Stuart Peevor
Manager Pricing and Access
GPO Box 2605
Adelaide SA 5001

escosa@escosa.sa.gov.au

South Australian Rail Access Regime Review – Draft Report

14 July 2015

Dear Stuart,

Aurizon welcomes the opportunity to respond to the Essential Services Commission of South Australia's **(the Commission)** draft report on the review of South Australian Rail Access Regime **(SARAR)**.

Aurizon's response to the issues paper considered that the effectiveness of the regime was largely untested and that cessation of SARAR should be supported by a finding of material net public benefit. In addition, the submission also noted some aspects of the SARAR which could be reviewed to better promote the competition objectives of the regime.

The draft report reasonably concludes that the state based regime should continue and that changes could be made to increase the clarity regarding the coverage of the regime. Aurizon welcomes these conclusions but provides further information in relation to:

- the performance and operation of the regime;
- promoting competition in the rail haulage market.

Performance and Operation of the SARAR

The draft report notes that submissions and information obtained by the Commission indicate that access seekers are successfully negotiating access to railway infrastructure services and that no disputes have been referred to the Commission since the regime commenced.

However, it is likely that there would have been few, if any, access negotiations undertaken pursuant to the SARAR where rail transportation services using the rail infrastructure have predominantly been subject to user negotiations with the incumbent rail operator who provides its own access.

In order to transparently identify whether the access regime has been tested, it is requested that the Commission include in its final report the number of notices it has received from access providers in relation to access seeker proposals under clause 31(3)(a) of the Railway (Operations and Access) Act 1997 **(ROA Act)**[1].

Where negotiations have primarily occurred between a user and the incumbent operator then dispute resolution is not possible under the SARAR. As noted in Aurizon's submission, and acknowledged by the Commission, an access negotiation (and therefore a dispute) can only occur between the access provider and an operator of rollingstock (as defined by an Industry Participant). Therefore the absence of disputes is not a reliable indication as to the performance of the SARAR and whether it is achieving its objectives.

The Commission also advises in the draft report that it is undertaking an independent review of the regulatory accounting practices. While the costs of the regime can be reduced by limiting the compliance and reporting obligations, it is reasonable and best practice for the regulator to periodically audit compliance against the requirements of the SARAR. In this regard the Commission notes that the scope of the review is to:

> *ensure that costs have been allocated appropriately between its below-rail and above rail businesses.*

Aurizon considers the scope of this review to be unduly narrow as clause 22(2)(b)(i) of the ROA Act also requires that accounts and records must identify income. The requirement to identify income is a necessary component in order to ensure that the unbundled price of comparable services that the access provider provides to itself as indicated by clause 38(1)(h) of the ROA Act can be ascertained. It is therefore submitted that the Commission should expand its review, where necessary, to assess income and not just costs.

Promoting Competition in the Rail Haulage Market

Aurizon's submission noted that competition in the rail haulage market can only occur where customers are willing to test the market and the SARAR provides an appropriate framework to allow contestability to occur. For services in markets that do not have the capacity to pay the full economic cost of both above and below rail, then this can only feasibly occur where the below rail price is a given and common input into that process.

The Commission appears to have mis-interpreted our statements that this should require the regulatory framework to require benchmark prices or reference tariffs. Aurizon does not consider the determination and publication of indicative charges as necessary to promote commercial negotiation. However, it should be recognised that in order for competition to occur the access seeker must, subject to differences in cost or risk, be provided the same price for the same below rail service as the owner of the facility is prepared to provide to itself. The role of the indicative price being provided to the access seeker is to ensure that a more efficient rail operator is able to compete fairly in the downstream market.

In relation to the need to provide this unbundled price the Commission notes that section 4.3 of the Information Kit requires the rail infrastructure providers to provide an unbundled price for rail access. These requirements do not necessarily facilitate the regime's objectives of promoting competition as:

[1] Clause 31(3)(a) requires that the access provider must give written notice of the receipt of an access proposal to the regulator.

- it merely requires the service provider to quote a wide interval price between floor and ceiling prices; and

- does not require that the service provider must provide an unbundled price to a related operator.

It is preferable where a related operator provides a rail freight service that it is required to quote that service by clearly identifying the above and below rail components of that price. This is essentially the problem identified by Penrice Soda Products in its submissions to the 2009 inquiry into the rail regime in which the stakeholder was unable to obtain any information in relation to the below rail access charge from the bundled service price.

While changes to the Information Kit require the 'likely price' to be quoted to access seekers as that of a similar service, this is not readily obvious to an end user when assessing competing offers (as it is unable to seek access under the ROA Act, it is unable to obtain an unbundled price), or if the access provider is not maintaining unbundled prices to a related party. This is essential to allow the end-user to assess the prospective benefits of pursuing alternate offers from potential competitors to the incumbent provider. It is therefore submitted that the Commission should confirm whether an end-user is permitted to be 'a person with a proper interest in making an access application' and is able to obtain the information in s.29 of the ROA Act.

The Information Kit also identifies the ceiling price requirement of the ROA Act to be the 'full economic cost'. This sets an extremely high threshold against which to assess:

> *the ceiling price should reflect the highest price that could fairly be asked by an operator for provision of the relevant services*[2]

Given the nature of the markets to which the SARAR applies and the competition objectives of the ROA Act, the ceiling price which could be fairly asked may also be that which is consistent with the vertically integrated rail provider's freight rate less its avoidable above rail costs. This would provide an access charge which maintains profitability of the regulated service but allows for competition and a potentially lower above rail price. This is consistent with the principles underpinning the competitive imputation price in the Australasian Railways Access Code for which ESCOSA is also responsible.

A key consideration the Commission has identified as being relevant to its analysis is whether there is, or there may be, the exercise of market power. The interpretation and application of the ceiling price is particularly relevant to the consideration of this matter as the vertically integrated rail operator might seek to set an access price which does not allow an access seeker to effectively compete even if it has a more efficient service.

Where the SARAR does not adequately address this incentive then competition can, and will only occur, where prices are close to full economic cost (as end users have greater incentives to promote competition). Therefore, the substantial discretion in the setting of the below rail access charge up to the ceiling price can hinder effective competition. It is therefore submitted that a more fundamental issue that the Commission should address in its final report is whether the intention of the ROA Act is to promote competition and efficiency for all services which are priced below economic cost.

---

[2] Section 27(2) of the ROA Act

Aurizon also recognises that the provision of access to third party rail operators can impose significant inefficiencies. On balance, these loss of efficiencies can impose further indirect costs which are materially greater than the direct costs of regulation and may be greater than any benefits arising from increased competition.

These indirect costs of regulation are largely unaddressed in the Commission's analysis. The materiality of these indirect costs are largely dependent on the relevant characteristics of the railway such as service density, contractual complexity and investment expectations. Indirect costs associated with misalignment of incentives are mitigated due to the integrated service provision. Therefore, in assessing whether the SARAR has a net public benefit it may assist current and potential market participants for the Commission to consider the markets or circumstances in which the provision of access and the promotion of competition is desirable.

Should you have any questions in relation to this submission please contact Dean Gannaway, Principal Regulatory Economist by phone on 07 3019 2055 or by email at dean.gannaway@aurizon.com.au.

Kind regards,

[Original Signed]

John Short
Vice President, National Policy