



**AUSTRALASIA RAILWAY
(THIRD PARTY ACCESS)
CODE: GUIDELINE REVIEW
FINAL DECISION**

September 2008



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GLOSSARY OF TERMS

AARC	AustralAsia Railway Corporation
ABOVE-RAIL OPERATOR	The operator of locomotives, carriages, wagons and the like
ACCC	Australian Competition and Consumer Commission
THE ACCESS ACT	<i>AustralAsia Railway (Third Party Access) Act 1999 (SA & NT)</i>
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 services provided by the Railway
APT	Asia Pacific Transport – the Access Provider for the Railway
ARTC	The Australian Rail Track Corporation Ltd
CIRA	Competition and Infrastructure Reform Agreement
COAG	Council of Australian Governments
THE CODE	The AustralAsia Railway (Third Party Access) Code contained in the Access Act.
THE COMMISSION	Essential Services Commission of South Australia,
DORC	Depreciated Optimised Replacement Cost
EXISTING RAILWAY	The section of the Railway between Tarcoola and Alice Springs
NEW RAILWAY	The section of the Railway constructed between Alice Springs and Darwin
NT	Northern Territory
THE RAILWAY	The AustralAsia Railway to which the Code applies, being the whole of the railway from (a point near) Tarcoola to its end in Darwin (in the Port of Darwin), and so comprising the Existing Railway and the New Railway
RAILWAY INFRASTRUCTURE FACILITIES (ALSO RAILWAY INFRASTRUCTURE ASSETS)	The infrastructure facilities necessary for the operation or use of the Railway, including railway track, signalling, train control and communications
SA	South Australia

1 INTRODUCTION

The Essential Services Commission (the Commission) has undertaken this guidelines review pursuant to clause 45A(1) of the AustralAsia Railway ('Third Party Access') Code ('the Code'), which is itself a Schedule to the *AustralAsia Railway (Third Party Access) Act 1999* (SA & NT) ('the Access Act').

The AustralAsia Railway ('the Railway') runs from Tarcoola to Darwin.

The Code has been certified as an 'effective' State-based access regime in accordance with the principles set out in clauses 6(2)-6(4) of the Competition Principles Agreement.¹

Clause 5 of the Code appoints the Commission as the regulator under the Code.²

The Commission foreshadowed its intention to examine the various guidelines it had made under the Code in its 2006 report reviewing the rail access regime set out in the Code, to ensure they remain up-to-date and relevant.³

Clause 45A(1) of the Code empowers the Commission, from time to time as it thinks fit, to vary or revoke guidelines developed and published under the Code, or to develop and publish new or substitute guidelines.

1.1 Issues Paper

When considering the adoption or variation of a guideline, clause 8 of the Code requires the Commission to undertake a public consultation process.

An Issues Paper published in November 2007 commenced the review.

The Issues Paper highlighted three particular issues for consideration, namely:

- ▲ in relation to Guideline No. 1: the merits of the current approach to reference prices and whether more detailed direction is required;
- ▲ in relation to Guideline No. 2 (and 3): whether any asset roll forward should be adopted, and if so what form it should take; and
- ▲ in relation to the guidelines generally: the degree of alignment with ARTC's access undertaking⁴ and the implications of the COAG Competition and Infrastructure Reform Agreement (CIRA) for the guidelines.⁵

¹ The Competition Principles Agreement is one of the COAG agreements comprising the National Competition Policy, dated April 1995. It can be accessed via www.ncc.gov.au/publication.asp?publicationID=99&activityID=39.

² Note that Clause 5 actually nominates the South Australian Independent Industry Regulator (SAIIR), which is the Commission's predecessor. Schedule 2 of the *Essential Services Commission Act 2002* provides the appropriate succession arrangements.

³ The report: *Ministerial Review of the AustralAsia Railway (Third Party Access) Code: Final Report, May 2006*, is available at: www.escosa.sa.gov.au/site/page.cfm?u=128&c=1657.

⁴ The ARTC Access Undertaking is available of the ARTC website at www.artc.com.au.

⁵ The CIRA, dated February 2006, is available on the COAG website at http://www.coag.gov.au/meetings/100206/attachments_a-h.pdf.



Submissions were received on the Issues Paper from:

- ▲ Asia Pacific Transport Pty Ltd, the track operator;
- ▲ Australian Rail Track Corporation Ltd; and
- ▲ a downstream transport operator who requested its submission be treated as confidential.

1.2 Draft Decision

In May 2008, the Commission published its Draft Decision on whether or not it should vary the guidelines initially developed and published under the Code. The Draft Decision included proposed amendments to the guidelines, which are discussed in Chapter 3 of this Paper.

Submissions were received on the Draft Decision from:

- ▲ Asia Pacific Transport Pty Ltd, the track operator; and
- ▲ the NT Chief Minister, on behalf of the Northern Territory and South Australian Governments.

The Draft Decision, Issues Paper, and non-confidential submissions, are available on the Commission's website at www.escosa.sa.gov.au.

1.3 Final Decision

The Commission has now prepared its Final Decision as documented in this Paper.

The Commission also intends to incorporate the resulting amended guidelines into a single Information Kit to provide ready access to the full suite of regulatory materials under the Code.⁶

⁶ The Commission has already adopted this approach in its capacity as regulator under the South Australian Rail Access Regime, refer: www.escosa.sa.gov.au/webdata/resources/files/061006-D-SARailInfoKit.pdf.

2 BACKGROUND TO THE GUIDELINES

2.1 The Railway

The Railway comprises both the recently constructed line from Alice Springs to Darwin (the 'New Railway') and the pre-existing line between Alice Springs and Tarcoola (the 'Existing Railway').

The date of commencement of operations on the New Railway was 15 January 2004.

Asia Pacific Transport (APT) is the track operator and hence is the access provider for the services provided by the Railway.

APT presently has the benefit of concessional rights to operate the Railway, under the AustralAsia Railway Project Concession Deed between APT, the AustralAsia Railway Corporation (AARC) and the SA and NT Governments. Broadly, the Concession Deed provides for the grant to APT of the concession to build, operate and then transfer back to the AARC the Railway after 50 years, being the period of the concession.

Freight Link Pty Ltd (FreightLink) is the main above-rail operator on the Railway and is a related body corporate of APT.

Commercial operations are now into the 4th year of the 50 year concession period. Since commencement:

- ▲ around 90% of general freight business between Adelaide and Darwin has switched from road to rail transport;
- ▲ three major bulk minerals haulage access agreements have been settled for the transport of materials north to the Port of Darwin; and
- ▲ access agreements covering passenger services have also been settled, most notably involving Great Southern Railway Ltd, operator of The Ghan passenger service between Adelaide and Darwin.

To date, there have been no access disputes.

2.2 The Code

2.2.1 Code objectives

Neither the Code, nor the Access Act, contain objectives or an objects clause. However, being an effective access regime suggests that the objectives of the Code are aligned with those underlying clause 6 of the Competition Principles Agreement. In essence, the clause 6 principles:

- ▲ identify the type of infrastructure services that should be subject to access regulation; and
- ▲ establish principles that the regulatory framework should embody.

