

PACIFIC NATIONAL

Submission to the Essential Services Commission of
South Australia:

Review of the SA Rail Access Regime Regulator
Components

June 2005

1. Introduction

Pacific National welcomes the opportunity given by the Essential Services Commission ("ESC") to respond to the matters in the Issues Paper dated May 2005 ("**Issues Paper**") and to suggest changes which would enhance the South Australian Rail Access Regime¹ (the "**Access Regime**").

Two of the key objectives of the Access Regime are to:

- (a) facilitate competitive markets in the provision of railway services; and
- (b) provide access to railway services on fair commercial terms and on a non-discriminatory basis.

A key impediment to achieving these objectives is a lack of transparency. Pacific National believes that the Access Regime needs to be strengthened to provide for far greater transparency about the formulation and imposition of access prices to ensure that vertically integrated access providers are complying with their anti-discrimination obligations in the Railways (Operations and Access) Act 1997 (the "**ROA Act**").²

This lack of transparency coupled with the approach to the calculation of ceiling prices can result in very high access prices. This ability to charge high access prices increases the risk of entry (access charges may increase significantly post entry) and allows an access provider to set access charges high enough to deter competitive entry. This problem is illustrated by the fact that there has been very limited competition in the intrastate network for freight haulage in South Australia.

2. The Pricing Principles

Issue 1

Is there any merit in the Commission not establishing any pricing principles, that is, simply abolishing the existing ones?

- 1.2 Pacific National submits that the pricing principles should be retained as they provide information to access seekers about potential access charges. However, in order to give access

¹ The Access Regime is set out in Parts 3 to 8 of the Railways (Operations and Access) Act 1997 (the "**ROA Act**").

² Section 27 of the ROA Act.

seeker realistic price signals, they must be provided with more specific pricing information in addition to the pricing principles. The type of pricing information that should be provided to access seekers is outlined in detail in Section 3 of this submission entitled "Information about Access".

- 1.3 The Commonwealth has just announced that pricing principles will form part of the National Access Regime under Part IIIA of the Trade Practices Act 1974 (Cth), and that it will seek State agreement to amend the Competition Principles Agreement to require such principles to extend to State access regimes. Accordingly, Pacific National believes that the retention of pricing principles in the Access Regime is justified for the reasons given in the Productivity Commission Review of the National Competition Policy, the Commonwealth's response to that review and the Explanatory Memorandum to the Trade Practices Amendment (National Access Regime) Bill released on 2 June 2005. The Commonwealth Government stated:

"The Government agrees that statutory pricing principles should be established in relation to Part IIIA. Pricing principles will provide guidance for pricing decisions and contribute to consistent and transparent regulatory outcomes over time. They will also help to provide certainty for investors and access seekers alike and facilitate commercial negotiations between parties.

*Decision-makers will be required to have regard to the pricing principles, rather than requiring each and every principle to be satisfied. Some slight modifications to the Commission's recommendations are proposed. These modifications are designed to provide general guidance about the approach to be taken by decision-makers, focussing on efficiency and investment considerations, which are consistent with the Government's proposed objects clause Part IIIA and existing pricing principles under certified access codes."*³

Issue 2

2. **How should the Commission design the floor pricing policy principles to best reflect the requirements of the ROA Act, and why?**
- 2.1 The current approach to calculation of the floor price is appropriate and changes should not be made, particularly the inclusion of fixed or overhead costs. However, in Pacific National's view the imposition of an effective non discrimination regime is more important than the correct implementation of a floor price.

³ Government Response to Productivity Commission Report on the Review of the National Access Regime, Commonwealth Treasurer, 20 February 2004, pp4-5, at <http://www.treasurer.gov.au/tsr/content/publications.asp>; and confirmed in Second Reading Speech re Trade Practices Amendment (National Access Regime) Bill 2005, 5 June 2005.

Issue 3

3. How should the Commission design the ceiling pricing principles to best reflect the requirements of the ROA Act, and why?

3.1 The present ceiling pricing principles result in the possibility of very high access charges, which may be in excess of the access charges actually recovered from train operators on most of the intrastate network.

