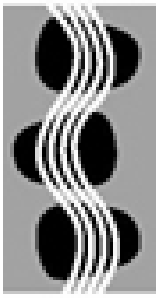
NSW MINERALS COUNCIL



SUBMISSION TO THE PRODUCTIVITY COMMISSION:

REVIEW OF ECONOMIC COSTS OF FREIGHT INFRASTRUCTURE AND EFFICIENT APPROACHES TO TRANSPORT PRICING

May 2006

Table of Contents

1 Introduction

The NSW Minerals Council (NSWMC) welcomes the opportunity to provide this submission to the Productivity Commission's 'Review of Economic Costs of Freight Infrastructure and Efficient Approaches to Transport Pricing'.

NSWMC represents the State's $9 billion mining industry. It provides a single, united voice for mineral producers, operators, explorers and extractive material producers and associated service providers operating in NSW.

NSWMC works closely with government, other industry groups and key stakeholders to foster a dynamic, efficient and sustainable mining industry in NSW. The primary focus of NSWMC is on State issues, however the organisation also works closely with the Minerals Council of Australia (MCA) (national body based in Canberra) on national policy issues.

The primary objectives of NSWMC are to:

- promote a responsible and considered approach to land use in NSW that embraces appropriate access to mineral resources and to land for exploration purposes
- ensure that the legislative and regulatory framework is relevant and effective for an industry which is operating in highly competitive domestic and international markets
- promote the highest standards of occupational health and safety and environmental management.
- ensure the community understands the benefits of a modern, environmentally responsible minerals industry
- promote a healthy economy in which the industry can operate profitably.

NSWMC understands that this is a national review, however as a state based organization, our submission reflects the concerns of our members and as such is focused on NSW.

In each section, road and rail are dealt with separately where appropriate and specific examples are given of price impediments, and impediments to the efficient provision of road and rail infrastructure.

We have also provided detailed, specific responses to the key questions posed in the Commission's Issues Paper as an attachment to this submission.

We would be happy to elaborate on any of the issues raised in this submission.

2 Executive Summary

Mining is a major contributor to Australia's prosperity. The output of the NSW minerals industry in 2004_05 was around $9bn, higher than the State's entire farm sector including wool, crops and livestock. It is NSW's largest single merchandise exporter, worth more than $7bn per annum in export minerals, and $2bn in metals derived from mining. The industry in NSW employs more than 20,000 people directly with a further 100,000 jobs dependent on the minerals industry.

The cost of road and rail infrastructure and the ongoing price of access is a significant determinant in assessing the viability of new coal and other minerals projects. NSWMC notes that in remote regions, road upgrade levies and road development costs form a substantial proportion of the cost incurred by the mining company. When vehicles are also required to pay normal road user charges it can represent a form of double charging. The added imposition of truck load restrictions by State Government bodies (often inconsistently between States), imposes further costs that can jeopardise investment decisions that benefit local communities and the national economy.

In many regional communities, the past few decades have seen a vicious cycle of population shift, regional industry closures, rural consolidation and rail branch line closures. Mining presents a significant opportunity to rebuild communities and encourage wealth and business back into remote and regional areas. However, this is predicated on the provision of reliable road and rail infrastructure being available on an equitably priced basis.

Generally speaking, NSWMC supports the principle that all transport modes in Australia should be subject to pricing and other access principles on a consistent basis. Ideally, with all price and non-price imperfections removed, a single access regime should apply across Australia.

NSWMC supports road and rail being subject to access regimes that do not discriminate between the two modes of transport, and are consistently applied. NSWMC recognises that investment is essential to Australia's continued growth and prosperity. NSWMC also supports changes to eliminate any genuine disincentive but believes that the NCP needs regular re-appraisal to ensure that the balance is never tilted too much in favour of service providers at the expense of their customers, and ultimately of economic efficiency.

Below is a brief overview of NSWMC's key concerns, each of which is outlined in greater detail in this submission.

- The mining sector is both highly, and equally dependent on both road and rail. NSWMC recommends the appointment of an independent state infrastructure development facilitator to ensure that funding for both road and rail infrastructure is given high priority (Refer to Section 3)

- NSWMC believes that further improvements are possible to National Competition Policy with respect to the regulation of investment by infrastructure owners (Refer to Section 4)

- The minerals industry is often required to contribute directly (and in some cases fully) to the cost of rail, road and bridge development, and ongoing maintenance costs. NSWMC supports the Auslink model in respect of financing, operation and ownership of transport infrastructure. The use of Public Private Partnerships (PPPs), and greater State Government involvement in the financial risk associated with infrastructure that has a clear community value, should be further encouraged. (Refer to Section 5)

- Great care must be given in adapting the ARTC undertaking to Australian transport infrastructure access regimes to satisfactorily address the issues associated with the implementation of the price discrimination and floor and ceiling features of the ARTC undertaking. (Refer to Section 6)

- Application of the amendments to the *Trade Practices Act 1974* (Cth) ("*Act*") will require careful management to ensure that a reasonable balance is maintained between the interests of service providers and their customers in determining appropriate rates of return on investment. If National Competition Policy ("NCP") has discouraged economically efficient

investment in those areas to which it applies, NSWMC would support changes to eliminate any genuine disincentive. (Refer to section 7)

- NSWMC recognises that discriminatory pricing will form part of access regimes. However, we believe that this needs to be both transparent, and transparently justified. Non-price discrimination must be taken into account in that justification. This will be particularly important in demonstrating the even-handedness of the road and rail access regimes in eliminating discrimination between the two. (Refer to Section 8)

3 The Importance of Road and Rail to the Minerals Industry

The mining industry offers a significant economic opportunity for regional NSW. Minister for Natural Resources, The Hon. Ian Macdonald MLC, himself noted that there are about 30 coal and petroleum projects and 28 metallic and industrial mineral projects at various stages of the development approvals process (NSWMC 2005 Industry Report). These potential developments, if all were to proceed, would involve a cumulative investment of nearly $2.5bn and generate some 2,000 permanent new jobs in regional NSW.

There have been many arguments put forward about the relative merits of road and/or rail, and more specifically whether they operate on a level playing field. The fact is that both road and rail are essential to the mining industry, and therefore the health of the state of NSW. The provision of both road and rail are essential to the competitiveness of the State's mining businesses, and to encourage ongoing mining investment, development and employment of the State.

NSWMC supports the views of the Business Council of Australia, CEDA, AUSCID and the Minerals Council of Australia, amongst others, in urging the Federal Government to ensure that funding for both road and rail infrastructure is afforded the highest priority.

3.1 Road

Road is essential for the transport of mined materials, including metalliferous ores, bulk materials and coal. In almost all cases it is equally essential for the supplies of equipment and materials needed by the mine sites – in this sense it will often be superior to rail, not only where rail simply doesn't exist, but also as a means to ensure supplies on a just in time basis. This does not simply apply to transport over many hundreds of kilometres between mine site and processing plants or port facilities. Road is also important for shorter trips between mine site and rail loading points.

While transport tonnages from metalliferous mines are much lower than for coal, the value of production is high, and trucking of these materials is the logical mode of transport. Equally, where rail paths are limited, such as occurs in some sectors of the Illawarra based coal industry, product is road hauled to Port Kembla.

Without road it would be impossible to transport high value minerals from sometimes very remote locations. Rail branch line closures over the decades have further highlighted the strategic significance of the State's roads to remote and regional locations. Roads ensure interregional connectivity for the industry and the State as envisaged by Auslink, and therefore the long term viability of the mining sector.

3.2 Rail

Rail is used to transport some 90 million tonnes per annum of export coal (source: HVCCLT, PKCT 2004_05), worth over $7bn in export earnings. For environmental and social reasons it is impracticable to transport this coal by road. Rail therefore supports the key export coal supply chain now, and will become even more critical as areas more remote from ports are opened up for large-scale development.

Investment in vital rail infrastructure is an imperative for the State's continued economic prosperity. By supporting coal and other minerals exports, rail ensures the long term viability of NSW ports and cities.

