SA Rail Access Regime Review Submission

Introduction

Pacific National (PN) welcomes the opportunity to provide a submission to the SA Rail Access Regime review. We understand the *Railways (Operations and Access) Act 1997 (*the Act) requires the Essential Services Commission of SA (the Commission) review the SA intrastate access regime and form a view as to whether or not it should continue from 31 October 2020 for five years.

Genesee & Wyoming Australia (GWA) operates the intrastate network and is a vertically integrated provider. PN relies on access to GWA yards and sidings to conduct its East-West interstate operations on the ARTC network. The SA access regime also serves as a 'back-stop' regime for the SA sections of the ARTC interstate network (in the event ARTC did not have an ACCC undertaking in place). We also observe the Commission draws heavily on the SA access regime for its oversight of the Tarcoola-Darwin railway (which operates under a similar regime) which is also operated by GWA.

PN submits it is critical for both its current and future SA and interstate operations for the SA access regime to continue and this review presents an opportunity to improve the regime. PN provided comprehensive submissions (attached in the Appendix) to the Commission's recently reviewed access regime guidelines which identified significant areas for improvement to the access regime. We understand these submissions will be re-considered in this review.

The Commission should strengthen its enforcement of the regime

The SA access regime review comes at a time when the Western Australian (WA) Government has announced a major strengthening of its rail access regime in response to stakeholder concerns[1]. The SA rail access regime has many of the deficiencies identified (and now corrected) in the review of the WA regime. The SA regime is defective as there is no effective regulatory oversight of price and terms and conditions of access; access seekers have been forced to negotiate contracts with monopoly networks outside of the access regime. As noted in previous submissions, this has resulted in sub-optimal outcomes: the closure of intrastate lines, declining rail freight volumes and difficulties in seeking access to the network on reasonable terms and conditions.

The Commission indicates in its review Issues Paper that it does not have the power to make changes to the regime as it is a matter for Government pending the outcomes of this review. We do not agree – there is scope within the Act to enforce changes now; Part 7 of the Act provides the Commission with wide ranging powers to monitor and enforce compliance and Section 62 allows the Commission to request any relevant information (including financial information) for this purpose.

[1] Significant improvements include the requirement for access providers to publish a standing offer price for defined rail tasks; submit a standard access agreement for regulatory approval and publish service quality indicators to assess network performance.

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Accordingly, we contend the Act provides the Commission with the power to (and accordingly should):

- Monitor non-discrimination between GWA's above-rail operations and its below-rail network in terms of the prices it offers to other above-rail providers and the basis for the costs of provision (as well as the terms and conditions of access) (Sections 39, 60 (1), 62 (1)).
- Publish service quality indicators to assess network performance for the provision of railway services (Section 62 (1)).

The regime needs to be strengthened and the Act amended in order to be certified as an effective access regime

In terms of the review as to whether the access regime is necessary to meet the object of the Act, we submit strong regulatory protections must be in place because the dominant rail network in SA (GWA) has significant market power arising from its vertically integrated status. In our previous submissions we provided examples of how it used its market power to propose monopoly prices for access to its network and generally frustrates access for non-GWA rail operators. The benefits of continuing with the access regime far outweigh the costs to GWA of compliance.

The SA access regime is certified as an effective regime by the National Competition Council (the Council) until 26 July 2021. As the Commission is aware, 2017 amendments to the *Competition and Consumer Act 2010* (CCA Act) raised the certification threshold.

We submit it is unlikely the regime in its current form would meet clause 6(4)(a)-(c) and (e) of the Competition Principles Agreement (CPA) and Part IIIA objective of the CCA Act. The CPA principles seek to ensure an access regime provides an appropriate balance between commercial negotiation and regulatory intervention to facilitate access negotiations. Based on the examples provided in our previous submissions as well as the fact all agreements have been negotiated outside of the regime, it strongly implies the negotiation framework in the regime is inconsistent with these clauses and would not be capable of certification.

