APPLICATION FOR CERTIFICATION
OF THE NSW RAIL ACCESS REGIME

RECOMMENDATION

MARCH 1999

National Competition Council
OVERVIEW

On 12 June 1997, the National Competition Council (the Council) received an application from the NSW Government (NSW) to consider the effectiveness of the NSW Rail Access Regime (the Regime). It comprises the NSW Rail Access Regime operating in conjunction with the Commercial Arbitration Act 1984 (NSW), Transport Administration Act 1988 (NSW), Rail Safety Act 1993 (NSW), State Owned Corporations Act 1989 (NSW) and Independent Pricing and Regulatory Tribunal Act 1992 (NSW).

The Regime has the objective of facilitating third party access to the NSW Rail Network. It utilises a Baumol floor/ceiling cost approach to define the band within which prices can be negotiated. It also includes some specific arrangements for coal access. Coal will revert to the general pricing approach after 1 July 2000.

The Council adopted a public consultation process and immediately made available an Issues Paper seeking submissions by 10 July 1997. After a substantial period of negotiation with NSW on appropriate changes to the Regime, the Council issued its draft recommendation in April 1998. In it the Council advised that it should be able to recommend certification of the Regime if the remaining concerns were addressed. NSW submitted an amended Regime for the Council’s consideration on 16 October 1998. After further amendments, the Council issued a circular on 2 November 1998 to all parties that had registered an interest, outlining its remaining concerns.

NSW is required, by its Transport Administration Act, to subject substantial changes to its Regime to public comment. NSW completed its public process and gazetted the resulting Regime (Attachment 2) on 19 February 1999. This Regime was provided to the Council for its final consideration on the same day. The Council considers that this Regime meets all the Competition Principles Agreement (CPA) criteria.

The Council had been concerned that some access elements and groups of consumers were not directly covered by arbitration processes in the original Regime. The Council considers that all elements necessary for effective access are now covered by robust dispute resolution processes. Additionally, these processes are now open to a broader range of service consumers – they are now available to substantial freight haulage consumers, such as coal miners, as well as to rail operators.

The Council had been concerned that the original Regime determined the capital cost calculations without independent expert scrutiny. The Council’s concerns were addressed when it was agreed that the Independent Pricing and Regulatory Tribunal (IPART) would conduct a public review of the cost principles embedded in the Regime, in accordance with terms of reference agreed with the Council. The Regime was amended so that it automatically adopted IPART’s final recommendations. The Council has reviewed IPART’s draft recommendations, together with its public process, and considers that its final recommendations will draw on its own expert considerations as well as those of consultants representing the various interested parties. Given the robustness of the process and the expertise exhibited by IPART in past reviews of similar matters, the Council considers it unnecessary that it vet IPART’s final recommendations to determine the effectiveness of the Regime.

The Council had concerns regarding claims that charges for accreditation services reflected inefficient practices and inequitable cost allocations. These concerns were addressed by an IPART review of safety accreditation practices and costs, in accordance with terms of reference agreed with the Council. The NSW Government subsequently committed to automatically adopt IPART’s
recommendations. IPART delivered its final report early in March 1999 and its recommendations will be adopted by the end of June 1999.

The Council had been concerned that train operators would not be able to recover (some) value for prepurchased timepaths that they could not ultimately use. NSW proposed the development of a Capacity Transfer Policy to govern the RAC’s conduct in this area. A draft Capacity Transfer Policy was developed and the consultation period determined and commenced. In the meantime, the NSW Government confirmed that timepath disputes would be treated as an access issue and so be resolved by the Regime’s nominated arbitrator, IPART. As a consequence, the Council does not regard the completion of this policy as a necessary condition for effectiveness at this time.

The Council had been concerned that the nationally agreed mutual recognition arrangements were not working effectively in NSW, potentially imposing a barrier to interstate train operators. The Council considered that NSW should review and reform its practices regarding these arrangements as appropriate. Draft terms of reference and a reporting timeframe were agreed. This review is yet to be completed. While this review is internal and adoption of its recommendations is not guaranteed, the Council’s concerns were alleviated by changes in legislation that allowed the Administrative Decisions Tribunal to test the merits of accreditation decisions rather than requiring such disputes to be resolved through a more costly process in the NSW Supreme Court. As a consequence, the Council assesses that these arrangements no longer cause the Regime to be ineffective. Nonetheless, possible national developments, including a national review of mutual recognition arrangements or the full implementation of national access arrangements, may mean that reforms are necessary to maintain the Regime’s effectiveness.

The Council has recommended a relatively short duration for certification: from the date of certification until 31 December 2000. The prime reason for this short period is that the development of a national rail access regime may significantly increase the influence of NSW rail infrastructure beyond the borders of NSW, making the NSW Rail Access Regime ineffective. This short certification period is also likely to provide the Council with the opportunity to generally test its conclusions, in light of the working experience of the Regime.
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NSW RAIL ACCESS REGIME

STATEMENT OF REASONS FOR THE NATIONAL COMPETITION COUNCIL’S RECOMMENDATION UNDER SECTION 44M OF THE TRADE PRACTICES ACT

1. BACKGROUND

Section 44M of the Trade Practices Act 1974 (TPA) provides for the National Competition Council (the Council) to make a recommendation to the relevant Minister on the effectiveness of an access regime established by a State or Territory Government. The Council must recommend to the Minister that the regime is either effective or not effective.

In making its recommendation, the Council must apply the relevant principles set out in the Competition Principles Agreement (CPA) and must not consider any other matters. These principles are set out in Clauses 6(2) to 6(4) of the CPA. The Council must also recommend the period that certification should be in force.

On 12 June 1997, the Council received an application from the NSW Government (NSW) to consider the effectiveness of the NSW Rail Access Regime (the Regime). It comprised the NSW Rail Access Regime, Commercial Arbitration Act 1984 (NSW), Transport Administration Act 1988 (NSW), Rail Safety Act 1993 (NSW), State Owned Corporations Act 1989 (NSW) and Independent Pricing and Regulatory Tribunal Act 1992 (NSW).

The Process

The Council adopted a public consultation process and immediately made available an Issues Paper seeking submissions by 10 July 1997. Five submissions were received and made publicly available. The Council noted that submissions to previous applications for declaration of RAC services would also be considered.

The Council engaged a pricing consultant, Dr David Cousins of KPMG, to provide advice on the Regime's pricing principles. Dr Cousins’ brief was to assess the pricing principles in concept, interpretation and practicality. Dr Cousins’ report was made publicly available and comments were subsequently received from the NSW Minerals Council and Easton Business Consultants. The Council sought permission to treat these comments as submissions to the certification application, taking submissions received to seven.

After NSW provided a series of proposals to change the Regime, the Council published a draft recommendation in April 1998. This draft asked for comments on the Council’s view that if the changes proposed by NSW were made, together with the additional changes outlined in the draft recommendation, the Council should recommend certification of the Regime.

The Council received four submissions to its draft recommendation. These were made publicly available and took the total number of submissions to this process to eleven.

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1 The Minister for Financial Services and Regulation is currently the relevant Minister. He was invited to assist the Treasurer with competition policy matters on 9 December 1998.

2 These were applications for rail services on the Sydney to Broken Hill and Hunter Lines.
NSW submitted an amended Regime for the Council’s consideration on 16 October 1998. Not all the changes outlined in the draft recommendation had been made. After agreement on further amendments, the Council issued a Circular on 2 November 1998 outlining its concerns including issues related to the Regime’s treatment of capital cost calculations, accreditation and timepath allocations.

NSW is required by Section 19B(b) of its Transport Administration Act to subject substantial changes to its Regime to public comment. NSW advertised its process on 16 December 1998, calling for submissions by 22 January 1999. NSW completed its process and gazetted the resulting Regime (Attachment 2) on 19 February 1999. This Regime was provided to the Council for its final consideration on the same day.