3.2 It is undesirable to have a ceiling which is well above current charges and the maximum price at which rail is competitive, regardless of how that ceiling is calculated, because:

- (a) this can lead to significant uncertainty on the returns to above rail investments, increasing the cost of capital for the above rail sector and possibly deterring efficient investments;
- (b) it provides an opportunity for the vertically integrated rail operator to price the third party access seekers out of the market; and
- (c) it can lead to windfall gains to the access provider as volume rises. Attracting additional volume on rail is largely the result of the efforts of the above rail operator. As freight volume grows owing to the efforts of the above rail operator, the below rail operator can (by increasing access charges without constraint) appropriate the benefit of the increased volume, which will, over time, damage the prospects for growth of rail freight volumes as the above rail operator receives low or no benefit in return for its efforts in inducing demand.

As a result, this may lead to a less than socially optimal rail network utilisation.

3.3 There may well be value in considering alternative methods to calculate the ceiling price such as the competitive imputation model, or reducing the value of the regulated asset base as has occurred with respect to electricity distribution network assets in Victoria in country areas, water assets in New South Wales⁴ and to water assets and rail track in the United Kingdom. However, Pacific National submits that the critical issue with respect to pricing under the Access Regime is transparency and non-discrimination, because, where there is a vertically integrated operator, non-discrimination and transparency of transfer prices (in the absence of

⁴ IPART Report, "Sydney Water Corporation, Prices of Water Supply, Sewerage and Drainage Services; Medium Term Price Path from 1 July 1996", page 18.

reference tariffs) can ensure a level playing field for all above rail operators and allow fair competition in rail freight.

- 3.4 In the absence of a reference price or information about the level of access prices charged to the incumbent train operator on a particular route, the operator has scope in a very high ceiling regime to offer access prices high enough to deter competition in the haulage of freight on the intrastate network. The lack of transparency about the actual access prices being charged means that there is nothing to prevent the operator from building margin into the below rail access charges and thereby squeezing the revenue the access seeker may generate from providing rail freight services in competition with the ASR related above rail operator.
- 3.5 Pacific National considers that if it, as a third party rail operator, was offered the same access charges as ASR, it could offer customers a competitive service to that provided by ASR. Conversely, if third party above rail operators do not have access to the same access charges as ASR, then no third party above rail operator will be able to match ASR's price, and accordingly it will be extremely difficult for any competition to develop in the provision of intrastate rail freight services in South Australia.
- 3.6 Accordingly, Pacific National submits that below rail operators should be required to provide more detailed access pricing information to access seekers and to the ESC for monitoring purposes. This proposal is discussed in more detail in Section 3 of this submission entitled "Information about Access" and Section 4 entitled "Regulatory Information Requirements".

Issue 4

4. **Should the Commission establish different pricing principles for different classes of railway services (including the option of not establishing pricing principles for some classes of railway services)? Which pricing principles should apply to which classes of railway services, and why?**
- 4.1 Pacific National considers that there may be some merit in establishing different pricing principles which recognise differences in the nature of the services or the cost structure of the services being provided.
- 4.2 The ESC may wish to establish different pricing principles for the following services:
- (a) passenger and freight services;
 - (b) different freight services, i.e. intermodal, grain, coal and bulk.

However, there is no basis for differential pricing between operators with respect to the same freight task other than on the basis of differential cost or risk to the access provider. Where such differential charging does apply, the basis for the differential based on, say, cost or risk should be objectively and publicly disclosed so that all operators are aware of the basis for the differential charges.

- 4.3 If the ESC decides to establish different pricing principles for different freight tasks, it is crucial that access seekers are aware of the basis used to differentiate price, i.e. the basis used to calculate prices for different freight tasks over the same train path. Access seekers need to be able to access this information prior to making an access application.

Issue 5

5. Whether practices from other regimes are or are not applicable to the pricing principles in the South Australian Rail Access Regime, and why?

