2009 SA RAIL ACCESS REGIME INQUIRY

DRAFT INQUIRY REPORT

July 2009

The Essential Services Commission of South Australia
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REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (the Commission) invites written submissions from interested parties in relation to the issues raised in this paper. Written comments should be provided by **6 August 2009**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

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

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

Responses to this paper should be directed to:

2009 SA Rail Access Regime Inquiry: Draft Inquiry Report

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Public Information about ESCOSA's activities

Information about the role and activities of the Commission, including copies of latest reports and submissions, can be found on the ESCOSA website at www.escosa.sa.gov.au.

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GLOSSARY OF TERMS

ABARE	Australian Bureau of Agricultural and Resource Economics
ABB GRAIN	ABB Grain Ltd
ACCC	Australian Competition and Consumer Commission
ACCESS PROVIDER	A party providing, or able to provide, railway infrastructure services – sometimes referred to as a below-rail operator
ACCESS SEEKER	An Above-Rail Operator seeking access to the Railway
ARTPA ACT	Australasia Railway (Third Party Access) Act 1999
APT	Asia Pacific Transport Pty Ltd
ARTC	The Australian Rail Track Corporation Ltd
AWB	AWB Ltd
CIRA	Competition and Infrastructure Reform Agreement
COAG	Council of Australian Governments
CPA	Competition Principles Agreement 1995
DORC	Depreciation Optimised Replacement Cost
ESC ACT	Essential Services Commission Act 2002
GRA	Gypsum Resources Australia
GWA	Genesee and Wyoming Australia Pty Ltd
INFORMATION BROCHURE	A document containing information relevant to access that an operator is obliged to prepare and provide in accordance with section 28 of the ROA Act
PSP	Penrice Soda Products Pty Ltd
NCC	National Competition Council
ROA ACT	Railways (Operations and Access) Act 1997
SOUTH AUSTRALIAN RAIL ACCESS REGIME	The Access Regime in Parts 3 to 8 of the ROA Act.
THE COMMISSION	The Essential Services Commission of South Australia
TPA	Trade Practices Act 1974
WPR	Western Plains Resources Ltd

1 EXECUTIVE SUMMARY

The Essential Services Commission of South Australia (the Commission) has been directed by the Acting Treasurer to conduct an Inquiry into the Access Regime that applies to the major intrastate railways in South Australia. The Inquiry is to focus on the extent to which the existing Access Regime, which is set out in the Railways (Operations and Access) Act 1997, is consistent with certain principles under the Council of Australian Government's Competition and Infrastructure Reform Agreement (CIRA). Broadly speaking, CIRA commits all signatories to ensure that access seekers can gain access to significant infrastructure in a more timely and nationally consistent way. The Inquiry will also consider whether or not the Access Regime could otherwise be generally improved. This Draft Inquiry Report presents the draft conclusions of the Commission's Inquiry.

The Commission has identified three areas where greater consistency between the ROA Act and the relevant CIRA principles could be achieved:

- objects of the ROA Act – amending section 3(c) of the ROA Act to better reflect the concept of economic efficiency;
- principles of arbitration - introducing additional principles that are to be taken into account by an arbitrator; and
- timeframes for decision making by the regulator – introducing a six-month timeframe to the conciliation and arbitration process set out under the ROA Act to resolve access disputes.

The Commission has also identified the following areas where the Access Regime's overall effectiveness could be improved:

- a review of the Commission's Information Kit be carried out to ensure that the information being provided in an Information Brochure is sufficiently detailed and transparent to give adequate guidance to an access seeker in the first instance;
- a confidentiality provision be introduced into the ROA Act to protect the commercially sensitive information being exchanged in a negotiation process;
- various procedural improvements that could be introduced into the negotiate-arbitrate framework; and
- the definition of an "access contract" be narrowed to reduce administrative burdens on rail operators.

The Commission has considered the extent to which coverage of the Access Regime remains appropriate, and its draft conclusion is that there is no reason to change the list of services that are currently covered by the regime. While concerns have been raised by some stakeholders on whether or not certain rail sidings are covered by the regime, the

Commission considers that the application of the regime to rail sidings is appropriate. The definition of “private sidings”, which are excluded from the access regime, does not appear to capture any rail sidings for which access is likely to be an issue.

The Commission requests comments from interested parties on this Draft Inquiry Report by 6 August 2009. The Commission will consider all comments received and will prepare a Final Inquiry Report in September 2009.

2 INTRODUCTION

The Commission is conducting an Inquiry into the Access Regime that applies to the major intrastate railways in South Australia. The Inquiry is focusing on the following aspects:

- whether or not the existing Access Regime, which is set out in the *Railways (Operations and Access) Act 1997* (ROA Act), is consistent with certain principles under the Council of Australian Government's Competition and Infrastructure Reform Agreement (CIRA)[1]; and
- areas for general improvement of the Access Regime that may improve its overall effectiveness.

In conducting the Inquiry, the Commission will also be performing functions under section 6 of the *Essential Services Commission Act 2002* (ESC Act). Therefore, in addition to address the Terms of References[2] referred to it by the Acting Treasurer, the Commission must meet its legislative responsibilities and carry out the Inquiry in a manner which meets the objectives set out under section 6 of the ESC Act.

As part of the Inquiry, the Commission has been directed to provide a recommendation to the South Australian Government on whether or not the Access Regime complies with certain principles set out in clause 2 of the CIRA, and to recommend changes that could improve the effectiveness of the Access Regime.

2.1 South Australia's Railways

South Australia's key railways are owned and managed by a combination of government-owned entities, and private companies. The Commonwealth-owned Australian Rail Track Corporation (ARTC), for example, owns and manages South Australia's inter-state gauge lines. On the other hand, private companies such as Genesee and Wyoming Australia Pty Ltd (GWA) control various other intra-state lines, with an open access regime in place.

Broadly speaking, South Australia's major railways comprise the following:

- the broad gauge rail lines within metropolitan Adelaide used mainly for urban public transport services, operated by TransAdelaide;
- the standard gauge rail lines which form part of the national railway network, used for passenger and freight train services, controlled by the ARTC, or, in the case of the Tarcoola to Darwin line, operated by Asia Pacific Transport Pty Ltd (APT);
- the intra-state lines operated by GWA used primarily for freight services, including:

1 The CIRA is available at: http://www.coag.gov.au/meetings/100206/attachment_b_ncp_review.pdf.

2 The Terms of Reference for the Inquiry are contained in Appendix 1 of the Draft Inquiry Report.

- the narrow gauge lines on the Eyre Peninsula;
- the broad gauge lines in the mid North; and
- the standard gauge lines in the Murray-Mallee region

▲ the standard gauge line between Port Augusta and Leigh Creek used principally for coal freight trains, controlled by Flinders Power (Babcock and Brown Power); and

▲ the narrow gauge lines on the Eyre Peninsula used for ore haulage, controlled by OneSteel Ltd.

2.2 The ROA Act

Railway ownership on South Australia's metropolitan (TransAdelaide) and intra-state (mainly GWA) lines is vertically integrated. This means the owner of the below-rail infrastructure is also a provider of above-rail services on those lines.

To ensure other operators could offer above-rail services to customers and compete with the owner/operator by obtaining access to the railways on commercial terms, the South Australian Parliament passed the ROA Act in July 1997.

In general, the ROA Act establishes a framework for the negotiation of access to certain railway services and for the resolution of access disputes that may arise between operators (access providers) and proponents (access seekers).

2.3 South Australian Rail Access Regime

The Access Regime is set out in Parts 3 to 8 of the ROA Act, and was intended to be consistent with the National Competition Principles[3] and with Part IIIA of the *Trade Practices Act 1974* (TPA). While it was envisaged that the Access Regime would be submitted to the National Competition Council (NCC) for certification as an effective access regime under the TPA, certification has not yet been sought.[4] Until certification is achieved, access to services provided by intrastate railways may be subject to declaration under Part IIIA of the TPA.

The scope of services covered by the Access Regime is determined by proclamation.[5] These services can be varied by further proclamation. The Access Regime currently applies to all intra-state railways in South Australia, with the exception of certain railways such as the Glenelg tramlines, tourist or heritage railway lines, and other privately-owned rail sidings.

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3 The Competition Principles Agreement is one of the agreements comprising the National Competition Policy. It can be accessed via: http://www.ncc.gov.au/publication.asp?publicationID=99&activityID=39.

4 CIRA requires the South Australian Government to submit the Access Regime for certification by no later than the end of 2010.

5 Services that are proclaimed to fall within the definition of "railway infrastructure" services, and are therefore covered by the Access Regime, were published in the South Australian Government Gazette on 7 May 1998.

The Commission is the regulator of the Access Regime and has been assigned the following specific functions set out under Parts 3 to 8 of the ROA Act:

- monitoring and enforcing compliance with Part 3 (general rules for conduct of business) of the Act;
- monitoring the costs of rail services;
- making an application to the Supreme Court for appointment of an administrator where a rail operator becomes insolvent, ceases to provide railway services or fails to make effective use of the infrastructure of the State;
- establishing pricing principles;
- establishing requirements for information about access to rail services;
- conciliation of access disputes and referral of disputes to arbitration;
- fulfilling any other functions and powers conferred by regulation under the ROA Act.