The National Competition Council has described the overall goals of access regulation in the following terms:⁷

“The application of an efficiency objective in access regulation has the following three broad components:

- *first, ensuring the efficient use of natural monopoly infrastructure, especially by denying infrastructure owners the opportunity to misuse market power (in either the market for these services or in related markets) by refusing access to, and monopoly pricing of, infrastructure services;*
- *second, facilitating efficient investment in natural monopoly infrastructure, especially by ensuring:*
 - *infrastructure services are maintained and developed appropriately;*
 - *infrastructure owners (and potential owners) earn sufficient returns to provide incentives for efficient investment; and*
 - *incentives for inefficient development of competitive infrastructure and for inefficient investment in upstream and downstream activities (that is, overinvestment and underinvestment) are minimised; and*
- *third, promoting competition in activities that rely on the use of the infrastructure service where competitive infrastructure services are not economically feasible.”*

2.2.2 Key features of the Code

The Code unbundles railway services (both freight and passengers) into:

- ▲ below-rail services (relating to the provision of track and associated infrastructure); and
- ▲ above-rail services (running rolling stock, or trains, on the below-rail infrastructure).

The Code regulates the provision of below-rail services only. It establishes a right for above-rail operators to negotiate access to the below-rail services of the Railway.

The Code sets out the rights and responsibilities of above-rail operators (access seekers) and the access provider (APT), and covers matters such as the negotiation process, dispute resolution, and the terms and conditions of access.

The Code establishes a right to negotiate access to the services provided by means of the Railway. The Code follows a negotiate/arbitrate model, where parties first attempt to agree on an access arrangement, with dispute resolution processes available if necessary.

⁷ National Competition Council, *The National Access Regime: A Guide to Part IIIA of the Trade Practices Act*, Part C Certification of Access Regimes, February 2003 p.11 – available at www.ncc.gov.au/pdf/DEGeGu-003a.pdf.

This negotiate/arbitrate access regime was put together as part of the broader railway project and reflects its nature and distinguishing characteristics, such as:

- ▲ The existing transport companies that provided freight services over the same route as the Railway (or between the same destinations) are in competition with rail freight.
- ▲ On the transport corridor between Alice Springs and Darwin, rail is the new entrant. Since rail is the new mode competing with incumbent road, sea and air operators, any advantages of incumbency that exist in the freight market lie with these other modes.
- ▲ The 'greenfields' nature of the rail project sees the owners and operators of the Railway bearing substantial demand risk, as the Railway needs to win demand from alternative and incumbent modes of transport, such as sea, road and air. As a result, the Railway starts with little revenue or profit in the early years, and may only make a profit after many years of operation. This position is different to other utilities and even other rail infrastructure built to serve an established market.
- ▲ The railway is owned and operated by the private sector on a Build, Own, Operate and Transfer (BOOT) basis. The concession period expires 50 years after construction.
- ▲ Three Governments have also contributed to making the Railway financially viable. Government support for the project has been principally provided in the form of asset contributions. The Governments do not require a return on the capital invested in these contributed assets at any time during the concession period. They do, however, require the contributed assets to be returned to them at the end of the concession period along with the transfer of all project-funded assets.

Enforceable dispute resolution processes back access negotiations. The arrangements in the Code recognise that some issues may be small or time sensitive so that above-rail operators may not take them to arbitration, given the time and costs it involves. Without a less costly means of dispute resolution, many small or time sensitive disputes could go unresolved. This could discourage access.

The Code provides several levels of dispute resolution including:

- ▲ advice provided by the regulator on whether or not a negotiated outcome is consistent with the Code;
- ▲ voluntary conciliation by the regulator; and
- ▲ full arbitration.

The Code includes a Pricing Schedule which provides considerable direction for access pricing in different circumstances.

All prices for access are to be struck within a floor/ceiling band, set in accordance with efficient, forward looking costs. Where competition from non-rail freight is sufficient to discipline rail operators to minimise their costs and prices, the Code's "sustainable competitive" approach uses the price of the competitive non-rail freight as the starting point for calculating the rail access price between the floor/ceiling band. This ensures that access prices are based on competitive principles.

The Code also recognises the importance of service quality, time-path allocation and reallocation policies and day-to-day train management. The access provider must develop policies on how it will manage these issues. These policies are to be consistent with guidelines developed by the regulator.

2.3 The Guidelines

Key features of the Commission's role as the regulator under the Code are:

- ▲ facilitating access negotiations and (with consent of the parties) settling access disputes;⁸
- ▲ monitoring and enforcing compliance with the Code as well as periodically conducting, or assisting with, reviews; and
- ▲ the development and maintenance of various guidelines, including:
 - arbitrator pricing requirements;
 - access provider reference prices and service policies; and
 - access provider information reporting requirements.

The Commission has issued the following guidelines:⁹

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

2.3.1 Guideline No. 1

Clause 9(1) of the Code obliges the access provider to provide, on application of any person, information reasonably requested by the person about:

⁸ In the event of an access dispute, the Commission is to appoint an arbitrator, who will be called upon to "set" prices through the arbitration process. Note that the Commission itself will not be the arbitrator – the Code keeps separate the role of regulator and arbitrator.

⁹ Each guideline is available from the Commission's website: www.escosa.sa.gov.au/site/page.cfm?u=126.

“(a) the extent to which the Access Provider’s Railway Infrastructure Assets are currently being used;
(b) technical details and requirements of the Access Provider, such as axle load data, clearance and running speeds;
(c) time-path allocation and reallocation policies for the Railway;
(d) service quality and train management standards; and
(e) relevant prices and costs associated with railway infrastructure services provided by the Access Provider, prepared by the Access Provider for reference purposes in accordance with guidelines developed and published by the Commission.”

Clause 9(3) provides that the access provider must, for the purposes of clauses 9(1)(c) and (d), develop and maintain time-path allocation and reallocation policies and service quality and train management standards in accordance with principles contained in guidelines developed and published by the Commission.

Guideline No. 1 is published by the Commission to fulfil the requirements for guidelines in both clauses 9(1)(e) and 9(3). It sets out requirements for reference pricing, train-path policy, train control and service quality.

The distinguishing feature of Guideline No. 1 is that it provides guidance to the access provider (APT).

2.3.2 Guideline No. 2

In the event of an access dispute, the Code requires an arbitrator – appointed by the Commission – to determine an access price payable to the access provider by an access seeker for a railway infrastructure service.

At various points in the Pricing Schedule to the Code, an arbitrator is obliged to apply particular principles and methods in accordance with guidelines developed and published by the Commission.

When developing such guidelines, the Pricing Schedule also empowers the Commission to include provisions that the Commission considers appropriate in addition to those specifically nominated in the Pricing Schedule.

Guideline No. 2 is published by the Commission to fulfil the guidelines requirements of the Pricing Schedule. It sets out requirements for ceiling pricing, floor pricing, arbitrated pricing (both with and without sustainable competitive prices) and rate of return parameters.

The distinguishing feature of Guideline No. 2 is that it involves guidance directed at any arbitrator appointed by the Commission in the event of an access dispute.

2.3.3 Guideline No. 3

At various points in the Code an access provider is obliged to keep and/or report certain information to the regulator or an arbitrator in the furtherance of their functions under the Code, including:

- ▲ clause 15(1) where the Commission, and an arbitrator, would apply the Code's pricing principles for the purposes respectively of undertaking conciliations and arbitrations;
- ▲ clause 39(1) where an Access Provider responds to requests for information issued by the Commission;
- ▲ clause 46 where an Access Provider must keep separate accounts and records, including in compliance with any guidelines issued; and
- ▲ clause 50(4) in relation to the Commission undertaking revenue reviews.

