

Submission to ESCOSA Issues
Paper

Tarcoola – Darwin Railway – Ten
Year Review of Revenues

December 2014

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1 INTRODUCTION AND BACKGROUND

Asciano welcomes the opportunity to respond to the Essential Services Commission of South Australia (ESCOSA) Issues Paper relating to the ten year review of revenues of the Tarcoola-Darwin railway, which is currently operated by GWA. The review is required by the AustralAsia Third Party Access Act.

Asciano' undertake numerous rail activities in South Australia via its Pacific National subsidiary. In particular Asciano currently undertakes "hook and pull" operations on the Tarcoola-Darwin railway on behalf of Great Southern Railways (GSR); however Asciano has no commercial interface with GWA in relation to this operation. The access and commercial interfaces are between GWA and GSR. Consequently this submission makes no comment on issues relating to GSR operations on the Tarcoola-Darwin railway¹.

Asciano has previously sought access to the Tarcoola-Darwin railway and continues to actively seek rail freight haulage business along the rail corridor; consequently Asciano has a strong interest in improving the regulatory and access regime which is currently being applied to the Tarcoola-Darwin railway.

This submission is public.

2 ASCIANO'S EXPERIENCE ON THE TARCOOLA-DARWIN RAILWAY

Since GWA purchased the railway in 2010 Asciano has sought access on the Tarcoola-Darwin railway twice. In both of these instances no trains were operated due to issues related to end user operations.

These access requests related to long haul freight tasks for mineral projects. In relation to these projects road transport was not considered a viable option.

Asciano received an access price for one of these access requests². The access price received was at the upper limit of the range of rail access prices which Asciano

¹ GSR only operates passenger services and these passenger services are exempt from the revenue and costing process required by this current regulatory process. Thus any comment on these services is unlikely to be relevant to the current ESCOSA process.

² The project which was the subject of the other access request was indefinitely postponed by the project proponent prior to an access price being delivered.

is charged in Australia. In particular the price offered was substantially higher (i.e. more than double) than many of the access prices charged to Asciano for long haul freight tasks for mineral projects in other Australian markets. While Asciano recognises that pricing differences may reflect differing infrastructure costs and differences in rail operations the level of the pricing offered on the Tarcoola – Darwin railway raises prima facie concerns as to whether revenues received from such access prices would be excessive.

Furthermore Asciano’s experience of the process for seeking access on the Tarcoola-Darwin railway is that it is overly lengthy compared to processes for seeking access on other Australian rail infrastructure. For example, under one access application process it took Asciano approximately nine months to obtain an access price (before any access agreement was negotiated). In most other access application processes on Australian rail infrastructure a period of nine months would be sufficient to obtain an access price and finalise an access agreement.

3 ASCIANO COMMENTS ON ESCOSA’S ISSUES PAPER

Section 50 of the AustralAsia Third Party Access Act requires ESCOSA to review the revenues paid by access holders for railway infrastructure services where no “sustainable competitive prices exist” and determine whether these revenues are excessive having regard to the costs required to provide the services (where these costs include an allocation of fixed costs). This analysis is to cover the years between 2004 and 2013.

Prior to considering more detailed issues related to Section 50 of the AustralAsia Third Party Access Act Asciano believes that several broader issues should be considered, including:

- The lack of detailed publicly available accounting and cost information relating to the Tarcoola - Darwin railway makes it difficult to make informed comment on the current regulatory process. Asciano believes that in order for there to be a high level of confidence in both the current regulatory process and in Tarcoola – Darwin railway access pricing more generally a reasonable level of Tarcoola – Darwin railway accounting and cost information should be publicly available. A lack of transparency limits the effectiveness of an access regime, and in particular a lack of cost transparency limits the ability of

potential new entrants (who are not related parties of the track owner) to commercially negotiate access pricing. Overall the more transparent the regulatory regime and accounting information then the less likely that both excessive revenues and discrimination will occur.

- Similar to the above point, the level of ring fencing applying to the Tarcoola – Darwin railway is less than that which applies to other vertically integrated freight rail operations in Australia. This raises concerns in regard to cost allocations and cost shifting between above rail and below rail operations. Asciano believes that in order for there to be a high level of confidence in both the current regulatory process and in Tarcoola – Darwin railway access more generally a higher level of Tarcoola – Darwin railway ring fencing should apply

Asciano believes that ultimately issues of information and accounting transparency and stronger ring fencing will need to be addressed on the Tarcoola-Darwin railway before there can be certainty that the railway is not receiving excessive revenues.

When considering the more detailed issues related to Section 50 of the AustralAsia Third Party Access Act Asciano believes that before undertaking the revenue assessment process outlined in Figure 2 of the Issues paper ESCOSA should work from first principles and consider the allocation of revenue and expenditure between above and below rail services on the Tarcoola-Darwin railway in order to ensure that the railway infrastructure services revenue is correct.

Asciano recognises that the AustralAsia Third Party Access Act and Code and the relevant ESCOSA Guideline³ require the segregation of accounts for GWA, however working from first principles will ensure that any costing or allocation anomalies can be identified. Given that GWA operates both above rail and below rail services on the Tarcoola-Darwin railway working from first principles will identify any inadvertent misallocations or cross subsidies.

Verifying and auditing this allocation is particularly important as a vertically integrated rail operator (particularly one which does not face above rail competition) may have the ability to shift revenues and costs between above and below rail activities in such a way as to ensure that the below rail revenues do not appear excessive, while any

³ ESCOSA Rail Industry (Tarcoola Darwin) Guideline No 3 Regulatory Information Requirements

excessive revenue is shifted into the contestable above rail operations (this approach is most likely to succeed in markets where the above rail sector is theoretically contestable but there is no actual competition).