- 5.1 Pacific National has been an access seeker in South Australia, Queensland, New South Wales, Victoria and Western Australia and to the interstate track owned by ARTC. In Pacific National's experience the most effective access regimes are those which are transparent and non-discriminatory. Such regimes maximise the scope for commercial negotiations and deliver dispute resolution in a timely and effective manner. The strong information disclosure framework minimises an access provider's ability to discriminate between the incumbent train operator and access seekers.
- 5.2 In the absence of such an effective access regime, obtaining access can become a Herculean effort. For example, it took 9 months for Pacific National to negotiate access prices with Queensland Rail Network Access ("**QRNA**") for intermodal freight services on the North Coast Line in Queensland, and a further 9 months to conclude negotiations for an access agreement. This was due in part to significant weaknesses in the negotiation framework in the QR Undertaking 2001 (the "**Undertaking**"), which is currently the subject of a review by the Queensland Competition Authority.
- 5.3 Pacific National submits that the best way to enhance the Access Regime is to strengthen the information provisions requirements as discussed below.

3. Information about Access

Issue 6

6. **What additional content, beyond that mandated in the ROA Act, should the Commission require in the Information Brochure, and why? What role is there for reference tariffs in the Access Regime and how might they be constructed?**
- 6.1 Pacific National is concerned, that despite the anti-unfair discrimination provisions in section 23 of the ROA there is still a lack of transparency in the operation of the South Australian Rail Access Regime which means that there is considerable potential for access providers to discriminate between access seekers without access seekers knowing. Of particular importance is transparency of pricing information both in the method in which access charges are calculated, and the access charges charged to competing train operators.
- 6.2 At present under section 28 of the ROA, the access provider must provide the access seeker with the floor and ceiling prices for access as well as reference tariffs where they exist.⁵ However, there is no obligation on the access provider to supply the price the access provider is prepared to offer the access seeker for the access sought, nor for it to disclose what its transfer price to its own above rail operator is on that line.
- 6.3 In other jurisdictions more information is provided to access seekers. For example, in Queensland as part of the Indicative Access Proposal in response to a request for access, QRNA must provide an initial estimate of the access charge for the requested access rights based on the pricing principles set out in Part 6 of the Undertaking.
- 6.4 Pacific National has proposed as part of the review of the Undertaking, that QRNA also provide:
- (a) any calculations used to arrive at those prices; and
 - (b) sufficient information so that an access seeker can determine whether or not the prices being offered comply with clause 6.1.2 of the Undertaking which places limits on price differentiation for access charges between access seekers.
- 6.5 Ideally, reference prices should be published covering the major tasks on the network. These reference prices would detail how access on particular network segments would be priced. Access seekers need this type of reliable information about pricing in order to properly prepare

⁵ See p24 of the "South Australian Rail Access Regime Information Kit" dated May 2004.

their offers to potential customers and design the most appropriate train service for them. The reference pricing would apply to all above rail operators including ASR.

6.6 The reference prices would include information, ideally in the form of detailed formulae, as to how those access charges will vary if there are differences in the characteristics of the services currently offered on a particular network segment and the service the access seeker proposes to provide. For example, the formula might allow third parties to calculate how much the access rate will vary if a proposed train service is faster or slower, lighter or heavier, than operated by another operator. It is assumed that any variation in access rates due to differences in the train service characteristics should reflect the actual cost impact on ASR. This information would provide important price signals to third parties and assist in the design of their proposed train services.

6.7 Reference Tariffs provide an important source of information to access seekers and operators about the likely cost of providing a specific train service. They provide operators with greater certainty about the cost of business as well as transparency of cost components. The problem common to access seekers is that while they can usually obtain an access price for a particular service, it can be very difficult to obtain information as to how that price was calculated.

6.8 In the absence of reference tariffs, ASR should be required to publish the access prices that it charges its above rail operator. The reality is, that if third party access seekers cannot obtain the same access prices as ASR then there will be little actual competition in the provision of rail freight services on the intrastate network and no purpose would be served by the access regime.

6.9 In summary, Pacific National submits that the ESC should require the access provider to supply the reference prices for all significant task currently on the network. In addition, at the time of access application, the access seeker should be supplied with:

- (a) an initial estimate of the access charge for the requested access rights;
- (b) the access rate charged to ASR per '000 Gtk for the service in the last 12 months.