2. COMPLIANCE WITH CLAUSES 6(2) - 6(4) OF THE CPA
The Council considers that the Regime gazetted in the NSW Government Gazette on 19 February 1999 meets all the CPA criteria and can therefore be recommended for certification.

The following sections assess the Regime against each criterion contained in Clauses 6(2) to 6(4) of the CPA.

CLAUSE 6(2) - Compatibility with National Regime
The regime to be established by Commonwealth legislation is not intended to cover a service provided by means of a facility where the State or Territory Party in whose jurisdiction the facility is situated has in place an access regime which covers the facility and conforms to the principles set out in this clause unless:
(a) the Council determines that the regime is ineffective having regard to the influence of the facility beyond the jurisdictional boundary of the State or Territory; or
(b) substantial difficulties arise from the facility being situated in more than one jurisdiction.

To meet criteria Clause 6(2)(a) and (b) the Council must have confidence that the Regime meshes with proposed national arrangements to facilitate access across State and Territory boundaries.

The Commonwealth, States and Territories agreed to national arrangements to cover interstate rail operations. NSW pointed to these developments as evidence of the Regime’s compliance with this criterion:

On 14 November 1997 the Australian Transport Ministers entered into an agreement that will establish a corporation known as the Australian Rail Track Corporation (ARTC) from 1 July 1998, to provide a new and more commercially viable system of interstate rail infrastructure and access arrangements. It is proposed that ARTC be the sole provider of interstate rail access rights in Australia. To effect this it is proposed that existing relevant access rights, “paths for interstate trains”, provided by Rail Access Corporation (RAC) and other rail track owners be transferred to ARTC ...

The Agreement sets out that the functions of ARTC will be, inter alia, to provide access for interstate operations by accredited rail operators to track it manages and other track through agreements with track owners such as RAC.
NSW, through RAC, has agreed to make available to ARTC, from 1 July 1998 additional train paths through the Sydney Metropolitan network representing a 5% increase in freight paths currently used and an additional 5% by July 1999. ARTC may also negotiate with RAC for further train paths beyond this 10% increase in capacity.

Insofar as the relationship and consistency between ARTC and NSW and the Regime the following points will ensure that the two systems will co-exist:

(a) As a practical matter, “interstate” and “intrastate” trains share rail tracks in NSW, due to NSW having standard gauge (1435mm) track. Use of tracks by intrastate trains will impact on interstate access opportunities and vice versa. Accordingly, as a practical matter and from a regulatory and market participant’s perspective it will not be sensible to establish completely separate or inconsistent access regimes for interstate and intrastate rail in NSW;

(b) NSW has already indicated that it has no objection to making the necessary amendments to legislation to expand the definition of “rail operator” [to ensure direct negotiations can occur between RAC and substantial customers who do not operate trains, such as ARTC] … Once such an amendment and consequential amendments are enacted, there will be no impediment to RAC entering into contracts to provide access rights to ARTC. Clearly all negotiations and agreements between RAC and ARTC will be consistent with the Regime;

(c) the ARTC Agreement envisages a mechanism whereby existing interstate contracts (where RAC will continue to manage its interstate track) are proposed to be novated (this can only occur with the agreement of the rail operator) and new access contracts will be negotiated on commercial terms. Where an existing access contract is novated RAC is to receive from ARTC a sum equivalent to the revenue that it would have received from the rail operator under the terms of that existing contract. Such moneys are to be paid by the ARTC;

(d) ARTC proposes to enter into access contracts with rail operators and complementary contracts with RAC for the supply of train paths of a specific quality and related services and for payment of the services. These contracts will include incentives for reduced track costs and increased system capacity and business growth;

(e) ARTC will negotiate agreements and operating protocols with RAC, track owners and operators for the purpose of providing seamless access and operations;

(f) the ARTC Agreement provides that a formal basis for access arrangements and pricing will be pursuant to an access undertaking lodged with the Australian Competition and Consumer Commission (ACCC) as soon as practicable. ARTC will consult with RAC and all track owners in preparing the undertaking which can be lodged jointly with other track owners.

Although the terms and conditions of the access undertaking to be lodged with the ACCC have not yet been formulated, it appears to NSW that there is likely to be little conflict between the aims, functions and access arrangements between ARTC and rail operators and those of RAC and rail operators.³

In its draft, the Council noted the advances made with regard to the establishment of the national arrangements. However, these arrangements are only in their early stages of development and implementation is still to be fully defined.

The Regime harmonises with the National Regime as it presently stands. However, there is insufficient evidence to assure the Council that this will still be the case when the National Regime is fully developed. The Council has taken this factor into account when considering the duration of certification (see Section 3 below).

**CLAUSE 6(3) - Apply to monopoly services**

For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:
   (i) it would not be economically feasible to duplicate the facility;
   (ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and
   (iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

(b) incorporate the principles referred to in subclause (4).

Clause 6(3) sets out the types of infrastructure services that may be covered by an effective State or Territory access regime. While the threshold tests for certification contained in Clause 6(3)(a) differ from the declaration criteria under section 44H(4) of the TPA, there are broad similarities. Accordingly the Council expects that both Part IIIA and effective access regimes will focus on natural monopoly services.

6(3)(a) - Significant infrastructure facilities

The services covered by an effective access regime should be provided by significant infrastructure facilities. The term ‘significant’ may be compared with the ‘national significance’ criterion used in assessing applications for declaration. Section 44H(4) relates ‘national significance’ to size, importance to constitutional trade or commerce or importance to the national economy. The Council believes it is appropriate to relate the term ‘significant’ to similar contexts but with a more state or regional focus.

The Regime covers terms and conditions of access to the NSW Rail Network including railway lines and associated infrastructure as detailed in Schedule 1 of the Regime.

The Council notes that access revenues totalled $531m in 1996-97. In the same year, the written down replacement cost value of RAC assets (community service and commercial) totalled $6b\(^4\). The NSW Rail Network carries a high proportion of commuters within the major urban areas of NSW each working day. It also carries high volumes of goods and commodities to both domestic and export markets. In 1996-97 these included 57 m.tonnes of coal and 7.8 m.tonnes of grain\(^5\).

The quantity of revenue obtained for the services covered by the Regime, the value of the assets used to generate such revenue and the importance to domestic and international trade of the cargoes carried, satisfies the Council that the services provided by the NSW Rail Network meet this criterion.

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\(^{5}\) FreightCorp Annual Report, 1996-97.
6(3)(a)(i) - Not economically feasible to duplicate the facility
The Council considers that this criterion should be considered from a social\(^6\) rather than private\(^7\) perspective and is intended to capture services provided by natural monopoly facilities. Such facilities are characteristically not economically feasible to duplicate. They constitute assets that are specific to the service and not readily redeployed to another use. Their minimum efficient scale of entry provides a capacity in excess of initial market demand – allowing unit costs to fall as market demand increases and mitigating competitive new entry.

NSW concluded in its application that the State Network was not economically feasible to duplicate. The Council concluded in its recommendations to declare the Sydney to Broken Hill and the Hunter Lines, that these separate parts of the NSW Rail Network had natural monopoly characteristics and that it would be uneconomic to develop another facility to provide these services. For instance, in National Rail’s submission to the Minerals Council’s application to declare the Hunter Line, consultants Sinclair Knight Metz noted that RAC could increase capacity sufficient to meet foreseeable demand more quickly and at lower cost than a new entrant\(^8\).

Many of the network’s lines operate under capacity and do not recover their costs. Although NSW pays substantial subsidies to RAC to cover unprofitable services, RAC’s 1996-97 Annual Report indicates that without revenues from coal freight usage, it would have incurred losses.

Given the lack of viability of a range of network services and the evidence that RAC can add capacity to the Hunter Line substantially below new entry costs, the Council concluded that the network would not be economically feasible to duplicate.

The NSW Rail Network meets this criterion.

