an Access Price for reference purposes.

The Pricing Schedule sets out pricing principles to be used in arbitration, taking into account whether or not there is a sustainable competitive price. The process for determining prices in arbitration is shown in Appendix B.

### 2.4.2.1 Competitive imputation price

When there is a sustainable competitive price, the Access Price is to be determined by the arbitrator calculated in accordance with the competitive imputation methodology set out in Division 1 clause 6 of the Pricing Schedule, and is to be no less than the floor price and no higher than the ceiling price determined by the arbitrator.<sup>26</sup> The competitive imputation methodology is calculated as the competitive rail-line haul price (ie maximum competitive price) minus the incremental cost of providing the freight service.

When there is no sustainable competitive price, the Access Price is determined by the arbitrator, subject to both floor and ceiling prices calculated in accordance with the Pricing Schedule to the Code and any other matters as set out in clause 21 of the Code (which lists the general principles that the arbitrator must take into account in making an award).

<sup>26</sup> See Pricing Schedule, Division 1, clause 3(f).

### 2.4.2.2 Ceiling price

An important aspect of the guidance on ceiling price calculations is how the fixed costs of Railway Infrastructure are to be allocated.

When there is not a sustainable competitive price, the ceiling price is to be based on the concept of full economic cost (where total cost is apportioned among multiple access holders; refer Appendix B). The intent of full economic cost is to ensure that, when multiple access users are involved, the ceiling price recovers not only the directly incurred incremental cost of access but also an appropriate contribution by the Access Seeker towards the fixed costs of the Railway Infrastructure. The full economic cost ceiling pricing principle is also utilised by the Commission in the Information Kit for the South Australian intrastate railway access regime, which is also currently subject to review by the Commission.<sup>27</sup>

On the other hand, when a sustainable competitive price is determined to exist, the ceiling price is based on the concept of total stand-alone cost (where the total cost attributable to the Railway Infrastructure is imposed on each access holder; refer Appendix B). The total stand-alone cost may not be a “fair” ceiling price when multiple access users are involved, as it could lead to over recovery of total costs (as multiple users would pay for the same fixed costs) and allow excessive profits to accrue to the Access Provider. However, in such a situation the competitive imputation pricing rule assumes that competing forms of transport can be established to form the base-line competitive imputation price. Moreover, competing modes of transport may, in practice, prevent the Access Provider from facing the theoretical ceiling price based on total stand-alone cost.

### 2.4.2.3 Floor price

The floor price for access to freight services on the Tarcoola-Darwin Railway is to be calculated the same way, no matter whether there is a sustainable competitive price or not.<sup>28</sup> That calculation is based on the avoidable costs of Below-Rail Services attributable to the usage of that required infrastructure by all other access holders.<sup>29</sup> The use of avoidable cost reflects the lowest price at which an Access Provider could charge an Access Seeker without incurring an economic loss from providing that particular service.

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<sup>27</sup> See Commission, ‘2019 Review of the South Australian Rail Access Regime Information Kit, draft report, March 2019, p.10.

<sup>28</sup> See Pricing Schedule, Division 1, clause 3.

<sup>29</sup> See Pricing Schedule, Division 1, clause 3, and Pricing Schedule, Division 2, clause 2.

## 3 Considerations on and proposed amendments to the Guidelines

The Commission proposes to retain the majority of existing procedures and guidance in Guidelines No 1, No 2 and No 3, with only a few amendments proposed. The Commission also plans to update the format of the Guidelines, so as to be in line with its publications in other regulated sectors.

### 3.1 Guideline No 1: Access Provider Reference Pricing and Service Policies

Guideline No 1 sets out the Commission's guidance on information requirements for an Access Provider and an Access Seeker in respect to Access Prices and track and service information (including train-path and -control policy, and service quality).

