One Rail Australia Submission to ESCOSA

One Rail Australia welcomes the invitation from ESCOSA to respond to the South Australian Rail Access Regime Review Issues Paper (February 2020). The review is timely given recent developments in the rail industry in South Australia, which are set out in detail below. Overall, our position is:

- There is no compelling case to change the current regime significantly.
- Whilst volumes on intrastate main lines continue to reduce, this has been driven by increased competition from road transport, rather than deficiencies in the access regime.
- Other than lower volumes, there has been no significant change in the operation of the market since 2015, such that ESCOSA's conclusions at the time supporting the continuation of the existing regime should have altered;
- The current regime is a cost-effective way to provide protection to both access seekers and access providers in South Australia and provides certainty for all parties through the negotiation and arbitration framework;
- ESCOSA reflects a fit-for-purpose regulator for the South Australian rail market given its size relative to the national regulated market which allows for efficient communication and resolution of issues; and
- Changing to a national regime would be a costly process during transition and would raise regulatory compliance costs of all parties in the long run. It would also generate risks around the process of transition and there may be opportunity for other parties, such as national transport carriers, to exert market power.

The rest of this submission sets out some information about One Rail Australia, an update on the South Australian freight transport industry, an overview of our perceptions of strengths and weaknesses of the current regime. Following this we directly respond to the questions posed by ESCOSA in the issues paper.

About One Rail Australia

One Rail Australia Pty Ltd (One Rail Australia), formerly Genesee & Wyoming Australia Pty Ltd (GWA), is no longer a wholly-owned subsidiary of Genesee & Wyoming Inc. (GWI) following the acquisition of GWI by Brookfield Infrastructure and Singaporean investment firm GIC in late 2019. Under the terms of this sale, GWA's existing shareholders, Macquarie Infrastructure and Real Assets (MIRA) and PGGM, agreed to acquire the majority share from GWI and are subsequently, the sole shareholders of One Rail Australia.

One Rail Australia is a fully integrated rail operator and owner of rollingstock and rail infrastructure. One Rail Australia provides freight services and / or maintains infrastructure across four Australian states and territories: South Australia, New South Wales, Queensland and the Northern Territory

In South Australia, under the *Railways (Operations and Access) Act 1997*, One Rail Australia is the access provider to rail lines on the Eyre Peninsula (narrow-gauge), the regional lines between Tailem Bend and Pinnaroo and Tailem Bend and Loxton (standard-gauge), the Mid-North and Barossa line (broad-gauge) and the Appamurra line (standard gauge). In addition, One Rail Australia also provides access to a number of main line sidings and standard-gauge railway yards such as those at Port Augusta, Port Pirie, Dry Creek, Port Adelaide and Tailem Bend.

Due to the nature of the intrastate main line network in South Australia, there is a tendency for each line to have only one end user. Consequently, the continuing and practical operation of One Rail

Australia's network is reliant on retaining its existing end customers in the face of increasing competition from road.

Recent Developments in the South Australian Freight Transport Industry

The South Australian rail freight industry has not undergone significant change since ESCOSA's last review and continues to be characterised by strong and increasing competition with road.

Generally, high volume, long distance and bulk freight lend themselves to the use of rail. However, rail's share of total intrastate freight (including commodities possessing these features i.e. grain) continues to fall compared to road due to the increasing prevalence of high productivity vehicles (HPVs). The use of HPVs erodes the traditional advantages of rail and limits the ability of rail operators such as One Rail Australia to set a price that is both competitive and which allows infrastructure to be appropriately invested in. Currently, rail's share of intrastate freight is below 20%.[1]

Despite competition and the widespread negative externalities associated with the use of road, larger vehicles continue to be approved for use in South Australia. For example, 2019 saw the first B-Quad Road Train introduced to the State's road network.[2] This reflects a long-term bias in government regulation of road compared to rail transport. Under current approaches to regulation there are no access arrangements applicable to road transport and trucks do not cover their incremental costs for access to roads (such as their damage) let alone the capital costs for roads. This is unlikely to change in the short to medium term.

One Rail Australia has directly experienced the growing competitiveness of road with the loss of significant grain business along the Eyre Peninsula lines during 2019. This comes as Viterra invests capital to convert its Port Lincoln site for operation of HPVs.[3] Due to the 'one customer per line' nature of much of the South Australian intrastate rail network, loss of business to road transport can and does result in the closure of regional lines. Closure of the Eyre Peninsula lines means that only One Rail Australia's 74 kilometre Thevenard to Kevin regional line is currently active, following the closures of the Barossa and Mallee lines in the past 5-6 years.