6(3)(a)(ii) - Access necessary for competition in another market
In its recommendations to declare the Sydney to Broken Hill and the Hunter Lines, the Council concluded that access to rail line services was necessary for the delivery of downstream rail freight services and that competition in this market would be promoted if these services were declared. While road transport can be an effective substitute for a range of rail freight services, for many bulk commodities and goods being transported over long distances, there is no economic substitute for rail freight.

The services provided by the NSW Rail Network meet this criterion.

6(3)(a)(iii) - Safe use of the facility is ensured
In its application for certification of the Regime, NSW stated that:

The safe use of the facilities by rail operators seeking access can be ensured at an economically feasible cost. Appropriate regulatory arrangements exist under the Rail Safety Act 1983 (NSW) which requires rail operators and owners of railways (such as the Rail

\(^{6}\) It is socially economical to develop another facility if the economy-wide benefits outweigh the economy-wide costs. A social test considers the interests of the whole community, that is, all the costs and benefits to the community.

\(^{7}\) It is privately economical to develop another facility if the benefits outweigh the costs from the perspective of the person making the investment decision. That is, there need not be a net benefit to Australia overall from a decision made from a private perspective.

\(^{8}\) Sinclair Knight Metz Advice (Appendix to National Rail Submission), p.4.
Access Corporation) to be accredited by the Director General of the NSW Department of Transport.

In this and previous applications relating to the NSW Rail Network, interested parties expressed concerns that the NSW safety requirements could be used as a barrier to entry\(^9\). NR and SCT related such concerns to the costs of NSW accreditation arrangements and the cumulative costs of needing to gain accreditation in each State\(^{10}\). These costs are said to accrue in spite of an Intergovernmental Agreement, incorporating principles of mutual recognition across jurisdictions.

The Council discussed these issues with NSW. It proposed the changes to the Regime discussed below in Section 6(4)(a)-(c) - 1 Safety requirements.

**The Council concluded that the Regime would meet this criterion, if provisions for addressing the concerns raised below under 6(4)(a)-(c)- 1 Safety requirements, were made. As provisions to address these issues have now been made, the Council concludes that the Regime meets this criterion.**

6(3)(b) - the Regime must incorporate the 6(4) principles

Clause 6(3)(b) requires that a State or Territory access regime must incorporate the principles outlined in Clause 6(4) (a)-(p) before it can be recommended for certification. The following sections assess the Regime against each of these principles.

**CLAUSE 6(4)(a)-(c)**

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

The Council considers these three clauses together since they establish a framework in which access negotiations can take place. Clause 6(4)(a) implies a preference for negotiated outcomes. Clauses 6(4)(b) and (c) indicate that effective regimes should establish a right to negotiate access and a process to enforce the negotiated outcome. The Council considers that access to rail line services requires negotiation of a number of components. These include:

1. safety requirements;
2. a suitable timepath;
3. agreement on price including arrangements for any necessary new investment;
4. agreement on more general terms and conditions; and
5. resolution of disputes (issues of dispute resolution relating to safety and timepaths are discussed below as part of Sections 1. Safety requirements and 2. Timepaths. Arbitration on prices and other access conditions is discussed under Criteria 6(4) (i)(j) and (l)).

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\(^{10}\) National Rail, Submission, p.5.
1 Safety requirements

National Regime
In April 1995 Commonwealth, State and Territory Transport Ministers endorsed an Intergovernmental Agreement (IGA) aimed at establishing a nationally consistent approach to rail safety regulation. It primarily involved an agreement to recognise the accreditation decisions of all signatory governments (mutual recognition) and thereby minimise the need to duplicate accreditation procedures across states. Reportedly a number of governments, including NSW, required additional procedures that had the effect of undermining the intent of the agreement. This increased the costs of safety management to rail operators and constrained their access to track services.

NSW initially undertook to:

[ensure] that the Department of Transport give effect, as far as is legally possible, to accreditation to rail operators in other states of Australia; and
...review ... the issue of mutual recognition and particularly the question of its adequacy without the necessity for underpinning legislation.

NSW subsequently undertook to review its approaches to mutual recognition in the next five year review, to be conducted by the Department of Transport, required by Section 103 of its Rail Safety Act. NSW has now provided the Council with the draft terms of reference for this review, which commits it to:

...bring together 2 major evaluation tasks to achieve rail safety improvement, namely, the required statutory review of the Rail Safety Act 1993 and consideration of national issues associated with mutual recognition of safety accreditation and uniformity improvements.

The Department of Transport has undertaken to take the views of the Council, among others, into account and to report to its Director-General by 31 July 1999.

While the Council would have preferred greater advancement through this process, it notes that accreditation decisions can now be reviewed by the Administrative Decisions Tribunal (see below), alleviating its concerns about scrutiny of the regime’s treatment of mutual recognition of accreditation.

The Regime adequately addresses this issue.

Simpler dispute resolution mechanism
Section 44(1) of the NSW Rail Safety Act stated that the NSW Supreme Court will handle appeals on the Regulator’s accreditation decisions. The Council asked NSW to consider the establishment of a less costly mechanism. NSW proposed:

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11 Submissions to the applications for declaration of NSW rail line services from Sydney to Broken Hill and to the Hunter Line, as well as submissions to the House of Representatives, Standing Committee on Communications, Transport and Microeconomic Reform (July 1998) generally raised this as a substantial issue.
Under the Administrative Decisions Legislation Amendment Act 1997, which was passed by the NSW Parliament in June 1997, s.44 of the Rail Safety Act 1993 was amended to provide for a person aggrieved by a decision of the Director General or an authorised agent under Division 3 or 4 to apply to the Administrative Decisions Tribunal (ADT) for review of the decision. The ADT is an administrative review body similar to the Commonwealth Administrative Appeals Tribunal.15

NSW confirmed that these amendments resulted in ADT coverage of all accreditation decisions.

Commencement of the ADT’s operations was delayed16. NSW later confirmed that the right of appeal transferred from the Federal Court to the Administrative Decisions Tribunal on 1 January 199917. The ADT has been able to review accreditation decisions since that date.

The Regime adequately addresses this issue.

Review of safety regulation processes and fees
Regulators are under few pressures to provide services at least cost – inefficient practices and cross subsidies can emerge. Fees for NSW safety regulation services are set in compliance with Section 47 of the Rail Safety Act and the fee schedule gazetted on 27 December 1996. Industry discussions raised concerns over service charges and the way costs are allocated across rail operators18.

The draft recommendation considered there was a need to independently review the relevant processes and fees. NSW referred the matter to IPART on 31 August 1998. IPART reported its findings on 12 March 1999.

IPART concluded that:

… most of the functions carried out by the TSB [Transport Safety Bureau] are necessary to ensure the continuing safe operations of the rail industry. However, a move to a national accreditation regime would reduce the overall costs of safety accreditation for all participants seeking entry or already operating within the industry.

The Tribunal believes that the majority of benefits of the safety accreditation process are enjoyed by the rail industry or individual rail participants. Indeed the benefits received far outweigh the costs of regulation and therefore full cost recovery is justified for many of the functions of the TSB.19

IPART concluded that public funding of the accident investigation process should be considered to ensure its independence. It also considered that the current processes required duplication of some activities by TSB and operators. For instance the maintenance of detailed records on all rolling stock and employees. IPART outlined a more limited role for TSB and recommended that it not recover the costs of these duplications.