A fundamental design flaw of the current access regime is its reliance on arbitration as the main avenue to address failed negotiations between a monopoly provider and an access seeker. Arbitration is not an effective alternative to upfront certainty on agreed terms and conditions of access.

Consistent with other rail access regimes (Queensland, ACCC and now WA) a regulated price determination process and standard access agreement is essential to balance the position of the railway owner with the interests of the access seeker (and its customers). At a minimum, GWA should be required to submit a standard access agreement (for defined reference services) with a standing offer price for Commission approval, with this agreement being the default access agreement. We note the Act would need to be amended to enable this change – this should be a key recommendation of this review. Once amended, it is highly like the regime will be capable of certification as an effective access regime.

Conclusion

PN recommends the Commission enforce its current powers under the Act and request the SA Government amend the Act to further strengthen the regime prior to an application for certification to the Council.

Appendix – Previous PN submissions to Commission reviews

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16 May 2019

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Submitted by email: escosa@escosa.sa.gov.au

Dear Mr. Caputo

2019 Review of rail guidelines for Tarcoola-Darwin Railway and South Australian rail access regime information kit

Pacific National welcomes the opportunity to provide a submission on the review. The review is a continuation of the same review which commenced in 2016. We note the review has not recommended material changes on either the guidelines or the information kit. Accordingly, Pacific National's February 2017 submission remains relevant to the extent issues including the lack of strong ring fencing protections, compliance and information provisions remain unaddressed.

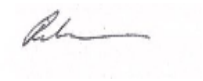
The AustralAsia Railway (Third Party Access) Code (the Code) Schedule provides the regulator (the Commission) with the power to ensure appropriate ring fencing of the access provider's accounts and the ability to review relevant revenues to deterimine if access revenues charged are excessive.

Pacific National previously applied for access on the Tarcoola- Darwin railway operated by vertically integrated Genesee and Wyoming (GWA) in 2017 and was quoted charges significantly higher than other long distance services. This raises two issues: are the access charges being efficiently set under the Code, and is it reasonable to assume GWA would offer its above-rail business the same level of charges. To address these issues, the Commission should stress test the proposed amended guidelines and information kit prior to finalisation and strengthen the protections to access seekers available under the Code.

A fundamental design flaw of the current access regime is its reliance on arbitration as the main avenue to addess failed negotiations between a monopoly provider and an access seeker. Arbitration is not an effective alternative to upfront certainty on agreed terms and conditions of access.

We note issues raised in 2019 review submissions will be considered by the Commission as part of the 2020 Access Regime review (2020 Access Review). The purpose of this submission is to detail areas for improvement (with reference to other rail access regimes) to ensure an effective rail access regime in South Australia. We submit some of these improvements (including greater information provision) are allowable under the Code, the Commission should update the current guidelines to incorporate the additional information in the lead up to the 2020 Access Review.

Yours sincerely



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Pacific National Submission

2019 Review of rail guidelines for Tarcoola-Darwin Railway and South Australian rail access regime information kit

May 2019

Public

Introduction

Competitive and efficiently priced access (on reasonable terms) to below rail networks is essential for above rail operators to compete with other freight transport businesses (road, shipping and air freight services).

We note rail freight has experienced a decline in South Australia (SA). As recently as February 2019, grain handling group Viterra announced it will not renew its GWA rail haulage contract and at the end of May 2019 will cease grain movement (by rail) on the Eyre Peninsula. This is because maintenance and investment costs of the rail line have risen to the point where it is no longer economic for Viterra to move grain on the Eyre Peninsula network[1].

South Australian railways, particularly railways serving interstate supply chains and bulk product markets in regional areas, have the inherent characteristics of natural monopoly infrastructure. The SA access regime is light handed and premised on commercial negotiation between access seekers and railway owners with access to arbitration in the event of dispute. In the last full review of the regime in 2015, the Commission concluded the lack of disputes as being evidence of access seekers successfully negotiating access to railway infrastructure[2].