#### 3.1.1 Publication of reference prices

The Commission sees value in reference prices, or the formula/methodology for calculating them, being published by the Access Provider on its website. Such an approach would be more in line with practices by rail companies in other jurisdictions in Australia. Increased transparency of Access Prices can help to facilitate commercial negotiations for access and promote efficient use of and investment in infrastructure.<sup>30</sup>

Calls for greater transparency for Access Prices on the Tarcoola-Darwin Railway have been a theme of submissions to this review<sup>31</sup> and previous reviews of Guidelines.<sup>32</sup>

The Commission's previous review of the Guidelines in 2008 did not recommend publication of reference prices. The publication of these prices was seen as being complicated by the competitive imputation pricing method (where reference prices may change from time to time, based on competition), the infrequent and specific nature of access requests on the railway and the short-time period in which the railway had been in operation.<sup>33</sup>

However, with the railway having now been in operation for fifteen years, for several reasons the Commission considers that the costs associated with the publication of reference prices is likely to be limited and outweighed by the benefits of greater pricing transparency. First, the Access Provider already must produce Access Price information for reference purposes upon request.<sup>34</sup> Second, while the competitive imputation methodology means access prices may vary according to the cost of competitive freight rates, the publication of a formula (or principles) of their calculation could serve as suitable notification of a reference price. Third, the availability of reference prices on the website would be a move in line with modern business practices and could lead to fewer written applications for reference prices under clause 9(1)(e) of the Code.

The Commission understands that GWAN is reviewing the access information that it makes available on its website and strongly encourages GWAN to include reference prices within that suite of information so as to meet its customers' expectations and reflect good business practice. The Commission may further consider use of the Guideline to address its customers' concerns in relation to reference prices, but will provide an opportunity for GWAN to take that initiative in the first instance.

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<sup>30</sup> This may also assist commercial decision-making in upstream markets such as in the minerals and resources sector.

<sup>31</sup> See Pacific National, p. 4, and MCA-NTD, pp. 1-4.

<sup>32</sup> See, for example, ARTC submission to the 2008 Guideline Review, p. 5, available at <https://www.escosa.sa.gov.au/ArticleDocuments/718/071220-AustralasiaRailwayCodeGuidelineRev.pdf.aspx?Embed=Y>

<sup>33</sup> See Commission, 'AustralAsia Railway (Third Party Access) Code: Guideline Review', 2008, pp. 24-26.

<sup>34</sup> See Clause 9(1)(e) of the Code.

### 3.1.2 Modification to general information to accompany a written request for access

The Commission proposes to make a minor modification in section 2(d) of Guideline No 1. The words 'nature of goods' are proposed to replace the words 'end market':

*'the nature of goods for the required (freight or passenger) Services in terms of the range of goods published for this purpose by the Access Provider.'*

The modification aims to improve clarity of the text and address potential confidentiality concerns of an Access Seeker who might interpret 'end market' to mean 'the Access Seeker's customer'.<sup>35</sup>

### 3.1.3 Retention of guidance on train-path and train-control policy and service quality

The Commission proposes to retain its guidance relating to train-path and train-control policy, and service quality. Much of the guidance is procedural in nature and its scope is more limited than in some other jurisdictions (such as the interstate network<sup>36</sup>).<sup>37</sup> GWAN noted in its submission that documents on train-path and train-control policy and service standards are provided to an Access Seeker as part of the information pack provided once an access application request has been received.<sup>38</sup>

No submissions raised material concerns in regard to these sections of Guideline No 1. However, during consultation on this Draft Decision the Commission remains open to submissions raising any issues in regard to guidance on train-path and train-control policy, and service levels. Further, GWAN has committed to improving the availability of information on operational track information, train-path policy and service quality policy on its website in 2019.<sup>39</sup>

### 3.1.4 Publication of maps and diagrams

An area that attracted attention in submissions was the publication of rail maps and diagrams. In contrast to other jurisdictions, there are no requirements on the Access Provider to publish diagrams, maps or plans for the Tarcoola-Darwin Railway (Table 2). Some submissions noted a lack of transparency of information about the railway, including rail line diagrams, and suggested this could lower business confidence, reduce access and adversely impact investment in upstream markets (such as in the mining sector).<sup>40</sup>

Table 2: Requirements for publishing diagrams, maps or plans

Jurisdiction	Diagrams, maps or plans	Regulated frequency of publication
South Australia - Intrastate	On request for Information Brochure <sup>41</sup>	Must be kept up to date

<sup>35</sup> Based on private information provided to the Commission.