As such, the Commission is obliged to monitor and enforce compliance with the whole of the Access Regime, and put in place arrangements to ensure that businesses covered by the Access Regime comply with, and are capable of complying with, their obligations.

Some key aspects of the Access Regime are summarised in Appendix 2.

2.4 Process for the Inquiry

The Inquiry into the Access Regime commenced in February 2009 with the release of an Issues Paper for public consultation. The Issues Paper sets out several key issues identified by the Commission that may be of relevance to the Inquiry for stakeholders comment. It was intended that the submissions received will guide and inform the Commission in preparing the Draft Inquiry Report.

Seven submissions to the Issues Paper were received from the following parties[6]:

- ABB Grain Ltd;
- Asciano;
- Genesee & Wyoming Australia Pty Ltd[7];
- Gypsum Resources Australia

[6] Submissions to the Issues Paper are available on the Commission's website at: http://www.escosa.sa.gov.au/site/page.cfm?u=179&t=submissionsXList&xlistId=62.

[7] GWA has provided the Commission with an initial and supplementary submission to the Inquiry. The supplementary submission provided comments on submissions made by other parties.

- Penrice Soda Products Pty Ltd
- Western Plains Resources Ltd;

As was indicated in the Issues Paper, the Commission's approach to the Inquiry relies substantially on the expectations and experiences of stakeholders. As such, the submissions were considered to be particularly important to the Inquiry.

The Commission appreciates the contributions made by these stakeholders to the Inquiry process and acknowledges the valuable input that the submissions have provided into the preparation of this Draft Inquiry Report.

2.5 Requirements for conducting the Inquiry

This section sets out the legislative requirements and the Terms of Reference for the conduct of the Inquiry.

2.5.1 Application of the ESC Act

The objectives of the Commission are set out in section 6 of the ESC Act.

Section 6 of the ESC Act states that:

In performing the Commission's functions, the Commission must:

- *Have as its primary objective protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and*
- *At the same time, have regard to the need to:*
  - *Promote competitive and fair market conduct;*
  - *Prevent misuse of monopoly or market power;*
  - *Facilitate entry into relevant markets;*
  - *Promote economic efficiency;*
  - *Ensure consumers benefit from competition and efficiency;*
  - *Facilitate maintenance of the financial viability of regulated industries[8] and the incentive for long term investment; and*
  - *Promote consistency in regulation with other jurisdictions.*

2.5.2 Terms of Reference for Inquiry

Pursuant to part 7 of the ESC Act, the Acting Treasurer has referred the Inquiry to the Commission. The Commission will consider the extent to which the Access

8 The Commission notes that the South Australian intrastate rail industry is not a regulated industry for the purpose of the ESC Act.

Regime is consistent with certain principles of the Competition and Infrastructure Reform Agreement (CIRA), entered into by the Council of Australian Governments (COAG) in February 2006. The Inquiry will also consider whether or not the Access Regime could otherwise be generally improved.

The clause 2 CIRA principles which are the focus of the Inquiry seek to establish a simpler and consistent national approach to economic regulation of significant infrastructure. The relevant provisions from clause 2 of the CIRA, to which the Commission must have regard, are set out in the Inquiry's Terms of Reference in Appendix 1.

In summary, these provisions set out COAG's agreed principles relating to access regimes for services provided by significant infrastructure facilities. They are as follows:

- a simpler and consistent national approach to economic regulation of significant infrastructure should be established (clause 2.1);
- access regimes should promote commercially agreed outcomes between the access seeker and the infrastructure operator (clause 2.2);
- price monitoring should be considered as a first option where price regulation is required or when scaling back from more intrusive regulation (clause 2.3);
- access regimes should have consistent regulatory principles relating to, among other things, promoting economic efficiency and effective competition in upstream or downstream markets, and the setting of regulated access prices (clause 2.4); and
- there should be a timeframe of up to six months for the making of regulatory decisions under an access regime (clause 2.6).

The CIRA requires that these principles be incorporated into existing access regimes for services provided by means of significant infrastructure facilities as soon as practicable or as they are reviewed, provided that they are included in such regimes no later than the end of 2010.

The Commission will examine the Access Regime to determine whether or not each of the above CIRA principles finds effect in the current legislation. Where changes to the legislation are required in order to achieve compliance with the CIRA principles, the Commission will provide advice to the South Australian Government as to the form that such changes should take.

In 2007, the Commission conducted an Inquiry into the consistency of the ports access regime with these same CIRA clauses.[9] The Government directed the Commission to undertake the ports access Inquiry, and amendments to the *Maritime Services (Access) Act 2000* (the MSA Act) have recently been enacted to implement many of the recommendations made by the Commission. Having amended the ports regime to introduce greater consistency with the CIRA, and having made other various changes to improve the effectiveness of the regime, the Government has committed to submit the ports access regime to the NCC for certification by 2010. In conducting this Inquiry into the SA Rail Access Regime, the Commission is mindful of the changes that have been made to the ports access regime, and to access arrangements for ports and railways generally, in order to ensure that consistency of arrangements is achieved where relevant.

[9] A copy of the Commission's 2007 Ports Pricing and Access Review is available at: http://www.escosa.sa.gov.au/webdata/resources/files/070706-PortsPriceAccessFinalReport1.pdf.

3 CONSISTENCY OF THE ACCESS REGIME WITH CIRA

Pursuant to section 35(1) of the ESC Act, the Acting Treasurer has directed the Commission to undertake an Inquiry into whether or not the Access Regime is consistent with certain principles set out in clause 2 of the CIRA. In particular, the Commission has been directed to consider clauses 2.1, 2.2, 2.3, 2.4 and 2.6 of the CIRA. These clauses were discussed in section 2.5.2 of this paper, and are contained in the Inquiry Terms of Reference provided in Appendix 1.

Clause 2 of the CIRA commits all signatories to establish a simpler and consistent national approach to economic regulation of "significant infrastructure". This is defined by COAG as:

> *infrastructure, including ports and export related infrastructure, that falls within the scope of subclause 6(3)(a) of the Competition Principles Agreement or Part IIIA of the Trade Practices Act 1974.*

The South Australian Government has committed to reviewing the intrastate rail access regime for the purposes of clause 2 of the CIRA, and implement necessary changes to promote greater consistency with CIRA before the end of 2009.[10]

The South Australian Government has committed to reviewing the Access Regime and to implement the consistent principles before the end of 2009, as was agreed under CIRA. It is also required to apply for certification of the Access Regime before the end of 2010.

The Issues Paper sought comments from stakeholders on any areas where greater consistency between the Access Regime and relevant CIRA provisions could be achieved. Some of the submissions to the Issues Paper commented on this. These comments are further discussed in the sections below.

The Commission has had regard to these comments in considering whether or not the current Access Regime is consistent with the relevant requirements of clause 2 of the CIRA. The Commission's draft findings are discussed below.

3.1 Clause 2.1

Clause 2.1 of the CIRA specifies that:

> *The Parties agree to establish a simpler and consistent national approach to economic regulation of significant infrastructure*

[10] The COAG National Reform Agenda: Competition Reform April 2007 is available at: http://www.coag.gov.au/coag_meeting_outcomes/2007-04-13/docs/coag_nra_competition_reforms.pdf.

The policy objective to introduce greater national consistency in rail access regulation has been given greater prominence since the establishment of Infrastructure Australia in 2008. In a report to COAG, released in December 2008, Infrastructure Australia noted that separate regulatory regimes across different jurisdictions in the area of land transport have contributed to inefficiencies and, more importantly, adversely impacted upon Australia's economic growth.[11] As such, Infrastructure Australia considered it critical for the nation to address this issue by adopting the principle of "one set of rules for one economy". It envisaged that such a simpler and national approach to the economic regulation of railways would minimise uncertainty and make it easier for businesses to operate across state and territory borders.

The Commission acknowledges the economic argument put forward by Infrastructure Australia that different regulatory arrangements across jurisdictions can create uncertainty for access providers and access seekers, drive up costs and ultimately lead to inefficiencies. However, the Commission is wary about simply adopting a uniform national regulatory approach to be applied across all intrastate railway networks.

The Commission notes that different railway networks in Australia operate under differing industry structures and competitive environments. As such, the aim to establish an overarching national regulatory approach needs to be balanced against the specific context in which regulation is being applied. A "one-size fits all" approach to rail access regulation may impose undue limitations in this respect.

The Commission believes that an Access Regime should be sufficiently flexible to recognise the particular circumstances in which the railway industry operates, reflective of the state of any intermodal competition within a jurisdiction, and should strike an appropriate balance between the interests of all stakeholders. For example, in an environment where there is potential for market power to be exercised, a more heavy-handed form of regulatory regime may be required to curb anti-competitive behavior.

The Commission interprets Clause 2.1 of the CIRA as not suggesting that a uniform access regime should be applied to all significant railways in Australia. The ultimate policy objective is to achieve greater national consistency in rail access regulation, not uniformity of regulation. The context to regulation will always remain important, and consistency of regulation where contexts are similar should be the desired outcome. Even where this is the case, there may be a number of alternative ways to achieve greater consistency within the Part IIIA framework of the TPA.[12] For example, irrespective of whether access is provided for through an ACCC approved access undertaking or through a state-based access regime, consistency of the regulatory principles that underpin the access regime, where appropriate, is important.