Pacific National's experience in dealing with a monopoly railway owner

Pacific National's experience negotiating for rail access in SA does not align with this conclusion. We have applied for access as recently as 2017 on the GWA vertically owned Tarcoola to Darwin railway. The process and outcome were inconsistent with a commercial negotiation between two equal parties. For example, during negotiations, GWA delayed the application process by requesting small parcels of information instead of being upfront on the information required (and its relevance to the access request). Despite the level of information provided by Pacific National, the access offer was substantially higher than equivalent long distance routes even though no infrastructure upgrades were required for the services proposed.

Pacific National raised concerns about the Tarcoola-Darwin vertical integration to the Commission[3] and these issues remain today; to our knowledge there has been no Commission compliance review undertaken on ringfencing compliance. To address these issues, the Commission should stress test the proposed amended guidelines and information kit prior to finalisation and strengthen the protections to access seekers available under the Code.

2020 Access Review

For the 2020 Access Review, it is our position that a regulated price determination process is essential to balancing the position of the railway owner with the interests of the access seeker (and its customers). This is a far superior option to having access to an arbitration process which is likely to be lengthy and commercially ineffective (the contract may expire while the arbitration runs its course).

We note issues raised in 2019 review submissions will be considered by the Commission as part of the 2020 Access Regime review (2020 review). The purpose of this submission is to detail areas for improvement (with reference to other rail access regimes) to ensure an effective rail access regime in South Australia.

[1] https://www.abc.net.au/news/rural/2019-02-26/viterra-to-switch-from-rail-to-road-eyre-peninsula/10850900
[2] South Australian Rail Access Regime Review, August 2015 (Section 3.1, p 26).
[3] 2014 ESCOSA Review of Tarcoola-Darwin Revenues, 2017 Escosa Review of SA & NT Rail Access Guidelines

Pricing guidance

Regulator set indicative tariffs result in more efficient pricing outcomes

The experience in Queensland (regulated by the Queensland Competition Authority((QCA)) and in the Hunter Valley (regulated by the ACCC) is that an indicative tariff (approved by the regulator) constrains monopolist behaviour. For example, Pacific National note the significant differences in price resulting from the QCA setting the reference tariff in Queensland Rail's undertaking compared to Queensland Rail being permitted to set prices it determined appropriate.

Access Undertaking Process	Initial Tariff Claim	Ultimate QCA Approved Tariff
Queensland Rail[23] 2005 Draft Access Undertaking	$12.48-$13.19/'000gtk	$8.50/'000gtk
Queensland Rail 2015 Draft Access Undertaking	$19.41/'000gtk (escalated to $19.74/'000gtk by the time of the QCA decision on the 2016 Access Undertaking)	$17.92/000gtk West Moreton $16.66/000gtk Metropolitan

The QCA's final decisions on these processes indicate the claims submitted exceeded reasonable allowances by 32-36% for the 2005 Draft Access Undertaking and 7-14% for the 2015 Draft Access Undertaking. We would expect similar outcomes from an indicative tariff setting process if applied in the SA regime.

How pricing guidance could be improved

The current rail access regime requires the establishment of a floor price (effectively a price based on incremental cost) and a ceiling price (effectively a price based on stand alone cost), and the access seeker and railway owner negotiate the final access price between these two price limits. It appears to Pacific National that these pricing principles are designed to be used during arbitrations rather than upfront.

Pacific National strongly believes the floor and ceiling pricing approach is inadequate as it requires the use of a negotiate-arbitrate access approach between two distant price benchmarks. This negotiate-arbitrate access approach is also problematic as it requires access seekers to negotiate with a natural monopoly railway owner.

The Commission should have the power to approve tariffs for defined reference services, with these being the default tariffs for these reference services. However, the access seeker and railway owner should be able to negotiate away from these tariffs with agreement.

The structure of the indicative tariffs should include mandatory and negotiable provisions (like the arrangements in the ARTC Hunter Valley Access Undertaking). These arrangements are designed to be flexible, so the final access charge can vary from the indicative charge to better reflect the access proposal, and the associated cost and risk profiles; the railway owner would submit a draft access agreement, or standard terms and conditions to be met to access the indicative tariff.

