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**Australian  
Competition &  
Consumer  
Commission**

17 April 2013

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Dear Ms Scott

**Re: ACCC response to comments in the submission by Australian Rail Track Corporation (ARTC) to the Productivity Commission (PC) regarding the review of the National Access Regime**

The ACCC wishes to provide some clarification regarding the following issues discussed in ARTC's 8 February 2013 submission to the PC:

- the timeliness of regulatory processes;
- rate of return considerations;
- flexibility and transparency of access pricing; and
- regulatory consideration of alignment with other parts of the supply chain.

The ACCC's views on these issues are outlined below.

### **The timeliness of regulatory processes**

ARTC submits that the extended time needed to develop and approve an undertaking imposes significant additional cost and resourcing to the access provider. ARTC considers the Hunter Valley Access Undertaking (HVAU) approval process was a protracted and very detailed process, noting it originally submitted the HVAU to the ACCC around 26 months ahead of final approval. The ACCC would like to provide some context as to the timeframes involved in the approval process.

The timelines setting out key stages of the ACCC's assessment of the HVAU are at Appendix A.

A number of factors impacted the timing of the HVAU assessment. The HVAU approval process involved ARTC submitting three separate access undertaking applications. ARTC submitted a partial undertaking application in April 2009, where prices were not submitted until October 2009. The ACCC would not have been in a position to make a decision in the absence of this information. Consequently, the ACCC was obliged to extend the decision-making timeframe.

ARTC withdrew its first application in April 2010. ARTC revised its proposal and submitted a second undertaking application in September 2010. With this application ARTC twice requested a 'clock stopper' to extend the period for assessment. The ACCC's final decision on the HVAU was in relation to the third application submitted by ARTC, which was submitted by ARTC on 23 June 2011.<sup>1</sup>

Accordingly, the ACCC notes that many of the factors that led to delays in the approval process for the HVAU were within the control of ARTC.

### **Rate of return considerations**

ARTC states in its submission to the PC that during assessment of the HVAU it sought recognition in its allowed rate of return of the specific risks it faced, in order to adequately encourage investment in the rail network and compensate investors for those risks. ARTC states that these risks include:

- ARTC's exposure to the global markets for coal (as compared with domestic electricity or gas markets);
- ARTC's obligations in relation to coal chain alignment; and
- a performance mechanism designed to penalise ARTC if it failed to deliver contracted capacity entitlements (the true-up test).

ARTC submits that the ACCC 'found it difficult to take a flexible approach in this regard where it saw itself bound by a fairly narrow set of boundaries largely governed by regulatory precedent'.<sup>2</sup>

The ACCC considers that Part IIIA currently allows for sufficient flexibility to take into account the specific circumstances of regulated infrastructure in determining an appropriate rate of return. The pricing principles in Part IIIA state that access prices should include a return on investment commensurate with the regulatory and commercial risks involved.

In assessing ARTC's rate of return under the HVAU, the ACCC had regard to a number of factors including the risks faced by ARTC and factors that mitigated those risks, along with regulatory precedent regarding weighted average cost of capital parameters.<sup>3</sup>

The ACCC recognised, for example, that proposed climate change policies and their potential impact on coal demand created uncertainty which may increase the risk faced by ARTC.<sup>4</sup> On the other hand, the ACCC also noted that a number of characteristics of the proposed access arrangements mitigated the risk faced by ARTC, including:

- the use of long term take or pay contracts;
- the ability for ARTC to require access seekers to demonstrate financial viability prior to entering contracts; and

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<sup>1</sup> ACCC, *Decision in relation to Australian Rail Track Corporation's Hunter Valley Rail Network Undertaking*, 29 June 2011, pp. 21-2.

<sup>2</sup> ARTC, *National Access Regime: ARTC Submission to the Productivity Commission Issues Paper*, 8 February 2013, p. 17.

<sup>3</sup> ACCC, *Position Paper in relation to the Australian Rail Track Corporation's proposed Hunter Valley Rail Network Access Undertaking*, 21 December 2010, p. 106.

<sup>4</sup> *Ibid.*, pp. 106-7.

- the use of conservatively short asset lives to calculate allowable revenue.<sup>5</sup>

The ACCC also noted that complementary sunk investments in mines and ports contribute to minimising the long-term risks faced by ARTC.<sup>6</sup>

After taking into account submissions on its draft view, the ACCC considered that a rate of 8.57 per cent could be appropriate. However, ARTC sought a higher rate of over nine per cent. The rate determined by the ACCC was lower than the rate proposed by ARTC, mainly due to the ACCC taking into account additional factors which mitigated ARTC's risks.

As negotiations continued, it became apparent that coal producers were prepared to accept a higher rate of return for ARTC in exchange for ARTC agreeing to adopt additional measures into the proposed HVAU.

In accepting the final HVAU proposed by ARTC, the ACCC explicitly recognised this negotiated agreement between ARTC and coal producers and accepted a higher rate of return of 9.1 per cent.

