



AUSTRALIAN RAIL TRACK CORPORATION LTD

Ref No:

20 December 2007

Mr. Luke Wilson
AustralAsia Access Code Guideline Review
Essential Services Commission of SA
GPO Box 2605
ADELAIDE SA 5001

Dear Mr. Wilson

**AUSTRALASIA RAILWAY CODE GUIDELINE REVIEW
ARTC SUBMISSION**

Please find attached a submission prepared by the Australian Rail Track Corporation in response to your Issues Paper published in November 2007.

The submission contains no information that ARTC would consider commercial-in-confidence.

For further information regarding the preparation of this submission, could you please contact Mr. Glenn Edwards, (08)82174292 (Ph), (08)82174578 (Fax), gedwards@artc.com.au (Email).

A handwritten signature in blue ink, which appears to read 'David Marchant'. The signature is fluid and cursive, with a large initial 'D'.

David Marchant
Chief Executive Officer

AUSTRALASIA RAILWAY CODE GUIDELINE REVIEW ARTC SUBMISSION

The Essential Services Commission of South Australia ("Commission") is undertaking a review of the various guidelines made under the Australasia Railway (Third party Access) Code ("Code") Access). The Commission has to date issued four guidelines under the Code being:

- Guideline No. 1: Access Provider Reference Pricing and Service Policies;
- Guideline No.2: Arbitrator Pricing requirements (incorporating the commission's regulated rate of return determination);
- Guideline No. 3: Regulatory Information Requirements; and
- Guideline No. 4: Compliance Systems and Reporting.

ARTC notes that the Commission has already conducted a review of the Code itself in 2006, with no changes to the Code resulting from that review. ARTC participated in that review by way of submission. Key aspects of ARTC's submission at the time related to:

- a significant part of the business on the Network utilises at least some part of the interstate network managed by ARTC;
- the importance that access regimes (including pricing approach) within each jurisdiction in Australia are consistent to the maximum extent possible, whilst recognizing structural differences between providers in each jurisdiction;
- The Council of Australian Governments (COAG) has re-inforced views of the ACCC and the rail industry in this regard;
- a proposition that a process of regular review be incorporated in the Code, at least until such time as significant testing of the various aspects of the Code has occurred upon which longer term arrangements can be locked in confidently by the Ministers and industry.
- support for regular reviews of the Code by the NCC in order to establish that many aspects of the Code that originally caused some concerns for stakeholders, continued to satisfy the criteria for certification.
- Previous issues raised by ARTC in relation to the Code, focusing on both pricing and non-pricing issues.

ARTC does not propose to re-iterate its views in relation to these matters in this submission, but will focus specifically on the above guidelines and issues raised by the Commission.

ARTC stresses however that significant volumes could be lost to the interstate rail network (either diverted to another mode or new projects not getting off the ground) as a result of a lack of coordination and consistency between jurisdictions and regimes covering the Tarcoola – Darwin and interstate network. Similarly, the conduct of one access provider can impact on rail volumes generally, and affect the viability of the network as a whole.

ARTC submitted a voluntary access undertaking in accordance with Part IIIA of the TPA to the Australian Competition and Consumer Commission (“ACCC”) in June 2007. Following initial regulatory consultation and development with the ACCC, ARTC withdrew the undertaking in October 2007. ARTC has continued to work with the ACCC to address its issues and is expected to submit a revised Undertaking in the very near future.

Asset Roll Forward

ARTC has raised issues in relation to the treatment of assets contributed to the project by governments in several previous submissions to the Commission, and does not propose to re-iterate these issues again in this submission.

Firstly, ARTC supports the use of DORC as the method for valuation assets under the Code. This is consistent with most other rail regimes in Australia.

In relation to the notion of asset roll-forward, ARTC 2002 Access Undertaking contemplated a roll forward of the regulatory asset base (by the application of CPI and depreciation) between regulatory resets. ARTC took this approach on the basis that the 2002 Access Undertaking also provided for ARTC’s relevant assets to be re-valued every five years. This approach was endorsed in the circumstances by the ACCC at the time.