<sup>36</sup> For more details see ACCC Final Decision, Australian Rail Track Corporation Access Undertaking – Interstate Rail Network, July 2008, available at <https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20the%20ARTC%20Interstate%20Rail%20Access%20undertaking.pdf>.

<sup>37</sup> Specifically, train-path policy includes requirements for a master train plan, reserved paths and competition for the same paths, while train-control policy sets out expectations that a statement of principles, rules and practices should be applied to the Access Provider's services.

<sup>38</sup> GWA, pp. 8-9.

<sup>39</sup> Based on information provided to the Commission.

<sup>40</sup> See MCA-NTD, pp. 8-9.

<sup>41</sup> See Commission, Review of the South Australian Rail Access Regime Information Kit, pp. 6-7.

Jurisdiction	Diagrams, maps or plans	Regulated frequency of publication
South Australia – Tarcoola to Darwin	No requirements	N/A
Western Australia	Must be made available <sup>42</sup>	As often as necessary to be up to date but subject to audit at least every two years <sup>43</sup>
Queensland - 2016 Access Undertaking	Published on website (preliminary information, line diagrams <sup>44</sup> and capacity information)	Must be kept up to date
ARTC	On request and published on website <sup>45</sup>	Must be kept up to date

The Commission agrees that, in principle, more information about rail line segments can help to reduce barriers to negotiation (by allowing information to be available to a wider group of potential Access Seekers).<sup>46</sup> However, both the Access Seeker and Access Provider have a commercial incentive to share this type of information, and regulating the provision of maps would impose costs. Further, there is nothing that restricts the Access Provider from itself publishing maps and diagrams to assist commercial negotiations. Indeed, as noted above, GWAN has committed to improving the availability of rail information on its website during 2019 and has already commenced publishing new and additional information.<sup>47</sup> For these reasons, the Commission does not propose to require publication of maps and diagrams.

### 3.2 Guideline 2: Arbitrator pricing requirements

The Commission proposes to retain most existing principles and information for access to freight services in Guideline No 2.

As noted earlier, the Code requires an arbitrator to determine Access Prices in the event that a dispute is referred by the Commission to arbitration. The Pricing Schedule of the Code outlines the methodology to calculate floor and ceiling prices. It also sets out a role for the Regulator to publish

<sup>42</sup> See Railway (Access) Code 2000 (WA), Schedule 2, clauses 2 and 4, available at [https://www.legislation.wa.gov.au/legislation/prod/filestore.nsf/FileURL/mrdoc\\_28343.pdf/\\$FILE/Railways%20\(Access\)%20Code%202000%20-%20%5B01-f0-03%5D.pdf?OpenElement](https://www.legislation.wa.gov.au/legislation/prod/filestore.nsf/FileURL/mrdoc_28343.pdf/$FILE/Railways%20(Access)%20Code%202000%20-%20%5B01-f0-03%5D.pdf?OpenElement)

<sup>43</sup> See ERA, Final Determination on Brookfield Rail’s Proposed Revised Train Management Guidelines, p. 13, available at <https://www.erawa.com.au/cproot/10996/2/20121130%20-%20D99106%20-%20Rail%20-%20Brookfield%20Rail%20-%20Final%20Determination%20-%20Brookfield%20Rail%20Proposed%20Revised%20Train%20Management%20Guidelines.pdf>. This indicates that the train management guidelines (which include maps and diagrams) can be audited every two years.

<sup>44</sup> See QR Access Undertaking 1, clauses 1.2.3, 2.1.1 and Schedule A, available at <https://www.queenslandrail.com.au/business/access/Access%20Undertaking%20and%20related%20documents/Queensland%20Rail%20Access%20Undertaking%201%202016.pdf>

<sup>45</sup> See ACCC, Final Decision, Australian Rail Track Corporation Access Undertaking – Interstate Rail Network, July 2008, p. 43, available at <https://www.accc.gov.au/system/files/ACCC%20final%20decision%20on%20the%20ARTC%20Interstate%20Rail%20Access%20undertaking.pdf>.

<sup>46</sup> See Commission, Review of the South Australian Rail Access Regime Information Kit, p. 14.