Example: **Development of the Gunnedah Basin**

The opening up of the Gunnedah basin to large scale coal mining is predicated on a significant investment in rail infrastructure. To not make this investment would ultimately mean that as the Newcastle and Hunter region coal depletes over the next 20 years, a strategically key NSW port city would diminish in importance.

The impact of mine development on the wealth of Gunnedah, Boggabri and other smaller townships has already been demonstrated through the significant increases in employment and economic activity in the region. This will continue as long as rail infrastructure allows it.

Demand on the Gunnedah – Muswellbrook rail line will reach existing capacity as greater tonnages of coal are railed. Coal trains at present are restricted in size to 42 100-tonne wagons, as opposed to the maximum 91 120-tonne wagon trains further down the line in the Hunter region. Necessary projects include duplication of tracks on steeper grades, new loops and loop extensions to facilitate more and longer trains, and over the longer term, the re-alignment of rail track on the Liverpool Range to a route which can better accommodate heavy coal-carrying trains.

Recommendation

NSWMC continues to call for an independent state infrastructure development facilitator. The role would act as a central point of arbitration on key negotiations deadlocks, policy contradictions, and delays in priority infrastructure projects. The remit would be to streamline the development of road, rail and other infrastructure, and pricing and funding arrangements.

4 Enabling Investment

NSWMC believes that National Competition Policy should encourage economically efficient investment in those areas to which it applies.

Capital investment by monopoly infrastructure owners should be encouraged, and the rate of return should fair and reasonable to all parties.

This issue is further discussed in section 7.

4.1 Investment under Access Undertakings

Regulators are required to determine rates of return that are theoretically adequate to match the risks involved. Nevertheless, service providers have in the past expressed public concern about the rate of return that the regulator determines for their investment in infrastructure. They have linked their concern to the level of investment that they are prepared to make.

It is important that there are no delays to investment in important and high priority infrastructure projects. The accessibility to and cost of Australia's transport infrastructure is a key competitive advantage for the country. NSW competes in a global market, and there are other countries that can increase the supply of coal to the market.

Recommendation

Practical arrangements to improve the flow of investment are recommended as follows:

- Developing firm guidelines on the relationship between rates of return as indicated by the approach used by Australian regulators, and rates permitted under the Trade Practices Amendment Bill

- Permitting users to finance infrastructure directly, as is currently permitted under the NSW Rail Access Undertaking

- Devising ways of reducing the already low risk to monopoly infrastructure owners, such as through the 'unders and overs' mechanism incorporated into the NSW Rail Access Undertaking and reflecting this in permitted rates of return

- Identifying underinvestment, and restricting the grounds upon which monopoly infrastructure owners can limit or minimise a necessary level of investment

5 Costs Associated with Access to Road Infrastructure

The NSW mining industry pays a significant price for the provision and use of road infrastructure. Many of these costs are overlooked in the debate over the fair pricing of roads and road usage. In many respects the costs are a form of hidden levy on mining businesses given that similar costs are not levied on other businesses that rely on truck transport.

It is notable that Auslink envisages and encourages private sector involvement in ownership, financing and the operation of capital projects and in the full range of opportunities arising from such projects. But there is also an inconsistency here. Where mining companies pay for rail, road and bridge infrastructure, which often have an enduring value for and utility to the broader community, the mining businesses do not levy tolls on them as other infrastructure providers can do.

Nevertheless the industry recognises both the need to assist Government, and to ensure that high priority projects take full advantage of current economic conditions. The provision of road and rail infrastructure to the mining industry on fair and equitable terms, and with minimum delay, is essential to Australia's economic wellbeing.

Auslink establishes a sensible approach to the financing, operation and ownership of transport infrastructure. NSWMC supports and encourages the adoption of the key principles encapsulated in the Auslink strategy.

5.1 Road

5.1.1 The Minerals Industry Pays for Enduring Public Infrastructure

The industry is consistently required to pay for:

- road infrastructure – up front at no cost to the taxpayer - both within and around mine sites to a higher standard than roads and bridges already in existence. Examples include many kilometres of new connecting roads, new bridges, intersections and intersection upgrades

- improvements to existing roads and bridges to cater for heavier loads and flood resistance, beyond the life of the mining operation, ensuring that road infrastructure will be useful and a lasting legacy for the broader community

- perceived road wear and tear as a result of truck usage.

For many companies, particularly the medium and smaller miners operating in remote locations, capital costs of road infrastructure and the road transport task represents a significant proportion of mine costs. Thus the largest and most efficient trucks are essential for delivering mine site supplies and hauling product from mine site to processing plant, rail loading point or port.

5.1.2 Inadequate Road Maintenance is a Cost to the Industry

In regional locations companies are required to hold detailed and time consuming negotiations with the NSW Roads and Traffic Authority ("**RTA**") and local councils in order to ensure that essential road and bridge infrastructure is provided. In many instances the full cost of the infrastructure is borne by the mining company, but does not guarantee a timely or streamlined process of approval. Important examples:

Example: **Restrictions on road usage**

Many of the State's more remote locations, such as the highways west of the Darling River, are gazetted for road train usage. However NSW Government policy to date has been to limit companies to B-double truck sizes. Some of these limitations have been removed, and there are indications that access for AB triple road trains will be made available in the future.

On roads such as the Silver City Highway however, the RTA has acknowledged that a lack of funding for maintenance has been a major impediment to the use of larger trucks. To remove this impediment, the RTA has indicated that companies would need to contribute to a road maintenance levy. This is despite the fact that the larger trucks have a lower Standard Equivalent axle load, and therefore contribute less to road maintenance costs (and greenhouse emissions) than trucks which will not be required to pay the levy.

Consideration should be given to the fact that a triple road train configuration which has a 20% greater payload than a double road train implies a 20% reduction in truck journeys, a better spread of weight, a commensurate decrease in road wear, a 15-20% reduction in greenhouse gas emissions and greater efficiency for the freight customer and the community.

Bridges in regional locations are often required to be strengthened or even replaced to ensure that they can cater to the larger more frequent truck traffic envisaged by the mine development. Their costs can range from less than $300k to more than $950k. In many cases, bridges are built or improved beyond that which was in place beforehand and they thus serve as enduring assets that are of equal benefit to the local community.

Recommendations

While NSWMC is and always has been supportive of the principle of user pays, an equitable sharing of the cost associated with infrastructure that has a clear community value should be further encouraged.

6 Application of the Existing ARTC Undertaking

Great care must be given to adapting the ARTC undertaking to Australian transport infrastructure access regimes to satisfactorily address the issues associated with the implementation of price discrimination, floor and ceiling prices and other features that are untested in the ARTC undertaking.

6.1 The ARTC Access Undertaking

The existing ARTC undertaking is used by ARTC for pricing on its interstate rail network and appears to work satisfactorily for that purpose. While it provides for discriminatory pricing and floor and ceiling price limits, it does not appear that these features of the ARTC undertaking have yet been applied.

These features are effectively identical to those contained in the NSW Rail Access Undertaking ("**NSW undertaking**") which is applied to coal traffic on the NSW rail network between Stratford, Ulan and Dartbrook mines in the north, and Teralba in the south ("**the Hunter rail network**"). The price discrimination and floor and ceiling features of the NSW undertaking are used and there are several problems in their implementation.

These problems were set out in some detail in a letter from NSWMC to the ACCC of 14 January 2002. A copy of that letter is attached to this submission as Attachment 2.

The key points raised in that letter, which apply in some cases to road as well as rail networks, are as follows:

- The ACCC, in approving the ARTC undertaking, took considerable comfort from the strong competition from road traffic on ARTC's interstate rail network. This competition is not present in all rail networks, particularly the rail networks servicing the coal industry because mines are generally obliged to transport coal by rail

- Requirements for provision of information to access seekers are inadequate

- If the pricing principles in the ARTC undertaking were to be applied so that the ceiling test is relevant to pricing, some parts of the principles would be contradictory

- The provisions in the ARTC undertaking relating to charge differentiation can be applied in such a way that infrastructure users can be required to pay for more infrastructure or network capacity or quality of service than they can utilise: that is, they can be required to subsidise other users

Recommendation

Adopting the ARTC undertaking for a national transport access regime needs to done in light of the NSW experience.