Any information sought by the regulator is done so pursuant to clause 39 of the Code. Information so collected is then protected by the confidentiality provisions of clause 40 of the Code.

Guideline No. 3 sets out the regular reporting requirements of the Commission in relation to regulatory accounts, detailed cost information, usage information and various related requirements.

2.3.4 Guideline No. 4

Clause 6 of the Code assigns to the Commission the function "to monitor and enforce compliance" with the Code. This compliance function is common to most of the Commission's regulatory roles (although it may be stated differently for different industries).

Guideline No. 4 sets out a process for the reporting of compliance by an access provider in a way that meets the Commission's requirements and demonstrates that appropriate compliance systems are in place. Taking this approach reduces the need for exhaustive testing and investigation by the Commission of compliance systems by providing an appropriate level of assurance and reporting of compliance issues. This allows the Commission to fulfil its clause 6 obligation while maintaining a relatively light handed approach to the Code.

Notwithstanding this approach, the Commission considers effective compliance systems, and the associated assurance, as being an important part of its regulatory responsibilities. This is particularly so for an access regime such as that in the Code, where compliance problems may remain otherwise undiscovered until a dispute arises, causing an effective failure of the regime.

3 ASSET ROLL FORWARD

3.1 Background

The Pricing Schedule to the Code states that, for both ceiling price (section 2(7)) and floor price (section 3(4)) purposes:

“The guidelines must—

(a) ...adopt an approach for valuing capital assets which reflects the Depreciated Optimised Replacement Cost [DORC] of those assets; ...”

For ceiling price purposes, section 2 of Guideline No. 2 provides that:

“The DORC value of the railway infrastructure assets is to be established and/or verified by an experienced and independent valuer using valuation principles and methodologies consistent with the principles and methodologies applied in the independent valuation of ARTC’s Interstate Network assets approved by the ACCC.”

This ‘value of the Railway’ is the value of all associated railway infrastructure assets – whether funded by APT or by government contributions and donations. This is because the ceiling price reflects the stand alone, or bypass, cost of the Railway.

On 4 April 2005, in accordance with section 2 of Guideline No. 2, the Commission finalised its acceptance of the value of the railway infrastructure assets (hereafter termed ‘**the value of the Railway**’) as at the date of commencement of operations. The valuation was prepared by Booz Allen Hamilton for the railway operator APT in line with directions from the Commission. In accordance with the Code (and Guideline No. 2), the valuation is based on the DORC methodology.

The value of the Railway as at 15 January 2004 was \$1,696.9 million (in dollars of 1 July 2003).¹⁰

Section 5 of Guideline No. 2 also sets out the asset valuation to be used for arbitrated prices where there is no sustainable competitive price. For this purpose, the relevant value is the value of the capital invested in railway infrastructure assets by the access provider, being the value of the Railway less the value of government-contributed assets and other government financial assistance.

The value of the capital invested in railway infrastructure assets by the access provider required under section 5 of Guideline No. 2 (hereafter termed ‘**the value of private capital invested**’) as at the date of commencement of operations was not directly determined at the time that the value of the Railway was determined.

¹⁰ This valuation comprised of a value of the New Railway of \$1,159.1 million (in dollars of 1 July 2003) and a value of the Existing Railway of \$537.8 million (in dollars of 1 July 2003).

Guideline No. 2 is also silent on how either the value of the Railway or the value of private capital invested is to be updated over time.

In the Issues Paper, the Commission invited comment on three specific issues relating to the value of the Railway, namely:

- ▲ the commencing value of the Railway;
- ▲ the value of private capital invested; and
- ▲ the asset value roll-forward methodology.

These issues are dealt with in turn in the remainder of this chapter.

3.2 Commencing value of the Railway

3.2.1 Issue

Section 2 of Guideline No 2 presently establishes the process for a value on the railway infrastructure assets calculated for ceiling price purposes ('the value of the Railway'), namely that:

The DORC value of the Railway Infrastructure Assets calculated for Ceiling Price purposes is to be established and/or verified by an experienced and independent valuer using valuation principles and methodologies consistent with the principles and methodologies applied in the independent valuation of ARTC's Interstate Network assets approved by the ACCC. (section 2)

Since the guideline was made, the Commission has approved the value of the Railway as at the date of commencement of operations of the Railway prepared in accordance with section 2 of Guideline No. 2.

3.2.2 Draft decision

The Commission proposed to insert the commencing value of the Railway (\$1,696.9 million, in dollars of 1 July 2003) into Guideline No. 2.

3.2.3 Views in submissions

No party has raised any objections to this aspect of the Commission's Draft Decision.

3.2.4 Final decision

The Commission therefore confirms that it has decided to insert the commencing value of the Railway (\$1,696.9 million, in dollars of 1 July 2003) into section 2 of Guideline No. 2.

3.3 Value of private capital invested

3.3.1 Issue

The value of private capital invested as at the date of commencement of operations was not directly determined at the time that the value of the Railway was determined for the purpose of section 2 of Guideline No. 2. The value of private capital invested is required under section 5 of Guideline No. 2.

The relevant value is the value of the Railway (\$1,696.9 million, in dollars of 1 July 2003) less the value of government-contributed assets and other government financial assistance.

The value of New Railway (the section between Alice Springs and Darwin) as at the commencement of operations (15 January 2004) was determined as \$1,159.1 million in 1 July 2003 prices. Therefore, the value of the Existing Railway (the section between Tarcoola and Alice Springs) is calculated as follows:

Value of Railway	\$1696.9m
Less: Value of New Railway:	\$1,159.1m
Equals: Value of Existing Railway	\$537.8m (in dollars of 1 July 2003)

The government contribution of the Existing Railway is specified in the Concession Deed. Rather than being gifted outright, this government asset contribution is in the form of a highly concessional, long-term leasing arrangement.

In addition to this contribution, the Government Works Agreement provides for the government-funded construction of certain components of the New Railway.¹¹ These then form part of the concession granted to APT. The government improvements are, in essence, those parts of the New Railway paid for by government financial assistance. Under the Government Works Agreement, the government improvements have a total agreed value of \$427.5 million (in dollars of 1 July 2003). The individual contributions are detailed below:

\$ Millions	TOTAL
Commonwealth Government	165.0
Northern Territory Government	137.5
South Australian Government	125.0
TOTAL	427.5

¹¹ Examples of the government improvements include: site preparation for construction of the new railway, earth retaining structures and culverts, bridges, access roads, signalling, and yards and freight handling facilities at Berrimah, Katherine and Tennant Creek.

For the purposes of section 5 of Guideline No. 2, the value of private capital invested (in dollars of 1 July 2003) is therefore calculated as:

- ▲ the value of the Railway (\$1,696.9 million)
- ▲ less the value of the Existing Railway (\$537.8 million)
- ▲ less the government-funded proportion of the value of the New Railway (\$427.5 million)
- ▲ Equals the value of private capital invested (\$731.6m)

3.3.2 Draft decision

In its Draft Decision, the Commission proposed to include the resultant value of private capital invested as at the date of the commencement of operations of \$731.6 million (in dollars of 1 July 2003) into section 5 of Guideline No. 2.