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[11] Infrastructure Australia's report to COAG is available at: http://www.infrastructureaustralia.gov.au/files/A_Report_to_the_Council_of_Australian_Governments.pdf.

[12] A copy of ACCC's Access Regime: A Guide to Part IIIA of the Trade Practices Act is available at http://www.accc.gov.au/content/index.phtml/itemId/264169.

Whilst the South Australian Rail Access Regime is considered by the Commission to be more light-handed compared to other access regimes (e.g. Victoria[13] or ARTC), the Commission notes that this in part reflects different market conditions and industry structures. For example, the SA railways are largely shorter-haul, bulk transport lines with fewer users relative to the interstate network. Moreover, the Commission is not aware of any principles underpinning the Access Regime that are in conflict with that underpinning other access regimes. Nevertheless, the Commission would welcome comments from stakeholders on this matter.

The Commission notes that clause 2.1 of the CIRA provides an overarching principle, and should be read in conjunction with the subsequent provisions of clause 2, which provide more specific requirements for access regimes. The Commission proposes to focus on clauses 2.2, 2.3, 2.4, 2.6 and 2.7 of the CIRA, on the basis that the intent of the CIRA is for parties to adopt these specific requirements as a means of achieving a simpler, more consistent national approach to economic regulation of significant infrastructure.

The Commission has therefore proceeded to examine the more specific requirements under clause 2.

3.2 Clause 2.2

Clause 2.2 of the CIRA specifies that:

> *The Parties agree that, in the first instance, terms and conditions for third party access to services provided by means of significant infrastructure facilities should be on the basis of terms and conditions commercially agreed between the access seeker and the operator of the infrastructure.*

The Commission notes that the ROA Act favours commercial negotiation for access to a railway service. Section 32 provides that:

> *(1) The operator must negotiate in good faith with the proponent with a view to reaching agreement on whether the proponent's requirements as set out in the access proposal (or some agreed modification of the requirements) could reasonably be met, and, if so, the terms and conditions for the provision of access for the proponent; and*
>
> *(2) The other respondents (if any) whose rights (or prospective rights) would be affected by implementation of the access proposal must also negotiate in good faith with the proponent with a view to reaching agreement on the provision of access to the proponent and any consequent variation of their rights (or prospective rights) of access.*

[13] It is noted that the Essential Services Commission of Victoria is currently undertaking an inquiry into the effectiveness of the Victorian Rail Access Regime. For further information, please refer to: http://www.esc.vic.gov.au/public/Rail/Consultations/Victorian+rail+access+regime+review+2009/Victorian+Rail+Access+Regime+%28VRAR%29+review+2009-10.htm.

In addition, section 27 of the ROA Act, which provides for the development of pricing principles by the Commission, specifies that:

> *(3) The pricing principles do not prevent an operator from entering into an access contract on terms that do not reflect the principles.*

The "negotiate-arbitrate" model for access as set out in the ROA Act places a strong emphasis on allowing parties to reach commercially agreed outcomes before having to apply access regulation. The Commission therefore believes that this is entirely consistent with the principle specified in clause 2.2 of the CIRA.

Draft Report Conclusion

The Commission's draft finding is that the Access Regime is consistent with CIRA clause 2.2.

3.3 Clause 2.3

Clause 2.3 of the CIRA specifies that:

> *The introduction of price monitoring for services provided by means of significant infrastructure facilities should be considered, where this would improve the level of price transparency, as a first step where price regulation may be required, or when scaling back from more intrusive regulation.*

The Commission notes that the ROA Act does not currently impose any form of price regulation for intrastate rail services. Rather, it allows the Commission to establish pricing principles that are to be taken into account in the event of arbitration of access disputes. Therefore, the question under clause 2.3 is whether or not the introduction of price regulation is warranted at this stage and, if so, is price monitoring the appropriate response.

Whilst the Issues Paper sought comments from stakeholders on whether or not price regulation is warranted for the Access Regime, the Commission did not receive any submissions expressing support for the introduction of price regulation.

GWA's submission to the Issues Paper commented that:

> *"price monitoring if put in place in South Australia, might narrow the price window in which negotiations can take place and discourage full commercial negotiation."*[14]

[14] GWA's submission to the Issues Paper, pg 2 of unnumbered document.

Asciano supported this view, commenting that:

> *"[it] believes there is no need at this stage for the implementation of a more heavy handed form of regulation for the SA Regime, especially given the Commission under Part 7 of the ROA Act has the power to require an access provider to submit information on the cost of railway services it provides."*[15]

The Issues Paper sought comments from stakeholders on whether price regulation of any form should be introduced into the Access Regime and, if so, to provide any positive evidence to substantiate the argument for its introduction. The Commission did not receive any comments or positive evidence on this matter. The Commission notes that submissions from Penrice and GRA argued for greater price transparency in the provision of below-rail services, but did not directly support the introduction of price regulation. Issues relating to price transparency are discussed in chapter 4 of this report.

In the absence of any support from submissions to this Inquiry and based on its experience under the current intrastate rail access regime where there has not been any access disputes, the Commission's draft finding is that there are no persuasive arguments for the introduction of price regulation, including price monitoring, and therefore clause 2.3 of the CIRA is not applicable to the Access Regime at this stage.

Draft Report Conclusion

The Commission's draft finding is that as there is no case for price regulation, CIRA clause 2.3 is not applicable to the Access Regime at this stage.

3.4 Clause 2.4

Clause 2.4 of the CIRA specifies that:

> *All third party access regimes for services provided by means of significant infrastructure facilities will include the following consistent regulatory principles.*
>
> *a. Objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.*
>
> *b. Regulated access prices should be set so as to:*
>
> *i. generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service of services and include a return on investment commensurate with the regulatory and commercial risks involved;*

[15] Asciano's submission to the Issue Paper, pg 2 of unnumbered document.

ii. *allow multi-part pricing and price discrimination when it aids efficiency;*

iii. *not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and*

iv. *provide incentives to reduce costs or otherwise improve productivity.*

c. *Where merits review of regulatory decisions is provided, the review will be limited to the information submitted to the regulator.*

In relation to clause 2.4(a) of the CIRA, the Commission notes that section 3 of the ROA Act does contain an objects clause, the objects being:

(a) to promote a system of rail transport in South Australia that is efficient and responsive to the needs of industry and the public;

(b) to provide for the operation of railways;

(c) to facilitate competitive markets in the provision of railway services;

(d) to promote the efficient allocation of resources in the rail transport segment of the transport industry; and

(e) to provide access to railway services on fair commercial terms and on a non-discriminatory basis.

The Commission believes that these objects are broadly consistent with those set out in clause 2.4(a) of the CIRA, although the concept of economic efficiency is given greater prominence in clause 2.4(a) than in section 3 of the ROA Act.

Section 3(c) of the ROA Act does discuss facilitating competitive markets in the provision of railway services, which the CIRA states is the objective of promoting economically efficient use of, operations and investment in significant infrastructure.

However, the submission to the Issues Paper from Gypsum Resources of Australia Pty Ltd (GRA) expressed concern that the Access Regime, in its current form, does not explicitly promote economic efficiency, commenting that:

> *"[it] believes that the operation of the current rail access regime encourages the access providers downstream above rail services to remain inefficient both from itself having inefficient sources of supply on long term contracts with little apparent incentives to perform and having commercially obsolete equipment."*[16]

The Commission makes the general observation that the Access Regime is designed to encourage efficiency in the provision of below-rail services and to ensure that there is no

[16] GRA's submission to the Issues Paper, pg 5 of unnumbered document.

leveraging of market power from below-rail services to above-rail services so that all industry participants in the above-rail market can compete evenly.

The Commission interprets GRA's comments as suggesting that there is presently no incentive for GWA's above-rail business to be efficient, and that there is not a level playing field for industry participants in the provision of above-rail services. Whilst GRA has not provided any specific evidence to the Commission to substantiate its claim, the Commission notes that the ROA Act requires an access provider to not unfairly discriminate between proponents (including its own above-rail business) and to ring-fenced its upstream rail business from its downstream rail business. The Commission has not received any submissions suggesting that the current ring-fencing requirements are insufficient in ensuring adequate separation between the upstream and downstream parts of the rail business.

The Commission believes that the relevant question under clause 2.4 is whether or not the objects clauses in the ROA Act are explicit enough to reflect the concept of economic efficiency set out under CIRA and, if not, what changes in particular, would be necessary.