7 Pending Changes to National Competition Policy

Application of the amendments to the *Trade Practices Act 1974* (Cth) ("*Act*") through the *Trade Practices Amendment (National Access Regime) Bill 2006* ("**Trade Practices Amendment Bill**") will require careful management to ensure that a reasonable balance is maintained between the interests of service providers and their customers. Continuing regulatory control is essential to ensure that service providers cannot impose monopoly rents on infrastructure users, thereby detracting from economic efficiency.

7.1 National Competition Policy can Encourage Investment in Infrastructure

A key challenge for National Competition Policy (NCP) is the need to encourage investment in new or expanded infrastructure. Nowhere has this been more evident than in the Australian minerals industry. The Commission addressed this issue in its Report No. 17, *Review of the National Access Regime* of 28 September 2001. In that report it made several recommendations to improve the incentives for new investment in the provision of monopoly services.

The Commonwealth Government is now responding through amendments to the Competition Principles Agreement and to the Act through the Trade Practices Amendment Bill. This Bill includes new provisions on pricing principles. One of these new provisions suggests that the rate of return on assets may now be open-ended, by specifying that revenue be *at least* sufficient to meet the efficient costs of providing access.

Another provision in the Trade Practices Amendment Bill new to NCP is the specific recognition of discriminatory pricing of access to infrastructure where this enhances economic efficiency. This is discussed in more detail in the next section of this submission.

Recommendation

If National Competition Policy ("**NCP**") has discouraged economically efficient investment in those areas to which it applies, NSWMC would support changes to eliminate any genuine disincentive.

8 Access and Access Pricing

NSWMC supports the Auslink model that seeks to increase private sector involvement in land transport infrastructure planning.

The Trade Practices Amendment Bill contains specific endorsement of price discrimination in NCP for the first time.

NSWMC realises that priority to passenger trains and price discrimination against coal trains is not likely to change soon. Nevertheless, infrastructure owners should be required to demonstrate the benefits of discrimination where it is applied.

Equally, service quality should be consistent with access pricing (or vice versa). Non-price discrimination should not be applied where it counteracts any efficiency benefits that price discrimination is intended to produce or, if it is applied, it should be taken into account in any price discrimination that is imposed.

8.1 Road

8.1.1 Road Restrictions in NSW are an Impediment to Efficient Pricing

NON-PRICE FACTORS - SEPPs

Numerous State Environment Planning Policies (SEPPs) have been established to protect the community from noise, road congestion and other environmental factors.

The SEPP regime is an appropriate mechanism to ensure that communities are not unduly impacted, and in general the industry supports the intent of the SEPPs. Significant advances have been made around truck noise, and of course noise abatement is further achieved through barriers. Nevertheless the SEPPs are a form of non-price discrimination. Without proper attention to new road and rail infrastructure and planning, population growth will ensure that the problem is an increasing one, and the effect is equally social and economic.

Example: **Restrictions on Transport Movements**

The Port Kembla Coal Terminal ("**PKCT**") is unable to maximise the efficiency of its road receival facility due to the State Environmental Planning Policy No. 7 (SEPP 7), which restricts public road receivals at PKCT from 7am to 6pm on Monday to Saturday with no deliveries permissible on Sundays and Public Holidays.

This provides a total of only eleven hours per day, six days per week of public road receival capacity, when PKCT operates 24 hours per day, 365 days a year.

This translates to only 39% of available time in any week when the PKCT can receive coal by public road. It also forces coal deliveries to be made at the same time as commuters are using the main arterial road between the city of Wollongong and its southern suburbs. Furthermore, it is an inefficient use of a multi-million dollar asset and importantly inhibits PKCT's ability to take up their current excess ship loading capacity.

(source: Submission to the House of Representatives Standing Committee on Transport & Regional Services, PKCT February 2006)

NON-PRICE FACTORS – INADEQUATE ROAD MAINTENANCE AS A BARRIER TO EFFICIENCY

Many inland roads are not in good condition, and this appears to be a key reason that restrictions remain on axle loads. Paradoxically, greater truck sizes have a significantly reduced impact on road

wear through better and lower spread of weight; lower environmental impact as a result of higher tonnage to fuel use ratios; and greater business efficiency.

The most immediate benefit of eliminating restrictions on truck sizes in remote areas, coupled with greater flexibility in the Higher Mass Limit (HML) regime, would be to reduce the per-tonne cost of hauling material, and to encourage greater investment in mining activity in regions where economic development is needed most.

If truck sizes are restricted because of inadequate roads, this raises the question of whether users of those roads should have to pay exactly the same as users of higher-quality roads, especially when costs are already inflated by having to use trucks smaller than the optimum size. Equitable pricing should take into account such access restrictions on road usage.

PRICE FACTORS

Mineral producers, operators, explorers and extractive material producers and associated service providers operating in NSW are the 'end users' for heavy vehicles, particularly the 9-axle B-double, and Double Road Train vehicles that were the main focus of the recent National Transport Commission ("**NTC**") Regulatory Impact Study ("**RIS**").

In remote locations and in the Illawarra region the industry makes extensive use of road for transport of materials between mine and processing plant, and also between mine and rail loading points.

Under the current NSW Higher Mass Limit (HML) regime, a number of locations are restricted to the B-double and equivalent axle weight vehicles, when triple axle road trains would be more economical, more environmentally friendly and, with the better distribution of axle weight, less wearing on roads.

The result of these restrictions is a reduction in operational and economic efficiency. Any access pricing regime that seeks to promote economic efficiency would need to take into account such restrictions on usage in equivalent pricing of access.

The recent NTC proposals on fuel excise and registration would have been significantly detrimental to the industry, given the allocation of greatest cost to the B-double and Double road trains. To simply increase the price of registration and other costs for larger B-double type trucks will not eliminate the need for such trucks by the industry. Indeed given the relatively fixed nature of such costs, they will simply become a further imposition regardless of the economic cycle.

Example: **B-double Trucks in Remote Regions**

NSWMC opposed the NTC's proposals to increase registration and diesel excise charges for heavy trucks.

The NTC proposals, outlined in its Third Heavy Vehicle Road Pricing Determination Regulatory Impact Statement, would have increased registration charges of B-double trucks and road trains by 37 per cent and net diesel excise by 2.1¢ per litre. If the new charging regime had been endorsed it would have resulted in an increase in truck operating costs by as much as 7 per cent which in turn, would have been directly passed on to those in the minerals industry reliant on these trucks.

Those operating in regional locations such as the Central West, and more remote locations such as the Murray Basin, who are heavily reliant on these trucks to get their products to key domestic and export markets, would have been burdened with yet another increase to their production costs.

Where truck transport is required, the industry is heavily reliant on the B-double and Double Road Train trucks, which NTC noted would have borne the greatest increase in costs. Given that the industry is often restricted to this size of vehicle in regional areas (other than West of the Darling River) under the current HML regime, the industry rightly believed that these cost increases would have been both inefficient and inequitable. It would further discourage new investment and minerals exploration in the areas of NSW most in need of new infrastructure and employment generation.

8.2 Rail

8.2.1 Alignment of Discrimination in Pricing and Service Quality

Discriminatory pricing is allowed and practiced in existing Australian rail access regimes, and is now to be formally recognised in the pricing principles of NCP with enactment of the Trade Practices Amendment Bill.

Discriminatory pricing is currently applied to rail haulage of coal on the Hunter rail network. While the theoretical justification for this discriminatory pricing is maximisation of economic efficiency, there has never, to NSWMC's knowledge, been any authoritative analysis carried out that demonstrates that the price discrimination applied to Hunter coal traffic does in fact enhance economic efficiency.

Before price discrimination is applied, it is important that the infrastructure owner be able to demonstrate to the users affected, and to a regulator if users request it, that the proposed discrimination will improve economic efficiency. The application of discrimination needs to be fully transparent in pricing.

Pricing is not the only area where discrimination is applied to coal traffic. Non-price discrimination plays a key role in the Hunter coal logistics system.

Example: **Passenger Train Priorities in the Hunter Region**

Under the *Transport Administration Act 1984* (NSW), passenger trains are accorded a priority on the Hunter rail network.