17 NSW Cabinet Office letter 19 February 1999.
18 Confidential sources quoted amounts approximating $500,000 per annum for large consumers of rail track.
IPART noted that the method used by TSB to recover its costs was inefficient. However, it also noted that this was a problem common to all Australian States. It therefore recommended a charging mechanism suitable for use by all States under a national safety regime:

The primary purpose of the TSB is to minimise the risk of adverse accidents and incidents from occurring. A risk based charging mechanism would appear to be the most closely aligned with the regulatory objectives of the TSB. The Tribunal has suggested that an acceptable risk based charging methodology could be based on the national categories for the reporting of incident and accidents and a broad risk categorisation of rail corridors. This charging methodology should be relatively simple to implement as it is based on statistics available within the industry and should promote positive safety outcomes.\textsuperscript{20}

IPART concluded that gains from implementing changes in only NSW would be minimal and therefore recommended that:

… reform of the NSW charging mechanism be conditional on acceptance of the recommended approach as a national system. In the interim, the Tribunal has recommended that the existing NSW charging regime remain in place.\textsuperscript{21}

NSW committed to adopt IPART’s recommendations on the efficiency of safety regulation practices and fees charged within 3 months of receiving IPART’s report. While IPART recommended no change on the approach to charges until its recommendations were adopted nationally, NSW is committed to effect its recommendations on efficiency and cost recovery of some specified practices within 3 months of receiving IPART’s report.

The Regime adequately addresses this issue.

2 Timepaths

Master timetable

Customers argued in previous NSW declaration processes that timepath allocations were neither transparent nor equitable. The draft recommendation indicated that RAC would develop a timetable protocol and make its master timetable publicly available. The Council now understands that RAC provides access seekers with that part of its master timetable considered relevant.

NSW subsequently advised that the Regime requires RAC to provide information on train control and time-tabling procedures (Schedule 5(vi)) sufficient to ensure equity and transparency\textsuperscript{22}. On the understanding that the Regime’s arbitration processes cover timepath allocations, the Council has concluded that this approach is adequate.

The Regime adequately addresses this issue.

Trading timepaths

The timepath originally allocated to a customer may ultimately prove unsuitable. The freight may be cancelled or its carriage postponed. Customers need a mechanism that introduces flexibility into timepath allocation. This issue is likely to become more important as the number of rail operators and the volume of traffic increases.

\textsuperscript{20} ibid., p.ii.
\textsuperscript{21} ibid.
\textsuperscript{22} NSW Cabinet Office letter 10 September 1998.
NSW initially proposed that it develop a Capacity Transfer Policy over a three month period with input from the NCC, RAC and IPART\textsuperscript{23}.

It suggested that this policy take into account the following guidelines:

\begin{enumerate}[(a)]
\item that the aim of such a policy is the optimum efficient utilisation of the NSW Rail Network by rail operators;
\item that RAC have the power, where appropriate, to ensure that a rail operator does not retain the right to use timepaths that are not being utilised in circumstances when they can be allocated to another rail operator;
\item where a rail operator is not utilising capacity and surrenders the unutilised capacity, and the access fees payable to RAC are not based on usage of the NSW Rail Network, it may be necessary to adjust the access fees; and
\item where a rail operator seeks access to capacity that is already utilised by another rail operator, RAC will approach the other rail operator to seek to negotiate an amendment to its agreement so as to facilitate the rail operations of the prospective rail operator.
\end{enumerate}

The Council asked if a substantial consumer could be added to this group. NSW proposed that it provide the Council with a draft Capacity Transfer Policy and later outlined a process that would allow input from substantial consumers:

\begin{enumerate}[(a)]
\item the comments of the Council will be sought on the advanced draft of the policy;
\item the advanced draft will be provided to major access seekers and end users for comment. This will be followed by meetings between Government representatives and the interested parties;
\item the assistance of IPART will be sought in finalising the policy.
\end{enumerate}

\textit{Once the Capacity Transfer policy has been finalised, the RAC is required to give notice of the policy by publishing it in newspapers and the Government Gazette\textsuperscript{24}.}

Section 7.2 of the Regime now requires RAC to give Public Notice of its Capacity Transfer Policy to interested parties. Section 2.3 restricts access to only those access seekers (excluding ARTC) that in RAC’s opinion do not intend to trade access rights. When the Council asked NSW to explain how Sections 7.2 and 2.3 could be consistent NSW stated:

\textit{There is no inconsistency between the policy and clause 2.3 of the Regime, which states that RAC will only permit access where access is not intended for the purpose of trading in access rights. This is because the draft Capacity Transfer Policy provides that all transfers will occur through the RAC as conduit\textsuperscript{25}.}

The detail of the draft Capacity Transfer Policy was provided to the Council on 15 March 1999. The policy has the objective:

\begin{quote}
…to facilitate the optimum efficient utilisation of the NSW Rail Network by rail operators through the establishment of effective mechanisms for the transfer of access rights between operators.
\end{quote}

\textsuperscript{23} NSW Cabinet Office letter 10 November 1997.
\textsuperscript{24} NSW Cabinet Office letter 16 October 1998.
\textsuperscript{25} ibid.
It provides two options for customers to change timepaths – relinquishment to RAC or transfer to another operator. NSW has undertaken to conclude the public consultation process by the end of May 1999 and submit the final policy to the RAC board meeting scheduled for 29 June 1999. While the draft policy marks a significant development, implementation is still far from complete. However, the Council is reassured by NSW’s confirmation that timepath disputes will be arbitrated by IPART.

**The Regime adequately addresses this issue.**

### 3 Negotiations for new investment

The Regime submitted in June 1997 gave no guidance to negotiations on access requiring new investment. This element of access was covered by the IPART Act indicating that arbitration rather than negotiation would deal with new investment.

NSW proposed to include the following in its Regime to address this issue:

*The Corporation shall negotiate in good faith with existing or prospective Rail Operators in relation to New Investment on condition that:*

(a) such New Investment is technically and economically feasible and consistent with the safe and reliable operation of the NSW Rail Network;
(b) the Corporation’s legitimate business interests in the NSW Rail Network are protected;
(c) the terms of Access for the existing or prospective Rail Operator take into account the costs borne by the Corporation and the existing or prospective Rail Operator for the New Investment and the economic benefits to the Corporation and the existing or prospective Rail Operator resulting from the New Investment; and
(d) the New Investment complies with the Regime. ²⁶

Section 3.6 of the Regime broadly adopts this proposal although it changes “existing or prospective Rail Operators” to the more general term of “Access Seekers” and omits (d). The Minerals Council noted this omission as a cause for concern ²⁷. In its draft recommendation, the Council indicated that (d) imposed a relationship between new investment and the maximum rate of return stipulated in the Regime ²⁸.

The Regime’s capital cost approaches are to be amended to reflect IPART’s final recommendations. These will cover applicable rates of return, asset and depreciation methodologies across new and old investments. In its draft report, IPART recommended a rate of return on assets of 7.5 per cent (real pre tax) ²⁹. Its draft also recommended that this rate be applied to an asset valuation calculated on a depreciated optimised replacement cost (DORC) basis, adjusted each five years to reflect changes in value and new investments (tested for prudence).

In the interim period, new investments would be taken into account through a rolling forward process to take asset values forward from one year to the next:

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²⁶ NSW Cabinet Office letter 10 November 1997.
²⁷ NSW Minerals Council submission to the NSW Government’s public process relating to the amendment of the NSW Rail Access Regime, 11 February, p.26.
²⁸ NCC, Application for Certification of the NSW Rail Access Regime, Draft Recommendation, April 1988, p.11.
the process for rolling forward the asset base used for RAC’s access pricing from year one to year two involves:

1 using the final DORC asset value for year 1 as the starting point;
2 indexing of the final asset value for year 1 by the actual Sydney CPI for year 1;
3 adding expected RAC funded capital expenditure made during year 2 (assumed operational at the middle of each financial year);
4 subtracting a depreciation charge;
5 establishing a final DORC asset value for year 2.

The Regime adequately addresses this issue.

4 Terms and Conditions

4(a) Prices

The Council engaged a consultant, Dr David Cousins of KPMG, to assist in its assessment of the Regime’s pricing principles. The Council used Dr Cousins’ report, the advice of other academics, IPART’s draft report on capital costs and information from the submissions of interested parties (to this and previous related matters) in its assessment.