The Commission's draft finding is that there is scope for the ROA Act to better reflect the concept of economic efficiency set out under CIRA. The Commission believes that the objects clause of the ROA Act could be made more consistent with clause 2.4 of the CIRA and recommends that the South Australian Government consider inserting the following object into section 3 of the ROA Act:

> *To promote the economically efficient use of, operation of and investment in, railway services.*

Clause 2.4(b) of the CIRA concerns the principles by which regulated prices are set. The Commission notes that it does not set prices for railway access, rather, it establishes pricing principles for fixing floor and ceiling prices for railway services. In addition, the ROA Act provides certain principles that an arbitrator must take into account in determining any award relating to an access dispute. Section 38 of the ROA Act provides that:

> *(1) the arbitrator must take into account*
>
> *(a) the objects of this Act;*
>
> *(b) the non-discrimination principles;*
>
> *(c) the operator's legitimate business interests and investment in railway infrastructure;*
>
> *(d) the cost to the operator of providing access as sought by the proponent (excluding costs arising from increased market competition);*
>
> *(e) if applicable – the economic value to the operator of additional investment the proponent proposes to undertake;*

(f) the economically efficient operation of the railway infrastructure;

(g) the pricing principles;

(h) the price of comparable services for other industry participants (including – if applicable – the operator itself);

(i) the interests of industry participants whose interests may be affected by the proposal;

(j) the contractual obligations of the operator and existing industry participants;

(k) the operational requirements for the safe and reliable operation of the railway infrastructure;

(l) the public interest in market competition; and

(m) relevant technical and legal issues.

(2) the arbitrator may take into account other matters the arbitrator considers appropriate.

On the basis that the principles listed in 2.4(b) are intended to be reflected in the principles to be taken into account by an arbitrator under section 38 of the ROA Act, the Commission's draft finding is that there are no principles between the two sets that are in conflict. However, to introduce greater consistency between the two sets, the Commission recommends that the South Australian Government consider the addition of the following provisions to section 38(1) of the ROA Act:

The pricing principles relating to the price of access to a service are as follows:

(n) that access prices should allow multi-part pricing and price discrimination when it aids efficiency;

(o) that access prices should not allow a vertically integrated operator to set terms and conditions that would discriminate in favour of its downstream operations, except to the extent that the cost of providing access to others would be higher; and

(p) that access prices should provide incentives to reduce costs or otherwise improve productivity.

The Commission notes that the proposed non-discrimination principle above is intended to be consistent with the general obligation under section 23 of the ROA Act that requires an operator to not unfairly discriminate between proponents.

Clause 2.4(c) of the CIRA concerns the information to be made available to a merits review, if such a review is provided for. The Commission notes that section 56 of the ROA Act provides for an appeal on a question of law, and does not provide for a merits review. As such, the Commission's draft finding is that this CIRA principle is not relevant to the Access Regime.

Draft Report Conclusion

The Commission recommends that the South Australian Government consider an amendment to section 3(c) of the ROA Act to provide the following object:

(b) to facilitate competitive markets in the provision of railway services, by promoting the economically efficient use of, operation of and investment in, railway services.

The Commission also recommends that the South Australian Government consider the addition of the following provisions to section 38(1) of the ROA Act:

The pricing principles relating to the price of access to a service are as follows:

(n) that access prices should allow multi-part pricing and price discrimination when it aids efficiency;

(o) that access prices should not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and

(p) that access prices should provide incentives to reduce costs or otherwise improve productivity.

3.5 Clause 2.6

Clause 2.6 of the CIRA specifies that:

> *The parties agree to introduce requirements that regulators will be bound to make regulatory decisions under an access regime within six months, provided that the regulator has been given sufficient information.*
>
> *a. Regulators will have the discretion to determine when the six month time limit is suspended:*
>
> *i. Grounds for commencing time limits include when the regulator considers that sufficient information has been provided to enable the regulatory process to commence; and*
>
> *ii. Grounds for suspending time limits include requests for further information from significant infrastructure facility service providers, provided these are on reasonable grounds, and consultation periods during which the regulator seeks submissions from third parties or the community.*

b. *Where the service provider of significant infrastructure facility has not provided the requested information, a regulator will be permitted to make a determination on the information before it in order to satisfy six month time limits.*

The Commission notes that the ROA Act does not currently provide for any time limits in relation to regulatory decisions made by the Commission under the Access Regime. As such, a provision similar to that set out in clause 2.6 of the CIRA would need to be inserted into the ROA Act to achieve greater consistency between the two sets.

In general, submissions to the Issues Paper supported the introduction of greater time certainty to the conciliation/arbitration process set out under the ROA Act to resolve access disputes.

ABB Grain's submission to the Issues paper commented that:

> *"[it] considers this could be improved by providing potential access applicants more certainty in both the range of access pricing which may be applied and the time frames required to navigate the arbitration process."*[17]

The Commission's draft finding is that there is significant merit in providing time certainty to the process of resolving access disputes and that a time limit provision should be inserted into the ROA Act to reflect clause 2.6 of the CIRA. Notwithstanding this, provisions should be made for the suspension of the six-month time limit on grounds such as requests for further information and consultation periods during which submissions are sought from third parties and the community. Section 30(A) of the *Maritime Services (Access) (Miscellaneous) Amendment Act 2009* provides an example of the type of time limit provision that is required.

Draft Report Conclusion

The Commission recommends that the South Australian Government consider the insertion of a six-month time limit provision into the conciliation-arbitration framework set out under part 6 of the ROA Act to reflect clause 2.6.

3.6 Clause 2.7

Clause 2.7 of the CIRA specifies that:

> *The principles in clauses 2.4 and 2.6 will be incorporated in existing access regimes for services provided by means of significant infrastructure facilities and Part IIIA of the* Trade Practices Act 1974 *as soon as practicable or as they are reviewed, provided that they are included in such regimes no later than the end of 2010.*

[17] ABB Grain's submission to the Issues Paper, pg 2 of unnumbered document.

The Commission notes that the South Australian Government is committed under the COAG National Reform Agenda to the implementation of consistent principles between the Access Regime and CIRA in 2009, and to have the regime certified by no later than the end of 2010.

The Commission believes there is significant merit in having the Access Regime certified as effective by the NCC. A certified access regime provides the greatest level of regulatory certainty to all industry participants over how access will be regulated. This assists in promoting new capital investments in the upstream and downstream markets. In the absence of a certified access regime, the potential for declaration by an access seeker under Part IIIA of the TPA provides significant uncertainty to an access provider.

The Commission therefore recommends that the South Australian Government submit the Access Regime to the NCC for certification as soon as practicable following necessary amendments to the ROA Act

Draft Report Conclusion

The Commission recommends that the South Australian Government commence the certification process at the earliest opportunity following necessary amendments to the ROA Act.

4 AREAS FOR GENERAL IMPROVEMENT

The Inquiry's Terms of Reference direct the Commission to provide advice on any other changes to the Access Regime that may improve its overall effectiveness. Having considered comments raised in submissions to the Issues Paper, direct consultations with stakeholders, and based on the Commission's experience with the Access Regime, the Commission provides the following draft recommendations on areas for improvement.

4.1 Coverage of the Access Regime

In order to determine whether or not it should recommend that the South Australian Government amend the coverage of the Access Regime by further proclamation, the Commission has considered various factors, which are discussed in further detail below.

4.1.1 Mining Developments in South Australia

The Issues Paper had discussed the expected increase in mining developments in South Australia, and queried whether or not the Access Regime is flexible enough to cater for this increase in mining activities. However, no comments were received on this issue.

In assessing whether or not the current Access Regime is flexible and robust enough to respond to future challenges, the Commission believes that it needs to be considered from a long-term perspective. Notwithstanding the current economic downturn, in which demand for mineral outputs has declined significantly and funding for capital intensive mining developments is constrained by tighter credit market conditions, there are a number of positive indicators for the South Australian mining industry. South Australia remains highly regarded for its favourable business environment[18] and mining potential.[19]

Furthermore, BHP Billiton's expansion plans for Olympic Dam[20] and the Australian Bureau of Agricultural and Resource Economics (ABARE) latest commodities demand forecast[21] support the view of an expected increase in mining activities in South Australia.

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18 South Australia was ranked the least risky jurisdiction in Australia and second internationally for mining exploration activities by London-based ResourceStocks magazine in its annual World Risk Survey. A copy of this survey is available at: http://en.gtk.fi/export/sites/default/ExplorationFinland/ExplorationNews/world_risk_ranking_list_only2008.pdf.

19 South Australia was ranked in the top ten in terms of mining potential in the Fraser Institute's 2008/09 survey of 71 jurisdictions worldwide by mining and exploration companies. A copy of this survey is available at: http://www.fraserinstitute.org/researchandpublications/.

20 Information in relation to BHP Billiton's proposed expansion of Olympic Dam is available at: http://www.bhpbilliton.com/bb/odxEis.jsp.

21 ABARE has forecasted for the nation's mining exports to continue expanding in volume terms in the long term, despite a flat or lower in value terms during 2009-10. A copy of ABARE's commodities demand forecast is available at: http://www.abareconomics.com/publications_html/ac/ac_09/ac09_March_a.pdf.

The Commission believes that the current economic slowdown represents an opportune time for the Access Regime to be reviewed to ensure it is flexible and robust enough to respond to an eventual upturn in global economic conditions and mining activities.

Whilst the Issues Paper sought comments from stakeholders on whether or not the coverage of the Access Regime should be extended to certain existing railway infrastructure that are not currently covered particularly to accommodate future mining developments, the Commission did not receive any specific comments on this matter, other than on the issue of private sidings which is discussed further below. The Commission's draft finding is therefore for the Access Regime's coverage to remain unchanged.

