

# **Pacific National Submission to the ESCOSA Review of Rail Guidelines**

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# 1. Introduction

Pacific National welcomes the opportunity to respond to the Essential Services Commission of South Australia (ESCOSA) relating to the review of:

- the South Australian rail access guidelines under the Railways (Operations and Access) Act 1997 which establishes the South Australian rail access regime; and
- the Tarcoola-Darwin rail access guidelines under the AustralAsia Railway (Third Party Access) Act 1999, which establishes the Tarcoola-Darwin rail access regime.

Pacific National understands that ESCOSA are currently reviewing the guidelines to ensure the guidelines:

- provide effective protection to existing and prospective railway users while ensuring that regulatory costs are kept to a minimum;
- are clear and represent contemporary practice, and
- anticipate future changes in the rail industry.

Pacific National is one of Australia's largest train operators and undertakes extensive rail activities in South Australia, including interstate intermodal rail operations and interstate bulk mineral operations. These operations primarily use Australian Rail Track Corporation rail infrastructure but do use some rail yards controlled by Genesee and Wyoming (GWA) which are subject to the guidelines. In addition Pacific National has previously sought access to the Tarcoola-Darwin railway and continues to seek opportunities along the Tarcoola-Darwin rail corridor.

Pacific National has a strong interest in improving the access guidelines which apply to rail infrastructure regulated by ESCOSA. In particular Pacific National believes that strengthening these guidelines, which regulate access to natural monopoly rail infrastructure, will result in more efficient outcomes in transport markets.

This submission is public.

## 2. Pacific National's Concerns Relating to South Australian and Northern Territory Rail Access Guidelines

Pacific National believes that the South Australian and Northern Territory rail access guidelines must be considered in the context of South Australia's and Northern Territory's rail industry structure. South Australia's and Northern Territory's rail infrastructure involves a large degree of common ownership by GWA of both the above rail and below rail assets. This common ownership along with the relatively weak functional separation of the above rail and below rail activities and the lack of a transparent access price determination process raises concerns that the access guidelines cannot facilitate competition and do not fully protect existing and prospective railway users. Pacific National believes that the current guidelines should be strengthened by strengthening the ring fencing provisions and information provisions of the guidelines.

### Ring Fencing

The South Australian and Northern Territory rail access regimes and guidelines lack strong ring fencing requirements. Pacific National believes that where there is vertical integration in the rail industry then a strong ring fencing regime must be in place to ensure that the integrated entity does not use the monopoly position it holds in its rail infrastructure activities to benefit its activities in the competitive above rail market. The ring fencing regime which applies under South Australia's and Northern Territory's rail access guidelines is not as prescriptive as that which applies to other vertically integrated freight rail operations in Australia.

Pacific National believes that the ring fencing requirements in the South Australia's and Northern Territory's rail access guidelines should be strengthened to include accounting separation, functional separation and a level of corporate management separation<sup>1</sup>.

South Australian Guidelines and Ring Fencing - The common ownership of below rail and above rail assets in South Australia creates concerns regarding the equal treatment of above rail operators and the potential for the transfer of information between the below rail and above rail operating activities of GWA.

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<sup>1</sup> A much more detailed outline of Asciano's position on a strong ring fencing regime can be found in various Asciano submissions to the Queensland Competition Authority relating to the regulation of Aurizon Network. These submissions include Asciano Submission to the QCA in Relation to the 2013 Aurizon Network Draft Access Undertaking October 2013 and Asciano Submission to the QCA in Relation to the 2014 Aurizon Network Draft Access Undertaking October 2014

Pacific National recognises that South Australia's rail access guidelines<sup>2</sup> require separation of accounts, prohibit unfair discrimination and prohibit hindering access. However given the common ownership of below rail and above rail assets the guideline requirements regarding functional separation are minimal when compared with the requirements of other rail access regimes such as the Aurizon Network access undertaking. This undertaking<sup>3</sup> requires relatively strong separation of staff and protection of confidential information.

Pacific National recognises that the Railways (Operations and Access) Act objective (section 3) includes a provision that rail access will be provided on a non-discriminatory basis. Further to this Pacific National notes that the Example in section 23 (1) of the Act implies that the terms of access agreed between the track infrastructure provider and a related party train operator would include an access price (rather than an internal corporate cost allocation). Pacific National believes that these access prices between related parties should be identified and subject to a level of regulatory review in order to ensure that the requirements of the Act are being met. To this end the guidelines should require the access prices agreed between related parties to be provided to the regulator for review.