Pricing matters were divided into:

i) approach “in principle”;
ii) constraints on price negotiation; and
iii) the appropriateness of components used to calculate prices.

i) Approach “in principle”

The Regime uses a “Baumol floor/ceiling cost band” approach to define the price parameters within which RAC may offer access. RAC has stated in various fora that it uses Ramsey pricing, based on its estimates of a consumer's likely change in consumption as prices rise, to strike differential prices within this band across customers.

Baumol band

The Minerals Council argues against the Baumol band approach on issues of practicality. It argues that with the numbers of services delivered and the variations in volumes carried on each line over time, RAC could not practically continually recalculate the sets of prices that would meet (and not exceed or fall short of) the floor, ceiling and combinatorial tests.

In its draft Report, IPART notes that:

In theory, the number of combinations is large. However, the plausible number of combinations likely to breach the ceiling test is far lower as:

ibid., p.34.

In 1997/98 the ceiling price including the maximum rate of return was only paid by mines using 11 rail loading loops in the ‘central’ Hunter Valley.

RAC charges the same (pre-cusp) access price to mines which load from the same rail loading loop.

All central Hunter Valley coal traffic travels up to 153km in one direction, east to the port.32

On the basis of his examination of RAC applications of the band approach, Dr Cousins concluded that, while the RAC did not apply the combinatorial floor and ceiling tests exactly, it did apply the principles with sufficient rigour to deliver efficient outcomes33.

**Box 1 - Description of Baumol band approach**

The ‘floor/ceiling’ approach to pricing regulation is associated with the work of Professor William Baumol. It sets a band within which prices can be negotiated. Prices can not fall below or rise above this band. This approach has two overarching purposes:

- the ceiling is based on stand alone costs and aims to prevent the regulated firm extracting monopoly profits; and
- the floor is based on avoidable costs and aims to ensure that prices are not set so low that some rail operators do not pay for the costs of the services they use.

The floor/ceiling approach reflects the boundaries of pricing which would exist if the market was open to competition and so provides an economically defensible method of price regulation.

The stand alone cost test encompasses the situation where a single service is provided to a rail operator or rail operators and also the situation where a group of services are provided. In this case, the ‘combinatorial’ stand alone cost test is that the revenue from a group of operators cannot exceed the economic cost of the services provided to them if they were provided by a separate facility. Therefore, where there are multiple users of a line section or group of line sections, it will be impossible to charge all operators the stand alone costs of their individual operations and still pass the combinatorial test.

Source: Dr D Cousins, Report on the pricing principles contained in the NSW Rail Access Regime, September, 1997, p. 32.

**Ramsey Pricing**

The Minerals Council argues that the Baumol band approach encourages Ramsey or differential pricing which, while theoretically sound, is impractical to implement due to its reliance on information that is difficult to collect and accurately translate into predictions of a customer’s change in demand34.

Ramsey pricing is used when pricing in line with competitive market outcomes would not fully recover the costs of supplying the output. Natural monopoly services, with high fixed costs, low operating costs and initial low demand, are often in this category. Ramsey pricing recovers the highest proportion of fixed costs from those customers least likely to reduce consumption as prices rise.

33 Dr D Cousins, Report on the pricing principles contained in the NSW Rail Access Regime, 1997, p.50.
Efficient Ramsey pricing requires accurate predictions of who these customers are. Otherwise consumption can fall more than predicted, lowering cost recovery. In the NSW Rail context, a group of coal miners are required to pay the highest proportion of fixed costs.

The Minerals Council argues that predictions of changes in consumption are never accurate. Therefore, a Ramsey pricing approach results in high efficiency losses due to higher than predicted reductions in consumption.

The magnitude of price differences across coal mines can be as large as the differences between prices reflecting ceiling costs plus an adjustment component\(^{35}\) and prices reflecting only floor costs. Dr Easton\(^{36}\) and Associate Professor Trace\(^{37}\) argue that Ramsey pricing across common good producers, such as coal miners, would change relative competitiveness in the final market.

The Minerals Council propose that prices be based on a fully distributed costs (FDC) approach\(^{38}\) (results in similar prices to customers of a common service). In support of its argument it used modelling work by ACIL. This concluded that adoption of a FDC approach would incur fewer efficiency losses than those incurred by inaccurately predicted Ramsey prices. Dr Cousins stated in his report that although more transparent and less costly to implement, FDC pricing did not guarantee efficient outcomes\(^{39}\).

The Council notes that Ramsey pricing can allow cost recovery while minimising efficiency losses in instances where competitive market pricing will not fully recover costs. However, it also notes that efficient Ramsey prices are difficult to predict and losses in efficiency will result from any inaccuracies. Differential pricing across producers of common goods will change their relative competitiveness in final markets either positively or negatively. Therefore, significant differential pricing could foster inefficiencies by favouring the expansion of higher cost producers.

The Council considers that the Baumol band approach provides considerable flexibility but minimal information to guide negotiation and arbitration. Ramsey Pricing offers an efficient approach to recover costs in instances, such as the provision of natural monopoly services, where competitive market pricing will fall short. The complex matters relating to Ramsey pricing will need to be taken into account in relevant arbitrations.

The following sections deal with the Baumol band approach and the Regime’s amendments to increase transparency.

Asymmetries of information
Competitive markets disclose information on prices in the course of their operations. Part IIIA aims to replicate these markets through regulatory mechanisms. Dr Cousins listed the information likely

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\(^{35}\) Mines operating on the hauls listed in Table 1, Schedule 3 of the Regime, have an adjustment component added to a ceiling price. Mines not operating on Table 1 hauls pay lower prices, some as low as their direct costs.

\(^{36}\) EW Easton, KPMG Report on pricing principles contained in the NSW Rail Access Regime, Submission, pp. 3-4.


\(^{39}\) Dr D Cousins, op.cit., pp. 30-31.
to improve the effectiveness of the Regime\textsuperscript{40}. The Council asked that the Regime oblige RAC to provide each access seeker with sufficient information to facilitate negotiation. Schedule 5 of the Regime lists the information now to be passed to access seekers. It appears to encompass the information recommended by Dr Cousins.

Negotiation will be assisted if both parties are fully aware of probable arbitration outcomes. Schedule 5 indicates that the information package will include all arbitration determinations. Section 6.3 requires the Arbitrator to publish all but confidential information pertinent to an arbitration decision. Section 6.4 gives the Arbitrator the discretion to publish information nominated as confidential by one of the parties, if it considers such publication is in the public interest.

Critical to relating cost information to charges are the definitions of cost terms used in the Regime. NSW asked IPART to define these terms in its cost review (IPART’s draft report recommendations are discussed below and in Attachment 1). The Regime will adopt the definitions recommended by IPART’s final report.

The information package includes RAC’s pricing policy published in September 1996. This pricing policy is now somewhat dated and it will need to incorporate IPART’s recommendations to regain relevancy.

Section 8.8 allows an access seeker to request further relevant information. Such requests are subject to arbitration.

**The Council considers that the relevance and adequacy of the information package will be maintained and refined by negotiation and arbitration over time.**

**Cost definitions**

The Minerals Council argues that the Regime contains no objectives that require the service provider and the Arbitrator to deliver prices consistent with efficient economic principles. Without such direction, the floor and ceiling cost parameters could be set using inefficient cost components. For instance, actual maintenance costs could be charged to customers. These may not be “best practice” following the NSW decision to delay the maintenance contestability program.