4.1.2 Private Sidings

Pursuant to a Proclamation gazetted on 7 May 1998[22], the provisions of the Access Regime under the ROA Act do not apply to, amongst other things, "private sidings".

Under the proclamation, a "private siding" is defined as a private siding within the meaning of the *Rail Safety Act 1996* that is used or maintained to provide access to an area that is used (or predominately used) by the person who owns and maintains the siding (or any other person) for a purpose other than for transport purposes.

Under the *Rail Safety Act 2007* (which repealed the 1996 Act), a private siding is defined as a siding that is managed, owned or controlled by a person, other than a person who manages the rail infrastructure with which the siding connects or to which it has access, but does not include a:

- marshalling yard;
- crossing loop;
- passenger terminal;
- freight terminal; or
- siding, or a siding of a class, prescribed by the regulations not to be a private siding.

Furthermore, pursuant to the *Rail Safety (General) Regulations 2008*, the following are also not private sidings:

- a siding under the control and management of an accredited rail infrastructure manager; and

[22] p. 2115.

- a balloon loop used for the purpose of loading or unloading trains.

After discussing the intent of these provisions with the South Australian Government, the Commission understands that private sidings are meant to capture privately-owned sidings where the railway infrastructure is for the sole use of the owner (e.g. for manufacturing processes) and is not meant for access purposes.

In reviewing the GWA and ABB Grain submissions, there appears to be some ambiguity over which rail sidings are covered by the Access Regime. Both have argued that private sidings should be brought within the Access Regime.

ABB Grain argued that access to rail sidings is an integral part of gaining access to railways generally, commenting that:

> *"without access to these sidings it is not physically or economically viable for a competing rail operator to load trains."*[23]

The Commission interprets ABB Grain's comments as suggesting that there are some grain sidings that are considered to be "private". As such, a rail operator may not be able to gain access to these grain sidings that links grain storage and loading facilities to a main railway line.

Whilst it believes that access regulation may be appropriate for certain private sidings with monopoly characteristics, the Commission has to firstly ascertain whether or not the grain sidings referred to by ABB Grain are in fact covered by the Access Regime and, if not, whether there are justifications for these grain sidings to be covered by the Access Regime.

Based on the discussions held with the South Australian Government and the Commission's interpretation of the legislation, the Inquiry's draft findings are:

- both ABB Grain and GWA are accredited as rail infrastructure managers under Part 4 of the *Rail Safety Act 2007*. As such, any sidings owned by either parties are covered by the Access Regime; and
- pursuant to the *Rail Safety (General) Regulations 2008,* AWB-owned balloon loops are also covered by the Access Regime.

Whilst the draft finding is that all grain sidings known to the Commission are covered by the Access Regime, it notes that the issue of grain access needs to be considered within the context of the entire supply chain. For example, not all grain storage and loading facilities are covered by the Access Regime. As such, even if a user gains access to the grain siding, there is still a separate question of whether access can be gained to all grain loading and handling infrastructure where it is

[23] ABB Grain's submission to the Issues Paper, pg 1 of unnumbered document.

uneconomic to build competing infrastructure. The Commission therefore sees merit in considering rail access issues in the grain industry as part of a broader review of the entire supply chain, noting that it would allow for the specific circumstances of the grain industry to be appropriately considered and scrutinised. The Commission supported such a review in its 2007 Inquiry into the ports access regime.

The Commission notes that there is a grain handling access regime that exists separately to the rail access regime in Victoria, and that ACCC is also presently reviewing access to infrastructure used for the purposes of wheat exporting.[24]

Draft Report Conclusion

The Commission recommends that coverage of the Access Regime to remain unchanged.

The Commission is not aware of any sidings that are not covered by the Access Regime, which should be brought within the scope of the Access Regime.

4.2 Provision of Information

The Commission believes that the provision of relevant information forms a critical input into the process of commercial negotiations between an access provider and an access seeker. The ROA Act obliges an access provider to provide an access seeker with an Information Brochure, which documents the terms and conditions on which the railway infrastructure would be made available.[25] Section 32 of the ROA Act also obliges an access provider to negotiate in good faith with an access seeker with the view to reaching an access agreement. The Commission has received several comments on this matter, some of which are discussed in further detail below.

4.2.1 Transparency of Price Components

Some submissions to the Issues Paper have expressed concerns over the lack of transparency in the manner in which pricing information was being provided to access seekers.

For example, GRA's submission to the Issues Paper has suggested that offers are being provided by GWA in a bundled form, encompassing both above and below-rail services, commenting that:

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[24] For further information in relation to ACCC's review, please refer to: http://www.accc.gov.au/content/index.phtml/itemId/846439.

[25] Information that must be included in an Information Brochure is set out in the Commission's publication – South Australian Rail Access Regime: Information Kit, which is available at: http://www.escosa.sa.gov.au/webdata/resources/files/061006-D-SARailInfoKit.pdf.

"[its] experience is that the current act fails to adequately structure a negotiation process or explicitly provide for transparency between above and below rail pricing"[26]

As such, GRA's submission asserted that an access seeker is unable to make an informed decision as it is not able to identify the key drivers of any price increase or effectively benchmark prices against other above-rail service providers.

As a matter of principle, the Commission believes that prices provided to access seekers should be provided in a manner that would provide for a clear differentiation in above and below-rail access charges and, more importantly, allow access seekers to determine the reasonableness of the access charges offered.

On the basis that GRA's comments were meant to imply that an access provider is able to cover inefficiencies in its above-rail operations through cross subsidies between above and below-rail access charges, the Commission would consider this to contradict the objects of the ROA Act which, among other things, is to allow users to benefit from competition and to gain access to railway services on fair commercial terms.

To investigate this matter further, the Commission queried GWA on the claims made by GRA. In response, GWA has provided the Commission with documentary evidence to substantiate its claims that it used its best endeavours to provide GRA with adequate transparency in the manner in which access charges are formulated over the course of negotiation. This documentary evidence relates to, among other things, DORC valuation of infrastructure. This documentary evidence is confidential and cannot be disclosed, but was considered by the Commission as part of its investigations.

Having reviewed the documentary evidence provided by GWA, the Commission has found no evidence to suggest that offers are being provided to access seekers in a non-transparent manner. Whilst the information was not provided as part of GWA's initial offer it was provided after being requested by GRA. GWA has argued that it's general practice involves the provision of information that often exceeds the requirements of the Information Kit.

The Commission believes that a framework that promotes successful commercial negotiation of access must ensure that sufficient information on prices is provided to an access seeker, to enable it to assess the reasonableness of the offer.

The Commission can therefore see merit in clarifying the nature of the price information to be provided by an access provider to an access seeker under its Information Kit particularly given that current commercial practice appears to exceed the current requirements. Section 6 of the ESC Act requires the

[26] GRA's submission to the Issues Paper, pg 7 of unnumbered document.

Commission to have regard to the need to prevent the misuse of monopoly or market power, and to ensure consumers benefit from competition and efficiency. The Commission believes that price transparency is a critical component to achieving these objectives. This matter is discussed further in section 4.2.2.

4.2.2 Information Requirements

Section 28(1) of the ROA Act obliges an access provider to provide to an access seeker, on written application, an Information Brochure which must contain, among other things, the terms and conditions on which it is prepared to make its railway infrastructure available and, if not, the reasons why the service cannot be provided.

Asciano's submission to the Issues Paper has expressed concerns that these terms and conditions are not being scrutinised sufficiently by the Commission, commenting that:

> *"[it's] understanding is that these terms and conditions, including price limits, are not scrutinised or approved by the regulator."*[27]

On the basis that Asciano's comments imply that the terms and conditions provided to an access seeker are not sufficiently detailed to allow it to make an informed commercial decision, the Commission notes that the principal function of these standard terms and conditions, including price limits, is to provide a starting point for meaningful commercial negotiations to occur, and is not intended to limit the extent or scope of information being exchanged in a commercial negotiation process. Therefore, it is reasonable to expect the Information Brochure to provide only high level and indicative information, noting that it is not possible for the access provider to address the specifics of an access request in the first instance.

Whilst some submissions to the Issues Paper have suggested that certain cost and price information (e.g. asset valuation) should be specified in an Information Brochure and be made available to any industry participant on written application in the first instance, the Commission believes it is more appropriate for specific cost and price information to be provided following the receipt of an access application when requirements are known. The Commission considers that this is more likely to produce more relevant information for negotiation.

The Commission believes that the requirement on an access provider to negotiate in good faith encompasses the need to provide sufficiently detailed information on the terms of access, including price, to ensure that an access seeker can understand the basis on which the offer was prepared. Transparent and timely information is a key input into successful negotiation.

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[27] Asciano's submission to the Issues Paper, pg 1 of unnumbered document.

In considering the issue of information requirements, the Commission has examined its Information Kit and has identified several components that could be further improved. For example, the Commission considers the current requirement for an access provider to demonstrate how the floor and ceiling prices relate to the pricing principles is somewhat vague and could be clarified. As such, it would be more beneficial to require an access provider to provide more specific information to demonstrate how the proposed access price was developed. The Commission is aware that GWA is already providing more detailed information to access seekers that is currently required by the Information Kit, and therefore believes that the Information Kit should reflect this ongoing business practice.

