

Submission to the NCC

**Certification of the South
Australian Rail Access Regime**

**Response to the SA Government
Submission to the NCC**

February 2011

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1 EXECUTIVE SUMMARY

Asciano welcomes the opportunity to respond to the Government of South Australia's application to National Competition Council (NCC) seeking certification of the South Australian Rail Access regime (SARAR) as an effective regime.

Asciano has concerns regarding the South Australian rail access regime. These concerns include the common ownership and operation of some above rail and below rail activities which are covered by the SARAR and the lack of detailed regulatory scrutiny of rail infrastructure pricing under the SARAR.

Asciano believes the SARAR could be further strengthened by increasing monitoring of the separation of above rail and below rail activities and detailed regulatory scrutiny of pricing.

In considering the application by the South Australian Government to seek a recommendation from the NCC that the SARAR be recognised as effective, the NCC should consider:

- the monitoring of the current separation of above rail and below rail activities under the SARAR; and
- the level of regulatory scrutiny of access pricing and access conditions under the SARAR.

This submission is public.

2 BACKGROUND

2.1 Asciano's Activities in South Australia

Asciano's rail activities on the intrastate South Australian railway infrastructure covered by the SARAR include the use of yards controlled by Genesee and Wyoming Australia (GWA) by Asciano trains. The use of these yards is governed by an access agreement negotiated between Asciano and GWA in 2010.

Asciano also undertakes above rail transport activities on the ARTC owned and operated interstate standard gauge lines that cross South Australia. While the access to these ARTC owned and operated lines is not governed by the SARAR, the use of the GWA yards is a necessary adjunct to, and component of, these above rail activities on the ARTC lines.

Asciano also undertakes port related activities at several ports in South Australia, although these activities are not directly relevant to this current review.

2.2 Asciano's General Views on the Characteristics of an Effective Access Regime

While the term 'effective access regime' is not defined, s44AA of Part IIIA of the Competition and Consumer Act¹ outlines the objectives of access regulation which may be used to broadly assess the effectiveness of a regime along with the relevant clause 6 principles of the Competition Principles Agreement. These s44AA objectives are:

- promoting the economically efficient operation of, use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
- providing a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

Clause 6 of the Competition Principles Agreement contains a series of principles which are used to assess the effectiveness of an access regime.

¹ On 1 January 2001, the Trade Practices Act was renamed the Competition and Consumer Act 2010

Asciano believes that these objectives mean that in order for a rail access regime to be effective it must:

- contain obligations to promote the economic operation of, and investment in, rail infrastructure, including an effective obligations to maintain and invest in the rail infrastructure
- contain obligations to encourage third party above rail access via the effective separation of the competitive above rail and non-competitive below rail operations and include effective prohibitions on preferential treatment; and
- seek to be generally consistent with access regimes which apply to connecting rail infrastructure.

As a consequence an effective rail access regime requires:

- a high level of transparency, which will in turn facilitate confidence in the regime and consequently facilitate third party access;
- a high degree of certainty related to regulatory processes and outcomes, which will facilitate:
 - economic operation and investment by the below rail asset owner; and
 - economic operation and investment by the above rail asset owner; which in turn will facilitate third party access;
- an appropriate monitoring regime to ensure all of the asset's regulatory obligations are met; and
- an appropriate enforcement regime to ensure appropriate penalties for any non-compliance.

In assessing the effectiveness of a regime, Asciano believes that the relevant legislation and regulations alone do not provide a complete picture of the regime and that the legislation and regulation must be considered in the context of the relevant market, in this case the market for South Australian rail infrastructure services, and the price determination process applied by the regime.

Rail infrastructure services subject to the SARAR include a degree of common ownership, control and operation of above rail and below rail assets by GWA. This common ownership raises concerns with regard to the separation of these functions

for the purpose of facilitating competition. Asciano believes that industry structures where there is complete separation of below rail and above rail assets are more conducive to facilitating competitive markets.

Rail infrastructure services subject to the SARAR are not subject to direct price regulation. The SARAR requires commercial negotiation with recourse to the state based regulator (ESCOSA) in the event that negotiation is not successful.

The combination of:

- o the common ownership, control and operation of above rail and below rail assets; and
- o the absence of direct price regulation;

raises serious concerns as to the appropriateness and effectiveness of the current access regime. In particular the lack of a transparent pricing process coupled with common ownership of above and below rail assets could be expected to provide substantial incentives for the owners of below rail assets to favour associated entities when negotiating pricing and terms and conditions of access in above rail access agreements.

Asciano is an access seeker in South Australia, Queensland, New South Wales, Victoria and Western Australia and to the interstate track owned by the ARTC. In Asciano's experience the most effective access regimes are those which are transparent and non- discriminatory, with strong separation of above rail and below rail assets and functions. Such regimes fully facilitate third party access.