IPART’s draft report worked through the cost factors an Arbitrator, taking into account the 6(4) principles, would use to determine prices. Issues considered included:

- cost objectives and definitions;
- forecast versus historical costs;
- efficient versus actual costs;
- appropriate track segmentation; and
- appropriate asset valuation, rate of return and depreciation methodologies.\textsuperscript{41}

IPART recommended that all components of price in the Regime be based on forecast efficient costs. It recommended methodologies for calculating efficient capital costs and asked for proposals to establish forecast efficient cost indicators:

\textsuperscript{40} ibid., pp. 54-55.
\textsuperscript{41} IPART, op.cit., February 1999.
In the final report IPART intends to recommend a process for ensuring RAC access prices are based on forward looking (forecast) efficient costs. One option could be to recommend RAC demonstrate to train operators and end customers its commitment to reach efficient costs by regularly publishing performance indicators measuring:

Operating efficiency: demonstrating that the productivity of inputs utilised in providing track meets and is maintained at world’s best practice.

Technical efficiency: demonstrating that the optimal type and combination of inputs is utilised to provide a safe and ‘fit for purpose’ track at the lowest possible cost.

Train operators should also conduct their own examination of proposed access prices to ensure they are based on forward looking efficient costs as part of the negotiation process.42

The Council concludes that the lack of information provided by the Baumol band approach transfers considerable responsibility for transparency to other Regime components. The Council considers the changes to the Regime, particularly those that will evolve from IPART’s reviews and subsequent arbitrations, will considerably strengthen the cost/price information base currently provided.

ii) Constraints on price negotiation

Negotiation of coal prices
The Minerals Council argues there is an inconsistency between (ii)(a) of Schedule 3:

prices will be on an origin-destination specific haul basis, irrespective of the Access Seeker, and irrespective of the route of the haul basis;

and (ii)(d) and (e)1 which indicate all access prices, whether for hauls attracting an adjustment component or not, will be negotiable rather than prescribed. NSW advise that pricing on an origin-destination basis will be reviewed prior to 1 July 2000 when coal comes under the general pricing principles applying to all other freights43. The apparent conflict reflects the transition between these two stages.

Coal mines are required by legislation to use the Hunter Line, and so do not negotiate from a position of power. However, the Regime now defines access seekers to include coal miners (Schedule 7). This allows coal miners access to arbitration.

The Council considers the arbitrator will be in the best position to assist RAC through this transitionary period.

Adjustment Component
Section (ii)(f) of Schedule 3 requires Table 1 and 2 mines to pay an adjustment component equivalent to:

42 ibid., p.15.
(f) ... the amount by which the 1996-97 rail freight haulage revenue exceeded costs for that haul as a per tonne rate, such costs comprising:

1. the Access price for the haul calculated as in paragraph (ii)(c)1.; plus
2. the full economic costs of rail operations for the haul calculated as in paragraph (ii)(e)(1).

(g) The adjustment component will be adjusted to the following:

1. 50 per cent for 1998-1999
2. 25 per cent in 1999-2000.

It is noted that the cost terms will be redefined according to IPART’s final recommendations. The redefinition of “full economic costs” may result in an inadvertant change to the amount that previously represented the adjustment component.

The Council notes that the adjustment component is an indirect means of charging for the right to mine community coal resources. The Council has no wish to make a judgement on the appropriateness of a community resource charge. However, it does note the potential distortions of imposing it through rail prices on only some mines.

The Council has an ‘in principle’ concern at the inclusion of a monopoly rent in an effective Regime. NSW argued that it would be difficult to change its method of rent collection in the short term and noted that the rents would be phased out by 30 June 2000. After this date, coal prices will only reflect efficient costs.

The Council accepts the phased approach in the Regime, given that it is effected within a relatively short time and is now subject to IPART scrutiny.

iii) The appropriateness of components used to calculate general prices

The general pricing principles use a number of cost components to develop prices that apply to all freight, including coal. IPART has considered these components in its cost review. Its draft report indicates that its final recommendations will improve the alignment of cost components with CPA principles.

Specified maximum rate of return
The Regime maintains the maximum rate of return at 14 per cent (nominal post tax). Some coal miners pay at least this rate in their access prices. In its draft recommendation, IPART recommended a maximum of 7.5 per cent (pre tax), approximately equivalent to 6.2 per cent (nominal post tax)\(^44\).

Asset valuation
The Regime requires below rail assets to be valued on a current cost depreciated replacement basis. In its draft report, IPART recommended the adoption of depreciated optimised replacement cost (DORC) revised each five years. It also recommended that:

\(^{44}\) IPART, op.cit., February 1999, p.60.
… the DORC asset value should be determined by an independent consultant. A draft DORC valuation should be published which invites stakeholder comment which must be considered by the consultant prior to establishing a final value. In the interim, RAC should continue to utilise the TCI discounted replacement cost value.\textsuperscript{45}

Depreciation
IPART’s draft report recommended that:

... depreciation for existing assets should be calculated based on a depreciated optimised replacement cost (DORC) asset valuation, assuming a forty year remaining coal mine life (from 1999) and using a straight line method. Depreciation on future capital investment should be made based on remaining mine life at the time the asset becomes operational. The estimate of remaining mine life should be revised every five years.\textsuperscript{46}

It asked for further submissions on suggested approaches for the recovery of major periodic maintenance\textsuperscript{47}.

Operating Costs
The Council was concerned that as a monopoly supplier, RAC could have operating costs higher than those permitted in a competitive environment. NSW initially gave a commitment to improve the efficiency of a major part of operating costs, track maintenance costs, through a contestability program. However, it later advised that this program would be delayed.

In its draft report, IPART confirmed that it would recommend the use of efficient forward-looking costs in all areas of RAC pricing, including operating costs. Its asked for submissions on mechanisms that could act as indicators of efficient costs.

These issues will addressed by the adoption of the recommendations contained in IPART’s final report within sixty days of its provision to the Premier.

4(b) Other terms and conditions

Access only to rail operators
The original Regime covered only rail operators and not customers. For coal freight, FreightCorp (NSW's freight carrier) was then the only operator. If a coal miner wished to verify the rail track component embedded in its charges it needed to encourage FreightCorp to seek arbitration on its behalf. The Minerals Council advised that competition would increase if its members could negotiate access terms and conditions directly with the RAC and subsequently negotiate freight haulage with the rail operator of its choice. They could then access arbitration on any matters in dispute with regard to rail line access.

The definition of Access Seeker (Schedule 7) now covers customers with the capacity to manage rail operators. These would include coal miners and Australian Rail Track Corporation (ARTC).

\textsuperscript{45} ibid., p.34.
\textsuperscript{46} ibid., p.42
\textsuperscript{47} ibid.
The Regime adequately addresses this issue.

CLAUSE 6(4)(d) - Regime review
Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

The policy intent of clause 6(4)(d) is to provide for the periodic review of the need for the regime. For example, while a facility may currently be uneconomic to duplicate, this may change over time.

The Regime lodged in June 1977 did not meet clause 6(4)(d). Section 9 now addresses this issue.

The Regime meets this criterion.

CLAUSE 6(4)(e) - Accommodate access
The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

An access regime may either incorporate this clause explicitly or contain general provisions that have the same effect.

Section 7.1 of the Regime requires RAC to use all reasonable endeavours to accommodate access. Section 8.1 requires RAC to provide access seekers with specified information. Section 8.8 allows access seekers to request further relevant information. Such requests can be subjected to arbitration.

The definition of Access Seeker (Schedule 7), now covers rail operators, customers (such as coal miners) with the ability to manage a rail operator and ARTC. This opens up the negotiation and arbitration processes to these customers.

The Regime now adopts the recommendations of the IPART reviews on accreditation and capital costs. Timepath trading will be developed in line with the policy submitted to the Council. Timepath allocation and trading can now be subjected to arbitration.

The Regime meets this criterion.

CLAUSE 6(4)(f) - Access need not be on the same terms and conditions.
Access to a service for persons seeking access need not be on exactly the same terms and conditions.

This clause aims to remove any doubt that services can be provided on different terms and conditions.

Section 4.8 of the Regime states that an agreement need not contain the same terms and conditions as another agreement.