3.3.3 Views in submissions

No party has raised any objections to this aspect of the Commission's Draft Decision.

3.3.4 Final decision

The Commission therefore confirms that it has decided to insert the commencing value of private capital invested (\$731.6 million in 1 July 2003 dollars) into section 5 of Guideline No. 2.

3.4 ***Annually updating asset values***

3.4.1 Issue

Even after the commencing value of the Railway and the commencing value of private capital invested are both inserted into Guideline No. 2, at present that guideline is silent on how these commencing valuations are to be updated over time. There is no provision for an updating or roll forward of these values other than, by inference, by a revaluation process based upon the DORC concept. Such a periodic DORC revaluation would need to be undertaken by an experienced and independent valuer using valuation principles and methodologies consistent with the principles and methodologies applied in the independent valuation of ARTC's Interstate Network assets approved by the Australian Competition and Consumer Commission (ACCC).

The Commission has acknowledged that more explicit updating or roll-forward provisions would be useful to all parties.

The Code (section 2(7)(a) of the Pricing Principles Schedule) requires the Commission's arbitrated pricing guidelines to adopt an approach for valuing capital assets which "reflects" the DORC valuation of those assets.

The Commission has implemented this requirement by requiring the *initial* capital cost of the Railway – i.e., as at the date of commencement of operations of the New Railway – to be a DORC valuation. This emphasis on the *initial* capital cost of the Railway derives directly from the requirement of clause 21(b) of the Code that among the matters that an arbitrator is to take into account is the "the initial capital cost of the railway infrastructure facilities". It is also consistent with the emphasis at various points in the Code on circumstances prevailing as at the date of commencement of construction of the Railway, most notably the expected risks at that time.

This initial valuation of the Railway could be updated by either of two approaches:

- ▲ further DORC revaluations; or
- ▲ an annual roll forward.

In general, roll-forward arrangements involve commencing asset values being adjusted from year to year for each of annual depreciation, annual additions, annual disposals and annual inflation.

Submissions in response to the Issues Paper generally supported the on-going use of DORC as the method for valuation of assets under the Code.

In particular, APT expressed concern that the application of a roll-forward mechanism to the initial DORC valuation without provision for future DORC valuations may not accurately reflect the value of Railway assets over time (particularly later in the concession arrangement), and could result in an artificially low value of Railway assets.

APT therefore expressed its support for the option of a new DORC valuation in future, supplemented with appropriate roll-forward provisions between such revaluations.

3.4.2 Draft decision

The Commission recognised that the alternative approaches (further DORC revaluations and an annual roll-forward) would give identical results only in certain circumstances, namely:

- ▲ in the absence of any 'optimisation' (with optimisation usually providing scope to lower asset values but rarely to increase them);
- ▲ if remaining asset life assumptions were identical (with DORC revaluations often reopening the remaining life issue); and

- ▲ if asset price inflation on average over time equaled general inflation (as measured by the consumer price index).

The optimisation process is a feature peculiar to the DORC valuation approach. (A roll-forward approach would only come close to mimicking a DORC valuation were it to include a “redundant asset” provision.) Dispensing with an optimisation process, as evident under a roll-forward approach without a redundant asset provision, has two main sets of attractions from a regulatory perspective:

- ▲ it is simpler and less costly; and
- ▲ it provides greater certainty all round (with optimisation increasing risks to investors, and a roll-forward approach effectively lowering such risks).

In the Commission’s view, the DORC approach therefore creates considerable additional costs and uncertainty for the access provider and access seekers alike. By contrast, once the initial asset value is set, that value is set forever under the roll-forward approach, and there is no further reopening of that value. Updating asset values to reflect new capital invested and the return of funds to investors (regulatory depreciation) provides greater certainty that investments made in the Railway will be recovered, and thus provides further incentive for investment. Likewise, from the perspective of participants in upstream or downstream activities, precluding the initial asset value from being reopened constrains the access provider from exploiting possible windfall gains over time at the expense of upstream and downstream development.

In this latter regard, the Commission’s ‘rate of return’ determinations underpinning the regulated rates of return in section 6 of Guideline No. 2 allow for possible upsides in returns so as to ensure that the access provider is not prevented from earning a reasonable risk-adjusted return on capital invested in the Railway. It is noteworthy that the manner in which these regulated rates of return have been determined by the Commission forestalls any need for the potential for windfall gains to also be included in the asset valuation. As a result, the real capital gains component of the return on capital invested in the Railway only requires the *initial* amount of capital invested in the Railway to be escalated annually in line with actual inflation. In fact, any windfall gains that might be derived from DORC revaluations would in effect involve an element of economic rent to investors in the Railway.

The Commission therefore considered the DORC valuation of the Railway as at the date of commencement of operations to meet the Code’s requirement that asset values “reflect” the DORC valuation of those assets. Thereafter, this initial valuation of the Railway would be best updated using the roll-forward approach.

As a result, the Draft Decision involved proposed amendments to Guideline No. 2 aimed at making explicit provision for the annual roll forward of the value of the Railway (in section 2) and in the value of private capital invested (in section 5).

In drafting such amendments, the Commission also indicated that the roll-forward arrangements would involve:

- ▲ any “additions” to the Railway being consistent with the coverage of the Code;
- ▲ the value of any asset acquired or constructed not funded by capital contributions and donations; and
- ▲ the actual amount of capital expenditure not being subject to any tests as to whether or not it is prudent or efficient.

3.4.3 Views in submissions

The NT Chief Minister indicated that:

“...the AustralAsia Railway Corporation ... acting on behalf of the Northern Territory and the South Australian Governments in respect of the [Guidelines] review ... has informed me that the draft decisions are appropriate.”

By contrast, in its submission on the Draft Decision, APT indicated its general disagreement with the Commission’s proposed adoption of a roll-forward approach rather than periodic DORC revaluations.

With regard to the choice between the further DORC revaluations and an annual roll-forward approach, APT argued that the DORC approach may be superior in some circumstances:

“The principal circumstances where APT considers that a DORC valuation should be used in preference to an asset roll forward calculation are:

- (i) Recovery/Restoration of Functionality of Railway – in the event of a major capital expenditure in respect of the Railway Infrastructure Assets that was not clearly an addition or disposal, nor an event of depreciation or linked to inflation (ie; the critical replacement of a material part of the asset, to restore functionality after a major natural disaster or other unforeseen event);*
- (ii) Use of Inappropriate Inflation in Asset Roll Forward Calculation – where APT (acting reasonably) disagreed with the proposed application of inflationary indicators (such as CPI) in the asset roll forward calculation, and where it considered that other variables were more suited to recording the inflationary pressures on the operation of the Railway (on the understanding that a revised DORC valuation would derive an updated replacement value of the Railway); or*
- (iii) By Mutual Agreement – where ESCOSA and the access provider (both acting reasonably) agreed that the use of a revised DORC valuation were more appropriate than the use of the annual asset roll forward mechanism.”*

Accordingly, APT disagreed with the mandating of one mechanism (i.e. annual asset roll-forward calculation) to the exclusion of the other (revised DORC valuations), preferring that:

“...the maximum level of flexibility should be retained ... {and} the ability to use further DORC valuations in certain appropriate circumstances should not be excluded.