In assessing the proposal, the Commission would consider the reasonableness of the proposal in the context of the railway's characteristics, its users and other pricing guidance in the regime. This arrangement avoids the potential for a vertically integrated railway operator to provide an access price on more favourable terms to its related party (through cost allocation mechanisms); this has been a longstanding concern for Pacific National in relation to the current access regime.

CPI escalation

Regulators typically allow escalation of annual price increases by CPI. However, this approach does not consider the declining competitive position of rail to its main competitor road. In contrast, it is estimated heavy vehicle operators have enjoyed only a 0.3 per cent increase in road user access charges from 2012-13 to 2017-18[4]. This increase for rail is an order of magnitude higher and significantly hampers the establishment of an efficient national competitive freight market across transport modes.

Moreover, CPI is not appropriate where there is doubt about the efficiency of the starting point. ACCC Chairman Rod Sims made the follow observations[5] which Pacific National agrees with:

> 'On the face of it, using a benchmark such as CPI may seem like a reasonable outcome. However, simply defaulting to CPI price increases does not necessarily mean that prices will reflect efficient costs over time. Firstly, what is the starting point; initially prices may not reflect efficient cost. Further, increasing volumes could mean that the average cost of providing services may actually decrease over time while, at the same time, revenues may increase due to both higher volumes and prices. This could increase the gap between costs and revenues and (potentially) monopoly rents.'

Pacific National submits an appropriate asset valuation (discussed below) will address the underlying efficiency level but it is nevertheless important to ensure road and rail are escalated competitively i.e. by the same rate. We would expect to see commentary in the final decision on escalation, and in the 2020 Access Review.

Asset Valuation

The underlying philosophy of monopoly regulation articulated in the Queensland Competition Act (s. 168A(a)) (and echoed in the SA regime) is the expected revenue for the access provider (railway owner) should 'include a return on investment commensurate with the regulatory and commercial risks involved' (s. 168A(a))[6]. Consistent with other jurisdictions, the QCA Act does not prescribe a mechanism to achieve this but when the initial asset valuation is undertaken, regulators typically use a DORC methodology. Under the negotiate-arbitrate model with an initial asset valuation, the ceiling price effectively becomes a regulatory building blocks calculation.

Pacific National believes the DORC methodology is a good approximation of cost a new entrant would face to enter the market and provide the same level of service. However, the mechanics of the DORC methodology need to remain flexible enough to allow consideration of the life and conditions of the assets. For example, in its decision on Queensland Rail valuation, the QCA placed a zero value on assets whose actual life exceed their expected useful life. This is because it is reasonable to consider these assets have already been fully depreciated and including them would amount to double counting[7] and excessive returns.

[4] National Transport Commission (NTC): PAYGO – Heavy Vehicle Charges Model. Version 2.2 (25 May 2018).
[5] Ports: What measure of regulation', Rod Sims, Port Australia Conference, Melbourne, 20 October 2016
[6] Queensland Competition Authority Queensland Rail's 2013 Draft Access Undertaking, Draft Decision, p xvi.
[7] Queensland Competition Authority Queensland Rail's 2013 Draft Access Undertaking, Draft Decision October 2014, p 138.

The valuation of a Regulatory Asset Base (RAB) needs account for circumstances where governments have gifted assets to railway owners at peppercorn rates. These should be treated as contributed assets for pricing purposes otherwise if they are included at market rates they would represent windfall gains to the asset owner - effectively the asset owner can seek a return of capital (depreciation) on the contributed assets at the same time as earning a return on capital. In addition, the valuation of the RAB for rail freight access should exclude expenditure directed at passenger services or otherwise undertaken for macro-economic or political purposes.

Rate of return

Setting the rate of return for monopoly infrastructure providers has been a source of significant debate between access seekers and access providers with both sides of the argument often presenting detailed independent advice but with the regulator having to make the ultimate judgement call.

In the heavily regulated energy sector, the Council of Australian Governments moved to amend the laws to replace the non-binding rate of return guidelines with a binding rate of return instrument.