The Regime meets this criterion.
CLAUSE 6(4)(g) - Appoint and fund an independent arbitrator

Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

An effective access regime must ensure that an independent body is appointed to resolve disputes. The Regime nominates IPART as its sole arbitrator.

Constraining arbitration to one entity may not render a regime ineffective if the arbitrator is independent of the parties. Part 2, Section 7 of the IPART Act states that IPART is not subject to Ministerial control in making its determinations or recommendations.

This Act allows IPART to arbitrate itself or appoint one or more persons from a panel approved by the Minister (the Premier). The Council sought information on how this panel was established. NSW advised that:

> A panel of 11 persons was approved by the Acting Premier on 16 December 1996. The panel of persons was submitted to the Premier for approval by the Chairperson of the IPART following a selection process conducted by the IPART.

> To compile the panel the IPART called for expressions of interest from persons with suitable qualification and experience to be included on the panel. The Tribunal received 20 expressions of interest and a number of persons were interviewed with a result that 11 people were submitted to the Premier for approval. Two members of the IPART are included on the panel, the Chairperson Professor Parry and Mr James Cox a permanent full-time member.

> When compiling the panel for approval, the IPART sought to ensure that the panel was of a sufficient number to:
>  - maximise the range of expertise available for arbitrations;
>  - ensure objectivity given that Tribunal members had been closely involved in developing access regimes for gas and electricity and it would be inappropriate for those members to be involved in arbitrating disputes under those regimes;
>  - ensure that sufficient arbitrators would be available at any given time.

> Following approval of the panel, the Premier has no further involvement in the appointment of arbitrators to individual matters. The IPART has complete autonomy to appoint one or more persons from the approved panel to hear and determine a dispute.48

The Regime meets this criterion.

CLAUSE 6(4)(h) - Rights of appeal should be preserved.

The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

An access regime should have credible enforcement arrangements to ensure an arbitrator’s decision is binding. In addition, the regime should preserve existing legislative rights of appeal. This does not require the insertion of lengthy appeals' provisions into a State access regime. However, a regime may offend this clause if it precludes any right of appeal against the legality of the dispute resolution

body’s decision under judicial review (for example, on account of breaches of the rules of procedural fairness).

Section 24D of Part 4A of the IPART Act provides for the enforcement of any arbitration. Sections 28 and 33 of the Commercial Arbitration Act provide that the award made by the Arbitrator is final and binding and may be enforced in the same manner as a judgment or order of the Court to the same effect. However, Section 38 provides for the Supreme Court to hear any appeal on any question of law arising out of an award. Subsection (4) allows such an appeal to be brought with the consent of the parties or with the leave of the NSW Supreme Court.

The Regime meets this criterion.

**CLAUSE 6(4)(i),(j) and (l) - Arbitration**

**Clause 6(4)(i)**
In deciding on the terms and conditions for access, the dispute resolution body should take into account:
(i) the owner’s legitimate business interests and investment in the facility;
(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;
(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;
(iv) the interests of all persons holding contracts for use of the facility;
(v) firm and binding contractual obligations of the owner or other persons (or both) already using the facility;
(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;
(vii) the economically efficient operation of the facility; and
(viii) the benefit to the public from having competitive markets.

**Clause 6(4)(j)**
The owner may be required to extend, or to permit extension of, the facility that is used to provide a service if necessary but this would be subject to:
(i) such extension being technically and economically feasible and consistent with the safe and reliable operation of the facility;
(ii) the owner’s legitimate business interests in the facility being protected; and
(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

**Clause 6(4)(l)**
The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

Section 24B(3) of the IPART Act requires IPART to take the following matters into account during any arbitration:

(a) the matters set out in clause 6(4)(i),(j) and (l) of the Competition Principles Agreement,
(b) any guidelines referred to in section 12A(2) for the access regime to which the dispute relates,
(c) any submissions made on the dispute by the public, in a case to which subsection (2) applies,
(d) any other matters that the arbitrator considers relevant.

An Arbitrator can take into account matters additional to clause 6(4)(i),(j) and (l) so long as there is no conflict between these additional matters and the Clause 6 principles. This Section does not obviously require IPART to consider matters in conflict with and the Clause 6 principles. However, IPART should be cognisant of this constraint when it considers (d) above.

In addition, Section 19B(4) of the TAA requires the IPART to effect this Regime:

An access Regime established in accordance with this section must make provision with respect to the application of Part 4A of the Independent Pricing and Regulatory Tribunal Act 1992 to a dispute with respect to third party access to the NSW rail network by persons as rail operators. In any arbitration of such a dispute, the arbitrator must:
(a) give effect to the access Regime, and
(b) take into account (in addition to the matters referred to in section 24B(3) of that Act) the desirability of ensuring priority and certainty of access for passenger services.

Note. Section 19E(5) of this Act requires the Rail Access Corporation to act in accordance with the NSW Rail Access Regime when exercising its functions.

The requirement to give effect to the Regime means that in order to recommend certification, the Council needs to conclude that all parts of the Regime are set appropriately. The Regime addresses the issues noted in the Council’s draft recommendation, namely:

- the phasing out of coal pricing principles (by 1 July 2000); and
- the adoption of recommendations of IPART for asset valuation, rate of return and depreciation.

The Regime meets these criteria.

**CLAUSE 6(4)(k) - Modification after material change**

If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

This clause should be considered in conjunction with clause 6(4)(a), which places an emphasis on commercial negotiation. The parties could define for themselves, during the course of commercial negotiations, what the threshold is for a ‘material change in circumstances’ and may insert in the contract those events that would trigger a reopening of negotiations. Alternatively, an access regime could make provision for parties to refer disputes concerning what constitutes a material change in circumstances to the dispute resolution body or some other independent body.

Paragraph (i)(j) of Schedule 2 of the Regime requires that any agreement following arbitration must contain a mechanism that allows each party to revoke or modify the agreement if there has been a material change in circumstances.

The Regime meets this criterion.
CLAUSE 6(4)(m) - Owner or user shall not hinder access

The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

An access regime may incorporate this clause explicitly or contain general provisions that have the same effect. Section 7.6 explicitly takes account of clause 6(4)(m).

The Minerals Council advised that its members wished to negotiate access conditions directly with RAC and subsequently negotiate freight haulage with an existing or prospective rail operator. Coal miners were regulated to use only rail for transport of their coal to markets. Until recently, FreightCorp had been the only freight hauler supplying coal freight services. Unless coal miners could require FreightCorp to seek arbitration on access prices, they must accept the prices negotiated between FreightCorp and RAC. The Regime now allows the direct negotiation of track services with customers (including coal miners) capable of managing rail operators.

Other customers argued that the costs of gaining accreditation were too high to be a prerequisite to the initiation of negotiations on price. Section 4.9 allows contract execution prior to accreditation in accordance with the Rail Safety Act. IPART was asked to consider the matters raised with regard to accreditation. It concluded that while some reforms could improve the efficiency of accreditation practices in NSW, a national approach was necessary to realise the substantial gains available from price and practice reforms. The recommendations on efficiency will be automatically adopted by the Regime.

The Regime meets this criterion.

CLAUSE 6(4)(n) - Separate accounting arrangements

Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

Dr Cousins’ report stated that RAC was developing an accounting system to underpin the Regime. He indicated that although the system was far from finalised, it appeared capable of meeting the requirements placed on it by the Regime.

Section 7.4 provides for the structuring of RAC’s accounting, business and financial arrangements to facilitate:

(a) the effective resolution of disputes;
(b) transparency in its:
   (i) Agreements, including as among the various Rail Operators;
   (ii) financial relations with the Government;
(c) the operations of the Australian Rail Track Corporation, including interstate access;
   and
(d) development, promotion and operation of the Regime so that it may be “effective” within the meaning of Part IIIA of the Trade Practices Act.