More broadly, there has been a recent uptick in interstate freight. In particular, drought conditions in the Eastern states (particularly Queensland and New South Wales) has resulted in demand for South Australian feedstock such as grains. However, One Rail Australia expects this uptick in demand to be sustained only temporarily while drought conditions persist and growers in these states continue to struggle to produce the volumes demanded.

In terms of future business, One Rail Australia does not foresee significant growth for rail freight in South Australia on the regional rail network. In other states, new mining projects can spur large increases in demand for rail, however, One Rail Australia is not aware of any mining projects that might seek access to our network over the next five years and none of One Rail Australia's existing users have indicated a desire to materially increase volumes or recommence services. Increased use of yards to facilitate mineral volumes moving on the ARTC main line network to ports in South Australia for export is a possibility while commodity prices remain high.

[1] BITRE 'Yearbook' 2019, https://www.bitre.gov.au/sites/default/files/documents/BITRE_2019_YEARBOOK.pdf
[2] DPTI 'South Australia's first B-Quad hits the road' 2019, https://dpti.sa.gov.au/news?a=563406
[3] Viterra 2019, http://viterra.com.au/index.php/2019/11/12/6million_upgrade_port_lincoln/

Given the condition of the South Australian rail freight industry, it is imperative that the State's rail access regime continue to be efficient and effective in the way it supports access seekers and providers through low compliance costs and an efficient negotiation process (including dispute resolution processes). It is the strong opinion of One Rail Australia that the existing regime meets these requirements as evidenced by the fact there have been no disputes that have required arbitration in the past five years.

One Rail Australia is aware of ongoing discussions around potential heavy vehicle charging arrangements but considers it highly unlikely that any changes, if they do occur, will materially impact the competitive position between rail and road in the medium term.

Strengths and Weaknesses of the Current Approach

One Rail Australia considers the current access regime to be cost effective for participants and fit for purpose. It is cost effective to manage and encourages negotiated outcomes. As such, it would be counterproductive to let it expire which would almost certainly involve a shift to a more prescriptive regime.

Key strengths of the current regime are that it:

- Provides clear guidelines for how users or potential users can seek access;
- Sets out arbitration processes; and
- Applies to both access seekers and access providers.

For One Rail Australia, the greatest strength of the existing regime is its efficient negotiation and arbitration framework. There have been no access requests that have required arbitration in the five years since the last ESCOSA review. Despite this, the negotiation and arbitration processes under the regime protects both access seekers and providers from undue market power. In addition, the existing access regime enables efficient negotiation in response to changes in demand. For instance, in recent years, the existing regime has supported the quick establishment of feedstock services (including grain) running from South Australia to drought affected states.

Under a national scheme, pricing is likely to become prescribed and supersede negotiation / arbitration processes in terms of priority and regulatory effort. This would be costly for One Rail Australia to participate in and could create risks around national access seekers exerting market power over the relatively small portion of the One Rail Australia network.

A shift towards a more prescriptive regime is unnecessary given persisting market conditions. Existing and increasing competition with road is the biggest determinant of rail prices. Currently, prices sit within the wide space between the floor and ceiling prices specified in the regime. As such, pricing under the regime is not considered a major factor as market conditions provide effective constraints on the market power of rail infrastructure providers. This is consistent with the findings of the 2015 ESCOSA Review - including that although One Rail Australia, in a theoretical sense, has market power, the likelihood of market power being misused is very low. While use of intrastate main lines is declining there is still significant activity within standard gauge yards associated with the interstate mainline which warrant a level of protection through a negotiation-based access regime.

Additionally, it is critical that the low volume nature of the South Australian market is supported by a low-cost regime. For One Rail Australia, current compliance costs for the 2019 calendar year are estimated at approximately $313,000. A shift to a more prescriptive regime is likely to attract several switching costs and an increase in compliance costs that One Rail Australia believes is unnecessary and counterproductive. A cost-effective regime is crucial in supporting the competitiveness of rail.

Ultimately, the conditions of the South Australian market are consistent with those of the last ESCOSA Review and as such, One Rail Australia believes the existing regime remains fit for purpose.

Response to Questions

This section sets out specific responses to each question raised by ESCOSA in the issues paper.