As a binding instrument, it must set out the precise value for the rate of return or set out a method for calculating the rate of return that can be applied automatically without exercise of discretion on future regulatory determinations[8].

The binding guideline is informed by different consumer and industry stakeholders and a review by an independent panel of five highly-qualified members. The panel members have diverse backgrounds and areas of expertise including regulatory, legal, economic, finance, consumer perspectives and institutional investment[9].

It is likely infrastructure regulators in other sectors, including rail, will at least reference this guideline in their own regulatory decisions. Pacific National suggests the 2020 Access Review considers how preexisting rate of return advice such as the rate of return guidelines produced by the AER could inform the 2020 Access Review, without undertaking additional and duplicative work.

Capacity extensions and expansions

A key component of an effective rail access undertaking is an efficient, transparent and accountable capacity and investment framework to underpin the development and investment in extensions and expansions to the rail network. It is important to have an effective and balanced standard user funding agreement (SUFA) framework.

The QCA developed three overarching principles[10] required for developing an effective SUFA which could be considered in the 2020 Access Review.

(a) workable – a SUFA must achieve the intended outcome with an appropriate allocation of risk and liabilities. It must recognise the legitimate business interests of the access provider and be in the interests of access seekers and investors in the network. It must be able to be executed by all parties without negotiation, if necessary.

(b) bankable – a SUFA must be financeable by access seekers and third-party financiers with recourse to the funded assets and rights. This requires there be a high level of confidence that the expected returns will be delivered and that the asset will be appropriately operated and maintained over its lifecycle.

[8] AER Rate of Return Instrument Explanatory Statement, December 2018, p 13
[9] AER Rate of Return Instrument Explanatory Statement, December 2018, p 12
[10] Queensland Competition Authority Queensland Rail's 2013 Draft Access Undertaking, Draft Decision October 2014, p, 158.

(c) credible – a SUFA must not create unnecessary risks and uncertainties for users and potential financiers or overlay unnecessarily high transaction, tax or finance costs on an extension project otherwise the funding agreement can never be a credible alternative to Network undertaking the extension itself.

Improve efficiency of the regulatory process

Publishing a standard information package and regulator approved access agreement

Instead of a guideline, Pacific National believes the access provider's standard access agreement should be approved by the Commission for defined reference services, with these agreements being the default access agreements. This ensures the Commission approved indicative tariffs are consistent with the Commission approved access agreements.

Stand track access agreement

The Commission should approve a standard access agreement containing the following elements:

- The STAA should include standard access principles.
- The STAA should include an appropriate pricing dispute mechanism so the STAA remains relevant and effective over the life of the agreement.
- The STAA should provide an option for access seekers to execute long term access agreements, say 10 years.
- The STAA should apply a commercially balanced approach to allocating risks to the contracting parties best placed to manage or mitigate the risks.
- The STAA should include a maintenance obligation. The railway owner should be obliged to maintain the network in a condition which allows the rail operator to provide train services in accordance with the access agreement.
- The STAA should provide certainty regarding the railway owner's minimum service standards to provide access to the contracted train paths over the life of the access agreement
- The STAA should establish transparent and clearly defined processed through which access rights can be varied (including renewal, relinquishment, transfer, suspension and/or termination).

  Pacific National considers operational performance levels should be included in the STAA. This KPI regime should provide an opportunity for rail operators and end users to monitor the network's compliance with, and its performance against, its obligations and responsibilities in the STAA. As a provider of a monopoly service, the network should be measured, and incentives should be applied to provide strong incentives for performance to be approved. The types of KPIs that could be considered in assessing performance levels include:

  - contracted vs scheduled vs actual train services;
  - network availability, including planned and unplanned maintenance, planned and unplanned track closures and planned and unplanned speed restrictions;
  - below rail transit time.

The Commission should update the current guidelines to incorporate the additional information above prior to the 2020 Access Review. This paves the way for a standard access agreement to be subject to regulatory approval by the Commission in the future.