The Commission therefore plans to address the existing deficiencies in the Information Kit and is considering the need for an access provider to:

- unbundle access charges;
- provide more explicit information on the level of service quality that is to be provided at that particular price; and
- demonstrate how any proposed capital expenditure is linked to service requirements and how it is being incorporated into the access charges (either through capital contributions or tariffs).

The Commission proposes a separate review of its Information Kit to be carried out in parallel with this Inquiry to provide stakeholders with the opportunity for meaningful input. It intends to use this Draft Inquiry Report as a vehicle to canvass views from stakeholders as to what sort of information should be provided as part of the Information Brochure and throughout the negotiation process, to give better initial guidance to an access seeker and formulate the starting point for an eventual access proposal anywhere on the covered network. The Commission would also welcome comments from stakeholders on the readability of its Information Kit, and whether or not it is sufficiently detailed to give readers an adequate understanding of the Access Regime and the Commission's role.

Comments received would then form an important input into the development of a Draft Information Kit, which is expected to be released for public consultation in September or at the time of release of the Final Report for this Inquiry.

Draft Report Conclusion

The Commission has found no evidence to suggest that offers are being provided to access seekers in a non-transparent manner.

The Commission proposes to undertake a separate review of its Information Kit in parallel with this Inquiry to require an access provider to:

- ***unbundle access charges;***
- ***provide more explicit information on the level of service quality that is to be provided at that particular price; and***
- ***demonstrate how any proposed capital expenditure is linked to service requirements and how it is being incorporated into the access charges (either through capital contributions or tariffs)***

The Commission would welcome comments from stakeholders on the type of information that should be provided as part of the Information Brochure and throughout the negotiation process in order to facilitate successful negotiation.

The Commission would also welcome comments from stakeholders on the readability of its Information Kit, and whether or not it is considered sufficiently detailed to give readers an adequate understanding of the Access Regime and the Commission's role.

4.3 Service Quality and Investments

The Commission has received several submissions to the Issues Paper expressing concern over the lack of service quality and infrastructure investment from access providers, some of which are discussed further below.

4.3.1 Service Quality in the Railway Network

GRA's submission to the Issues Paper commented that:

> *"[it] believes that to operate successfully the Access Regime should at least provide sufficient funds for the access provider to maintain the track. However, in the case of the rail infrastructure between Kevin and Thevenard, the access provider has chosen not to use these funds for this purpose but rather to take them as profit. As a consequence the above rail cost base has increased through additional fuel usage, crew time and higher rollingstock wear rates and GRA is being asked to pay again through an increase in access charges for the deferred*

maintenance work on the below rail asset and also the resulting higher above rail costs."[28]

However, GWA's supplementary submission refuted this claim, commenting that:

"GRA make the assertion that we have failed to maintain the track, however GWA has had an increasing maintenance regime and cost on this track over recent years (as the speed of track erosion has increased). GWA has not been in a position to make significant "investment" in the track to restore its efficient and function to past levels, however the price charged did not cover this."[29]

Whilst the Commission recognises the impact that service quality has on productivity and economic efficiency, it notes that it has not received any evidence of specific circumstances that would show that an access provider is failing to meet the required service levels due to deliberate under-investment.

In general, the Commission remains unconvinced that establishing a set of service quality standards is necessary to address the issue of service quality, noting that it would be inherently difficult to determine an over-arching set of service standards that best meet the requirements of different users with different operational requirements. In any case, the ROA Act also does not currently empower the Commission to establish such standards.

Moreover, the Commission notes that the Information Kit already requires an access provider to provide certain technical information (e.g. maximum speeds which apply on each section for typical trains, average transit times and estimated available capacity) as part of the Information Brochure. The Commission believes that the provision of such technical information is sufficient to give an access seeker an appropriate level of initial guidance as to the minimum level of service quality to be expected. The Commission would also expect parties in a negotiation to explicitly recognise service quality levels and to incorporate specific requirements into negotiated contracts.

It is therefore the Commission's view that the determination of optimal service standards is best left to be dealt with under the Access Regime's negotiate-arbitrate model as a subject of commercial negotiation. The Commission believes that this would be best able to account for individual circumstances and service level requirements, and to develop a price-service package that can provide certainty to both parties and alleviate any perceived risks. For example, commercial negotiations may allow financial compensation to be paid to a user should service delivery not be delivered to the agreed standards.

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28 GRA's submission to the Issues Paper, pg 4 of unnumbered document.

29 GWA's supplementary submission to the Issues Paper, pg 6 of unnumbered document.

4.3.2 Investment in the Railway Network

In an environment of fuel price volatility and greater public scrutiny on climate change, there should arguably be greater investment in the South Australian railway network given its economical and environmental advantages over other modes of transport (e.g. greater fuel efficiency and reduced greenhouse emissions).[30]

However, some of the submissions to the Issues Paper have expressed concern over the lack of investment in railway infrastructure by access providers. GRA, in particular, commented that:

> *"[it] does not believe that the current rail access framework provides sufficient incentive for the access provider to deliver productivity improvements required to maintain rail transport's competitive advantage or the required competitive advantage to [it's] business from low cost based overseas and interstate gypsum supply competition."*[31]

GWA's supplementary submission to the Issues Paper sought to refute any suggestion that it had deliberately under-invested, commenting that investment should be made as a result of commercial negotiation between parties that are prepared to make binding commitments towards each other. As such, the Access Regime should not put an access provider in a position where it is forced to make an investment without a fair return to maintain use of its rail facilities.[32]

In considering this issue of investment, the Commission is mindful of the fact that the railway industry is capital-intensive, requiring substantial capital expenditure on assets with long asset lives. As such, an access provider will generally require a commitment from users of those assets over future usage (e.g. term of access arrangement and a minimum volume), to provide some assurance that the investment can be recovered.

Whilst there have been instances where funding for capital investments have been obtained from external sources, the Commission makes the observation that these occurrences are predominantly in geographical locations where there are strong economic and social arguments justifying such external funding to be made.[33] As such, unless there are similar justifications, the Commission would expect parties to discuss service quality, investment or operating and maintenance (O&M) costs

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30 For further information analysing the efficiency and productivity of rail freight, please refer to the Productivity Commission's 2006 Inquiry, which is available at: http://www.pc.gov.au/projects/inquiry/freight/docs/finalreport.

31 GRA's submission to the Issue Paper, pg 8 of unnumbered document.

32 GWA's supplementary submission to the Issues Paper, pg 3 of unnumbered document.

33 In 2005, the Australian Government contributed $15 million towards a $30 million project for upgrading the Eyre Peninsula rail system. This contribution was conditional on a matching contribution from the South Australian Government, industry and local councils.

needed to provide that level of service, and an appropriate price package that would encompassed that investment or O&M costs.

It is the Commission's view that investment decisions are best left to be dealt with under the Access Regime's negotiate-arbitrate model. For example, it allows an access provider to obtain commitment from users regarding the extent of asset utilisation (e.g. term of access arrangement and a minimum annual volume) prior to any investment decision being made. The Commission believes that this model is best able to provide sufficient certainty to the access provider to alleviate any perceived risks of being left with an obsolete or underutilised asset if the user chooses to cease or reduce its operational activities. Notwithstanding this, the Commission also notes that the ROA Act does not preclude a user from participating in the financing of new investments (e.g. via joint-ventures), with the view of benefitting through greater operational efficiency and lower access charges.

Draft Report Conclusion

The Commission would prefer service quality and investment issues to be dealt with through commercial negotiation between access providers and access seekers.

4.4 Confidentiality Provision

The ROA Act currently does not provide for a confidentiality provision as part of the negotiation framework.

In responding to the Issues Paper which sought comment from stakeholders on how the Access Regime could be further improved, Asciano's submission expressed support for the insertion of a confidentiality provision into the ROA Act to limit access to, or disclosure of, the information or documentary material provided by an access seeker to another party including associated companies without prior written consent.[34]

GWA's supplementary submission supported this view, commenting that:

> *"[it is] a worthwhile suggestion if it also extends to information provided by an access provider to access seekers. GWA has used confidentiality agreements when supplying sensitive access pricing information to customers to date."*[35]

The *Australasia Railway (Third Party Access) Act 1999* (ARTPA Act) already contains a confidentiality provision.*[36]* The Commission notes, however, that it only protects the

[34] Asciano's submission to the Issues Paper, pg 2 of unnumbered document.

[35] GWA's supplementary submission to the Issues Paper, pg 3 of unnumbered document.

information being supplied by an access seeker to an access provider in a commercial negotiation.

The Commission can see merit in inserting a confidentiality provision into the ROA Act to protect the commercially sensitive information being exchanged between different parties in a negotiation process. It believes that such a provision would give greater protection to all parties, and in particular prevent an access provider from sharing commercially sensitive information obtained from other access seekers with its downstream businesses. This is particularly relevant given that section 6 of the ESC Act requires the Commission to have regard to ensuring monopoly power is not misused.

Whilst Part 5 of the ROA Act requires an access provider to provide written notice of an access proposal to the Commission and any affected industry participant, this obligation does not require the proposal itself to be disclosed and, therefore, there is no requirement to disclose any confidential information contained in the proposal to a third party.