What factors have led to the movement away from rail transport in favour of road? Are these factors likely to be permanent, or could market or regulatory changes lead to an increase in demand for rail?

Currently, One Rail Australia does not anticipate an increase in rail demand for rail freight services in South Australia on its regional lines, in the foreseeable future. However, yards might benefit from increased traffic while commodity prices are high and there are also increased grain movements interstate while drought conditions persist on the Eastern seaboard. This is in part, the result of larger trucks that reduce the traditional advantage of rail and limit the ability of operators such as One Rail Australia to set a competitive price that allows for the appropriate investment in the network.

There are several factors that contribute to the modal decision of a cargo owner. In addition to price, factors such as service timeliness, capacity and reliability are also important. The competitive constraints from road on the ability of rail to price appropriately raises a circular issue. Namely, that to compete with road, One Rail Australia must lower its charges, but this reduces our ability to invest which eventually reduces asset quality and performance, further reducing our ability to compete with road.

This is particularly true for grain where there are large fluctuations seasonally and train movements are used to move specific grain types to port. These sporadic movements make rail transport less streamlined than, for example, the gypsum trains on the Thevenard line (direct from mine model). Difficulties in competing on price and improving efficiencies in an environment where road can be highly flexible has resulted in the loss of business for One Rail Australia on the Eyre Peninsula lines in May 2019. The loss of this businesses has been estimated to increase truck movements by around 30,000 B-doubles a year.[4]

In contrast, the operational nature of Gypsum mining – for example - lends itself to rail transport. Consistent and significant volumes as well as tight integration results in several trains a day with one set of equipment. Consequently, this is an efficient operational model for rail and one which allows sufficient funding for capital investment in the track.

The nature of rail and the associated factors (including competition with road) are likely to be permanent unless market or regulatory changes address these issues. One Rail Australia sees the low administrative cost and efficient negotiation, dispute and arbitration processes of the existing access regime as a positive that supports any potential rail industry revival (including support of ongoing

[4] ABC 2019, https://www.abc.net.au/news/rural/2019-02-26/viterra-to-switch-from-rail-to-road-eyre-peninsula/10850900

business) in South Australia and consequently, does not see change to the regime as necessary in this regard.

For which declared rail infrastructure services is competition sufficient that parties would reach competitive access arrangements in the absence of the regime?

As discussed above, ultimately regional rail must compete with the road network to carry bulk commodities. On the face of it, this would imply that competitive rail access could be negotiated to infrastructure in the absence of an access regime. Further:

- As ESCOSA noted in its 2015 review, rail users are generally large businesses who can devote significant resources to negotiating access. They have significant countervailing market power and, in most cases, can provide a credible threat of not using rail infrastructure services at all. This has borne out through One Rail Australia's recent history of closing most of its regional rail lines due to competition from road; and
- Again as ESCOSA noted in its 2015 review and as discussed above, utilisation of the regional lines is now limited to a single user on the Thevenard line. Users seeking access to these lines would be monopsonists and do not have to compete with other users for access – One Rail Australia currently has no credible alternative users for these assets.

The existence of the access regime is far more important for negotiating competitive agreements for mainline yards, given the alternative of using road is not applicable. In the case of yards, the regime provides protection for both access providers and access seekers via the floor and ceiling pricing regime and arbitration process.

To what extent do parties rely on the access regime in negotiations for access to declared rail infrastructure services? Please specify the rail lines for which access was sought and any difficulties in gaining access. What other benefits does the access regime deliver?

This question is largely for access seekers to address. However, consistent with the discussion above, One Rail Australia considers that the existence of the regime is beneficial to both itself and access seekers for a number of reasons. The Act and associated legislative instruments provide a broad framework that all parties can recognise and work within and importantly provides a strong degree of clarity and certainty for all participants, without which the transaction costs associated with seeking and providing access would be significantly higher. This is particularly the case for new access seekers and in relation to matters such as:

- The process for seeking and considering access requests;
- The pricing principles which apply should an arbitration occur – and which provide a useful set of reference points for the negotiation process, particularly in respect of floor prices; and
- The obligations that One Rail Australia must meet including information it must provide to access seekers.

We consider that the current regime is working well to ensure that access to infrastructure is provided in South Australia in a way that supports our State's economic efficiency. Without the clarity provided by the regime One Rail Australia considers that the cost to all parties would be much higher.