This passenger traffic does not pay the full price of access, while at the same time it enjoys the highest priority of access.

Coal trains pay essentially all the costs of that network yet they receive only third or lower priority to access, behind passenger trains and scheduled freight services.

Another aspect of discrimination is the fact that while access pricing for coal traffic is based on an optimised network that is essentially the same as that which exists (so that coal trains meet virtually the whole cost of the network) only around one-half of total train paths are made available to coal trains.

This has the effect of greatly reducing the operational efficiency of the coal logistics chain, artificially reducing capacity and detracting from whatever economic efficiency gains might be realised by discriminatory pricing.

Recommendations

- End users should be involved and engaged in the planning process for new road and rail infrastructure.
- Where it is applied, discriminatory pricing needs to be both transparent and transparently justified to access seekers and, if requested by access seekers, to the regulator. Non-price discrimination must be taken into account in that justification.

Attachment 1

Responses to Questions Raised in the Commission's Issues Paper

Do participants agree with this approach [of establishing a framework and principles for pricing rail and road infrastructure, as well as feasible paths for implementing them …and exploring mechanisms and institutional arrangements that would better integrate infrastructure supply and demand] ? Given the terms of reference, where can the Commission's inquiry add most value? (p14 of the Issues paper)

NSWMC agrees that the establishment of a framework and principles for pricing rail and road infrastructure, feasible paths for implementing them and identifying mechanisms and institutional arrangements that would better integrate infrastructure supply and demand, is a desirable approach. The Commission's inquiry would add most value by

- Establishing a sound basis for comparison of the total costs of road and rail access, based on efficient economic costs
- Establishing a sound basis for the application of discrimination in pricing of monopoly services, which takes into account non-price discrimination in the provision of those services
- Recognising that the ARTC undertaking needs significant modification for it to be suitable to apply in circumstances where there is no competition in downstream markets.

Do participants agree that the Commission should focus on economic costs as the relevant measure of the costs of providing transport infrastructure? (p17)

NSWMC believes that the Commission should focus on economic costs rather than financial costs as the relevant measure of the costs of providing transport infrastructure. The reasons for this view include

- In determining costs for monopoly pricing purposes, efficient costs rather than actual (financial) costs should be used
- In developing the NSW Rail Access Undertaking, it was found that information on the capital costs of rail infrastructure that could be used for asset valuation purposes was unreliable and inadequate. This is a particular problem for such assets as rail and road networks, much of which was constructed many decades ago
- The Competition and Infrastructure Reform Agreement signed by the Commonwealth, States and Territories on 10 February 2006 ("**Competition Reform Agreement**") states that

  > The [Commonwealth, States and Territories] agree to implement a simpler and consistent national system of rail access regulation, using the Australian Rail Track Corporation access undertaking to the Australian Competition and Consumer Commission as a model, to apply to [nationally significant railways] …

  The Australian Rail Track Corporation access undertaking to the Australian Competition and Consumer Commission ("**ARTC undertaking**"), as well as most other, if not all, Australian rail access regimes, provides that in calculating Economic Cost for the purposes of the ceiling limit of the access charge, the rail network will be valued using the depreciated optimised replacement cost ("**DORC**") method of valuing assets. By definition it is not possible to use historical financial costs for the DORC method of asset valuation. This is because the DORC method uses a theoretical network design, rather than the actual network in place, as the basis of the valuation.

Is the ['forward looking Depreciated Optimised Replacement Cost (DORC) methodology for capital cost valuation] approach appropriate [for rail]? (p18)

If it is assumed that an access regime permits price discrimination and has a revenue or price ceiling test to cap revenues at full economic costs, then it would appear to be unavoidable to use the DORC methodology. This is the only valuation methodology that is consistent with the combination of a revenue or price cap and price discrimination, unless users are charged for assets they do not use i.e. unless they subsidise other users. Expressed another way, if another valuation method were used, the pricing principles in the ARTC undertaking and most other Australian rail access regimes would need to be changed to be consistent with that asset valuation method.

Should the same methodologies for assessing capital costs be applied in each mode? (p18)

If consistent and competitively neutral pricing regimes are to be established, it would appear to be necessary for the same methodology to be applied in each mode, or for it to be proven that the different methodologies produce effectively identical results in both the short term and long term.

What are the appropriate rates of return on road and rail infrastructure? (p18)

In the Competition and Infrastructure Reform Agreement signed by the Commonwealth, States and Territories on 10 February 2006 the Commonwealth, States and Territories agreed that

> 2.4 All third party access regimes for services provided by means of significant infrastructure facilities will include the following consistent regulatory principles …
>
> Regulated access prices should be set so as to:
>
> i. generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services and include a return on investment commensurate with the regulatory and commercial risks involved
>
> ii. allow multi-part pricing and price discrimination when it aids efficiency …

These principles have been incorporated into the Trade Practices Amendment Bill currently before parliament at s44ZZCA. The Act currently has no equivalent provision. These provisions were recommended by the Commission in its Report No. 17 *Review of the National Access Regime* of 28 September 2001 ("**Report No. 17**") as measures to facilitate efficient investment (Recommendation 12.1). Recommendation 11.3 from Report No. 17 suggested that addition of a 'truncation premium' to the cost of capital be considered. This would appear to be the basis for the above amendment.

Report No. 17 also contained considerable discussion on means by which investment might be encouraged. No discussion on rate of return can be divorced from the need to encourage investment.

NSWMC believes that, in principle, the rate of return should reflect the risks associated with the relevant infrastructure. Greenfield developments and expansion of existing infrastructure generally have different levels of risk and could merit different rates of return. Similarly, if road and rail investment has different levels of risk, different rates of return should apply. What is important is that the assessment of the appropriate level of risk and consequent rate of return be applied impartially and consistently in all cases, within and between road and rail transport.

The proposed amendments to the Act open the way for the Commission's truncation premium but do not indicate in what circumstances it might be used or how its magnitude might be determined. In practice, it could well result in outcomes that are similar to those recently arrived at.

Recent determinations by the Queensland Competition Authority ("**QCA**") for the Dalrymple Bay Coal Terminal ("**DBCT**") and by the Independent Pricing and Regulatory Tribunal of New South Wales ("**IPART**") for the NSW Rail Access Undertaking appear to reflect a premium for investment. In the case of the NSW Rail Access Undertaking, when IPART first set the rate of return in 1999 it nominated a value that was close to the top of the plausible range it had identified and about 1% above the midpoint of the range. When IPART reviewed the rate of return in 2005 it again nominated a value near the top of the realistic range, in order to encourage investment. In both that case, and the DBCT case, the infrastructure owners had publicly stated their views on a value of rate of return that they

considered necessary to induce them to invest and the rates recommended by the respective regulators were close to those values.

Determination on the magnitude of the rate of return needs to involve users as well as regulator and infrastructure owner, but the process needs to provide a mechanism to secure the commitment of infrastructure owners that once the rate of return is set, they will not stage an investment strike on the grounds, stated or implied, that the rate of return is too low.

How should land be valued? (p18)

In determination of the DORC for the Hunter rail network under the NSW Rail Access Undertaking land is assigned nil value. NSWMC believes this is the correct approach.

Given a requirement for full recovery of freight infrastructure costs, how should common costs be allocated across freight and passenger uses? What are appropriate criteria? For example, should common costs be allocated on the basis of 'fairness' or of 'efficiency'? Should common costs of road and rail be allocated in the same way? (p18)

In its Report No. 17 on its Review of the National Access Regime, the Commission advocated that access price structures should allow price discrimination where it aids efficiency (recommendation 12.1). This recommendation was adopted by COAG and clause 2.4 of the Competition and Infrastructure Reform Agreement signed by the Commonwealth, States and Territories on 10 February 2006 provides that

> 2.4 All third party access regimes for services provided by means of significant infrastructure facilities will include the following consistent regulatory principles.
>
> b. Regulated access prices should be set so as to:
>
> ii. Allow multi-part and discriminatory pricing where it aids efficiency,

This part of the agreement has been incorporated into the Trade Practices Amendment Bill now before Parliament.