The ability of the ACCC to accept this negotiated rate of return demonstrates the flexibility of Part IIIA to take into account the specific circumstances of regulated infrastructure in determining an appropriate rate of return.

### **Flexibility and transparency of access pricing**

ARTC submits that there is a trend by regulators towards seeking greater transparency in relation to how the level and structure of access pricing will be determined. ARTC submits that this results in the potential for greater prescription and rigidity in the regulatory framework as to how access pricing will be determined. ARTC states that 'whilst this can provide greater certainty for potential users of the network, the ability to negotiate flexible pricing to suit particular user needs becomes constrained'.<sup>7</sup>

The ACCC agrees that access providers need a level of flexibility in access arrangements to encourage efficient utilisation of the infrastructure and to facilitate negotiated outcomes. However, this flexibility must be balanced against providing sufficient transparency and certainty to access seekers. In its draft decision on the HVAU, the ACCC stated that:

*... it is appropriate for parties to negotiate certain matters to reflect their particular circumstances, and that flexibility ought to be retained in the HVAU to allow this to occur.*<sup>8</sup>

ARTC is subject to a revenue cap and not a price cap. Therefore, ARTC has discretion over the access charges it sets – subject to the overall revenue cap constraint and other mechanisms in the HVAU. In order to provide a degree of certainty for access seekers, ARTC is required to publish charges for Indicative Services.<sup>9</sup> The HVAU specifies a range of charge differentiation factors ARTC may take into account when determining charges for non-indicative services.

<sup>5</sup> ACCC, *Position Paper in relation to the Australian Rail Track Corporation's proposed Hunter Valley Rail Network Access Undertaking*, 21 December 2010, pp. 108-9.

<sup>6</sup> Ibid., p. 108.

<sup>7</sup> ARTC, *National Access Regime: ARTC Submission to the Productivity Commission Issues Paper*, 8 February 2013, p. 19.

<sup>8</sup> ACCC, *Australian Rail Track Corporation Limited Hunter Valley Coal Network Access Undertaking: Draft Decision*, 5 March 2010, p. 147.

<sup>9</sup> ACCC, *Position Paper in relation to the Australian Rail Track Corporation's proposed Hunter Valley Rail Network Access Undertaking*, 21 December 2010, p. 129.

It is an object of Part IIIA to promote the economically efficient operation of, use of, and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets. It is important that price signals be sufficiently transparent in order to effectively inform decision-making and achieve the objective of encouraging efficient use of infrastructure. If access seekers do not have sufficient transparency about differences in price between various services, they will be unable to make informed decisions that would benefit the coal chain as a whole.

Accordingly, when assessing ARTC's proposed charges for the Initial Indicative Services, the ACCC considered that access seekers should have sufficient information to be able to calculate, with a reasonable degree of certainty, the likely direction and estimated magnitude of pricing relativities between various services. The ACCC considered this transparency necessary to inform investment and contractual decisions by coal industry participants. In response, ARTC provided supporting documentation publicly outlining how it intends to determine its access charges for all services running on the network.<sup>10</sup> This formed an appropriate balance between providing sufficient transparency to industry and retaining ARTC's flexibility to consider the specific circumstances of particular access holders when negotiating charges, as provided for under the HVAU.

### **Regulatory consideration of alignment with other parts of the supply chain**

ARTC submits that it supports, in principle, the efforts of industry and the regulator to achieve alignment across all aspects of the coal chain during the assessment of the HVAU.

However, ARTC expresses concern that although regulatory oversight of one part of the coal chain focuses on coal chain efficiency objectives, failure to support these objectives by other un-regulated elements of the coal chain can 'undo any good outcomes that might arise'.<sup>11</sup> ARTC also notes that pursuing obligations in the HVAU intended to promote coal chain efficiency can result in sub-optimal decisions and outcomes for the regulated network itself. ARTC submits that:

*...it is not clear whether the existing provisions of Part IIIA are sufficiently developed and robust in order to support application to wider market perspectives beyond the covered monopoly infrastructure.<sup>12</sup>*

The ACCC notes that section 44ZZA(3)(e) of the Competition and Consumer Act 2010 (Cth) (CCA) provides for the ACCC to have regard to 'any other matters that[it] thinks are relevant' in assessing an access undertaking application. In assessing the HVAU, the ACCC considered that coal supply chain alignment and the objectives of the long term solution for the Hunter Valley Coal Chain were relevant 'other matters' to which to have regard in deciding whether to accept the HVAU.<sup>13</sup>

Indeed, the ACCC considers that it was entirely appropriate to take overall coal chain efficiency and alignment into account in assessing the HVAU. The ACCC considers that a critical element of the long term solution for the Hunter Valley is the development of mechanisms to ensure that contracts for capacity with all service providers across the coal chain are aligned, such that service providers enter

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<sup>10</sup> ACCC, *Decision in relation to Australian Rail Track Corporation's Hunter Valley Rail Network Access Undertaking - Initial Indicative Service variation*, 17 October 2012, pp. 39-41.