<sup>47</sup> This includes information for both the Tarcoola-Darwin Railway and the South Australian intrastate railway. Based on information provided to the Commission. The GWA website is available at [https://www.gwrr.com/railroads/australia/genesee\\_wyoming\\_australia#m\\_tab-one-panel](https://www.gwrr.com/railroads/australia/genesee_wyoming_australia#m_tab-one-panel).

Guidelines about information (such as costs, assets and rates of return) that would serve as an input to the arbitrator's calculations.<sup>48</sup>

Alongside general information about the methodologies for floor and ceiling prices, Guideline No 2 outlines guidance on:

- ▶ a procedure for calculating and valuing the capital asset base
- ▶ a timeframe for which costs be considered avoided
- ▶ the calculation of incremental cost when there is a sustainable competitive price, and
- ▶ the financial market data to be considered in the calculation of a return on assets.

### 3.2.1 Capital assets, roll forward and government contributions

To address a practical requirement to update the asset base over time, in 2008 the Commission updated Guideline No 2 to include both the value of the Railway as at the date of commencement of operations, together with a procedure (in line with industry practice) for updating the value of private capital invested over time.<sup>49</sup>

While the requirement to use a Depreciated Optimised Replacement Cost (**DORC**) to value the railway at date of commencement is set out in the Code,<sup>50</sup> the procedure for rolling forward the asset value is not. An alternative to using a roll forward mechanism would be conduct periodic DORC revaluations of the asset base.

A view was put forward in a submission to the 2008 Review, supporting periodic DORC revaluations, on the basis that there are risks of inaccuracy in any initial DORC valuation, which would be accrued on and magnified in a roll forward mechanism.<sup>51</sup> However, the Commission notes that periodic DORC revaluations is not free of difficulty, insofar as it could add regulatory risk, as a DORC valuation may write down (or increase) the value of assets depending on the level of utilisation in the period assessed. Such a variation would risk contravention of the Code, where a reasonable risk-adjusted return on the capital invested in the Tarcoola-Darwin Railway must not be prevented.<sup>52</sup> The Commission therefore proposes to continue to specify the rolling forward of the initial DORC valuation, as opposed to requiring periodic revaluations.

Government-contributed assets and financial assistance can be deducted from the DORC,<sup>53</sup> provided a reasonable risk-adjusted return is not prevented on invested capital. The Guidelines remove government-contributed assets and financial assistance for the purposes of providing guidance to an arbitrated price,<sup>54</sup> but do not remove it for ceiling price purposes,<sup>55</sup> as this is a theoretical upper bound – not a guidance on an arbitrated price. The Commission therefore proposes that the Guidelines continue the current approach.

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<sup>48</sup> See Pricing Schedule, Division 1, clause 6(f), (7)(a) and (7)(b)), Pricing Schedule, Division 2, clause (2)(d)(iii), (6), (7), (8) and Pricing Schedule, Division 3, clauses (3), (4), (5)) of the Code.

<sup>49</sup> See Commission, AustralAsia Railway (Third Party Access) Code: Guideline Review', p.10, available at <http://bit.ly/ThirdPartyAccessGuidelineReview-Final>.

<sup>50</sup> See Pricing Schedule, Division 1, clause 2(7)(a).

<sup>51</sup> ARTC submission to 2008 Guideline Review, p. 3, available at <https://www.escosa.sa.gov.au/ArticleDocuments/718/071220-AustralasiaRailwayCodeGuidelineRev.pdf.aspx?Embed=Y>

<sup>52</sup> See Pricing Schedule, Division 1, clause 2(8)(a).

<sup>53</sup> See Pricing Schedule, Division 1, clause 2(8).

<sup>54</sup> See Guideline 2, clause 5.

<sup>55</sup> See Guideline 2, clause 2.

### 3.2.2 Timeframe for avoided costs

The Commission proposes to retain the existing guidance defining the timeframe of avoided costs.<sup>56</sup> The timeframe for which operating and capital costs are to be assessed for floor and ceiling price purposes should be no greater than the proposed term of the Access Contract. Providing any more prescriptive guidance on timeframes is unlikely to be appropriate, as access on the Railway tends to be infrequent and specific to the needs of an Access Seeker.