Pacific National believes that the South Australian guidelines should be strengthened by requiring:

- further separation of network functions and staff from non-network staff and functions In particular the guidelines should have requirements for separation of staff so that staff working on access related network activities are explicitly prevented from undertaking any non-network related activities;
- improved protection of confidential information provided by access seekers to GWA; and
- improved processes for identifying access prices agreed between the track infrastructure provider and a related party train operator in order to assist in identifying any unfair discrimination under section 23 of the Railways (Operations and Access) Act;
- improved processes to remedy any identified discrimination, including improved enforcement provisions.

Pacific National believes that the above steps will assist in improving levels of effective protection for railway users while reflecting current regulatory practice.

*Northern Territory Guidelines and Ring Fencing* - The level of ring fencing and account separation applying to the Tarcoola – Darwin railway is less than that which applies to other vertically

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<sup>2</sup> As per South Australian Rail Access Regime Information Kit 2010 section 2.4 (page 6) and section 5.2 (page 23)

<sup>3</sup> Aurizon Network 2016 Access Undertaking Part 3, particularly between pages 18 and 39

integrated freight rail operations in Australia. This raises concerns in regard to cost allocations and cost shifting between above rail and below rail operations. Pacific National believes that in order for there to be a higher level of confidence in the current regulatory process facilitating third party access to the Tarcoola – Darwin railway then a higher level of Tarcoola – Darwin railway ring fencing should apply. Pacific National believes that ESCOSA should strengthen the ring fencing guidelines relating to the Tarcoola - Darwin railway.

The Tarcoola – Darwin railway guidelines (Guideline 3 section 2) require that regulatory accounts are kept for the above and below rail business, however the guidelines are not prescriptive as to how the accounts are to be derived and the guidelines (Guideline 3 section 6) provide the access provider with a broad degree of flexibility as to how the accounts will be derived.

Pacific National believes that ESCOSA should amend the guidelines to require substantially enhanced obligations to provide regulatory accounts. Pacific National notes that a 2015 KPMG Report<sup>4</sup> commissioned by ESCOSA states that “no interstate railway [i.e. Tarcoola – Darwin railway] below rail costs are directly attributed to services and that all interstate below rail costs are subject to allocation”. Given Tarcoola – Darwin railway costs are effectively determined by internal GWA cost allocations any cost information provided will not necessarily reflect an accurate allocation of costs. More prescriptive ring fencing and cost allocation guidelines are needed to address this issue.

As an absolute minimum the regulatory account provisions required by the amended guidelines should meet the standard of the South Australian information kit (including any amendments resulting from this current review).

In addition the Tarcoola – Darwin railway guidelines and access regime have only minimal provisions addressing unfair discrimination and protecting the confidential information of access seekers. Pacific National is particularly concerned with the lack of protection for access seekers under these guidelines. In particular Pacific National notes:

- protection of access seekers confidential information is contained in the Australasia Railway Third party access Act and Code but this is not reflected in the guidelines. The guidelines however do act to protect the confidential information of the Tarcoola – Darwin railway. Pacific National strongly believes that given the common ownership of above rail and below rail operations on this rail line then the guidelines should include very strong protections for confidential information provided by access seekers;

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<sup>4</sup> KPMG Review of GWA Financial allocations July 2015 page 4

- protection from unfair discrimination is contained in Guideline 1 and appears to be limited to unfair discrimination in relation to various operational matters. Pacific National strongly believes that the guidelines should include substantially stronger protections against unfair discrimination in relation to commercial and access pricing matters. In particular improved processes for identifying access prices agreed between the track infrastructure provider and any related party train operator should be implemented.

The current lack of protection for access seekers under the Tarcoola – Darwin railway guidelines results in a low level of confidence in the current Tarcoola– Darwin railway access regime. Pacific National believes that the above steps will assist in improving levels of effective protection for railway users while reflecting current regulatory practice.

#### Information Provision

One of Pacific National's concerns with the South Australia's and Northern Territory's rail access regime and guidelines is its reliance on the "negotiate and arbitrate" model for obtaining access. Pacific National believes that this access model is problematic as negotiations with natural monopoly infrastructure providers under this model result in outcomes favourable to the natural monopolist due to imbalances in bargaining power and information between the parties. This imbalance can be at least partially addressed by information provision.

South Australian Guidelines and Information Provision - Pacific National recognises that following the 2009 SA Rail Regime Access Inquiry a requirement for the provision of an information kit was introduced. This information kit includes the provision of cost information including the provision of incremental costs of providing the service (section 3.1, section 4.3), the full economic cost of providing the service (section 3.2, section 4.3), and an indication of the likely price (section 4A.1). In addition the information kit also requires an indication of the terms and conditions of access to be provided (section 4A.2).