Section 7.3 does not allow RAC to operate a rail haulage business. Section 7.5 requests RAC to maintain separate accounts for any elements of its business which do not relate to:
(a) the holding, management and establishment of Rail Infrastructure Facilities for Rail Operations; or
(b) the provision of Access pursuant to the Regime.

IPART’s draft report on capital costs has indicated that its final report will make recommendations with regard to approaches and record keeping for some cost components.

The Regime meets this criterion.

CLAUSE 6(4)(o) - Arbitrator has access to relevant information
The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

Access regimes should contain a provision that supports the dispute resolution body with the right to inspect all financial documents pertaining to the service.

Section 22 of the IPART Act gives the Arbitrator power to require the production of information.

The Regime meets this criterion.

CLAUSE 6(4)(p) - Access regimes to be consistent
Where more than one State or Territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other co-operative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

As the service does not extend across more than one State or Territory boundary, there is no issue relating to Clause 6(4)(p).

The Regime meets this criterion.

3. RECOMMENDED DURATION OF CERTIFICATION
Under section 44M(5) of the TPA, when the Council recommends that the Commonwealth Minister make a decision on a certification, the Council must also recommend the period for which any certification should be in force.

The discussion under Criteria 6(2) noted the need to consider the development of the National Regime in recommending the period of certification. As indicated by NSW, the Regime’s compliance with the National Access Regime will be a strong influence in the Council’s consideration of the appropriate duration period.

... if the NCC is satisfied with the NSW submissions on all other issues relating to the certification of the Regime, the NCC is likely to move to certify the Regime for such a period of time as to allow ARTC and others to submit an access undertaking to the ACCC. In this regard NSW proposes that the Regime may be certified until the ACCC accepts an undertaking from ARTC. Thereafter NCC may review the Regime with a view to assessing the compatibility between the Regime and the interstate access undertaking.49

The Council recommends certification from the date of certification until 31 December 2000. The prime reason for this relatively short period is that the development of a national rail access regime may change the influence of the NSW rail infrastructure beyond the borders of NSW, such that the NSW Rail Access Regime is rendered ineffective. This short certification period also provides the Council with the opportunity to test its conclusions regarding the elements of the Regime still to be fully implemented in any future application for certification.

The Council considers that the period of certification should extend from the date of certification until 31 December 2000.
Publicly available submissions

1. TNT Australia Pty. Ltd.
2. 3801 Ltd
3. Department of Transport and Regional Development – 10 July 1997
5. NSW Minerals Council - 24 September 1997
7. NSW Minerals Council - 31 October 1997
10. NSW Minerals Council – 22 May 1998
11. NSW Government – 13 May 1998
Attachment 1 Summary IPART’s draft cost objectives and definitions

The NSW Government requested IPART to review certain aspects of the NSW Rail Access Regime. The Review’s terms of reference required IPART to:

- define economic cost terms used in the floor and ceiling tests;
- determine the most appropriate asset valuation and depreciation methodologies to be used in the ceiling test; and
- set the maximum rate of return on RAC’s assets to be used in the ceiling test.

IPART released a draft report on these issues on 29 February 1999. It intends to issue a final report on 28 April 1999. The following represents a summary of the objectives and definitions of cost terms as outlined in the draft report (pps. 17-22).

The Regime uses a “Baumol floor/ceiling cost band”. IPART was required to examine the floor and ceiling parameters separately.

Floor Test

IPART set the objective of the floor test to be the recovery of avoidable costs of an operator.

The avoidable costs of an operator include the variable costs associated with their usage. Some fixed or common costs may also be avoidable with respect to a particular operator. Where an alteration or addition to the network is required to service a particular operator, the fixed cost of this alteration or addition should be included in the floor price. Some fixed costs such as administration, billing and information technology may also be reduced (avoided) when a particular operator is omitted from the system. This proportion of fixed costs should be recovered in the floor price, notwithstanding that they do not vary with a particular operator’s usage.

The pricing principles in Schedule 3 contain a floor test with two limbs. The first limb requires that operators meet their direct costs:

Access revenue from every Access Seeker must at least meet the Direct Cost imposed by that Access Seeker.

IPART defined direct costs as:

… the efficient and forward looking costs which vary with the usage of a single operator, excluding depreciation, within a 12 month period.\(^50\)

Schedule 3 gives the floor test a second condition:

... In addition, for any Sector or group of Sectors, revenue from Access Seekers together with Line Sector CSOs should, as an objective, meet the Full Incremental Costs of those Sectors ... requiring IPART to define the term “Full Incremental Costs” to meet its floor objective.

IPART considered that:

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\(^50\) IPART, op.cit., February 1999, p.18.
Fixed costs are generally considered to be costs which do not vary with track usage over the short run. The length of time period that encompasses the short run will determine which costs are fixed, as all costs become variable in the long run. ... While all fixed costs are included in the ceiling test, only a subset of fixed costs being "incremental fixed costs" are included in the second limb of the floor test.  

IPART firstly defined fixed costs. It concluded that the Regime should use the term “Fixed Costs” for “all costs which do not vary with usage within a 12 month period”. It concluded that incremental fixed costs are:

... those costs which do not vary with output (at least within 12 months), and are ‘incremental’ in the sense that they could be avoided if the line sector was to be removed. Hence, IPART believes incremental fixed costs includes only those fixed costs which would be avoided within the forthcoming 12 months if a line section was closed, such as reductions in overhead costs associated with having that line section operational. Incremental fixed costs excludes a rate of return and other "sunk" fixed costs being those fixed costs which remain notwithstanding closure of the line.

IPART defined incremental fixed costs as:

... the efficient and forward looking costs of a line sector (excluding depreciation) which do not vary with rail usage within a 12 month period, but could be avoided if that sector was removed from the system.

IPART supported a simple building block approach to the definition of “Full Incremental Costs” - the sum of “Incremental Fixed Costs” and “Direct Costs” assessed on a sector specific basis.

Ceiling Test

Section (i)(b) of Schedule 3 of the Regime sets the ceiling test as:

for any Access Seeker, or group of Access Seekers, Access revenue must not exceed the Full Economic Costs of the Sectors which are required for the Access Seekers on a stand alone basis...

Section (i)(c) sets the ceiling for network revenues:

total Corporation Access revenues must not exceed the stand alone Full Economic Costs of the entire NSW Rail Network.

IPART deferred to its consultant, Professor Stephen King, for assistance in setting an objective for the ceiling parameters:

A stand alone basis is often used to place an upper bound on the ‘legitimate’ revenue a monopoly can earn from the sale of any of its products. This is clearly its role in the rail access pricing principles.

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51 ibid., p.19.
52 ibid., p.16 - IPART defined a sector as a continuous length of track delineated by major junctions or significant traffic origins, which includes all rail infrastructure facilities associated with the track on that sector.
53 ibid., pp.19-20.
54 ibid., p.20.
IPART concluded that the terms “Full Economic Costs” and “Stand Alone Economic Costs” did not need separate definitions:

*In practice the Regime ceiling test needs only a single definition of ‘full economic costs on a stand alone basis.’ As IPART’s role is to provide greater clarity for the Regime, one definition for this purpose is provided.*

IPART concluded that “Full Economic Costs on a Stand Alone Basis” should be defined as:

… *sector specific costs plus a permitted rate of return and depreciation and an allocation of non-sector specific costs such as train control and overheads including a rate of return and depreciation on non-sector specific assets with all inclusions based on efficient and forward looking costs. A stand alone basis requires calculation based on the optimal configuration of the existing rail infrastructure to serve the operator or operators in question.*

Section (iii) of Schedule 1 commits the Regime to adopt the cost definitions included in IPART’s final report within sixty days of the Premier receiving this report. In the interim the cost definitions are as gazetted by NSW on 19 February 1999 (see Attachment 2 - "Notice for Gazette").

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55 ibid., p.21.
56 ibid., p.21.
57 ibid., p.22.