3 ASCIANO COMMENT ON THE SOUTH AUSTRALIAN GOVERNMENT APPLICATION

Asciano considers that in determining whether the SARAR meets the Competition and Consumer Act s44AA objectives and the clause 6 principles of the Competition Principles Agreement, the NCC should look carefully at the existence of common ownership and control of below rail assets and above rail assets and the lack of detailed regulatory scrutiny of pricing as Asciano believes that these elements create substantial concerns with the SARAR.

3.1 Improvements With Regard to Ownership Structures and Separation

Under the SARAR there are provisions within Part 3 of the South Australian Railways (Operation and Access) Act (ROA Act) for separation of accounts and records, prohibitions on unfair discrimination and prohibitions on hindering access. However the requirements of the ROA Act with regard to separation are minimalist in circumstances where there is the existence of common ownership and control of below rail assets and above rail assets. The existence of common ownership creates substantial and ongoing concerns in regard to equal treatment of above rail operators and the potential for information transfer of sensitive information between operating divisions of GWA.

In other jurisdictions, such as Queensland, where common ownership of above and below rail assets exists, these concerns have resulted in much more detailed and extensive requirements with regard to separation of above and below rail operating activities. For example under the Queensland rail access regime² there are substantially more explicit requirements relating to the functional separation of above rail and below rail activities, including, for example:

² The Queensland rail access regime was recommended for certification by the NCC in 2010. During this NCC process there was considerable debate as to the level of separation that was required between the above rail and below rail activities of the relevant service provider. Asciano was an active participant in this debate. Documents relating to the Queensland regime are on the NCC website at

http://www.ncc.gov.au/index.php/application/application_for_declaration_of_queensland_rails_queensland_coal_rail_network

and

http://www.ncc.gov.au/index.php/application/application_for_declaration_of_the_queensland_rail_network

- arms-length negotiations between related parties;
- the prevention of cost shifting, cross subsidisation and margin squeezing;
- auditing and reporting of compliance; and
- some independence of directors of the regulated entity.

Even with these requirements in place, Asciano believes that the current Queensland rail access regime could be further improved in regard to separation.

In Western Australia, which operates with a vertically separated track owner and above rail provider, the Western Australian rail access regime nonetheless has these additional competitive neutrality protections.

Given the current South Australian rail infrastructure ownership structures the current separation arrangements could be substantially strengthened to be more aligned with those in place in Queensland and Western Australia. In particular:

- the unfair discrimination provision of section 23 of the ROA Act could be strengthened and made more transparent, for example, by making public details of any noncompliance. Such increased transparency would provide access seekers with greater comfort that the regime is operating effectively. In the absence of such transparency, it is difficult for access seekers to be confident that the regime is operating as it should;
- section 24 of the ROA Act which deals with preventing or hindering access to railway services should be supported by more specific competitive neutrality provisions. The inclusion of the simple provision in section 24 which prohibits the access provider from engaging in conduct for the purpose of preventing or hindering access to railway services will not be sufficient to constrain the access provider's behaviour in a meaningful way in circumstances where there is common ownership of above and below rail assets;
- section 22 of the ROA Act which simply provides for a requirement to keep separate accounts and records of its railway service business should be strengthened by a requirement to actually segregate its access related functions from its other functions and to do so in a manner that is subject to the regulators approval (as embodied in the Western Australian Access Regime).

Overall, the SARAR would substantially benefit from stronger separation arrangements with increased transparency, which would in turn facilitate confidence in the SARAR, and consequently facilitate third party access.

3.2 Improvements With Regard to Regulatory Oversight of Access Pricing and Access Conditions

The current SARAR places a primacy on commercial negotiation rather than price determination by regulators. Asciano acknowledges that this approach is generally consistent with the Competition Principles Agreement clause 6 principles; however Asciano has concerns with this approach.

Part 7 of the ROA Act allows ESCOSA to monitor costs and access contracts, and requires an access provider to submit information on the cost of rail services. While Asciano supports the current ESCOSA monitoring and information gathering activities Asciano believes that regulatory scrutiny of pricing decisions could be increased.

Under the SARAR access pricing is not subject to either detailed regulatory scrutiny or regulatory approval. Similarly, access terms and conditions are not subject to either detailed regulatory scrutiny or regulatory approval. This lack of regulatory scrutiny and approval is a key point of difference when comparing the SARAR to other Australian rail access regimes.

This lack of detailed regulatory scrutiny consequently results in a lack of independently tested cost information being available to access seekers. This lack of cost information places access seekers at a disadvantage in negotiating access prices with the access provider, as only the access provider has detailed knowledge of their costs. This is in contrast to pricing established under rail access regimes with a higher degree of regulatory scrutiny, such as the regime which applies to the ARTC interstate network, as under these regimes both access seeker and access provider have knowledge of the access provider's costs.