Addressing information asymmetry

Access seekers and regulators face a significant information asymmetry if asset owners are not compelled to provide financial information. If the negotiate-arbitrate access model continues to be applied, then rail access negotiations and outcomes need to be improved by requiring rail infrastructure providers to supply a level of cost information which facilitates balanced negotiations. Other regulatory models either contemplate or mandate this level of detail.

For example, gas and electricity companies' applications to the Australian Energy Regulator for five-year regulatory revenue proposals and access arrangement decisions include their detailed financial model spreadsheets with workings[11].

In the context of the assessment of the interstate network, the ACCC stated the asset owner (ARTC) should provide stakeholders (and regulators) sufficient information to assess the prudency of capital expenditure[12] and this information should be audited. At a minimum it should include:

- Estimated capex to date and expected expenditure in ongoing projects.
- Explanations of the basis for the capex forecasts.
- Cost-benefit analysis for projects – ACCC expected network users could then rank projects in order of priority and provide input.
- Information on current and forecast prices and how they have been determined
- Expected information on the estimated impact on access prices of the proposed capital expenditure program would assist network users in assessing the potential financial implications of the capital expenditure program on their own operations.

Further an annual compliance assessment process would increase transparency over the capital and maintenance expenditure undertaken and provide stakeholders with clarity and certainty the railway owner is complying with its financial model[13].

In addition, Pacific National believes the information requirements necessary for a negotiate-arbitrate regulatory model include at a minimum:

- Access tariff applying to the rail corridor for which access is sought, including the written down book values of the rail infrastructure relevant to the rail corridor.
- Weekly Timetable, as amended from time to time, and an assessment of whether there is enough available capacity to accommodate the access sought by the rail operator.
- The cost of access, including operating and maintenance costs, to ensure the rail corridor will deliver the contracted services for the term of the agreement.
- Safety systems, line diagrams, and maps.

[11] ACCC Draft decision Australian Rail Track Corporation's 2018 Interstate Access Undertaking 20 December 2018, p 116.
[12] ACCC Draft decision Australian Rail Track Corporation's 2018 Interstate Access Undertaking 20 December 2018, pp 85-86.
[13] ACCC Draft decision Australian Rail Track Corporation's 2018 Interstate Access Undertaking 20 December 2018, p 206.

- Condition of the infrastructure comprising the rail corridor, including
    - train operational constraints such as maximum train speeds, maximum train length, sectional running times,
    - network operational constraints such as speed restrictions (with an adjustment factor to apply when speed restrictions impact sectional running times), planned possessions and unplanned possessions, and
    - parts of the rail corridor where interaction with other train services would impact on the access rights being sought.

We note some of this information is referred to in the current guidelines but could be expanded. Access seekers need to be able to assess the reasonableness of the proposed charges and associated expenditure proposals. This will reduce the possibility of the railway operator from acting in a discretionary manner in the negotiation, and delivery, of access services to its customers. In this context we note in the UK, Network Rail must produce a strategic business plan (SBP) as part of the consultation over its regulated charges. As the ORR notes:[14]

The SBPs will set out Network Rail's plans for operating, maintaining and renewing the network, and how it intends to improve its capability and efficiency. These plans will affect what the railway can deliver – and so have a significant impact on the service that train operators can offer to passengers and freight customers – and the future condition of the network.

Pacific National recommends the 2020 Access Review should include mandatory information provisions consistent with the regulatory regimes identified above, and to the extent allowable under the Code, the Commission should update the current guidelines to incorporate the additional information.

Confidentiality of information submitted to the Commission

The Commission needs to have sufficient and clear powers to collect and publish data as part of its responsibility for economic regulation of network access providers. Blanket or unsubstantiated claims of confidentiality should be prohibited.