Draft Report Conclusion

The Commission recommends that the South Australian Government consider the insertion of a confidentiality provision into Part 5 of the ROA Act to prevent the disclosure of commercially sensitive information to any third party without the consent of the party that provided the information or to which the information relates.

4.5 Conciliation/Arbitration

The Issues Paper sought comments from stakeholders on whether the conciliation/arbitration framework set out under the ROA Act is considered adequate and, if not, whether there are ways to enhance the processes.

The Commission has received several submissions to the Issues Paper in response to this question, some of which are discussed further below.

4.5.1 Advice and Directions

Part 6 of the ROA Act provides a framework for the conciliation or arbitration of access disputes. This framework reflects a negotiate-arbitrate model. Broadly speaking, the model works on the principle that parties involved in an access proposal have commercial incentives to negotiate access arrangements in good faith without recourse to conciliation or arbitration.

[36] A copy of the *AustralAsia Railway (Third Party Access) Act 1999* is available at: http://www.escosa.sa.gov.au/webdata/resources/files/RailAccessActAndCode.pdf.

However, in certain instances, an access provider may not use all endeavours to provide access on fair and reasonable terms. For example, an access provider may fail to negotiate in good faith in order to prevent or deter access. If so, this increases the likelihood of an access dispute being referred to the Commission for conciliation and, if needed, for the Commission to appoint an arbitrator and refer the dispute to the arbitrator.

Whilst the Commission has not yet received any notification of a dispute, it is concerned as to the necessity of such formal dispute resolution processes being utilised in the first instance given the time and cost involved. Moreover, given that outcomes are far from certain in such formal processes, an over-reliance on this avenue would generally be disruptive.

Asciano's submission to the Issues Paper supported this view, commenting that parties should attempt to resolve a dispute informally in the first instance prior to a formal dispute resolution processes being utilised.[37]

GWA's submission to the Issues Paper also supported this view, commenting that it would:

> *"provide a last ditch chance to negotiate and provide another opportunity to negate the need for arbitration."*[38]

The Commission can see merit in introducing an "advice and directions" provision into the ROA Act. It believes this would encourage the resolution of disputes at an informal level in the first instance and would make low cost dispute resolution more accessible for negotiation matters, noting that the ARTPA Act already contains such an advice and directions provision. Section 12(B) of the ARTPA Act provides that:

(1) An access seeker, the access provider or any other respondent to an access proposal may request the regulator to consider and, if appropriate, to give advice or directions with respect to any matter that has arisen in connection with the operation of this Division in order to facilitate the conduct of negotiations under this Division;

(2) A person making a request under subclause (1) must comply with any requirement published by the regulator for the purpose of this clause;

(3) The regulator may decline to consider or act on a request under subclause (1) for any reasonable clause;

(4) The regulator may, if the regulator thinks fit, give a general direction to the access provider under subclause (1) in respect of a particular matter under this Division;

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37 Asciano's supplementary submission to the Issues Paper, pg 2 of unnumbered document.

38 GWA's supplementary submission to the Issues Paper, pg 3 of unnumbered document.

(5) A person must not, without reasonable excuse, contravene or fail to comply with a direction given by the regulator under this clause

Penalty: $10,000.

(6) This clause does not limit or affect the ability of an access seeker at any time to request that an access dispute be referred to arbitration under Division 2.

4.5.2 Time Limit for Decisions

As was discussed in section 3.5, the Commission can see merit in providing greater time certainty to the process of resolving access disputes and that a time limit provision should be inserted into the ROA Act to reflect clause 2.6 of the CIRA.

The Commission therefore recommends that provisions be made in the ROA Act requiring any regulatory decisions to be made under the Access Regime within six months, providing that the Commission or the arbitrator has been given sufficient information to make the decision. Notwithstanding this, provision should be made for the suspension of the six-month time limit on reasonable grounds, such as requests for further information and consultation periods during which submissions are sought from third parties and the community. Section 30(A) of the *Maritime Services (Access) (Miscellaneous) Amendment Act 2009* provides an example of the type of time limit provision that is required.

Draft Report Conclusion

The Commission recommends that an "advice and directions" provision be introduced into the ROA Act.

The Commission recommends that the South Australian Government consider the insertion of a six-month time limit provision into the conciliation-arbitration framework set out under Part 6 of the ROA Act.

4.6 Access Notifications

Section 31(3)(a) of the ROA Act requires access providers to inform the Commission of any access notifications. The rationale behind such a requirement is to allow the Commission to monitor the extent to which access to railway networks covered by the Access Regime are being sought.

GWA's submission to the Issues Paper has questioned whether there is any value in this requirement, commenting that:

"the number of Ad Hoc access requests have reduced as more formal period contracts are negotiated with access seekers, but the process of isolating these access requests and

forwarding them to ESCOSA requires considerable administrative effort, with seemingly limited benefit to ESCOSA"[39]

Given that the current definition of "access contract" under the ROA Act is so broad in scope and requires GWA to provide access notifications to the Commission even if it was basic ad hoc arrangements that may be one-offs or only representing a very small revenue value, the Commission can see merit in narrowing the definition so that such access requests need not be reported.

GWA's submission to the Issues Paper noted that whilst it has no problem supplying the Commission with such information, it would like the notification process to be limited to access contracts with estimated annual revenue in excess of $50,000, to reduce administrative effort and costs.[40]

The Commission has queried GWA as to why it has proposed the $50,000 threshold. In response, GWA advises that a typical short-term ad hoc access arrangement is unlikely to exceed $10,000 annually. Furthermore, it noted that a majority of the small operators do not conduct significant business in South Australia, and therefore are not willing to negotiate longer-term contracts. As such, $50,000 is considered to be an appropriate threshold with the effect of eliminating the majority of the low value and short-term contracts.

The Commission has considered this matter and does not have any particular concerns with GWA's suggestion for the definition to be narrowed, particularly in light of the fact that the majority of substantive contracts are valued in excess of $100,000 per annum.

The Commission therefore recommends that the South Australian Government consider amending the definition of "access contract" under the ROA Act to specify a:

- contract giving access to railway services which:
    - has an annual value to an operator of $50,000 or more; or
    - is for a term longer than 2 months; or
- contractual variation of an existing contract affecting access to railway services in a significant way or to a significant extent.

The proposed amendments should ensure that the Commission still obtains copies of access contracts or arrangements of substance to allow monitoring of access but at the same time reduces the administrative burdens for railway operators.

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39 GWA's submission to the Issue Paper, pg 6 of unnumbered document.

40 GWA's submission to the Issues Paper, pg 6 of unnumbered document.

Draft Report Conclusion

The Commission recommends that the South Australian Government consider amending the definition of "access contract" under the ROA Act to a:

- ***contract giving access to railway services which:***
  - ***has an annual value to an operator of $50,000 or more; or***
  - ***is for a term longer than 2 months; or***
- ***contractual variation of an existing contract affecting access to railway services in a significant way or to a significant extent***

4.7 Segregation of Businesses

Section 21 of the ROA Act currently specifies that an operator must not carry on a business other than an "authorised business" being:

(a) the provision of railway services;

(b) the operation of railways;

(c) investing in railway infrastructure (including investment in the share capital of bodies corporate that own railway infrastructure);

(d) designing, constructing or maintaining railways; and

(e) providing consultancy, technical or other services related to investment in railway infrastructure or the design, construction, maintenance or operation of railways.

In its confidential supplementary submission to the Issues Paper, GWA has commented that it considers section 21 of the ROA Act to be prohibitive as it restricts a rail operator from carrying on a business other than a railway services business.

Broadly speaking, the Commission considers that it is unreasonable to preclude a private rail operator from pursing other commercial interests. The Commission's key concern is whether or not the appropriate ring-fencing arrangements have been put in place between the below-rail business and the above-rail business, to prevent rail competition from being adversely affected. The Commission is of the view that it is sufficient for a rail operator to comply with the ROA Act requirement to keep accounts and records of its railway services business separate to, and distinct from, the accounts and records of any other businesses it operates. Section 23 of the ROA Act, which prevents unfair discrimination between access seekers, is also intended to prevent a vertically integrated operator from behaving in an anti-competitive manner in the above-rail sector.

Furthermore, given that the legislation establishing the AustralAsia Railway access regime and the ports access regime do not include such restrictive provisions, the Commission is of the view that there is no real benefit in retaining such a clause as it restricts the businesses that rail operators can conduct.

Nevertheless, in light of the lack of consultation on this matter, the Commission is minded to seek comments from stakeholders as to whether there is any real benefit in retaining section 21 of the ROA Act and, if so, what types of non-rail businesses should be specifically prohibited before making its recommendation to the South Australian Government.

Draft Report Conclusion

The Commission would welcome comments from stakeholders as to whether there is any real benefit in retaining section 21 of the ROA Act and, if so, what types of non-rail businesses should be specifically prohibited.

5 NEXT STEPS

The Commission invites comments on the conclusions reached in this Draft Inquiry Report. Submissions to the Draft Inquiry Report are to be provided by 6 August 2009.

The Commission will review all comments and prepare the Final Inquiry Report for release in September 2009.