In the development of the NSW Rail Access Undertaking (including the NSW Rail Access Regime which preceded it), NSWMC has been consistently critical of the provisions of the Undertaking that allow discriminatory pricing. This is not because NSWMC opposes economic efficiency or efficient pricing, but because

- It had not been demonstrated that the monopoly service providers could accurately design discriminatory pricing to maximise efficiency
- NSWMC had demonstrated that the efficiency gains from the perfect application of the Ramsey pricing principles permitted in the undertaking would be small compared to the potential losses that could arise if the discrimination was imperfectly applied, when compared to an activity-based-costing approach

Under current conditions capacity constraints on the Hunter rail network at times limit the amount of coal that producers can rail. The Hunter Rail Access Task Force ("**HRATF**"), which on access matters represents mining companies which rail virtually all of the coal on the Hunter rail network, has determined that it would prefer that pricing be set on a basis that maximises network capacity, rather than operating efficiency. It believes that this will result in higher economic efficiency under conditions of network capacity constraint.

There are other factors that conspire to prevent the achievement of economic efficiency on the Hunter rail network. Clause 3.4 of the Competition and Infrastructure Reform Agreement says that

> 3.4. This agreement does not require any change to passenger priority policies.

The *Transport Administration Act (NSW)* 1984 provides that passenger trains have priority on rail track in NSW. This has been implemented by the NSW Rail Access Undertaking in clause 7.1(c) which requires the Rail Infrastructure Owner to maintain reasonable priority and certainty of access for railway passenger services in accordance with its obligations under the Transport Administration Act. This is further reinforced in the Memorandum of Understanding between NSW, the Commonwealth and ARTC on ARTC's lease of the NSW interstate and Hunter rail networks.

All this means that passenger services (and, in practice, other non-coal traffic) receive higher priority than coal traffic. This detracts greatly from operational efficiency and from economic efficiency, in limiting the amount of coal that can be railed and consequently sold. It can result in ship demurrage charges that exceed the rail access charges.

The result is that while coal traffic pays virtually all the fixed costs of the Hunter rail network it is limited to around half the total train paths available on the network, because it receives lowest priority to access. At the same time, there has never been an authoritative analysis that demonstrates that the discrimination that is currently applied to rail access pricing does result in higher economic efficiency than would otherwise be the case. Capacity restrictions are inconsistent with price discrimination to maximise economic efficiency – pricing coal train paths at the maximum rate is claimed to increase economic efficiency, but allocating lowest priority to coal train paths under capacity constraints reduces economic efficiency.

So while the pricing principles under the NSW Rail Access Undertaking permit pricing that is "not fair" (if that means consistent with economic efficiency), it imposes non-price restrictions that are clearly unfair in that they take away half the train-paths for which coal traffic pays. Under conditions of capacity constraints, this is clearly unfair and is also inconsistent with economic efficiency.

The ARTC undertaking provides that ARTC can charge any user or group of users all fixed costs (including capital charges) of sectors it uses, without optimising those sectors for that user. ARTC is required only to optimise sectors for ***all*** users. That is, any user or group of users can be required to pay all fixed costs of the un-optimised network – they can be required to pay for assets they do not need.

While ARTC does not currently apply price discrimination between traffic types on its interstate network there is nothing in the ARTC undertaking preventing ARTC from doing so if it desires. It does have four different levels of access charge, with traffic with the highest access priority paying the highest charges. This is in contrast to the Hunter rail network (access to most of which is administered by ARTC) where traffic with the highest priority pays the lowest access charge.

The rules that apply to coal railed to Port Kembla from the Western and Southern coalfields are different from those that apply to coal on the Hunter rail network. Currently mines in the Western and Southern coalfields benefit from the wide discretion in pricing for rail access in that they do not pay at the ceiling rate allowed under the NSW Rail Access Undertaking. At the same time this advantage is offset by non-price disadvantages, such as restricted access times, restricted axle loads, restricted train lengths etc that significantly increase their above-rail costs.

Road traffic can be similarly handicapped where there are restrictions on the times at which it can operate (as at Port Kembla), or other restrictions, such as size or load restrictions in remote areas.

If economic efficiency is to be maximised, access charges paid by road and rail need to be determined on the same basis. Where non-price discrimination is applied it needs to be consistent with the objective of the discrimination in pricing. Furthermore, if discrimination in pricing is applied it should be based on an authoritative analysis of the benefits of that discrimination.

Do participants agree with the costing methodologies employed and estimates made by rail regulators? Why or why not? What are the major differences across jurisdictions? What are the implications of any differences? (p19)

Under the NSW Rail Access Undertaking, the regulator does not employ costing methodologies or make cost estimates. This undertaking was established in 1996 (as the NSW Rail Access Regime) with no regulatory input. It was not until 1999 that it was certified as effective, until December 2000. Since certification lapsed there have been several significant changes, but no application for recertification. There was and still is no mention in this undertaking of costing methodologies.

In 1998, when the NSW government suspended the maintenance outsourcing programme of Rail Access Corporation (the predecessor to Rail Infrastructure Corporation), the then Minister for Transport undertook to have IPART benchmark RIC's costs to international best practice. That was never done. In 2001 the undertaking was amended to appoint IPART to the role of auditing compliance with the floor and ceiling tests.

In NSWMC's view, IPART does not have the resources in this field to carry out this task to the depth required. There is not sufficient transparency of access pricing under the regime for major rail users such as the Hunter coal industry to know what are the methodologies or estimates employed.

Do participants agree with this interpretation [that* consistency *requires the same pricing* principles *to be applied to, and within, both principal modes of freight transport]? (p21)

Do participants agree with [the Commission's] interpretation [that competitively neutral pricing implies an absence of* differential *subsidies implicit or explicit between transport modes or within them]? (p21)

NSWMC believes that consistency does require the same pricing principles to be applied within and between road and rail freight transport and that competitively neutral pricing implies an absence of differential subsidies implicit or explicit between transport modes or within them. In doing so however it recognises that it is not necessarily straightforward to apply consistency and neutrality in pricing. This is particularly the case where price discrimination is allowed in access pricing.

This emphasises the importance of justification of price discrimination being provided based on sound economic principles.

Are road and rail networks broadly covering their aggregate costs? (p22)

NSWMC believes that access pricing should be based on efficient costs rather than actual costs.

How efficient are current charging arrangements for use of rail infrastructure? What criteria are used to allocate fixed costs of infrastructure across rail users? Are these appropriate criteria? Would alternative allocations be more appropriate? If so, why? (p22)

On that part of the Hunter rail network where the ceiling test comes into play ("the 'constrained' network") the criterion used to allocate fixed costs of the network is that export coal traffic pays all the capital-related cost of a network optimised for that traffic. There is very little difference between the optimised network and the actual network, except for the line south of Broadmeadow in Newcastle which comprises only a small proportion of the network. It is likely that coal traffic pays all the fixed operating costs of the constrained network, with these costs not being optimised.

For a few years from around 1999/2000 to 2002/03 there was a specific allowance in access charges for coal traffic for the difference between actual and efficient costs. NSWMC is unclear whether this still applies, because of the lack of transparency in pricing.

It is not possible to say how efficient this charging arrangement is because

- There is a lack of transparency in access pricing that means that costs and revenues are not known to NSWMC

- To NSWMC's knowledge no authoritative analysis or evaluation has ever been carried out of the correlation between the extent of discrimination in access pricing on the Hunter rail network and economic efficiency of those sectors of the economy affected by this pricing

The Hunter Rail Access Task Force (HRATF) has considered different methods of allocating fixed costs between all traffic on the Hunter rail network.

In the past the HRATF's first preference has been for an activity-based costing approach, where each traffic bears a share of costs on each track sector proportional to its usage of that sector. But this is inconsistent with discriminatory pricing. As discussed elsewhere in this submission, the HRATF considers that consideration should also be given in pricing for differences in quality of service and that currently access charges have an inverse relationship to service quality, rather than a direct one which would apply in a competitive market.

If discriminatory pricing is applied, the HRATF has in the past advocated an activity-based approach within traffics. This approach was however developed in a situation of adequate network capacity. In the past few years rail network capacity has become a significant factor in the Hunter coal industry and the HRATF has now adopted a policy that, until rail network capacity is no longer a constraint on production and sales, pricing should be proportional to distance, consistent with floor and ceiling tests. It has adopted this approach in the belief that it will maximise capacity. One consequence is that shorter hauls would pay a greater share of fixed costs on the tracks they use than under activity-based pricing.