...a revised DORC valuation [could be] carried out every 5 years (or at such other periodic interval), with asset roll forward calculations implemented in between, based upon the most recent DORC valuation. APT believes that this strategy would benefit from the advantages of each system, without becoming an administrative inconvenience to any party. This would result in a system similar to that used by ARTC, and achieve the aim of aligning the regulation of the Railway more closely with the ARTC system.”

As to the general roll-forward mechanism itself, and in particular the Commission’s observation in the Draft Decision that the “... main point at issue in any roll forward relates to additions to Railway Infrastructure Assets”, APT argued that it:

“...does not consider that ‘additions’ to infrastructure are the only or, for that matter, the main relevant variable consideration in the proposed roll-forward methodology. APT’s position (and a principal basis for its concern relating to the adoption of an appropriate forward valuation methodology) is that the other variables also referred to by ESCOSA — depreciation, disposals and inflations — should be fully taken into consideration.

...Whereas APT considers that instances of disposals of Railway Infrastructure Assets are likely to be infrequent, the impact of inflation (particularly in relation to the cost of labour, goods, services and consumables procured by APT for the continued operation of the Railway) is considered to be of primary importance as well.”

APT also expressed some concerns about the requirement that “any additions to the Railway must be consistent with the coverage of the Code”:

“... Presumably this means that in order for an addition to Railway Infrastructure Assets to be a relevant consideration taken into account in an annual roll-forward calculation, it must first be an addition that is consistent with the purposes and objectives of the Code. This concept is referred to as “allowed capital expenditure” in ESCOSA’s proposed guideline amendments.

...APT considers there to be an extremely low likelihood of a Railway addition that is not consistent with Code objectives, unless it is an addition that is independently funded by an access seeker (in which case it is likely to be proximately linked with some other asset — such as a mine — near the Railway).

...As one example APT agrees that an independently-funded siding from the Railway to access a third party asset (such as a bulk minerals storage facility or a mine) may not be an “addition” appropriately taken into consideration for an annual roll-forward calculation. However, a passing loop constructed to service the Railway as a consequence of increased usage of the Railway from that siding would, by contrast, be an appropriate “addition” to be considered, and it must be considered in any roll-forward calculation. Therefore, to quarantine certain additions so that they cannot be taken into account for roll-forward calculations risks excluding a category of ancillary expenditure that is, conversely, appropriate to take into consideration.”

3.4.4 Commission's analysis

The Commission makes the following comments concerning APT's arguments regarding the potential superiority of the DORC approach to the roll-forward approach in some circumstances.

First, APT states that a roll-forward approach would not accommodate "...a major capital expenditure...that was not clearly an addition or disposal, nor an event of depreciation or linked to inflation (ie; the critical replacement of a material part of the asset, to restore functionality after a major natural disaster or other unforeseen event)". However, APT's argument is based on a narrow interpretation of the term 'additions', i.e. one limited just to any expansion or extension of the Railway. The Commission's intention is that, for the purpose of any asset roll forward, 'additions' encompass the renewal, rehabilitation and replacement of existing assets as much as extensions and expansions (i.e. new assets). This wider meaning is consistent with the practice of all regulators in Australia when applying an asset roll forward approach.

Secondly, the Commission disagrees that use of a general inflationary indicator like the CPI for the purposes of the inflation adjustment may disadvantage the access provider. The Commission acknowledges that there may be times when the cost of operating, maintaining and improving the Railway is increasing at a rate above CPI. The asset roll-forward approach accommodates this possibility by allowing for any capital additions to be rolled into the asset based at current cost. In relation to the initial capital base, the Commission believes that it is appropriate for this value to be escalated by CPI each year, to ensure that investors in the Railway are compensated for movements in inflation. This compensation does not relate to the cost of physically replacing assets since this cost is addressed when capital expenditure is incurred. The inflation of the existing asset base is intended purely to reflect the change in purchasing power over the long-term.¹²

Thirdly, the Commission is not convinced that there is a case for leaving open the possibility of further DORC valuations in "certain appropriate circumstances" – particularly where such circumstances are not defined. Cherry picking asset valuation outcomes is hard to justify in any circumstances.

The Commission therefore holds to its view that the roll-forward approach is superior to a DORC revaluation process.

¹² This is consistent with the financial capital maintenance concept, which is discussed in the Commission's 2005-2010 Electricity Distribution Price Determination – Part A, Chapter 9. See also the The Allen Consulting Group August 2003, Methodology for updating the regulatory value of electricity transmission assets, report to the Australian Competition and Consumer Commission.

The Commission notes that, in its recent final decision on the ARTC Interstate Access Undertaking, the ACCC has accepted the ARTC proposal to revalue its existing assets, using a DORC methodology.¹³

The Commission believes that this aspect of the ACCC decision is not inconsistent with the Commission's decision to adopt a roll-forward approach to updating the value of the Railway, as the ACCC decision appears to have been made under certain circumstances that are not relevant to the Commission's review. In particular, the ACCC appears to have given significant weight to the fact that the 2002 ARTC Access Undertaking specifically envisaged a revaluation. It has also accepted the proposal on the basis that ARTC has provided a commitment to lock in the resulting DORC value for subsequent regulatory periods. The ACCC has stated in its Final Decision that, while revaluation was not normal regulatory practice and not generally preferred by the ACCC, it could not reject the ARTC proposed revaluation for the above reasons.¹⁴

The Commission therefore believes that the ACCC decision to accept a revaluation of the ARTC assets does not, in itself, provide strong grounds for the Commission to adopt the same approach for updating the value of the Railway. Indeed, the expectation that there will be no future revaluations of the ARTC assets provides some support for a roll-forward approach.

As to the concerns which APT expressed about the proposed roll-forward mechanism itself, the Commission notes that the Draft Decision did not imply that 'additions' to infrastructure were "... the only or, for that matter, the main relevant variable consideration in the proposed roll-forward methodology". The comprehensive scope of the roll forward model is evident from a close examination of the description included in the draft amendments to section 2 of Guideline No. 2:

"The value of the Railway as at the beginning of the second or a subsequent year ('the later year') must be calculated by adjusting the value ('the previous value') of the Railway as at the beginning of the immediately preceding year ('the previous year') as follows:

- (1) the previous value of the Railway must be increased by the actual amount of allowed capital expenditure on Railway Infrastructure Assets for the previous year, where allowed capital expenditure on Railway Infrastructure Assets is restricted to:
 - (a) any actual additions to the Railway that are consistent with the coverage of the Code, and*
 - (b) the actual value of assets acquired or constructed that have not been otherwise recovered;**
- (2) the previous value of the Railway must be reduced by the actual amount of the annual regulatory depreciation on Railway Infrastructure Assets for the previous year (with "annual*

¹³ Australian Competition and Consumer Commission, July 2008, *Final Decision Australian Rail Track Corporation Access Undertaking - Interstate Rail Network*, Appendix B, pp. 141-144.

¹⁴ *Ibid.* Appendix B, p144.

regulatory depreciation” being as recorded in the Regulatory Accounts consistent with the requirements of Guideline No. 3);

- (3) the previous value of the Railway must be reduced by the actual disposal value of any asset included in that value that was disposed of during the previous year; and*
- (4) the previous value of the Railway must be increased by an amount necessary to maintain the real value of the Railway as at the beginning of the later year by adjusting that value for the actual inflation rate (based on the consumer price index) during the previous year.”*

The Commission’s comments on ‘additions’ in the Draft Decision were merely intended to recognise that the issues surrounding the measurement of ‘additions’ were possibly more problematic than those surrounding the measurement of depreciation, disposals and inflation.

