



AUSTRALIAN RAIL TRACK CORPORATION LTD

Ref No:

25 January 2008

Mr Lyndon Rowe
Chairman
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

Dear Mr Rowe

**REVIEW OF REGULATORY COMPLIANCE ARRANGEMENTS FOR THE
PUBLIC TRANSPORT AUTHORITY**

ARTC SUBMISSION

Please find attached a submission prepared by the Australian Rail Track Corporation in response to your review of the regulatory compliance arrangements for the Public Transport Authority.

The submission contains no information that ARTC would consider commercial-in-confidence.

For further information regarding the preparation of this submission, could you please contact Mr Glenn Edwards, (08) 8217 4292 (Ph), (08) 8217 4578 (Fax), gedwards@artc.com.au (Email).

David Marchant
Chief Executive Officer

ECONOMIC REGULATION AUTHORITY REVIEW OF THE REGULATORY COMPLIANCE ARRANGEMENTS FOR THE PUBLIC TRANSPORT AUTHORITY

ARTC SUBMISSION

Background

The Western Australian Economic Regulation Authority ('Authority') has sought submissions from interested parties on its proposals in relation to the regulatory compliance arrangements for the Public Transport Authority ('PTA'). ARTC notes that the objective of the review is to reduce the regulatory compliance requirements for the PTA in order to minimise the compliance and administration costs of the Regime while maintaining a rail access regulatory framework that ensures effective, fair and transparent competition on Western Australia's regulated access railway network. ARTC further notes that the proposed reduced compliance arrangements would not involve any change to the existing rail access legislation, and are supported by the PTA and the Minister for Planning.

ARTC has actively participated in the consultation processes conducted by the Authority (or its predecessor) and the NCC in relation to the WA Rail Access Regime and the regulatory supervision of the track manager in WA, including:

- The WA Government's Certification application to the NCC;
- Segregation Arrangements, Costing Principles, Overpayment Rules, Train Management Principles, Train Path Policy, Key Performance Indicators and Rate of Return to apply to WestNet Rail ('WNR');
- Floor/Ceiling Determination on the freight network.

Throughout this involvement, ARTC's positions and comments have largely been based around two broad themes, being:

- the need for a consistent approach to access to the interstate network, including that part of the interstate network in WA; and
- the need for the WA Access Regime and regulatory supervision to ensure that adequate measures are put in place to provide the market with confidence that

access to the WA network can be gained in a timely, fair and equitable way when the access provider is vertically integrated

The WA Rail Access Regime applies to all rail networks in WA with the focus of regulatory administration being on the freight network infrastructure operated by WNR and the urban passenger network infrastructure operated by the PTA. ARTC is the manager of a substantial part of the national interstate rail network of which the standard gauge network between Perth (including its ports) and Kalgoorlie is an important part. ARTC currently has a wholesale arrangement with WestNet Rail that provides ARTC with the right to negotiate access to the interstate network in WA for interstate services with a view to creating a 'one stop' approach to access to the interstate network. The wholesale arrangement however has not been particularly effective in achieving this outcome, but has resulted in limited benefits in the area of maintaining network pricing and service levels.

For the above reasons, ARTC's involvement in regulatory reviews to date has focused entirely on the network managed by WNR.

National Consistency

The WA Access Regime is, in many areas, broadly consistent with similar provisions incorporated in ARTC's Access Undertaking. However, there are still a number of different treatments that can cause some uncertainty in access to the operator of an interstate service including, for example, provision for capacity transfer, resolution of capacity demand conflicts, open-ness in pricing, and treatment of costs in floor/ceiling limits.

ARTC supported the suggestions made by the NCC to the WA Government during its consideration of application for certification of the WA Regime to extract interstate services from the scope of the WA Regime for inclusion within the scope of the national regime, or make provision in the WA Regime for the track manager to submit an access undertaking to the ACCC, in the event that a national regime was developed.

ARTC's access undertaking was approved by the ACCC in 2002, where the ACCC indicated that it saw it as a foundation for the development of a consistent 'national' rail access regime. ARTC is currently seeking the ACCC's approval for its second access undertaking to apply to the ARTC network in WA, SA, Victoria and NSW for the next 10 years. Consistency and simplicity of regulation on the interstate network has been

demanded by the interstate rail freight industry for many years, and would further reduce the substantial barrier to new entrants to the industry.

Market Confidence

The WA Rail Access Regime needs to promote market confidence and enhanced competitive outcomes, and efficient utilisation of, and investment in, the network, particularly where there is a vertically integrated access provider.

There is little doubt since the introduction of competition reforms in the rail industry in the mid 1990's that competition for rail freight services has taken hold mostly on the east-west interstate network. ARTC considers that this has occurred for a number of reasons including:

- horizontal and vertical structural arrangements on the bulk of this network that promoted above rail competition;
- rail natural competitive advantage and the relative economics of intermodal freight transport on this network;
- the improvement in quality and capability of the infrastructure that has led to improved rail efficiency and competitiveness; and
- Infrastructure pricing that rewards rail users for improved operating efficiency.

The outcomes of competition on the east-west interstate have resulted in improved transport outcomes for business and communities utilizing this network.