Under current circumstances the HRATF has adopted access charges proportional to distance, for the following reasons:

- It will be least disruptive to the principal current objective of maximising the capacity of the Hunter rail network to deliver coal to the port of Newcastle
- It is thought that this will result in less price shocks in moving to transparent and logical pricing
- It is simple to understand and implement
- It leads to consistent pricing of coal traffic within and across access regimes (those administered by ARTC and RailCorp) and between hauls that are and are not constrained by the ceiling test.

How closely do variable rail charges align with marginal costs of using rail infrastructure? Would it be feasible to align variable rail charges more closely with marginal costs? (p22)

On the Hunter rail network current access pricing for coal traffic is a one-part charge, subject to an annual tonnage threshold (**cusp**) above which charges fall to a lower level. The charge is a $/net tonne charge. Because of lack of transparency in pricing and costs it is not possible for NSWMC to quantify the values and it does not know if the post-cusp charges are above, at or below marginal costs.

The purpose of the cusp is to reduce risks to the infrastructure owner of annual tonnage falling short of forecast values (although that risk is completely removed by the unders and overs arrangement) and to provide a working capital advantage to the infrastructure owner. Conceptually the charge should be set so that all fixed costs, including capital-related costs, of the network are recovered when the cusp is reached, and marginal costs only are recovered when the cusp is exceeded.

The HRATF has concluded that its preferred access pricing structure for the Hunter rail network is for a continuation of the single-part $/net tonne charge, without the cusp. In reaching this conclusion the HRATF is aware that a two-part (or more) tariff is desirable to encourage maximum efficiency of operation of the Hunter rail network. Currently however the network is capacity constrained. It has been determined that capacity is maximised by operating trains that are less than the maximum length possible on the network. Using the typical two part, flag fall plus $/gtk, pricing structure would encourage use of longer trains that could result in the network being able to transport less coal. If the single-part tariff is retained in the ARTC Hunter undertaking, once there is adequate capacity to

accommodate optimum sized trains the HRATF would seek a review of the pricing structure to determine the most appropriate. It would expect that the resulting structure would align the variable component of charges with marginal costs.

Should costs of some or all external effects associated with freight transport be incorporated in road and rail charges? Which ones? Why or why not? Is it feasible to incorporate costs of some or all externalities in road and rail prices? (p23)

From a standpoint of maximising economic efficiency it would be desirable for external costs to be transparently incorporated into road and rail access charges. But there are some wider implications, as outlined below.

- It would be distorting for this to be undertaken only for road and rail transport. If it were done for road and rail transport, it should also ideally be done for the rest of the economy.

- Such principles would need to be applied within the road and rail industry, as well as between them. This could have unintended consequences.

  For example, when the Trade Practices Amendment Bill becomes law, under s44ZZCA NCP will explicitly permit discrimination between customers of monopoly service providers where this enhances economic efficiency. While the Hunter rail network remains capacity constrained, different types of rail traffic compete for the available trainpaths. Maximising economic efficiency under these circumstances could result in price discrimination in favour of coal traffic over all other traffic. It is likely that the priority that passenger traffic enjoys on that network would be found to detract from economic efficiency, but that priority is enshrined in the *Transport Administration Act 1984* (NSW) and the Competition and Infrastructure Reform Agreement of 10 February 2006 (clause 3.4).

Would incorporation of externalities in road and rail user charges lead to the efficient abatement of some or all externalities? Why or why not? For example, to what extent would imposition of congestion charges on heavy vehicles ease urban congestion in the absence of charges on passenger vehicles? By what mechanism would road or rail charges encourage reductions in noise and air pollution? (p23)

As outlined above, the Hunter rail network can at times be capacity constrained. This issue is expected to continue for some time. The coal industry meets most of the cost of this congestion through increased haulage costs (arising from coal traffic's lowest access priority) and the opportunity cost of foregone sales. Imposing congestion charges on coal traffic specifically and uniquely is not possible, as it currently pays virtually all fixed costs in any case yet receives the lowest priority to the network.

While the Commission's question implies congestion charges be applied to freight traffic and not to passenger traffic, it would appear to be more conducive to economic efficiency that if congestion charges are imposed they should apply to all traffic, not just non-passenger traffic. They could apply to both road and rail.

Trains carrying coal from Western and Southern Coalfield mines to Port Kembla currently bear a de facto congestion cost. Like elsewhere in NSW they have to give priority to passenger traffic. This has resulted in severe restrictions on the times during which these trains can operate, because of congestion on the Sydney metropolitan network. This increases haulage costs for coal delivered to Port Kembla.

A similar condition applies to the trucking of coal to Port Kembla, where there are severe restrictions on the times at which trucks can operate. This results in increased transport costs and, because the times at which trucks can operate include peak hours, increases traffic congestion rather than reducing it.

When appropriately set, prices efficiently ration use of existing assets, they indicate the opportunity cost of using scarce resources, and they signal the need for investment/disinvestment in a particular activity. In doing so, they promote efficient resource

use and, ultimately, community economic welfare. At the same time, however, price adjustments can have differential impacts on different members of the community.

What are the likely resource impacts of a shift to pricing regimes that better reflect marginal costs of using road and rail infrastructure? How would such pricing affect use of existing infrastructure? Would impacts vary across corridors? If so, why? (p24)

See the discussion above on the Hunter rail network, where coal users have indicated their preference for a pricing structure that does not discourage maximising available capacity as opposed to a structure that promotes maximum efficiency, until adequate network capacity becomes available for coal traffic to allow a change to marginal cost pricing.

How sensitive are freight users to price changes? (p25)
What are the key drivers of their decisions to use either road or rail transport? (p25)

Nearly all the coal carried by rail from mines in the Hunter Valley is required by the conditions of mining leases or development consents to be carried by rail. For that reason, price changes have no influence on the mode of transport used. Freight charges can however be a significant component of the Free On Board (FOB) costs of producing and delivering coal in a very competitive market. In that way freight costs do have an impact on the quantity of coal produced for and sold to export and domestic markets.

Other than price, what are the major impediments to efficient use of road and rail freight infrastructure? These might include (but not be limited to):

- ***Prescriptive regulations;***
- ***Differences in regulations across jurisdictions;***
- ***Inadequate infrastructure investment decisions;*** (p29)

Some impediments to efficient use of rail freight infrastructure on the Hunter rail network include

- The legislated priority to passenger trains in NSW (acknowledged in the Competition Agreement), and the interpretation of that priority in operations protocols

- The feature of the NSW Rail Access Undertaking that, quite rightly, limits the revenue from any group of access seekers to the full economic costs of rail sectors required by that group on a stand alone basis.

  The principle here is that a user should not have to pay for something it does not need or use. However this has caused problems in the Hunter in discouraging investment. Typical of the problems it has caused is the full duplication of single-line track between Antiene and Muswellbrook in the upper Hunter. Coal traffic pays the full cost of this sector, but uses only about half the trainpaths. Increasing coal traffic is requiring full duplication of the track. When this problem first arose the infrastructure owner at the time said it would not duplicate this section of track unless coal traffic paid for it. Yet under the regime that that owner had devised, coal could not be required to pay for the duplication because it was not needed on a stand alone basis.

- NSWMC notes here that ARTC's undertaking to the ACCC for the interstate rail network is different from the NSW Rail Access Undertaking. The ARTC undertaking does not limit the charge payable by any user or group of users to the costs that would be incurred by that user or group of users on a stand alone basis. Instead, it permits ARTC to charge one user the whole cost of a sector even though that user may not need or use all of that sector (for example, the second track on a double track network) or be able to utilise the standard of that sector (for example, where the track is constructed and maintained to accommodate passenger trains that travel at 120km/h, but the user needs only to operate its trains at 80km/h). This may not lead to large distortions on a predominantly single-track network such as ARTC's interstate network, but it can give rise to serious overcharging on a double-track network such as the Hunter rail network.