### 3.2.3 Calculation of incremental cost

The Commission proposes to retain the existing guidance on the calculation of Above-Rail incremental cost. This is relevant when there is a sustainable competitive price and the Access Price is to be determined by the arbitrator calculated in accordance with the competitive imputation methodology.<sup>57</sup>

The Pricing Schedule of the Code sets out that the incremental cost are costs the service provider would avoid if it did not provide the freight service, including avoided operating costs, administrative costs and an appropriate allowance for capital cost. Where Above-Rail assets do not exist, Guideline No 2 sets out that the acquisition costs of the relevant assets are to be based on the leasing market or similar agreement for assets of a similar quality. No submissions have suggested any change to this guidance. However, the Commission remains open to submissions raising any issues in regard to the calculation of incremental cost.

### 3.2.4 Guidance on financial market rates and risk premiums

The Commission proposes to retain the existing guidance on the rate of return parameters set out in section 6 of Guideline No 2.

The Pricing Schedule of the Code provides that the Guidelines must have regard to the risk premiums measured at the time of construction of the Alice-Spring to Darwin section of the Tarcoola-Darwin Railway, as well as financial market rates (including for measures of expected inflation and risk-free rates).<sup>58</sup>

*(4) The guidelines must – ...*

*... 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).'*

<sup>56</sup> According to the Pricing Schedule, the Regulator's Guidelines must *'...provide guidance on the timeframes within which the Regulator considers costs could be avoided'*. See Pricing Schedule, Division 1, clause (7)(b); Pricing Schedule, Division 2, clause (7)(b); and Pricing Schedule, Division 3, clause (4)(b).

<sup>57</sup> The competitive imputation methodology is set out in Division 1 clause 6 of the Pricing Schedule to the Code.

<sup>58</sup> See Pricing Schedule, Division 3, clause 4.

Guideline No 2 includes the estimated market risk premiums (as at time of construction), and also specifies the use of the bond break-even approach for estimating expected inflation and the use of the yield on ten-year inflation-adjusted Commonwealth Government Securities to measure the risk-free rate of return.<sup>59</sup> The latter two indicators are measured as forty-day averages.<sup>60</sup>

While some parameters in section 6 of Guideline No 2 are set out in the Pricing Schedule, such as the equity risk premium and the use of financial market indicators (including for expected inflation), the Commission has scope to vary the averaging period of financial market indicators and to specify an alternative market-based measure of inflation expectations (an example could be the use of swap-implied inflation rates).<sup>61</sup>

Nonetheless, the Commission sees limited benefit arising from any additional precision that might arise from modifying the averaging period in Guideline No 2, for example to make it a shorter period.<sup>62,63</sup> Further, while the swaps method for calculating inflation expectations could be specified in Guideline No 2 (for example instead of the bond break-even approach), the robustness of that method has not received significant support in research<sup>64</sup> or in rate of return decisions in other jurisdictions.<sup>65</sup> At this stage, the Commission proposes to retain the bond-break even approach in Guideline No 2. However, it remains open to submissions raising any concerns during consultation on this Draft Decision.

### 3.3 Guideline 3: Regulatory information requirements

#### 3.3.1 Ring fencing

The Commission proposes to retain the existing guidance on reporting and account separation applying to the Tarcoola-Darwin Railway.

Submissions raised concerns that section 2 of Guideline No 3 was not sufficiently prescriptive in relation to the derivation of the Access Provider's Above-Rail Services regulatory accounts, as distinct from the Below-Rail Services regulatory accounts.<sup>66</sup> At the centre of concern is the potential for cost shifting between Above- and Below-Rail Services by a vertically-integrated Access Provider, such that internal cost allocations may not necessarily reflect an accurate account of costs.<sup>67</sup>

Guideline No 3, however, requires that, if costs cannot be directly attributable to a specifically prescribed business, they are to be attributable on a causal basis. If that is not possible, they may be allocated on a non-causal basis, accompanied by supporting documentation. This requirement, coupled with no evidence of misallocation found in the 2015 review of GWA's financial allocations,<sup>68</sup> led the Commission to conclude at that time that the existing requirements provide sufficient ring-fencing.

In addition, and importantly, clause 46 of the Code requires the Access Provider to give a true and fair view of the Above-Rail business as distinct from the Below-Rail business. Further, should there be a

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<sup>59</sup> See Guideline No 2, pp. 16-17.