Since that time, the views of the ACCC and some other regulators seems to have changed where regulatory re-valuations of assets are no longer favoured, largely due to the possibility of windfall gains and losses arising from such re-valuations. The preferred option now is generally to lock in the value of the asset base at a particular point in time, and only allow re-valuation annually through an approved process of roll-forward.

This change in regulatory position has created some regulatory uncertainty for ARTC and other infrastructure providers, where the prior approval of a regulatory re-valuation was considered by the access provider in the overall balance of the undertaking, risk costing and pricing. As an example, the ACCC's independent consultants considered that ARTC had under-valued its assets by around 10% in 2002, which was one of the stated reasons for the ACCC's acceptance of ARTC's valuation. At the time ARTC sought not to correct the valuation at the time given the circumstance where revenues fall well short of economic cost, and ARTC's understanding was that the assets would be re-valued in 2007.

ARTC, in its 2007 Interstate Access Undertaking, is seeking to revalue the relevant assets, as provided in the 2002 Access Undertaking, and importantly to redress the initial under-valuation.

As such, it is paramount that any initial valuation (where no fundamental re-valuation is permitted) be accurate and not result in any under-valuation, as this may lead to perverse outcomes for investment on the network.

ARTC therefore considers it critical that before the Commission 'locks in' to the initial valuation, it ensures that that valuation is correct.

The Commission would also be aware that ARTC proposed in its 2007 Interstate Access Undertaking, a methodology for annually rolling forward the regulatory asset base that sought to include in the asset base the capitalization of any losses against economic cost.

ARTC's access undertaking documents and supporting explanations, including the loss capitalization approach can be found on the ACCC website.

ARTC's motivation for proposing this approach largely revolved around seeking to address the much publicized issue of infrastructure bottlenecks in a number of transport supply chains. ARTC saw the capitalization approach as one means to

promote efficient investment in the network, by enabling the provider to capitalize and subsequently recover (where the market permitted) losses, particularly in the early stages of projects where market is building up and the access provider is exposed to that market risk.

ARTC saw this as being particularly applicable on freight networks subject to intermodal competition (such as the interstate network), or network serving expanding mining operations.

Due to the substantial difference between access revenues and economic cost on the interstate network, capitalization of losses would result in large increases in the RAB and the potential for a ceiling test to never be breached. This would enable the access provider to earn revenue in excess of the traditional building blocks ceiling limit for some time, or even forever. ARTC does not see this as a problem, as long as long term economic cost recovery has not been achieved, as the additional revenues can only be generated through market growth where prices are constrained by competition.

The seemingly abnormal outcomes raised some concerns with stakeholders and the ACCC. ARTC has now reluctantly decided to revert to a more traditional building blocks approach in its interstate undertaking going forward, but considers that an opportunity to improve investment incentives in competitive transport infrastructure options may have been missed.

Having said this, there are other rail networks serving emerging markets (including the upper Hunter Valley) where the improvement of investment incentives is important, and the perceptions on the interstate network are non-existent. ARTC intends to continue to pursue this approach.

ARTC would urge the Commission to give serious consideration to such an approach in its jurisdiction, so taking a leading position in improving investment and transport outcomes.

Reference Prices

The Commission would be aware that ARTC committed to 'Indicative Access Charges' in its 2002 Access Undertaking, and propose to continue this in its 2007 Interstate Access Undertaking. Indicative Access Charges relate primarily to

intermodal type services on the ARTC network operated at a maximum of 21t axle load and maximum 110kph. The markets served by these types of services experience the most intermodal competition, and Indicative Access Charges are market (not cost) based. ARTC also commits to publish on its website Indicative Access Charges and any other charges for non-indicative services. To date there are charges for 4-5 different types of services published by ARTC.

ARTC has chosen to publish pricing as it believes greater pricing transparency and certainty, and resulting equity, help to stimulate market confidence, competition and growth. ARTC is, in no way, inhibited from differentiating pricing through negotiation for other types of services (and different access terms and conditions), and does not believe that its ability to negotiate differential pricing is constrained. It is unclear as to why an access provider would wish to negotiate a price that is differentiated from a published price for the same type of service in the same market, where the terms and conditions of access are substantially the same, unless it was seeking to discriminate based on the identity of the Access Seeker; a practice that is normally prohibited.