<sup>11</sup> ARTC, *National Access Regime: ARTC Submission to the Productivity Commission Issues Paper*, 8 February 2013, p. 20.

<sup>12</sup> *Ibid.*, p. 21.

<sup>13</sup> ACCC, *Australian Rail Track Corporation Limited Hunter Valley Coal Network Access Undertaking: Draft Decision*, 5 March 2010, pp. 41-52.

contracts based on the capacity of the coal chain as a whole, rather than the individual components of the chain.<sup>14</sup>

The ACCC recognised that alignment needed to be considered alongside the legitimate business interests of ARTC, as well as the interests of non-coal access seekers. In its Final Decision the ACCC acknowledged that 'ARTC has gone to some extent to facilitate outcomes in the interests of the broader coal supply chain, but...there may be points at which the regime created by Part IIIA cannot oblige ARTC to go further'.<sup>15</sup>

However, in the HVAU submitted to the ACCC on 23 June 2011 ARTC incorporated a number of additional alignment measures which it had agreed to include during negotiations with industry in exchange for a higher rate of return (discussed above). Notwithstanding that the Part IIIA regime may not have supported obliging ARTC to include these measures, the ACCC did not consider that the regime prevented it accepting the arrangements once proposed by ARTC.

The ACCC welcomes the opportunity to provide this additional submission, and intends to provide a more general public submission following release of the PC's draft report on the review of the National Access Regime.

Yours sincerely

Mark Pearson  
Deputy CEO  
Australian Competition and Consumer Commission

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<sup>14</sup> Ibid., p. 47.

<sup>15</sup> ACCC, *Decision in relation to Australian Rail Track Corporation's Hunter Valley Rail Network Undertaking*, 29 June 2011, pp. 16-17.

## Appendix A: Timelines of the assessment of ARTC's HVAU

The following timelines set out the key stages in the ACCC's assessment of the April 2009, September 2010 and June 2011 versions of the HVAU. All relevant documents are available on the ACCC's website at [www.accc.gov.au/rail](http://www.accc.gov.au/rail).

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### Timeline – April 2009 HVAU

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23 April 2009	ARTC access undertaking relating to the Hunter Valley rail network ( <b>the April 2009 HVAU</b> ) submitted to the ACCC for assessment under Part IIIA of the CCA.
29 May 2009 – 26 June 2009	Public consultation on April 2009 HVAU.
13 October 2009	Proposed Interim Indicative Access Charges for inclusion in the April 2009 HVAU submitted to the ACCC by ARTC.
21 October 2009	Decision-making timeframe for consideration of the April 2009 HVAU extended for a further six months until 22 April 2010.
10 February 2010	An ACCC Position Paper on Matters Other Than Price issued. While the ACCC did not commence a formal consultation, parties were welcome to make submissions.
5 March 2010	ACCC Draft Decision issued. The preliminary ACCC view expressed was to reject the April 2009 HVAU.
5 – 31 March 2010	Public consultation on ACCC Draft Decision.
19 April 2010	April 2009 HVAU withdrawn by ARTC.

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### Timeline – September 2010 HVAU

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7 September 2010	ARTC access undertaking relating to the Hunter Valley rail network ( <b>the September 2010 HVAU</b> ) submitted to the ACCC for assessment under Part IIIA of the CCA.  Commencement of 180 day 'expected period' for assessment.
16 September 2010 – 25 October 2010	Public consultation on September 2010 HVAU. Original deadline for submissions was 11 October 2010. In response to several requests from interested parties, the ACCC on 7 October 2010 extended the deadline to 25 October 2010.  Clock-stopped for public consultation.
21 December 2010	An ACCC Position Paper issued setting out comprehensive views on the required amendments to the September 2010 HVAU.

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### **Timeline – September 2010 HVAU (cont)**

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7 April 2011	ARTC informally submitted draft revisions to the September 2010 HVAU to the ACCC ( <b>the April 2011 HVAU</b> ).
11 April 2011	ARTC requested clock-stopper to expected period.
13 April 2011	ACCC agreed to clock-stopper, and expected period is extended to 9 June 2011.  Consultation on the April 2011 HVAU commenced.
11 May 2011	End of consultation on the April 2011 HVAU, though in light of ongoing engagement between ARTC and stakeholders, ACCC continued to accept submissions.
2 June 2011	ARTC requested clock-stopper to expected period.
8 June 2011	ACCC agreed to clock-stopper, and expected period was extended to 30 June 2011.
23 June 2011	Withdrawal of ARTC's September 2010 HVAU.

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### **Timeline – June 2011 HVAU**

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23 June 2011	ARTC access undertaking relating to the Hunter Valley rail network ( <b>the June 2011 HVAU</b> ) submitted to the ACCC for assessment under Part IIIA of the CCA.
29 June 2011	Decision to accept the June 2011 HVAU.

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