Regarding APT’s concerns about the requirement that “any additions to the Railway must be consistent with the coverage of the Code”, the Commission was not implying that capital expenditure would only be allowed into the roll-forward calculations if the addition involved was demonstrated to be “consistent with the purposes and objectives of the Code”. Rather, the Code makes specific provisions regarding asset “coverage”. Section 3(1)(b) of the *AustralAsia Railway (Third Party Access) Act 1999* defines "railway infrastructure facilities" covered by the Code to mean:

“...facilities necessary for the operation or use of the railway, including –

- (a) the railway track;*
- (b) the signalling systems, train control systems and communications systems; and*
- (c) such other facilities as may be prescribed,*

but not including rolling stock; ...”

Further, section 3(5) of the Act provides that, with respect to the prescription of any facilities under the above definition of “railway infrastructure facilities”:

- “(a) the Ministers must not prescribe a facility without first consulting with the regulator; and*
- (b) the prescription of a facility must be consistent with the criteria set out in Clause 6(3)(a) of the Competition Principles Agreement referred to in the Trade Practices Act 1974 of the Commonwealth.”*

The Commission is confident that these provisions will ensure that there is no risk that appropriate additions will be quarantined from the roll-forward calculations.

The Commission has decided to make a correction to the proposed amendments in its Draft Decision relating to the proposal that assets acquired or constructed that are funded by capital contributions and donations be excluded from ‘additions’ for the purpose of the roll forward. While this exclusion is appropriate when it comes to measuring the value of private capital invested (for the purposes of section 5 of Guideline No. 2), it is not appropriate when it comes to measuring the

value of the Railway (for the purposes of section 2 of Guideline No. 2). The value of the Railway encompasses all railway infrastructure assets irrespective of how they are financed (whether by governments or private investors, or through usage charges or by up-front capital charges).

The Commission has also identified a consequential change that is necessary in section 2 of Guideline No. 2 to reflect the proposed roll-forward arrangements. This change, which was not identified in the Draft Decision, clarifies the manner in which regulatory depreciation is to be calculated.

3.4.5 Final decision

The Commission reaffirms its Draft Decision to implement an annual roll forward of the value of the Railway and the value of private capital invested by appropriate amendments to Guideline No. 2. The Commission has , with the exception that any assets acquired or constructed that are funded by capital contributions and donations be included in ‘additions’ for the purpose of the roll forward when it comes to measuring the value of the Railway (for the purposes of section 2 of Guideline No. 2).

3.5 Guideline amendments

To give effect to the various aspects of its final decision outlined above, the Commission has decided to make the following variations to Guideline No. 2 (and to make the consequential changes to Guideline No. 3).

The following words in “Section 2: Ceiling Price” of Guideline No. 2 are to be deleted:

The DORC value of the Railway Infrastructure Assets calculated for Ceiling Price purposes is to be established and/or verified by an experienced and independent valuer using valuation principles and methodologies consistent with the principles and methodologies applied in the independent valuation of ARTC’s Interstate Network assets approved by the ACCC.

The lives of the Railway Infrastructure Assets used for the purposes of the DORC valuation of those assets for use in a pricing arbitration, and the associated pattern of depreciation, are to be those approved for such purposes by ESCOSA and must be consistent with the principles and methodologies applied in the independent valuation of ARTC’s Interstate Network assets approved by the ACCC.

and the following replacement words inserted:

Value of the Railway as at the commencement of operations

The value of the Railway Infrastructure Facilities calculated for Ceiling Price purposes (‘value of the Railway’) as at the commencement of operations (15 January 2004) is \$1,696.9 million (in dollars of 1 July 2003).

Establishment of the opening value of the Railway for each of the second and subsequent years

In this sub-section, "year" means a 12 month period commencing 1 July, except for the 12 month period including the date of commencement of operations where the year is taken to be just the period of days and months from the date of commencement of operations through to the following 30 June.

The roll forward model for the purposes of this sub-section is as follows:

The value of the Railway as at the beginning of the second or a subsequent year ('the later year') must be calculated by adjusting the value ('the previous value') of the Railway as at the beginning of the immediately preceding year ('the previous year') as follows:

- (1) the previous value of the Railway must be increased by the actual amount of allowed capital expenditure on Railway Infrastructure Facilities for the previous year, where allowed capital expenditure is restricted to any actual additions (encompassing asset renewal, rehabilitation and replacement) to Railway Infrastructure Facilities consistent with the coverage of facilities as set out in section 3(1)(b) of the AustralAsia Railway (Third Party Access) Act 1999,*
- (2) the previous value of the Railway must be reduced by the actual amount of the annual regulatory depreciation on Railway Infrastructure Facilities for the previous year. "Annual regulatory depreciation" is calculated on the value of the Railway as at the beginning of the previous year using depreciation schedules that reflect the economic life of the relevant assets. It involves the sum of the real value of the depreciation that is attributable to any asset or category of assets over the economic life of that asset or category of assets (such real value being calculated as at the time the value of that asset or category of assets was first included in the value of the Railway) being equivalent to the value at which that asset or category of assets was first included in the value of the Railway;*
- (3) the previous value of the Railway must be reduced by the actual disposal value of any asset included in that value that was disposed of during the previous year; and*
- (4) the previous value of the Railway must be increased by an amount necessary to maintain the real value of the Railway as at the beginning of the later year by adjusting that value for the actual inflation rate (based on the consumer price index) during the previous year.*

The following words in "Section 5: Arbitrated Price where there is No Sustainable Competitive Price" of Guideline No. 2 are to be deleted:

In an arbitration where there is no sustainable competitive price, and so where a reasonable price between the Floor Price and the Ceiling Price is to be based on the costs of providing a Service:

- (a) the return 'on' and 'of' capital components of such costs are to be based on the capital invested in Railway Infrastructure Assets by the Access Provider, such that the DORC value of the Railway Infrastructure Assets is adjusted to exclude the value of the government-contributed assets but not the government-sourced project funding (the concessional loan facility and the Governments' commercial investments); and*
- (b) the reasonable rate of return is to be calculated in accordance with the applicable rate in the Regulated Rates of Return section of this Guideline (section 6).*

and the following replacement words inserted:

In an arbitration where there is no sustainable competitive price, and so where a reasonable price between the Floor Price and the Ceiling Price is to be based on the costs of providing a Service:

- (a) the return 'on' and 'of' capital components of such costs are to be based on the value of the capital invested in Railway Infrastructure Facilities by the Access Provider ('value of private capital invested'); and
- (b) the reasonable rate of return is to be calculated in accordance with the applicable rate in the Regulated Rates of Return section of this Guideline (section 6).

where

"the value of private capital invested" for the purposes of this section means the value of the Railway (as defined in section 2) less the value of government contributed assets and other government financial assistance, where "government contributed assets and other government financial assistance" means the sum of the value of:

- the Existing Railway; and
- the government-funded construction of certain parts of the New Railway.