What are the direct and indirect costs of the access regime? Please provide qualitative or quantitative evidence.

For One Rail Australia, the total direct cost of administering the access regime is around $313,000 per year depending on the amount of external consultancy required. This figure is sourced from our regulatory accounts and takes into account the direct staff time attributed to managing the access regime and external consultancy costs. These costs mostly relate to staffing, managing websites, developing information sheets and other similar tasks. In our experience the annual costs don't change significantly from year to year.

Overall, One Rail Australia considers that this direct cost is not a significant burden and is a reasonable price to pay for a fit for purpose access regime taking into account the size of the network and the volume of freight transported, particularly on regional rail lines. The ability to keep costs of the regime at or around this level is a critical positive feature of the current access regime for One Rail Australia and movements towards a more costly regime would raise significant commercial concerns.

To what extent would the national access regime apply to intrastate rail infrastructure services in the absence of a state regime? What would be the costs and benefits of regulating access arrangements through the national regime?

If the state regime ceased to apply then we believe that the network would likely end up falling under the national regime.

It's our understanding that this would likely occur through either a voluntary decision by One Rail Australia to submit an access undertaking to the ACCC or by a third party access seeker applying to the National Competition Council to declare the network under Part IIIA of the *Competition and Consumer Act 2010 (Cth)*.

At this time, we cannot confirm whether or not One Rail Australia would submit a voluntary access undertaking to the ACCC should the state regime cease to apply. The benefits to One Rail Australia of doing so would have to be weighed against the significant additional costs.

In the event that a third party applies to the NCC, we can't pre-judge whether the NCC would find that the network satisfies all criteria listed under ss 44CA(1) and 44H(4) of the *Competition and Consumer Act* but we consider that, given that the network is currently regulated at the state level, there is a reasonable likelihood that the NCC would recommend to the designated Minister to declare the network.

In either of these cases, transition to the national regime would be a significant undertaking with large costs and significant time delay involved for One Rail Australia and access seekers. Under a voluntary access undertaking we would need to develop a range of information that is currently not required (including issues such as setting our initial capital base, developing detailed demand forecasts and determining a reasonable rate of return on investment). Under a declaration we would have to engage in a public consultation process and develop multiple submissions. More complex, costly yet largely pointless ring-fencing and information controls would be required. If the Minister declares the infrastructure then we would need to engage in negotiation and potential arbitration by the ACCC for access seekers.

All of these processes would impose significant costs on One Rail Australia as well as access seekers in a declining market for mainline access and where demand for yard use remains steady. It's difficult to put a precise figure on how our costs would change under the national regime but it is possible to provide a range of likely outcomes. Good information is available on the current compliance costs of QR in dealing with the QCA for its West Moreton Network. The West Moreton Network is around 314km, generates roughly $48 million in revenue and carries a mix of bulk, freight and passenger traffic. In both 2017-18 and 2018-19 QR spent an additional $2 million a year in operating expenditure relating to costs of preparing an updated Draft Access Undertaking and other QCA compliance activities.[5] Accounting for the difference in revenues between the two networks suggests that preparation of an access undertaking could cost One Rail Australia between $700,000 and $2,000,000 a year. The upper bound here is based on the fact that much of the regulatory regime under the national approach is fixed and would not vary much lower with the size of the network being regulated. This represents an approximate increase in our current costs of 2 to 6 times. We note that previous research by PwC indicates that the Queensland and National frameworks are very similar in terms of compliance requirements and so we consider that this range is a reasonable indication of potential annual costs for One Rail Australia when operating under a national regime.[6]

We also note that, in a recent submission to the Productivity Commission, the ARTC stated strong support for a system not unlike the present South Australian regime:

> *ARTC therefore strongly supports any movement towards a structure which promotes negotiated outcomes rather than adversarial regulatory processes that are based on abstract, subjective, and theoretical positions, divorced from the commercial positions of the participating companies.*[7]

We also consider that any move towards adoption of the national regime would raise the possibility of access seekers who operate nationally integrated services using their significant market power to essentially control the operation of yards and achieve pricing outcomes that are not sustainable in the long run and would not allow for the adequate maintenance of infrastructure. From One Rail Australia's perspective this is not a desirable outcome and would add complexity and cost while increasing the market power of access seekers that operate on a national level.