<sup>60</sup> The averaging period aims to balance the trade-off between volatility and the need to use the latest market data.

<sup>61</sup> See Moore, 'Measures of Inflation Expectations in Australia', Reserve Bank for Australia, *Bulletin*, December quarter 2016, p.28-30, available at <https://www.rba.gov.au/publications/bulletin/2016/dec/pdf/rba-bulletin-2016-12-measures-of-inflation-expectations-in-australia.pdf>.

<sup>62</sup> There is limited daily movement in the inflation-adjusted ten-year CGS. This suggests that a forty-day average is unlikely to be that different, on average, to the use of a shorter averaging period.

<sup>63</sup> The Commission's internal research suggests that the difference between shorter-term averaging periods (ie five day to sixty days) of nominal ten-year CGS are likely to be of only marginal difference.

<sup>64</sup> See Moore, p. 28-30.

<sup>65</sup> See AER, 'Regulatory treatment of inflation', Final position, December 2017, pp. 55-56, available at <https://www.aer.gov.au/system/files/AER%20-%20Final%20position%20paper%20-%20Regulatory%20treatment%20of%20inflation%20-%20December%202017%20-%20Web%20upload.PDF>

<sup>66</sup> See Pacific National, pp. 4-6.

<sup>67</sup> See Pacific National, pp. 4-6.

<sup>68</sup> See KPMG, 'Review of GWA financial allocations', July 2015, available at <http://bit.ly/GWAFinancialAllocations-KPMG>.

need the Commission has powers to obtain and review access contract information from the Access Provider.<sup>69</sup>

### 3.3.2 Minor modifications and clarifications

The Commission proposes to update Guideline No 3 to make some minor updates and clarifications to improve readability and update reporting dates. This includes updating Guideline No 3 to reflect GWA's current practice of reporting to the Commission on a calendar year basis.<sup>70</sup> There is also a modification proposed to the procedure regarding compliance of regulatory accounts, such that, in the event that the Access Provider does not have a Non-Executive Director, the statement of compliance may be signed by a Non-Executive Director of a related entity of the Access Provider.<sup>71</sup>

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<sup>69</sup> See Code, Part 4, clause 39.

<sup>70</sup> The change will help to clarify that future reporting periods for cost information will align with the Commission's revenue review cycle; see GWA, p. 9.

<sup>71</sup> The change may add flexibility; see GWA, p. 9.

## 4 Next steps

The Commission invites written submissions on all aspects of this Draft Decision by 17 May 2019. To facilitate the provision of submissions or address any queries, the Commission would be pleased to meet with stakeholders for a briefing upon request.

The Commission intends to release a Final Decision with final guidelines in July 2019.

## 5 Appendix A: Tarcoola-Darwin Railway

The Tarcoola-Darwin Railway operates from (a point near) Tarcoola to its end in Darwin at the Port of Darwin. It is operated by Genesee and Wyoming Australia (North) Pty Ltd, under a 50-year concession right granted under the AustralAsia Railway Project Concession Deed. The Concession Deed is due to expire in 2054, when the right to operate the Railway reverts to the AustralAsia Railway Corporation, which consists of representatives from both the Northern Territory and South Australian Governments.<sup>72</sup>

The Tarcoola-Darwin Railway comprises both an older section of line between Tarcoola and Alice Springs and the more recently constructed section of line between Alice Springs and Darwin – all standard gauge.

The Commission has been Regulator of the Code since its inception in 2004. The Code was certified by the Commonwealth Treasurer in 2000 as an effective state-based access regime until 31 December 2030.

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<sup>72</sup> See Commission, Ten-year review of revenues, p. 7.

## 6 Appendix B: Selected legislation and process for determining arbitrated access prices

### 6.1 Clause 9(1) of the Code

9—Obligation of Access Provider to provide information about access

(1) The Access Provider must, on application of any person, provide the person with information reasonably requested by the person about—

- (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 developed and published by the Regulator.