The PwC review of rail access regimes commissioned by the Department of Infrastructure, Regional Development and Cities specifically called out issues with obtaining information from SA railway networks:

> "Confidentiality agreements prevented PwC from being able to cite an indicative access agreement for any of the South Australian rail access undertakings. This made it difficult to fill out the table on the obligations and requirements of each party under an access agreement. Also, due to the lack of publicly available information and the inability of PwC to fill information gaps through stakeholder consultations, it was not possible to source qualitative information on these rights and obligations.
>
> As GWA is the largest operator and also the RIM of the Tarcoola to Darwin Railway, it is likely that the rights and obligations will be determined by how they would like to fun operations and provide access to their networks. This is an area where more research will be required."[15]

[14] http://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/price-controls/periodic-review-2018/pr18-consultations/consultation-on-draft-guidance-on-Network-Rails-strategic-business-plans
[15] Department of Infrastructure, Regional Development and Cities, Review of rail access regimes, May 2018, p 94.

As an example of best practice, the Australian Energy Regulator (AER) confidentiality guidelines requires the network provider to make a separate confidentiality claim for *each* piece of information it requires confidential[16]. This high threshold demonstrates the importance of stakeholders having access to sufficient information to enable them to understand and assess the substance of all issues affecting their interests.

Pacific National suggests the access regime should mandate claims of confidentiality will only be allowed in very limited circumstances and require sufficient justification; blanket confidentiality claims should not be allowed.

On the other side of the coin there is a need to protect access seekers' confidential information when dealing with a vertically integrated railway operator. We note 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. Pacific National strongly believes that given the common ownership of above rail and below rail operations on this rail line, the guidelines should include very strong protections for confidential information provided by access seekers.

Railway owner accountability

Reporting on service quality indicators

It is important for access seekers to have transparency about the service quality of the railway and therefore mandatory reporting on service indicators is very important. However, network performance incentives are a step further in establishing a best practice regulatory regime.

Network performance incentives

In Europe, most rail networks have a performance incentive scheme of some form in place, which typically relate to providing incentives to minimise delays. Other Australian regulated industries such as the energy sector have incentive schemes[17] built into the regulatory framework which could be adapted for the SA access regime in the 2020 Access Review.

For example, the service target performance incentive scheme[18] provides incentives to improve performance of network based on availability, reliability and market impact measures and ensure network businesses are not driven to reduce costs at the expense of service quality.

Network prices would be reduced where the network fails to meet targets, for example the network would not be allowed to recover revenue through take-or pay provisions. Performance measures should have a direct link with individual service performance, not aggregate performance.

Above rail operators require:

- Improved network availability (more train paths, less cancellations).
- Improved network performance (on-time performance, less transit times delay and temporary speed restrictions).
- Cost reduction or productivity improvements (for example short-term transfer or slot trading mechanisms).
- Under a STPIS scheme, adapted for the rail industry, potential metrics per service could include:

[16] AER Better Regulation, Confidentiality Guideline, August 2017, p 11.
[17] https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews
[18] ibid

- Decrease in planned possessions.
- Decrease in speed restrictions and/or average daily minutes caused by speed restrictions.
- Decrease trains cancelled due to network cause.
- Decrease in number of systems paths lost to planned maintenance.
- Decrease in number of systems paths lost to unplanned maintenance.
- Increase healthy trains on-time arrival.
- Increase unhealthy trains on-time arrival.

Other incentives schemes[19] adaptable for the rail sector include:

- Capital expenditure sharing scheme: networks are entitled to retain revenue from any underspend and bear cost of overspend for a total of six years (regulatory period is 5 years) the scheme drives cost saving for users through lower future regulatory allowances.

- Operating expenditure: a similar scheme exists for operating expenditure; however, it uses a revealed cost forecasting approach to assess the base year (with inefficient expenditure removed).

Pacific National suggests the 2020 Access Review considers these schemes in detail.

[19] ibid

27 August 2019

Mr. Mark Caputo
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Essential Services Commission
Submitted by email: escosa@escosa.sa.gov.au

Dear Mr. Caputo

Further Draft Decision on review of rail guidelines for the Tarcoola-Darwin railway

Pacific National is pleased to provide a submission to the Commission on its Further Draft Decision on its review of the rail guidelines for the Tarcoola-Darwin railway (Further Draft Decision).