Pacific National recognises that these requirements go some way to addressing concerns in relation to information provision but Pacific National believes that the provision of information could be further improved by requiring the access provider to submit floor and ceiling costs for indicative services to ESCOSA at regular intervals. These costs could then be published.

This approach will promote access by new entrants and increase the potential for above rail competition. In particular there is a benefit to the access seeker in having the certainty and transparency resulting from the provision of these pre-determined costs, as opposed to discovering these costs via the access proposal process.

In relation to the ceiling price Pacific National has a specific concern. Pacific National notes that the ceiling price is defined in the Rail Operations and Access Act as the highest price that could be fairly asked but in the information kit (section 3.2) this is interpreted to mean the prudent full economic cost of providing the service. Pacific National believes that there is potential for these cost concepts to be inconsistent and is seeking that the potential for this inconsistency be resolved.

Pacific National believes that while some cost information is available to access seekers, the transparency and accessibility of this information could be improved by requiring access providers to provide floor and ceiling costs for indicative services to ESCOSA at regular intervals.

In addition to the above concerns regarding cost information and pricing Pacific National believes there is some uncertainty as to the rail infrastructure assets which are covered by the South Australian rail access regime. Pacific National believes that the information kit (and ideally the GWA website and / or the ESCOSA website) should contain line diagrams or similar maps to provide clarity and certainty as to the assets which are covered by the South Australian rail access regime.

*Northern Territory Guidelines and Information Provision* - The Tarcoola – Darwin railway guidelines do not require the provision of detailed cost information to access seekers. Under Guideline 1 section 2 the access provider provides reference prices for negotiation but does provide the costs which underpin these prices.

Pacific National notes that a 2015 KPMG Report<sup>5</sup> commissioned by ESCOSA states that “no interstate railway [i.e. Tarcoola – Darwin railway] below rail costs are directly attributed to services and that all interstate below rail costs are subject to allocation”. Given Tarcoola – Darwin railway costs are effectively determined by internal GWA cost allocations any cost information provided will not necessarily reflect an accurate allocation of costs. More prescriptive cost allocation guidelines are needed to address this issue.

The lack of a requirement on the Tarcoola - Darwin railway to provide detailed information on its costs is likely to result in asymmetric negotiations between the access provider and any potential access seeker (which is not a related party). An access regime which requires that sufficient cost information be available to the negotiating parties is more likely to result in an access price which is efficient than a price negotiated in a regime where one party has incomplete information.

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<sup>5</sup> KPMG Review of GWA Financial allocations July 2015 page 4

The lack of cost information made available under the current Tarcoola – Darwin regime results in a low level of confidence in both the current guidelines and in the reasonableness of any Tarcoola – Darwin railway access pricing proposed by the access provider. This lack of cost transparency substantially limits the effectiveness of the access regime and limits the ability of potential new entrants to commercially negotiate access pricing.

Pacific National believes that ESCOSA should amend the guidelines to require improved provision of Tarcoola - Darwin rail line cost information to access seekers. As an absolute minimum the cost information provisions required by the South Australian information kit (including any amendments resulting from this current review) should apply to the Tarcoola - Darwin rail line, but ideally Pacific National believes that the access provider should submit floor and ceiling costs for indicative services to ESCOSA at regular intervals. These costs could then be published.

Pacific National believes that the above approach would improve levels of effective protection for railway users and reflect current regulatory practice.

### 3. Conclusion

The current ESCOSA review aims to review guidelines so that they provide effective protection to existing and prospective railway users, represent contemporary practice and anticipate future changes in the rail industry.

Given the vertical integration present in the South Australian and Northern Territory rail market Pacific National believes that the ESCOSA's reviews aims are best met by:

- strengthening the South Australian guidelines in order to:
  - require further functional separation of below rail and above rail operations;
  - require improved protection of confidential information;
  - require improved processes for identifying access prices agreed between the track infrastructure provider and a related party train operators in order to confirm that there are no concerns in relation to unfair discrimination; and
  - require additional information provision.
  
- strengthening the Tarcoola – Darwin guidelines in order to:
  - require effective ring fencing, including effective accounting separation and functional separation;
  - require protection of access seekers confidential information;

- require that access seekers be protected from unfair discrimination. To this end improved processes for identifying access prices agreed between the track infrastructure provider and a related party train operators should be implemented; and
- require the provision of substantial additional cost information to allow for more even-handed access price negotiation.

In making these recommendations to strengthen the guidelines Pacific National recognises that a balance needs to be struck between the need for strong and credible regulation and the fact that the rail assets being regulated are relatively lower use rail assets.