Similarly, this lack of detailed regulatory scrutiny also results in a greater likelihood of unbalanced terms and conditions between the access provider and the access seeker; with a different balance of risk apportionment, which favours the access provider, when compared to terms and conditions established under rail access regimes with a higher degree of regulatory scrutiny.

The SARAR could be improved by providing for regulatory scrutiny and approval of both access pricing and access terms and conditions. Such an approach will provide access holders and access seekers with increased certainty that the access pricing and access conditions are efficient and equitable, which in turn will facilitate third party access.

If an increase in regulatory scrutiny is not provided, commercial negotiations will continue to be problematic as there is an asymmetry of information, particularly cost information, between the service provider and the access seeker. If the commercial negotiation approach is to be maintained it requires an increase in the availability of service provider information to allow negotiations to be appropriately conducted between the two parties on an even basis³. Information gathering powers in the ROA Act should be further strengthened and the information gathered should be made publicly available to ensure that commercial negotiations result in efficient outcomes.

Furthermore, Asciano is concerned that there is limited regulatory scrutiny of the details of access arrangements. The commercial negotiation approach in the SARAR results in less regulatory scrutiny of agreements than some other rail access regimes which contain more prescriptive regulatory pricing provisions. For example, the ARTC Interstate Access Undertaking which was reviewed by the ACCC in 2008 includes an indicative access agreement. In comparison the current SARAR does not include such detailed documentation.

Asciano's view is that commercial negotiation with a natural monopolist on the details of an agreement is unlikely to be productive unless the commercial negotiation is guided by the existence of, at the least, an indicative access agreement which has been reviewed in a regulatory process. Asciano's view is that the acceptability and workability of terms and conditions contained in access agreements ultimately determines whether there is an environment that is conducive to effective negotiations and whether competitive above rail access occurs. As such these terms and conditions should be subject to at least some level of review by the relevant regulator.

³ Asciano recognises that following the 2009 SA Rail Regime Access Inquiry requirements for the provision of an information kit were introduced

An effective rail access regime requires a high level of transparency and certainty. A regime which requires the strengthening of information gathering and powers and the review of indicative access agreements is more likely to provide this high level of transparency and certainty.

3.3 Improvements With Regard to Regulatory Reviews and Processes

An effective rail access regime requires a high level of transparency, a high degree of certainty and a strong monitoring and enforcement regime.

Transparency is improved by the regulator having strong monitoring and information gathering powers. Asciano believes the current powers monitoring and information gathering powers in the ROA Act could be strengthened to align more closely with ACCC powers and should include a stronger regulatory auditing process.

Asciano is aware that ESCOSA receives compliance reports from industry participants, but believes that the current monitoring and enforcement of compliance could be strengthened to include an annual audit of the compliance of rail infrastructure providers.

Asciano believes that an audit of the service provider's compliance with its regulatory obligations should be undertaken annually by an independent external auditor. The audit should be wide ranging and cover financial, access and operational issues, and that the audit reports should be made publicly available in some form. The service provider should then be required to undertake any actions recommended by the auditor to ensure it remains compliant or becomes compliant. Such a process will provide an ongoing level of assurance that the access regime is operating effectively.

3.4 Need to Ensure Rail Access Regimes are Consistent

Asciano is a major user of interstate rail infrastructure, including the ARTC owned and operated tracks that cross South Australia. As noted above, the GWA controlled yards are an important adjunct to Asciano operations on these lines, although they are subject to a separate regulatory regime. Thus in seeking to operate interstate services in South Australia Asciano has to manage rail access across at least two access regimes. Multiple access regimes result in duplication and provide the potential for a lack of consistency between regimes which would be both inefficient and counter to the s44AA objective of regulatory consistency. However, if the regimes were separate, but consistent, then these concerns would be minimised.

While Asciano does not believe that this potential lack of consistency across access regimes is in itself a reason to reject the current application. However, it is an issue that should be monitored as Asciano believes this lack of consistency will continue to be a concern until it is addressed. Asciano would strongly encourage all relevant parties, including regulators and governments to seek to more closely align rail access regimes. In more closely aligning rail access regimes Asciano would seek that the best characteristics of each regime be used in any single regime or aligned regime.

4 CONCLUSION

Asciano believes that in considering whether the SARAR meets the requirements of the Competition and Consumer Act s44AA objectives and the clause 6 principles of the Competition Principles Agreement, the NCC should consider:

- the monitoring of the current separation of above rail and below rail activities under the SARAR; and
- the level of regulatory scrutiny of access pricing and access conditions under the SARAR.