Our 16 May 2019 submission on the review explained the AustralAsia Railway (Third Party Access) Code (the Code) Schedule provides the regulator (the Commission) with the power to ensure appropriate ring fencing of the access provider's accounts and the ability to review relevant revenues to determine if access prices quoted or charged are excessive.

Accordingly, we submited various improvements (including greater information provision) which are allowable under the Code; access seekers need to have information on the access provider's costs of providing rail services and pricing methodologies.

Unfortunately, the Commission has not included these changes in the guidelines. It appears the Commission's appetite to materially change the guidelines is low due to a full Code review commencing in 2020. We strongly disagree with this approach.

Pacific National applied for access on the Tarcoola-Darwin railway operated by vertically integrated Genesee and Wyoming (GWA) in 2017. We approached GWA to run three intermodal services which could be easily accommodated on its network. GWA quoted a price with a fixed charge of $74,000 per path with a variable charge of $2.00 per '000 GTK.

To put in to perspective, a comparable service of Port Augusta to Kalgoorlie on the ARTC network is significantly lower - $7500 and $3.25 '000 GTK respectively. Importantly, we were not able to substantiate the basis for the costs or whether the quote was consistent with its pricing for its own above-rail provider. The current guidelines provided no basis for GWA to provide this information.

In its final recommendation on certification, the National Competition Council stated the AustralAsia Railway access regime which applies to the Tarcoola-Darwin railway:

> '…relies heavily on the independent regulator to ensure that it can adapt as circumstances change during the period of certification'[1].
>
> The circumstances which have changed is that access was requested on a bona fide basis and monopolist pricing was offered.

[1] National Competition Council Final recommendation – AustralAsia Railway, p 5

'The access seeker should be provided with the level of information similar to that it would extract in the process of negotiating in a competitive market. For instance, in a competitive market a consumer could gain information on relative costs by securing a number of quotes. These would also specify the quality of the service linked to those costs, any technical details and relevant conditions of sale. As a consequence, it is important that the Regime ensures that arbitrated outcomes resemble those expected in a competitive market and that sufficient information regarding this probable outcome is provided to the parties[2].'

As stated above, we were unable to substantiate the costs, as a consequence the guidelines did not aid negotiations to replicate a competitive market.

Section 6 of the Code provides the Commission with wide ranging powers to monitor and enforce compliance with the Code. Further Section 39 allows the Commission to require certain information including financial information for the purposes of monitoring. Given the circumstances outlined by Pacific National there is a strong reason to do this.

We contend the Code provides the Commission with the power to (and accordingly should):

- Mandate the provision of indicative pricing information in the form of reference prices with methodologies and principles (Section 39, Schedule, Division 1 (2) (5)).
- Include a 'most favoured nation' clause to ensure non-discrimination between GWA's related party above-rail provider and its below-rail network compared to the prices offered to other above-rail providers (Section 39).
- Request information on whether GWA received access proposals and offered access pricing on a non-discriminatory basis (Section 10(4), Section 46 (2)(c), Schedule, Division 1 (2) (5)).
- Require separate regulatory accounts for its above and below rail businesses and to publish this information (Section 46).
- Conduct a compliance review of the ring fencing and confidentiality provisions and non-discrimination requirements (Section 12A and Section 46); to our knowledge there has been no Commission compliance review undertaken on ringfencing compliance.

More generally, section 11 of the Code imposes a duty to negotiate in good faith. During the negotiation process, the access seeker may call on the Commission for advice or to verify that an element of the access provider's proposal is within the bounds of the regime. The implication is the Code allows the Commission to prescribe information for verification purposes. To aid and encourage commercial 'like' negotiations the above information needs to be mandated in the guideline.

While we note this Further Draft Decision only relates to the interstate Tarcoola-Darwin Railway access regime, given the similarities between the two regimes, the Commission should incorporate these recommendations in its final decision on the review of the South Australian rail access regime information kit.

Yours sincerely

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[2] Ibid p, 23

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