Value of private capital invested as at the commencement of operations

The value of private capital invested for the purposes of this section as at the commencement of operations (15 January 2004) is \$731.6 million (in dollars of 1 July 2003), being comprised of:

- the value of the Railway as defined in Section 2 (\$1,696.9 million in dollars of 1 July 2003)
- less the value of the Existing Railway (\$537.8 million in dollars of 1 July 2003); and
- less the value of the government-funded construction of certain parts of the New Railway (\$427.5 million in dollars of 1 July 2003).

Establishment of the value of private capital invested for each of the second and subsequent years

This sub-section applies to the establishment of the value of private capital invested as at the beginning of one year on the roll forward of the value of private capital invested to that year from the immediately preceding year.

"Year" means a 12 month period commencing 1 July, except for the 12 month period including the date of commencement of operations where the year is taken to be just the period of days and months from the date of commencement of operations through to the following 30 June .

The roll forward model for the purposes of this sub-section is as follows:

The value of private capital invested as at the beginning of the second or a subsequent year ('the later year') must be calculated by adjusting the value ('the previous value') of the capital invested as at the beginning of the immediately preceding year ('the previous year') as follows:

- (1) the previous value of private capital invested must be increased by the actual amount of allowed capital expenditure on Railway Infrastructure Facilities for the previous year, where allowed capital expenditure on Railway Infrastructure Facilities is restricted to:
 - (a) any actual additions (encompassing asset renewal, rehabilitation and replacement) to Railway Infrastructure Facilities consistent with the coverage of facilities as set out in section 3(1)(b) of the AustralAsia Railway (Third Party Access) Act 1999, and
 - (b) the actual value of assets acquired or constructed that have not been otherwise recovered:
- (2) the previous value of private capital invested must be reduced by the actual amount of annual regulatory depreciation directly attributable to the assets financed by the capital invested in

Railway Infrastructure Facilities by the access provider for the previous year. The total of such "annual regulatory depreciation" is calculated on the value of the relevant assets as at the beginning of the previous year using depreciation schedules that reflect the economic life of those assets. It involves the sum of the real value of the depreciation that is attributable to any asset or category of assets over the economic life of that asset or category of assets (such real value being calculated as at the time the value of that asset or category of assets was first included in the value of the Railway) being equivalent to the value at which that asset or category of assets was first included in the value of the Railway;

- (3) the previous value of private capital invested must be reduced by the actual disposal value of any asset included in the value of the Railway where the asset was disposed of during the previous year; and*
- (4) the previous value of private capital invested must be increased by an amount necessary to maintain the real value of private capital invested as at the beginning of the later year by adjusting that value for the actual inflation rate (based on the consumer price index) during the previous year.*

4 REFERENCE PRICES

4.1 Background

Clause 9(1)(e) of the Code does not oblige the access provider (APT) to publish reference prices, for example by publication on a clearly identified and publicly accessible page of the access provider's website.

The Code only requires the access provider to provide such prices on request.

Guideline No. 1 addresses the process involved in the request and provision of such prices. The access seeker is required to put its request for reference prices in writing, to be accompanied by the general information necessary for this purpose as published by the access provider.

While Guideline No. 1 is currently limited to matters of procedure, in developing the guideline the Commission has acknowledged that it could provide guidance also on such matters as:

- ▲ the purpose to be served by reference prices (and the appropriate balance between the legitimate business interest of the access provider, the interest of the public and the interests of the access applicant);
- ▲ the nature of a standard service for reference pricing purposes;
- ▲ the appropriate structure of reference prices – and the extent to which reference prices could comprise a variable component, which is a function of distance and gross mass (\$/gtkm); and a flagfall component, which is fixed and specific to each service type and segment (\$/km);
- ▲ the rail sectors/segments to be used for pricing purposes; and
- ▲ the appropriate method for allocating non-segment specific costs to segments.

To date, however, the Commission has not pursued this broader approach on the basis that to do so might introduce some inflexibility into pricing negotiation. The Commission has been particularly influenced, given the role played under the Code by the competitive imputation pricing rule, by the role to be played by market-based – as opposed to cost-based – pricing. Under competitive imputation, pricing can be expected to vary more markedly than under a cost-based approach. In such circumstances, the Commission has considered that published reference prices might inadvertently hamper implementation of the competitive imputation pricing rule.

However, recent developments with the Railway have seen a focus on bulk traffic (e.g. minerals), which are less likely to trigger the competitive imputation approach to pricing (because there are less likely to be sustainable competitive modes for such traffic). A number of further bulk minerals haulage opportunities are also in prospect, as a result of

further mineral deposits being developed (or evaluated) in proximity to the Railway under the present mineral resources and commodity prices 'boom'.

In the Issues Paper, the Commission invited comment on the merits of its current approach to reference prices and whether or not more detailed direction should be provided in the Guidelines.

4.2 Draft decision

In response to the Issues Paper, some parties focussed on a perceived lack of transparency in APT's (reference) pricing. Concern was also expressed by a downstream transport operator regarding the differentiated access prices between northbound and southbound traffic.

In contrast, APT rejected the case for changing the level of existing regulation regarding reference pricing at this stage, arguing that:

"...Changes to the regulatory regime so early into the concession period (particularly changes that increase regulation):

- (i) risk destabilising present levels of certainty in negotiations for access to the Railway; and*
- (ii) may result in the access provider having less flexibility and resulting in a less innovative approach in attracting business to the Railway."*

In response, while it does not set or regulate prices for use of the Railway,¹⁵ the Commission noted that the Code does not prevent it from ramping-up the degree of prescription regarding reference pricing beyond just the procedural matters currently covered in Guideline No. 1.

Nevertheless, the Commission acknowledged that imposing ARTC-like reference pricing obligations on APT would be a substantial departure from earlier regulatory practice by the Commission, and should only be contemplated if there were clear benefits.

The Commission commented in particular on the concerns expressed by a downstream transport operator regarding any differentiated access prices between northbound and southbound traffic. Access prices that differentiate according to the direction of traffic cannot be taken as evidence of any misuse of market power. Rather, access prices differentiated according to the direction of traffic prices can reflect many different considerations, most of them legitimate. For example, differentiation between the pricing of traffic in one direction and the other could simply reflect a high fixed component to pricing. For bulk minerals traffic originating towards the southern end of the Railway, northbound traffic involves greater usage of the overall track and southbound traffic involves lower usage of the overall track.

¹⁵ Prices are instead negotiated within limits effectively set by the Code's pricing principles applying to any arbitration in the case of an access dispute and the Commission's associated guidelines to be observed by any arbitrator.



Moreover, reference prices (being by their nature *maximum* prices) are unlikely to address the issue of differential pricing between northbound and southbound traffics, with nothing preventing the offer of significant discounts to northbound traffic relative to southbound traffic.

All things considered, the Commission was unable to rule out that ARTC-like reference pricing could disadvantage access seekers in some situations and/or dissuade investment in some new projects. Such disadvantages could arise if APT felt it had to set published reference (maximum) prices at sufficiently high levels to accommodate all contingencies.

Accordingly, in the Draft Decision, the Commission did not propose any variations to Guideline No. 1. It remained of the view that it was too early to justify imposing ARTC-like reference pricing on APT.

4.3 Views in submissions

In response to the Draft Decision, APT indicated that it:

“APT agrees with, and welcomes, ESCOSA’s assessment that it is too early to justify imposing ARTC-like reference pricing on the access provider by way of a variation to Guideline No. 1.”