> These issues have not surfaced in ARTC's current undertaking with the ACCC because it does not practice discriminatory pricing (although it is allowed in the ARTC undertaking), and its revenues from any sector do not approach the ceiling permitted for that sector. Because these features of the ARTC undertaking that permit price discrimination have not been tested through application, it cannot be said to be proven as a suitable template for an Australia-wide transport access undertaking.

Impediments to efficient use of road infrastructure include:

- Poor road maintenance and the application RTA policy to truck sizes
- The HML regime
- SEPPs such as SEPP7 restricting truck access to Port Kembla

How should these impediments be addressed? Which are the most important? Is there a preferred sequence of reforms? (p29)

Awarding to passenger trains access priority over freight trains in NSW, yet charging passenger trains the lowest possible access price, represents a hidden subsidy to rail passengers. If passenger trains are to have access priority they should pay for it by paying a premium access charge. If this requires government to subsidise passenger traffic in a transparent manner so that it can pay an access charge that reflects the value of the train-paths it uses, it should do so.

The remedy for this type of problem is not to require users to pay for more than they need or use, but to recognise that traffic types which pay a higher access charge than others are entitled to a better quality of service, i.e. higher access priority than others. If capacity is restricted i.e. the infrastructure owner is unwilling or unable to invest to make capacity exceed demand, the users who pay the highest access charge under the discriminatory pricing principle should be the last to have their access restricted, in order to maximise economic efficiency. The long-term solution is to ensure that investment in capacity enhancements is made in a timely manner, by managing through NCP the levels of investment made by monopoly service providers.

Access regimes and undertakings should limit charges to any class of user to the maximum costs imposed by that class of user on a stand alone basis.

Many of the impediments identified in this submission arise from the recent or pending changes to NCP, as well as existing features of NCP. In some cases it would be necessary to reverse these changes and correct these existing features before progress can be made.

How can infrastructure investment decision-making be improved? For example, through application of consistent and transparent cost–benefit methodologies? Or are institutional reforms also needed to promote a more commercial approach to road and rail infrastructure provision and pricing? What institutional reforms would be most effective or desirable? (p29)

Regulators are required to determine rates of return that are theoretically adequate for a return appropriate to the risks involved. Nevertheless, infrastructure owners have in the past expressed public concern about the rate or return that the regulator determines for their investment in infrastructure, linking it to the level of investment they are able to make.

Clause 6.(4)(j) of the competition principles agreement allows total discretion to the service provider, in determining an appropriate level of investment, for a given rate of return. Specifically, Clause 6.(4)(j) says that an access regime should incorporate the principle that:

> 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 …

The Commission addressed this problem at some length in Report No. 17, in particular in Chapter 11 of that report. COAG has responded by agreeing to changes to the Competition Principles Agreement

mentioned earlier in this submission. As discussed elsewhere in this submission, NSWMC believes that some of these may be counter-productive.

In NSWMC's view, this problem could, and should, be addressed by the following measures:

- Developing firm guidelines on the relationship between rates of return as indicated by the approach used by Australian regulators, and rates permitted under the Trade Practices Amendment Bill

- Permitting users to finance infrastructure directly, as is currently permitted under the NSW Rail Access Undertaking

- Devising ways of reducing the already low risk to monopoly infrastructure owners, such as through the 'unders and overs' mechanism incorporated into the NSW Rail Access Undertaking

- Identifying underinvestment, and restricting the grounds upon which monopoly infrastructure owners can limit or minimise a reasonable level investment

Attachment 2

New South Wales Minerals Council Limited
ACN 002 500 316

227 Elizabeth Street
Sydney NSW 2000
PO Box A244
Sydney South NSW 1235
Telephone 61 2 9267 6488
Facsimile 61 2 9264 1121
E-mail access via : www.nswmin.com.au

14th January 2002

Margaret Arblaster
General Manager – Transport and Prices Oversight Branch
Australian Competition and Consumer Commission
GPO Box 520J
MELBOURNE VIC 3001

Dear Ms Arblaster

Australian Rail Track Corporation (ARTC)
Access Undertaking

Thank you for the opportunity to comment on the Draft Decision of the Australian Competition and Consumer Commission ("**ACCC**") on the undertaking submitted by ARTC on third party access to its rail network.

The NSW Minerals Council ("**Council**") represents the interests of minerals producers in New South Wales. It has an interest in the access undertaking submitted to the ACCC ("**Undertaking**") because of the suggestion that the Undertaking may be extended to other rail lines which come under the control of the ARTC. One of the lines to which it could apply is the Hunter rail network. Members of the Council currently rail around 70 million tonnes of coal annually for export and domestic customers on this network.

The Council has no objection to the Undertaking, amended as suggested in the Draft Decision, being applied to the current ARTC network. It is however concerned at the suggestion that the amended Undertaking could be extended without significant further amendment to other lines that ARTC could control in the future. The reason for this concern is that conditions that apply to the Hunter rail network are significantly different from those which apply to the current ARTC network.

The Undertaking would be inappropriate to apply to the Hunter rail network because in many aspects of the ACCC's Draft Decision, the Undertaking was accepted either because rail was considered to be in competition with other modes of transport for the end market, or because ARTC does not recover Economic Cost on any segment of its network, or because ARTC applies principles of non-discrimination between users. None of these applies or is likely to apply to rail transport of coal on the Hunter rail network.

Consequently, if the Undertaking were to be applied in future to the Hunter rail network, it would be necessary to modify it so that it would be appropriate for conditions on that network.

Further explanation of these conditions and the differences between the ARTC network and the Hunter rail network are set out in the Attachment.

Yours sincerely

John Tucker
Executive Director

Attachment

SUBMISSION TO ACCC
ON
DRAFT DECISION ON
AUSTRALIAN RAIL TRACK CORPORATION ACCESS UNDERTAKING

Summary

The Australian Rail Track Corporation ("**ARTC**") submitted an Access Undertaking ("**the Undertaking**") to the ACCC in February 2001. The Undertaking applies to the ARTC rail network, comprising standard gauge tracks linking Wodonga, Melbourne, Adelaide, Broken Hill, Tarcoola and Kalgoorlie. The ACCC has issued a Draft Decision to accept the Undertaking subject to ARTC addressing certain concerns raised by the ACCC.

It has been suggested that the Undertaking could be applied to additional parts of the larger standard gauge rail network in Australia which links the mainland capital cities, and to the rail network in the Hunter Valley of NSW ("**Hunter rail network**"). This network extends from Ulan, Dartbrook and Stratford mines to the Port of Newcastle and south of Newcastle for domestic and export coal. The purpose of this submission is to highlight certain of the provisions of the Undertaking which would be inappropriate if the Undertaking were to be extended to the Hunter rail network.

In general, the reasons that the Undertaking would be inappropriate is that in many aspects of the ACCC's Draft Decision, the Undertaking was accepted either because rail was considered to be in competition with other modes of transport for the end market, or because ARTC does not recover Economic Cost on any segment of its network, or because ARTC applies principles of non-discrimination between users. None of these applies or is likely to apply to rail transport of coal on the Hunter rail network.

The NSW Minerals Council recognises that these considerations do not affect the acceptance by the ACCC of the Undertaking for the existing ARTC rail network. If however the Undertaking is extended in future to the Hunter rail network, or to any part of it, these matters would need to be reconsidered and the Undertaking amended accordingly before approval of the extension were granted.

Basis for ACCC Draft Decision

In its draft Decision, the ACCC says (piii)

> *… in considering the environment in which ARTC operates, the Commission regards the following features as important:*
>
> - *… the majority of ARTC's revenues … are earned in markets that, in most cases, are subject to a substantial degree of competition from non-rail sectors …*
> - *Existing charges set by ARTC in the marketplace result in revenues that fall significantly below a level that would allow for the business to earn an adequate long-term economic rate of return.*
>
> *… ARTC intends to commit to ongoing reductions in real prices charges to users. This, combined with a proposed curb on price discrimination …*

The Draft Decision also says (piv)

> *The Commission has therefore considered the proposed undertaking from the point of view of setting in place a structure that:*
>
> - *recognises that competition imposes some degree of constraint, particularly in relation to inter-modal freight; …*

There are several other references (for example, p41) to competition imposing constraints on the conduct of ARTC in applying the Undertaking in practice.