6.10 In addition, the access provider should supply to the ESC:

- (a) the number of Gtk moved on the lines the subject of the access's seeker's request in the last 12 months;
- (b) the total revenue the access provider receives from each line the subject of the access seeker's request in the last 12 months;

- (c) the total revenue generated from access currently granted on the lines the subject of the access seeker's request in the last 12 months.

The Purpose of supplying this information to the ESC is so that any price hike to the access seeker (which might also apply to its own related body corporate thus complying with the non-discrimination rule) can be detected by the ESC.⁶

- 6.11 In addition, the Information brochure should also include current timetables, curve and gradient, axle load limits and detailed network diagrams for that part of the network relevant to the services the subject of the access request.

Issue 7

7. **What should be considered a reasonable charge for section 29 information, and why?**

7.1 Pacific National agrees with the ESC that in deciding whether or not to allow an operator to charge for the provision of information it should take into account the factors identified at page 13 of the Issues Paper. Pacific National notes that while charges are imposed in some access regimes for the provision of certain information, neither ARTC or RIC impose charges of this nature on access seekers.

7.2 Pacific National submits that a careful balance must be struck in the imposition of any fees such that they cover the direct administrative costs incurred by the access provider and deter all except bona fide access seekers, but are not so high as to deter access requests or permit an excessive return to the access provider.

4. Regulatory Information Requirements

Issue 8

8. **What information should the Commission require an operator to report on an ongoing basis, and why?**

8.1 The ESC should require an operator to disclose relevant price and costing information so that it can verify that the operator is not discriminating between its own above rail operator and third party access proponents, and that its prices are calculated in accordance with the pricing principles made under the Access Regime.

⁶ The access provider may be indifferent to the price hike to its related above rail provider because it recover the lost above rail margin in the below rail business as a vertically integrated operator, or has lost the customer to the competing access seeker, and thus the non-discrimination rule provides no protection from such a price squeeze.

- 8.2 Pacific National submits that this information should include:
- (a) the formulae used to calculate access prices on the particular segments of the network the subject of the access seeker's request;
 - (b) the number of Gtks moved on the network;
 - (c) the total revenue the access provider receives for the network;
 - (d) the total revenue generated from access currently granted on the network; and
 - (e) the access rate charged to ASR per '000 Gtks for the different train services on the network.
- 8.3 Pacific National submits that there is nothing inherently confidential about this information. In the absence of such information the ESC is unable to reliably verify whether the operator is discriminating between its own above rail operator and third party access seekers, or whether the operator's prices are calculated in accordance with the pricing principles made under the Access Regime.
- 8.4 Pacific National considers that it would be sufficient for the operator to provide this information to the ESC on a half yearly basis.

5. The Information Kit

Issues 9 and 10

9. **Are there any issue concerning the procedural matters identified above that the Commission should consider describing? What additional matters should the Commission consider for inclusion in the Information Kit?**
- 9.1 Pacific National agrees with the ESC's proposal at p 17 of the Issues Paper as to the additional matters to be addressed in the Information Kit. In particular, Pacific National thinks it would very valuable if the Information Kit set out in some detail the information which the ESC considers should be included in an access proposal. Providing access seekers with specific guidelines as to the information an operator needs to evaluate and respond to an access application, should decrease the time it takes for an operator to evaluate an access seeker's application.

6. Further Issues

10. Access to Other Rail Infrastructure

- 10.1 The Access Regime at present is silent as to the terms and conditions, including price, upon which an operator must offer an access seeker access to other rail infrastructure which is not subject to the Access Regime but access to which is required in order to provide a competitive above rail service. In this situation, there is the capacity for a bottleneck to arise, as has occurred in the other jurisdictions. The Access Regime would be enhanced by the inclusion of an expeditious means by which, on a case by case basis, where such necessity could be demonstrated, of extending obligations on the access provider to provide compulsory access to specified other rail infrastructure. In the event that charges for use of connecting infrastructure are not agreed by negotiation, an access dispute would arise for resolution under the ROA Act.