Once the revenue is confirmed the threshold issue to be considered (as identified in the Issues Paper) is to identify what railway services have been subject to sustainable competition in the first ten years of operation.

As noted in section 2 of this submission, based on Asciano's limited experience in operating in the Tarcoola- Darwin section of the rail market, road transport is not competitive for long haul minerals trains, and based on this limited experience such trains could not be expected to be subject to sustainable competition from road transport.

Following assessment of relevant revenues costs related to these revenues need to be calculated and allocated. This allocation includes an allocation of GWA fixed costs. Asciano's experience in other markets is that vertically integrated below rail operators will often seek to over allocate fixed costs, overheads and corporate costs to the below rail assets as such an allocation:

- increases the vertically integrated entity's below rail costs which in the current regulatory process will increase costs thus reducing the likelihood that revenues will be deemed to be excessive; and
- reduces the costs of the vertically integrated entity's above rail costs allowing this above rail business to compete with other above rail providers which have to bear an allocation of their company's overheads and corporate costs.

Given these potential impacts and the vertically integrated nature of GWA Asciano is seeking that ESCOSA closely scrutinise the allocation of these fixed costs. The allocations should be transparent and based on commercial substance over legal form.

More broadly Asciano believes that ESCOSA should also require that

- accounting and cost information relating to the Tarcoola - Darwin railway be made publicly available; and

- ring fencing provisions be strengthened.

These issues need to be addressed before there can be certainty that the railway is not receiving excessive revenues.

4 ADDITIONAL ASCIANO COMMENTS ON THE REGULATORY REGIME WHICH APPLIES TO THE TARCOOLA – DARWIN RAILWAY

While Asciano recognises that the current ESCOSA regulatory process is focussed on meeting the requirements of section 50 of the AustralAsia Third Party Access Act, the Issues Paper (page 4) seeks comment on any other matters that may be of relevance to the review.

Asciano believes that several other issues should be taken into account in considering issues of revenue recovery (and potential over recovery) on the Tarcoola-Darwin railway.

Asciano understands that besides GSR there are no other third party operators on the Tarcoola-Darwin railway⁴. Given the Tarcoola-Darwin railway is subject to a regulatory regime intended to facilitate third party access, the reasons as to why the railway been unable to encourage significant third party access to date should be investigated. The lack of third party access is concerning as above rail competition could be expected to reduce above rail haulage prices and improve service quality (via competition) thus making rail transport on the corridor more attractive to end users. This subsequent increase in volumes could then be expected to reduce unit costs for below rail infrastructure (whose costs are largely fixed costs).

Asciano believes that access regulation for rail infrastructure should allow for third party above rail access via the effective separation of competitive above rail and non-competitive below rail operations and include effective prohibitions on preferential treatment.

As outlined in section 3 above Asciano is concerned that the rail access regime which applies to the Tarcoola-Darwin railway does not necessarily meet these principles. In particular, the common control and operation of above rail and below

⁴ Asciano understands that in the past there was at least one other third party above rail operator on the Tarcoola – Darwin railway.

rail assets by GWA combined with ring fencing and access pricing regulations which are less rigorous than those that apply to other vertically integrated rail operators in Australia and the fact that there are no third party freight operators on the railway all raise concerns that the current regulatory regime may allow cost shifting between above rail and below rail operations and may allow the below rail operator to discriminate between above rail operators. Asciano believes that a more rigorous ring fencing regime should apply to the Tarcoola – Darwin railway. While ever there are no third party freight operators on the railway there will be concerns that the current regulatory structure does not facilitate a competitive market for above rail services.

Further to the issue of ring fencing, the current existence of common ownership of above rail and below rail assets on the Tarcoola-Darwin railway creates substantial concerns regarding the equal treatment of above rail operators and the potential for the transfer of sensitive information between operating divisions of GWA.

The current regulatory regime should further encourage above rail competition by increasing the provision of cost information to access seekers in order to reduce the level of information asymmetry between the service provider and the access seeker. (Successful commercial negotiation requires cost information of the monopoly service provider to be provided to third party access seekers so that negotiations can be conducted between the two parties on an even basis).

Further to the issues raised in this section Asciano strongly believes that there would be a strong benefit to ESCOSA conducting a broader review of the regulatory regime which applies to the Tarcoola – Darwin railway in the near future. Such a review should focus on ring fencing, non discrimination and the facilitation of access and could also consider whether regulated access pricing or regulated access contracts are appropriate given the vertical integration of the railway.

Asciano believes that these broader issues should be considered by the current ESCOSA review.

5 CONCLUSION

Asciano believes that in working through the section 50 process of the AustralAsia Third Party Access Act ESCOSA should pay particular attention to the allocation of

revenues and costs as the Tarcoola-Darwin railway is operated by a vertically integrated entity. In working through this regulatory process ESCOSA should ensure that revenue and fixed costs (including overheads and corporate costs) are allocated appropriately between above rail and below rail activities.

More broadly Asciano believes that given the lack of above rail competition on the Tarcoola-Darwin railway the rail access regime which applies to the railway should be reconsidered in order to strengthen the separation of above rail and below rail operations. In particular ESCOSA should consider issues such as the availability and transparency of cost information, ring fencing, non discrimination and the facilitation of access. To this end Asciano believes that ESCOSA should consider a broader review of the regulatory regime which applies to the Tarcoola – Darwin railway in the near future to consider these issues.