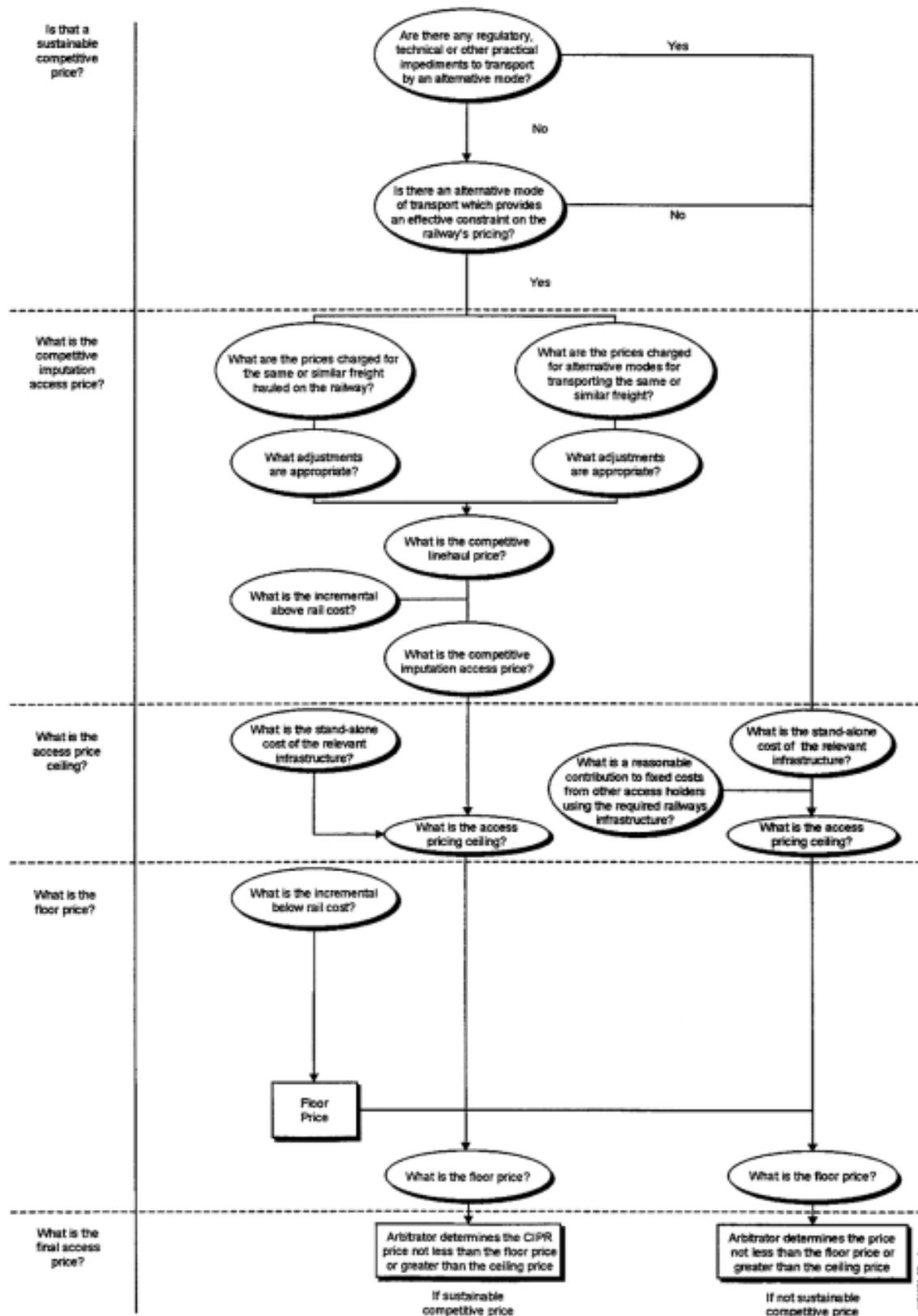
### 6.2 Clause 45A of the Code

45A—Power to vary Guidelines

(1) The Regulator may, from time to time as the Regulator thinks fit, vary or revoke guidelines developed and published by the Regulator under this Code, or develop and publish new or substitute guidelines.

(2) The Regulator should, in developing (or varying) guidelines under this Code, take into account interface issues that may arise under a 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).

### 6.3 Process for determining the arbitrated Access Price<sup>73</sup>



<sup>73</sup> Source: Code, Attachment A.



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