APPENDIX 1: TERMS OF REFERENCE FOR INQUIRY INTO SA RAIL ACCESS REGIME

The Hon Kevin Foley MP

MINUTE

Government of South Australia

Deputy Premier
Treasurer
Minister for Industry and Trade
Minister for Federal/State Relations

MINUTES forming ENCLOSURE to

To Chair, The Essential Services Commission of South Australia

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NOTICE OF REFERRAL FOR AN INQUIRY INTO THE RAIL ACCESS REGIME

BACKGROUND:

1. Pursuant to section 35(1) of the *Essential Services Commission Act 2002*, the Commission must conduct an inquiry into any matter that the industry Minister, by written notice, refers to the Commission.

2. The Act is committed to the Treasurer by way of *Gazettal* notice dated 12 September 2002 (p 3384).

3. The Competition and Infrastructure Reform Agreement (CIRA) of the Council of Australian Governments (COAG) provides for a simpler and consistent national approach to economic regulation of significant infrastructure, including for ports, railways and other export-related infrastructure. The agreed reforms aim to reduce regulatory uncertainty and compliance costs for owners, users and investors in significant infrastructure and to support the efficient use of national infrastructure.

REFERRAL:

I, PAUL HOLLOWAY, Acting Treasurer, refer to the Commission the matter described in Paragraphs (a) and (b) of the Terms of Reference and subject to the requirements and directions set out in this Notice.

TERMS OF REFERENCE:

The following are the Terms of Reference for the inquiry referred pursuant to section 35 (2) of the Act:

(a) Examine and provide advice on any amendments to the rail access regime legislated in the *Railways (Operations and Access) Act 1997* that would be needed to comply with the following sections from clause 2 of the CIRA.

"2.1 The Parties agree to establish a simpler and consistent national approach to economic regulation of significant infrastructure.

2.2 The Parties agree that, in the first instance, terms and conditions for third party access to services provided by means of significant infrastructure facilities should be on the basis of terms and conditions commercially agreed between the access seeker and the operator of the infrastructure.

2.3 The introduction of price monitoring for services provided by means of significant infrastructure facilities should be considered, where this would improve the level of price transparency, as a first step where price regulation may be required, or when scaling back from more intrusive regulation.

2.4 All third party access regimes for services provided by means of significant infrastructure facilities will include the following consistent regulatory principles.

a. Objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.

b. Regulated access prices should be set so as to:

i. generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services and include a return on investment commensurate with the regulatory and commercial risks involved

ii. allow multi-part pricing and price discrimination when it aids efficiency

iii. not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and

iv. provide incentives to reduce costs or otherwise improve productivity.

c. Where merits review of regulatory decisions is provided, the review will be limited to the information submitted to the regulator.

2.6 The Parties agree to introduce requirements that regulators will be bound to make regulatory decisions under an access regime within six months, provided that the regulator has been given sufficient information.

a. Regulators will have the discretion to determine when the six month time limit is suspended:

i. grounds for commencing time limits include when the regulator considers that sufficient information has been provided to enable the regulatory process to commence; and

ii. grounds for suspending time limits include requests for further information from significant infrastructure facility service

providers, provided these are on reasonable grounds, and consultation periods during which the regulator seeks submissions from third parties or the community.

b. Where the service provider of a significant infrastructure facility has not provided the requested information, a regulator will be permitted to make a determination on the information before it in order to satisfy six month time limits.

2.7 The principles in clauses 2.4 and 2.6 will be incorporated in existing access regimes for services provided by means of significant infrastructure facilities and Part IIIA of the *Trade Practices Act 1974* as soon as practicable or as they are reviewed, provided that they are included in such regimes no later than the end of 2010."

(b) Provide advice on any other changes to the access regime that may improve its overall effectiveness.

REQUIREMENTS OF THE INQUIRY:

The following requirements are made pursuant to section 35(5) of the Act:

1. A draft report of the review will be made available to the Treasurer and the Minister for Transport two weeks prior to the draft being released to the general public.

2. On completing the review, the Commission must forward to the Treasurer and the Minister for Transport a report on the review and the conclusions reached by the Commission as a result of the review.

3. If the Commission wishes to seek further information or guidance in relation to the conduct of this inquiry, it may contact Ms Christine Bierbaum, Executive Director, Government Relations and Reform Office, Department for Transport, Energy and Infrastructure.

DIRECTIONS:

I direct that in undertaking its inquiry the Commission must preserve the confidentiality of any information, material or documentation provided by Government to enable the Commission to undertake its inquiry and it must be stamped "Strictly Confidential".

Paul Holloway
Acting Treasurer

23 January 2009

APPENDIX 2: OPERATION OF THE ACCESS REGIME

The Access Regime is set out in Parts 3 to 8 of the ROA Act, and is summarised as follows:

Information about Access (Part 4, Division 2)

The Access Regime establishes requirements for the initial provision of information by an access provider to a prospective access seeker. The purpose of these information requirements is to establish minimum rights and obligations to facilitate the exchange of preliminary information about access, and is not intended to dictate how a party must start or conduct its commercial negotiations.

An access provider must, on written application of an access seeker, provide an Information Brochure, which sets out the terms and conditions of access, pricing principles, and any other information required by the Commission to be included within the Information Brochure. However, an access seeker may request reasonable additional information to suit its requirements.

Chapter 5 of the Commission's Information Kit sets out the current requirements for the Information Brochure. These include:

- a description of the operator's railway infrastructure that the access regime covers;
- proposed terms and conditions of access that would comprise an access contract;
- floor and ceiling prices for access, as well as reference tariffs, showing how the proposed terms and conditions of access relate to the pricing principles; and
- corporate information about the operator.

Pricing Principles (Part 4, Division 1)

Under the Access Regime, the Commission is not responsible for setting prices for access. Rather, the Commission establishes pricing principles for fixing a floor and ceiling price for railway services. While parties are free to enter into an access contract on terms that do not reflect the pricing principles, if an access dispute were to arise, the pricing principles establish bounds for an arbitrator to determine an arbitrated price. The Commission notes, however, that any price outcome from an arbitration process is at the discretion of the arbitrator, subject to the arbitrator taking into account the pricing principles set out by the Commission.

Negotiation of Access (Part 5)

The ROA Act sets out the information that an access seeker may include in a written proposal to the access provider, for obtaining access or materially varying an existing access contract. The access provider must provide a written notice of any access proposal to the Commission, and to any industry participant that may be affected by the access that is proposed.

The access provider is required to negotiate in good faith with the access seeker, as are any other respondents whose rights would be affected by the proposal.

Resolving Access Disputes (Part 6)

A dispute exists if there is no response to a written access proposal within thirty days, there is no negotiation in good faith, or there is a failure to achieve agreement after reasonable attempts to do so. A dispute also exists if another industry participant makes a formal objection to a proposed access contract.

In the event of a dispute, an access seeker may request the Commission to refer the dispute to arbitration. The Commission may attempt to conciliate the dispute and, if unsuccessful, may appoint and refer the dispute to an arbitrator. There is no obligation for the Commission to refer a dispute to arbitration where it considers that:

- The subject matter is trivial, misconceived or lacking in substance;
- The parties have not negotiated in good faith; or
- There are other good reasons why it should not.

The ROA Act sets out the powers and functions of the arbitrator and the factors the arbitrator must take into account in the event of arbitration. Some of the key provisions relating to the conduct of arbitration under Part 6 of the ROA Act include:

- The parties to an arbitration are limited to the access seeker, access provider, any other party that has a material interest in the outcome of arbitration and is nominated by the Commission as a party to the arbitration, and any other party that is joined to the arbitration by the arbitrator. The Minister responsible for the ROA Act may also participate in arbitration proceedings;
- There is an obligation on the arbitrator to proceed with the arbitration as quickly as the proper investigation of the dispute will allow;
- An arbitrator has the power to obtain information and documents on matters relevant to the access dispute from any persons and can conduct proceedings in any way (e.g. by telephone or video link);

- Any information collected can be kept confidential in whole or in part. Confidentiality must be requested and will be determined by the arbitrator;
- A number of other procedural powers are conferred upon the arbitrator in order to facilitate an expeditious hearing and determination of the dispute (e.g. ability to give procedural directions, refer a matter to an expert, or sit at any time or place);
- Arbitration proceedings must be in private, unless all parties agree to a public hearing. The arbitrator may give directions as to who can be present at proceedings that are private;
- An arbitration process can be terminated early in cases of triviality, if the proponent has not negotiated in good faith, or at the request of the proponent/parties;
- Before an award is made, the arbitrator must give a copy of a draft award to each party and the Minister, and must take into account any representations before finalising the award. A copy of the award must be given to each party and the Commission. The parties to an award may change it by agreement between all the parties to the award, and if the arbitrator is satisfied that the award is appropriate;
- Arbitration costs are to be borne by the parties to arbitration in proportions decided by the arbitrator, or where the arbitrator does not make such a decision, in equal proportions. However, if the proponent terminates an arbitration or elects not to be bound by an award, the proponent must bear the costs in their entirety; and
- There is a provision for appeal to the Court in respect of an award (or a decision not to make an award) on a question of law.