ARTC considers it unlikely that competitive outcomes on the east west interstate network have resulted from activities occurring under the Regime by itself, although it may be that competition in this market is being constrained by the fact that there is some inconsistency in access regulation on the east-west interstate network that is not being effectively mitigated by the wholesale arrangement framework. The absence of clear positive or negative evidence makes it difficult to conclude whether the Regime has, by ensuring adequate measures are in place to prevent anti-competitive behaviour and facilitating an environment where above rail competition is promoted, performed effectively in this regard.

The proposed reduction in Regulatory Compliance Arrangements

The impost of regulatory compliance arrangements, and the competitive outcomes of access regulation, on the network operated by the PTA is unlikely to have any direct impact on the activities on the interstate rail network. Nevertheless, ARTC considers that the application of regulation on any rail network should reflect:

- the degree of market power in relation to a network; and
- the degree of integration of the network access provider with above rail operations.

Different rail networks in Australia operate with differing degrees of market power in relevant markets, and different industry structure. As a result, there is a need for flexibility in regulation both in relation to those aspects of a rail network provider's business that need to be regulated and in relation to the intensity (heavy or light handedness) that should apply to the regulated business.

Where a network has market power, heavy handed regulation is likely to be needed primarily in the areas of pricing. Where an access provider is vertically integrated, there is likely to be a need for regulation to be heavy handed in the areas such as ring-fencing, accounting separation and reporting, and capacity management, where anti-competitive behaviour can arise.

ARTC is not completely familiar with the market, economic and operating circumstances on the PTA network, but would suspect that the likelihood of entry to the network by third parties **in competition with** the PTA is relatively low, and similar to that for other urban networks in Australia's capital cities. This is likely to arise from the existence of substantial entry barriers that exist in relation to urban passenger operations, and the low commercial returns associated with urban rail, often requiring substantial government support.

ARTC is aware that it is important for regulators to strike a balance between the interests of the access provider and access seekers in determining how heavy handed regulation should be applied where the access provider has market power or is vertically integrated. Further, this balance would recognise the particular circumstances of the regulated network.

Nevertheless, in order to maintain sufficient market confidence to promote above rail competition where the access provider is vertically integrated, a certain degree of

imposition on the access must be provided for as a minimum, regardless of the cost on the access provider. ARTC is concerned that consideration of a reduction in regulatory compliance merely to reduce the impost on the access provider may have adverse impacts on the effectiveness of the regulation in promoting market confidence and competition. The benefits and costs resulting from such a reduction must be carefully considered.

Another area of concern relates to the precedent that may be set, where a regulator is seeking to relax the arrangements for regulatory compliance for a vertically integrated access provider. Regulators, for consistency, often rely on the guidance of precedent in other jurisdictions in making regulatory decisions. ARTC is concerned that, even though a relaxation of the arrangements on the PTA network may be considered reasonable in the circumstances, such outcomes may be imported by other regulators on other vertically integrated networks, to the detriment of competitive outcomes.

To this end, it is important that any proposals to relax arrangements clearly and explicitly recognise those aspects of the circumstances on the PTA network that warrant such a relaxation, and clearly and explicitly identify the net benefit of any relaxation.

On the PTA network, the Authority has largely proposed to remove the requirement for:

- periodic compliance audits in relation to the Part 5 Instruments (train path policy, train management guidelines, costing principles and over-payment rules) and Segregation Arrangements (confidential information, conflict of interest, accounting separation);
- periodic KPI reporting; and
- periodic reviews of floor and ceiling costs

except where a third party approach the Authority (and the Authority agrees) that the requirement is necessary.

The Authority has sought to justify the above relaxations on the basis that:

- regulatory instruments should be tailored to differences between railway owners and there are differences between the PTA and WNR in the areas of ownership, structure and nature of business;
- the subsidised urban passenger network is unlikely over the foreseeable future to attract access seekers other than at the margin (such as SCT and GSR, not in competition to the PTA); and

- compliance costs (to the PTA) and administration costs (to the Authority) will be reduced.

In relation to the first point, ARTC agrees that there are differences between the PTA and WNR networks. ARTC is not convinced that the ownership of the access provider should impact on the nature and intensity of regulation. ARTC also considers that the current vertically separated nature of WNR now creates a greater argument for relaxation of regulatory compliance arrangements for that entity than can be made for the PTA which is vertically integrated.

In relation to the second point, irrespective of the likelihood of competition (to the PTA) arising on the PTA network, the intent of access regulation is to open up the contestable elements of essential infrastructure facilities to competition, or at least introduce a plausible and sustainable threat of competition. The intent of the compliance arrangements are to promote market confidence and reduce entry barriers to maintain a threat of competition regardless of whether it materialises. The test in this instance should be whether the proposed relaxation alters the degree of market confidence. ARTC does not believe that the Authority has demonstrated this and would await other stakeholder comment (particularly those of potential competitors if any) in this regard.

The requirement for a third party to now approach the Authority (and possibly convince the Authority) that it requires compliance to be demonstrated so that it could become confident that it could gain market entry on reasonable terms seems to simply create another entry barrier.

ARTC supports the application of minimum but effective regulation in the rail industry. However, where the Authority decides to proceed with these proposals, ARTC considers that it should clearly and explicitly recognise those aspects of the circumstances on the PTA network that warrant a relaxation, and clearly and explicitly identify the net benefit in terms of the effectiveness of access regulation on the network. The reasons proposed are fairly broad and could be applied on a number of other urban and regional passenger and freight networks around Australia. This may be justified in some circumstances, but each jurisdiction needs to be considered on its own specific merits.