[5] Queensland Rail 'Annual Performance Report' 2018 and 2019, https://www.queenslandrail.com.au/business/acccess/Compliance%20and%20reporting/2017-18%20QCA%20Annual%20Performance%20Report.pdf https://www.queenslandrail.com.au/business/acccess/Compliance%20and%20reporting/2018-19%20QCA%20Annual%20Performance%20Report.pdf

[6] PwC 'Review of Rail Access Regimes' 2018, https://www.infrastructure.gov.au/rail/publications/files/Review-of-Rail-Access-Regimes.pdf

[7] ARTC 'ARTC Submission Productivity Commission Issues Paper Economic Regulation of Airports' 2018, https://www.pc.gov.au/__data/assets/pdf_file/0015/231324/sub039-airports.pdf

What is the value in continuing the access regime as insurance in the event that demand for rail transport increases?

One Rail Australia supports the continuation of the current regime regardless of the current or potential future position of demand for rail transport. The current regime is delivering good value for money in the current market conditions of declining mainline rail volumes and steady usage of yards and we agree that, if demand increases, then the regime will become more valuable than it is currently, especially where most negotiation will be around investment. We therefore see significant value in maintaining the current access regime as 'insurance' should demand for rail transport increase.

A good example of this is that the regime has recently facilitated the ability of suppliers and transporters to quickly respond to current changes in demand caused by drought. We are currently seeing grain being transported from South Australia to Queensland and New South Wales to assist in meeting the shortfall of feed in that state. Without the current regime in place it could have been a slower process to open these markets to South Australian producers and transport grain across the country. A similar situation would apply for other potential future increases in demand.

What would be the costs and benefits of introducing a mechanism for stakeholders to seek to have rail infrastructure services declared or excluded from the access regime, and what form would it take (for example, should coverage be included in the periodic review of the access regime)?

One Rail Australia considers that, where rail is in use or has the potential to be in use, it should be included within the current regime.

We do see a role for coverage to be included in the periodic review of the access regime but only in limited circumstances. We can foresee a requirement to account for cases where future potential use of the network is highly unlikely. We would agree that it would be beneficial for there to be some mechanism to respond to these cases in the periodic review.

What other changes could improve the efficiency or effectiveness of the current regime? Please explain with reference to the costs and benefits that would accrue to each relevant party.

One Rail Australia considers that the current regime is generally working efficiently and is effective. The current regime provides good value for money in the context of the current South Australian rail market.

One area that will need to be addressed is that One Rail Australia intends to move to a more web-based approach to supplying information to potential customers. Currently we must report whenever an information brochure is issued to a potential customer. Once we move to a web-based approach, this reporting will simply not be possible. As a result, relevant parts of the Act will have to be updated. Benefits of making this change would include better access to information for access seekers and reduce administrative costs for One Rail Australia. This change is, however, not urgent.

Summary

Overall, in the face of declining rail volumes in South Australia, we see no compelling reason to change from the current regime. The current regime is providing good value for money in protecting both access seekers and access providers – we see value for money and efficient access to regulated infrastructure to be the critical elements of the regulatory regime. Any transition towards the national regime would have high initial costs and would raise regulatory compliance costs for all parties in the long run. As a result, One Rail Australia maintains its position that the current regime is efficient, effective and fit-for-purpose given the size and nature of the South Australian rail market. We see no reason that ESCOSA would change its views from the 2015 review where it found, amongst other things:

- *there is no evidence of the misuse of market power, which suggests that only light-handed regulation is required;*
- *the evidence does not support a move to a more heavy handed regulatory regime;*
- Compared to a national regime, *the certainty of the state-based regime, together with its relatively low regulatory costs, is likely to better prevent the misuse of market power and to minimise regulatory costs;*
- No disputes had arisen from an unsuccessful negotiation (and One Rail Australia notes this continues to be the case); and
- *No submissions were made in favour of removing the state-based regime*.[8]

We therefore encourage ESCOSA to maintain the current regime with only the minor adjustments mentioned above to accommodate changes in provision of Information Sheets and the ability to un-declare small portions of track that may never be used.

One Rail Australia again thanks ESCOSA for the invitation and opportunity to respond to your issues paper. We appreciate having an economic regulator who is listening and understands the needs of the South Australian rail market. We are, naturally, happy to continue to be involved in this decision-making process.

Please contact Paul Hollitt on 8343 5441 if you wish to discuss this submission.

[8] Direct citations are in italics and are drawn from the Executive Summary and section 3.1.1 of ESCOSA's 2015 Final Report