ARTC pricing is generally two-part, although ARTC may agree alternatives with an Access Seeker. ARTC does not believe that the structure of necessarily needs to be prescribed, except where there is potential that the pricing structure can be used to discriminate between users.

ARTC's views largely revolve around the publishing of pricing, as opposed to the regulatory approval of prescribed reference pricing as may also be being suggested by the Commission.

ARTC Undertaking and CIRA

ARTC considers that it is important that access regimes (including pricing approach) within each jurisdiction in Australia are consistent to the maximum extent possible, whilst recognizing structural differences between providers in each jurisdiction. COAG has, through CIRA, strengthened its commitment to achieving greater consistency of economic regulation on the national rail network focusing specifically on the interstate network, but including significant regional networks where the benefits outweigh the costs. To date, ARTC has actively participated in moving this agenda forward, and all jurisdictions are currently working towards achieving desirable outcomes.

A significant part of the business on the Network utilises at least some part of the interstate network managed by ARTC. The majority of this business currently relates to intermodal (containerized) freight movements between the southern capitals and Darwin (including some which is transferred to/from shipping movements between Darwin and ports in South East Asia), as well as interstate passenger services connecting southern capital cities, Alice Springs and Darwin. All freight movements on the Network are currently operated by FreightLink, a related above rail operator, whilst passenger services are operated by a third party operator, Great Southern Railway ("GSR"). The degree of separation between FreightLink and APT is not clear to ARTC. Information of FreightLink's website would suggest that APT no longer exists and access to the network is the responsibility of an arm of FreightLink.

ARTC is aware that FreightLink are seeking to grow freight volume on the Network largely through the expansion of overseas shipping trade through Darwin, and through the servicing of some mining opportunities in South Australia and the Northern Territory.

Access holders and prospective access seekers are required to negotiate various access aspects, including pricing, with both ARTC and FreightLink. ARTC, and its customers, would prefer consistency with respect to pricing and other facets of access between its own undertaking and neighbouring regimes. Significant volumes could be lost to the interstate rail network (either diverted to another mode or new projects not getting off the ground) as a result of a lack of coordination and consistency between jurisdictions and regimes covering these networks. Similarly, the conduct of one access provider can impact on rail volumes generally, and affect the viability of the network as a whole.

It is ARTC's view that any approach to consistent regulation needs to recognize the different commercial and structural arrangements that exist on various parts of the network. ARTC believes that it is possible to achieve consistency within this framework. It is important to recognize that consistency in economic regulation does not necessarily require uniformity.

Different rail networks in Australia operate with different degrees of market power in relevant markets, and different industry structure. As a result, there is a need for flexibility in regulation both in relation to those aspects of a rail network provider's business that need to be regulated and in relation to the intensity (heavy or light handedness) that should apply to the regulated business.

To address these differences, an option of 'streaming' both the application and intensity of regulation in accordance with the degree of market power and structural incentives of a rail network provider should be considered. An independent test, similar to a declaration test, could be undertaken prior to the submission of an undertaking and would essentially stream the network in terms of the application (ability of a regulator to impose) and intensity of regulation. In ARTC's view, there are currently relatively few railways that possess market power (basically the coal and iron ore lines). However, Governments have established access regimes that apply irrespective of the level of market power possessed by the railway in the transport market due to a desire to promote above rail competition.

In order to provide for sufficient flexibility to meet specific market and industry circumstances, it is necessary to ensure that all undertakings incorporate the same broad elements, but leave significant discretion for the regulator to determine the intensity of regulation. The history of regulation in Australia has been that different regulators apply general principles in materially different ways. This is the case with even relatively prescriptive regulatory instruments (such as the Gas Code).

As a result, ARTC is strongly of the opinion that effectively delivery of harmonisation and consistency between rail networks in differing jurisdictions, where administered by several jurisdictional regulators, is unlikely.

ARTC considers that to deliver an optimal degree of consistency and harmonisation between different covered rail networks, the rail regulation must be administered by a single national rail regulator. If this is not the case, then consistency will be difficult to achieve due to the significant discretion that must be provided to the jurisdictional regulator to achieve the necessary degree of flexibility as described above.