The Draft Decision makes the comment that (pv)

> *The Commission therefore anticipates that further access undertakings covering other parts of the interstate rail network can use ARTC's undertaking, and the Commission's assessment of it, as a guide.*

ARTC is currently discussing with the NSW Government an arrangement whereby it would control interstate track in New South Wales, including the Hunter rail network. The main considerations upon which the ACCC's evaluation of the Undertaking is based, namely competition from other transport modes, non-discrimination between users and lack of full cost recovery, do not apply to the Hunter rail network. Accordingly, any extension of the Undertaking to the Hunter rail network would not be appropriate without a full re-examination of the Undertaking.

Hunter rail network

The reasons why these main considerations do not apply to the Hunter rail network are

- nearly all coal mines in the Hunter are obliged, as a condition of their mining leases or development consents, to use rail to transport coal for export so there is no competition from other transport modes

- price discrimination is currently applied on the Hunter rail network, between coal traffic and non-coal traffic, between export coal traffic and domestic coal traffic, and between export coal traffic from various loading points. Most Hunter coal traffic currently pays both its marginal cost plus all fixed costs and capital-related charges associated with most of the Hunter rail network on a stand-alone basis. All other traffic is thought to pay only the marginal costs of its access to the network

- full cost of the Hunter rail network is currently being recovered, except for the Maitland – Craven line on which coal traffic is minor compared to non-coal traffics

Provision of information

Rail users would not be in a position to establish where ARTC's revenue limits actually lie on any particular segment (p122) unless they were in receipt of all relevant cost information. The additional information volunteered by ARTC as a new clause 3.3 in its letter of 5th December 2001 to the ACCC does not provide this.

As a guide, the information required in the NSW Rail Access Regime as specified in Schedule 5 of that regime may be taken to be the minimum required, with the following additions and qualifications

- cost information needs to be on a forward looking efficient cost basis
- cost information needs to be provided segment-by-segment
  - cost attribution methodology needs to provided in sufficient detail so that an Applicant can actually determine all costs on a segment-by-segment basis
- the portion of costs that are incremental costs for the purpose of determining the Floor Limit needs to be identified
- full details of the determination of Major Periodic Maintenance need to be provided
- usage needs to be defined precisely, rather than in wide bands

Rail users would need in addition full information on revenues by sector in order to determine the scope for pricing by ARTC where differential pricing is practised.

Determination of capacity

In relation to capacity (pxi and pp52-55), the experience of the NSW Minerals Council on the Hunter rail network is that the active cooperation of the network manager is needed to adequately determine

the capacity of that network, because of the high degree of interdependence of the various traffics when demand on a network is nearing capacity.

The Hunter coal industry has received a high degree of cooperation from Rail Infrastructure Corporation in carrying out an analysis of the capacity the Hunter rail network. This cooperation has been necessary in understanding fully the constraints on the network's capacity. The analysis has helped both parties to gain a better understanding of capacity issues on this network.

Passenger traffic priority

The NSW Minerals Council notes the comments in the Draft Decision on priority for passenger traffic (p26). Under s19D(2)(f) of the *Transport Administration Act 1988* (NSW), the current infrastructure owner is required to maintain reasonable priority to passenger train services in NSW, including on the Hunter rail network.

There is a particular problem of applying priority to passenger traffic when differential pricing may result in that traffic paying less than traffic given lower priority. The inequity of this would be exacerbated if an Applicant were required to pay the full cost of Additional Capacity, and then take a lower priority than passenger traffic to use of that Additional Capacity.

Application of Undertaking to additional tracks

It is noted that ARTC has committed to lodge an undertaking covering access to tracks it does not presently control, if it gains control in the future of tracks not covered by the current Undertaking. It is apparent from this submission that, if ARTC were to gain control over the Hunter rail network, a new undertaking which applies to only that network would be more appropriate than an amendment to the existing Undertaking (see p28, para 1).

Mutually exclusive capacity

Mutually exclusive capacity is considered (pp61-64) only in the context of a contracted timepath. Because the nature of the coal transport task on the Hunter rail network makes regular contracted timepaths irrelevant, a different approach is needed for such traffic. This would need to be addressed in a separate undertaking.

Pricing principles

Pricing principles in the Undertaking are summarised in the Executive Summary (pix) and discussed at some length in pp90-146. If the pricing principles in the Undertaking were to be applied to the Hunter rail network, some parts of the principles could be contradictory.

For example, the Undertaking imposes a ceiling limit for revenue from all operators of a segment or group of segments. The ceiling limit is based on the Economic Cost of the relevant segment or segments. There is also a limit on the extent to which the Indicative Access Charge can be increased. There has been a large amount of debate directed to clause 4.6(c) of the Undertaking which deals with the upper limit of any increase. Most or all of that debate has been directed at circumstances where revenue is well below the ceiling limit. It might be expected that under conditions where revenue is at the ceiling limit, this clause would not apply, or at least be overridden by the ceiling test.

There has been little attention directed to the ceiling test, because under current conditions on the network subject to the undertaking, it is only of academic interest. Clause 4.3(b) of the Undertaking provides that in formulating Charges ARTC will not differentiate between Applicants in circumstances where the Applicants are operating within the same end market. It is possible under this clause that revenue on a particular segment or segments could be at the Ceiling Limit, and an Applicant could already be paying all the fixed and capital-related costs of that segment or segments in its Charges while using only a relatively small proportion of trainpaths. If other traffic on that segment or segments, supplying different end markets, took up all remaining capacity, and the Applicant wished to increase its usage by a small amount which required Additional Capacity to be provided, the Applicant could be required to pay for all that Additional Capacity under Clause 6.2 of the Undertaking.

In the Hunter rail network that Additional Capacity could represent the duplication of a segment of track. The situation would then be that the Applicant is required to pay the full fixed costs and capital-related charges of a duplicate track when it needs much less than the capacity of a single track. Clearly for the Undertaking to be applied in circumstances where price differentiation is permitted and revenue does reach the ceiling limit, it needs a provision to limit the charges imposed on any particular traffic or group of traffics so that no traffic pays for more capacity than it needs on a stand alone basis.

It is noted that discussion in the Draft Decision of the pricing principles is in the context of an asset that is significantly underutilised. This does not apply to the Hunter rail network. It is also noted that the pricing principles are generally presented in the context of non-discrimination between traffics, and that in practice the pricing proposed by ARTC does not discriminate in any way between users. This may not be the case in pricing on the Hunter rail network.

Charge differentiation and revenue limits

The provisions relating to Charge differentiation are very general and non-prescriptive. The Undertaking allows Charge differentiation and specifies that the revenue generated by ARTC on a Segment or group of Segments will not exceed a specified Ceiling Limit. These two provisions taken together mean that it is possible for ARTC to charge a small group of Applicants the total Economic Cost of a Segment or group of Segments, even though the capacity of that Segment or group of Segments is far greater than that required by that group of applicants on a stand alone basis.

The Ceiling Limit needs a safeguard to protect Applicants against being required to pay for more capacity than they need if ARTC were to exercise its rights under the Undertaking to apply price differentiation.

Two-part tariffs

While the Council in principle supports two-part tariffs as a means of encouraging optimum track utilisation, maximising train lengths may not result in the most efficient utilisation of the Hunter rail network. Trials have recently commenced in the Hunter rail network of train lengths that are around 2/3 of the maximum possible. It is expected that this will result in an increase in coal capacity of the order of 10%. Accordingly, a two-part tariff for the Hunter rail network would need to be carefully designed so that it is consistent with the capacity characteristics of that network.

Conclusion

The Draft Decision has quite reasonably been based on the ARTC network to which it specifically applies. Many aspects of the Undertaking have been accepted by the ACCC because of the conditions that apply to that network and the traffic that currently uses it. If however ARTC gains control of additional track, in particular the Hunter rail network, these conditions and traffic types will be different. In that case it will not be practicable to simply extend the Undertaking to that network. Major modifications would be required to the Undertaking for it to accommodate conditions that apply to the Hunter rail network.