The submission from the NT Chief Minister also stated that “the draft decisions are appropriate”.

4.4 Final decision

The Commission remains of the view that it is too early to justify imposing ARTC-like reference pricing on APT via a variation to Guideline No. 1.

Accordingly, the Commission confirms that it has decided not to vary Guideline No. 1 at this time.

Nevertheless, the Commission confirms that it plans instead to commence (confidential) monitoring of APT’s access pricing using its clause 39 powers to obtain information.

Such monitoring will better position the Commission to deal with any future requests for directions (under clause 12B) aimed at facilitating the conduct of future access negotiations involving bulk minerals haulage opportunities.

Such monitoring is also a prerequisite before the Commission could give consideration to amending section 5 of Guideline No. 2 dealing with allowable and disallowable price differentiation in an arbitration where there is no sustainable competitive price.

5 ARTC UNDERTAKING AND CIRA

5.1 Background

Clause 45A(2) of the Code requires the Commission to take into account “interface issues” with other access regimes when making or varying guidelines.

Interface issues are defined by the Code as those issues which directly affect two or more railways (including the Railway) and which relate to operating a freight service or a passenger service by means of such railways.

For this reason, Guideline Nos. 1 and 2 both refer to and require varying degrees of consistency with the ARTC’s Interstate Access Undertaking, noting that the Railway connects to the ARTC interstate system.

The purpose of such an approach is to ensure that above-rail operators do not face a dramatic change of arrangements merely because they move onto the Railway. That is not to say that no differences can arise, as clearly the nature of the Railway and the Code will result in some difference.

While the existing Guidelines nominate consistency in some areas (e.g. the approach to DORC valuation, train path policy, train control and service quality), the Guidelines do not include such provisions in relation to other areas such as reference pricing.

Also, the Commission has indicated it might consider any changes in approach necessary to further align requirements on APT as the access provider with the requirements on ARTC in its Interstate Access Undertaking. In doing so, relevant considerations include:

- ▲ the emergence of minerals traffic, some of which will not interface with ARTC (i.e. some may move north to Darwin from points along the Railway); and
- ▲ the implications of proposed changes to the ARTC’s Interstate Access Undertaking.

The Commission is also mindful of the Competition and Infrastructure Reform Agreement (CIRA) entered into by the Council of Australian Governments (COAG) in February 2006 – after the four Guidelines were published.

The CIRA aims for a simpler and more consistent national approach to the economic regulation of significant infrastructure such as railways. Where third-party access regimes are needed, the CIRA has resulted in changes to the Competition Principles Agreement to incorporate a number of principles, including that:

- ▲ all third-party access regimes include objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure;
- ▲ all access regimes include consistent principles for determining access prices; and



- ▲ railways that are agreed to be nationally significant adopt a simpler and consistent national system of access regulation, using the ARTC access undertaking as a model.

It is notable that the Code is quarantined from CIRA's specific requirements. Nevertheless, the regulatory principles involved provide a benchmark against which some of the discretions exercised by the Commission when it developed and published the existing guidelines could be reconsidered.

5.2 Draft decision

In the Issues Paper, the Commission invited comment on the degree of alignment necessary with the ARTC access undertaking, and the implications of CIRA for the guidelines.

Submissions received from APT and ARTC both argued that there was no need for the guidelines to be impacted by any of the CIRA implications.

In response, the Commission accepted that, while the CIRA principles call for consistency in access pricing (and regulation) across railways, the Railway is specifically quarantined from the obligations which CIRA places on access regimes.¹⁶ Moreover, most of the inconsistency in pricing regulation between the Railway and ARTC's interstate network are the direct result of the Code. The Commission does not have the power or discretion to address these pricing and regulatory inconsistencies.

In addition, the Commission considered that it was too early to analyse proposed changes to ARTC's Interstate Access Undertaking. As such changes are still under consideration by ARTC (and are subject to approval by the ACCC as the regulator), there is little that the Commission could do now to further align the guidelines to ARTC's Interstate Access Undertaking.

Accordingly, the Commission did not propose in its Draft Decision any variations to the guidelines at this time aimed at achieving CIRA objectives or to reflect changes to ARTC's Interstate Access Undertaking.

5.3 Views in submissions

In its submission, APT raised a concern with the Commission's flagging that it might consider taking further action in future to align the Guidelines with the ARTC's access undertaking.

In response, APT repeated the position outlined in its earlier submission that it:

“(a) generally supports the principal (sic) of consistency between access regimes that govern the Railway and the ARTC system under the ACCC undertaking;

¹⁶ Refer clause 1.3 of the CIRA.

- (b) *considers that the existing provisions in Guideline No. 1 and 2 regarding consistency with the ARTC undertaking are an adequate level of regulation;*
- (c) *remains not supportive of principles of consistency regarding reference pricing between the Railway and the ARTC system;*
- (d) *remains not supportive of the proposition that the emergence of bulk minerals traffic on the Railway is a relevant consideration in examining consistency between the Railway and the ARTC system;*
- (e) *considers that there are not compelling reasons, presently, why ESCOSA needs to take into account matters relevant to CIRA in reviewing the Guidelines; and*
- (f) *does not consider that the Guidelines need be impacted by any of the CIRA implications, because the existing provisions of the Guidelines regarding alignment of the access regimes of the Railway and other nationally significant railway infrastructure is already adequate.”*

5.4 Commission’s analysis

The Commission notes the general support for the draft proposals and remains of the view that it is not appropriate to make any amendments to the Guidelines to specifically address the ARTC undertaking or CIRA, even in light of the recent ACCC Final Decision on the ARTC Interstate Access Undertaking. To the extent that most of the inconsistencies arise from the Code itself, the Commission is unable to address them through a review of the Guidelines.

5.5 Final decision

Accordingly, the Commission confirms that it does not propose to vary the guidelines at this time aimed at reflecting changes to ARTC’s Interstate Access Undertaking. In addition, the Commission accepts that variations are not necessary or appropriate to achieve CIRA objectives.

6 FUTURE REVIEWS

Certification of the Code as an 'effective' State-based access regime has been granted until 31 December 2030.¹⁷ Section 50(1) of the Code provides that a joint Ministerial review of "the operation of the Code" may be undertaken at any time, but at least:

- ▲ firstly, not later than 30 June in the third year of operations of the railway; and
- ▲ secondly, not later than 12 months before the expiration of the period for which the Commonwealth Minister has specified under section 44N of the Trade Practices Act 1974 of the Commonwealth that the access regime, of which this Code is a part, is to remain in force.

The first scheduled review was undertaken in 2006 and the second scheduled review is to occur by no later than 31 December 2029. Further Ministerial reviews may be conducted at any other time.

In accordance with Clause 45A of the Code, the Commission intends to monitor the effectiveness of the current Guidelines and will consider the need to vary or revoke the Guidelines, or issue new Guidelines, should circumstances warrant it. In doing so, Clause 8 of the Code requires the Commission to undertake a public consultation process. To assist the Commission in its ongoing monitoring of the effectiveness of the Guidelines, the Commission would welcome any feedback from stakeholders on the operation of the Guidelines and any suggestions for future improvements.

¹⁷ Refer to the Treasurer's statement of reasons for the certification decision, available at <http://www.ncc.gov.au/pdf/CERaNIde-001.pdf>.