VICTORIAN RAIL ACCESS REGIME

CONSULTATION PAPER, MAY 2013

DEPARTMENT OF TRANSPORT,
PLANNING AND LOCAL INFRASTRUCTURE

State Government Victoria

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1 Background

The Victorian Rail Access Regime (VRAR) is set out in the *Rail Management Act* 1996. The regime applies to declared rail transport services and requires that the providers of those services submit an Access Arrangement to the Essential Services Commission (ESC) for approval. An Access Arrangement sets out the terms and conditions, including price and infrastructure standards, on which the transport service provider will provide access to the service, all of which must be approved by the ESC. Under the current process, the ESC makes a determination that the terms and conditions set out by the transport service manager are appropriate and consistent with the legislation and other guiding principles. This includes approving the form of access agreements with access seekers and the access manager's operating handbook.

The rail transport services which are currently declared under the regime are freight transport services provided by:

- The metropolitan network under management of MTM
- The regional freight network under management of V/Line
- South Dynon terminal held by Pacific National
- The parts of North Dynon terminal owned operated by VicTrack

In February 2010 the ESC completed a review of the VRAR. The review recommended retention of the VRAR, although in a more 'light handed' form. The review also recommended that the services provided by the intrastate and the metropolitan networks and South Dynon Terminal remain covered by the regime, but that the services provided by Dynon Intermodal Terminal and the North Dynon Agents Sidings should no longer be declared infrastructure. In its place the review recommended monitoring by the ESC of terms and conditions at Dynon Intermodal Terminal, North Dynon Agents Sidings, and East and West Swanson rail terminals and Westgate Ports Victoria Dock rail terminal.

Government has not yet responded to the review. Since February 2010, all Access Arrangements approved by the ESC under the scheme have been renewed. Access Determinations have been made by the ESC for MTM (August 2011), V/Line (June 2012), VicTrack (June 2012), and Pacific National (June 2012). The earliest expiry date for current Access Arrangements is May 2015.

Given the time that has lapsed since the review, the Department of Transport, Planning and Local Infrastructure is undertaking a short period of targeted consultation with stakeholders to discuss options for the future of the VRAR. This paper sets out a number of options for consideration by stakeholders and poses a number of questions for consideration.

1.1 The Victorian rail network

The Victorian rail network consists of three interrelated systems: the metropolitan network, subject to management by MTM trains, the intrastate network, subject to management by V/Line, and the interstate network, managed by the ARTC.

The network under ARTC management is subject to the ARTC access undertaking submitted under the national access regime.

Both MTM and V/Line are subject to the VRAR and have approved Access Arrangements in place with the ESC.

Typically, freight operators may need to negotiate access paths and have access agreements with two or three operators, depending on which sections of the network they traverse.

Both MTM and V/Line, as well as managing the below rail networks under infrastructure leases with the Public Transport Victoria, deliver above rail passenger services under franchise agreements. Neither MTM nor V/Line deliver above rail freight services.

In addition to the below rail infrastructure, the network also consists of a number of rail terminals used for loading and unloading freight. A number of regional terminals are operated by independent operators who contract with rail operators to provide container services to the Port of Melbourne. None of these terminals is subject to the VRAR. At the Port of Melbourne, there are a number of on dock and off dock terminals which are owned by either VicTrack or the Port of Melbourne and leased to terminal operators. Of these, only South Dynon Terminal and the parts of North Dynon operated by VicTrack are subject to the VRAR.

There is also a network of specialised grain handling facilities throughout country Victoria and at the Ports of Portland, Melbourne and Geelong. Those at the ports are subject to access arrangements overseen by the Commonwealth Government and the ACCC.

2 Issues

2.1 Conformity to *Competition Principles Agreement*

The Victorian Government is party to the 2008 National Partnership Agreement to Deliver a Seamless National Economy. Under this agreement, state access regimes are to conform to a set of principles set out in the *Competition Principles Agreement* (as amended in 2007), and should be submitted for certification by the National Competition Council. Certification of a state based regime means that no-one can apply under the national access regime administered by the ACCC to declare a facility covered by the certified state regime. The relevant principles of the *Competition Principles Agreement* are reproduced at Attachment 1. Some key items are:

- The regime should apply where access to a facility is essential to facilitate competition and it is not feasible to economically duplicate the facility.
- Wherever possible access should be provided on terms and conditions agreed between the access seeker and the access provider.
- The access regime should provide a right to negotiate and a power of enforcement.
- The access regime should provide for the establishment of a dispute resolution body whose decisions are binding.

2.1.1 Questions

1. To what extent does the existing VRAR conform to the principles set out in the *Competition Principles Agreement*?

2. What is the risk to Victoria of not gaining certification under the 2008 National Partnership Agreement?

2.2 Market power, competition and conflicts between users

Access regulation is generally recognised as a means of promoting competition in markets that rely on services provided by essential infrastructure, particularly where there is market power over those facilities or they are bottleneck facilities. As an example, infrastructure operators who are vertically integrated, providing upstream or downstream services, have the opportunity and incentive to earn monopoly profits from those services by denying access to their facilities or by making the terms and conditions of access so unattractive that competitors are disadvantaged.

Access regulation does however impose costs in the form of transaction and compliance costs and also can act as a deterrent to efficient investment on the part of infrastructure owners, especially where such investments are undertaken at the risk of the private sector.

The decision to impose an access regime therefore needs to consider the costs and benefits of doing so and take into account the current market context in which services are being provided. This is the intent of the principles set out in the *Competition Principles Agreement*. Subheading level 3

2.2.1 V/Line network

The current access regime applying to the V/Line network was designed when the market structure of regional rail was different to today. The above and below rail business was integrated and was privately operated by Pacific National (PN). The access regime was considered necessary for above rail competition to ensure that PN allowed reasonable access by competitors in the above rail market to the infrastructure within its control.

Today, the network management role is separated from above rail freight operations. The network management role is undertaken by V/Line and is largely funded through state Government appropriation to V/Line. V/Line does not earn a commercial rate of return on its assets and current policy settings offer subsidies to above rail operators for access to the below rail infrastructure.

As far as the Department is aware, there are few if any conflicts over access to train paths on the regional rail network. Generally there is excess capacity available. Since 2010, the Government has directed V/Line's pricing for access to the regional rail network for bulk grain freight.

In their review the ESC concluded that there is not substantial or sustainable market power in the intrastate below rail market and noted the other constraining effect on market power (apart from the structural arrangements) is the considerable competition to rail in the market for freight transport from road.

However, the 2010 review identified a concern that V/Line as the integrated passenger service provider would have greater licence to discriminate against freight in favour of its passenger service operations, and could shift greater risk to freight train operators through unconstrained pricing. This concern also relates to the fact that V/Line would have little commercial incentive to provide access to freight services as it represents such a small proportion of its revenue. The *Rail Management Act* 1996, which creates the VRAR, also sets out a principle of passenger priority. This principle is not supported by any operational detail but does result in the network manager giving preference to passenger services over freight services both in terms of network scheduling and in managing day to day operations.

On the whole the ESC concluded that despite the constrained market power situation, retention of an access regime was useful to promote above rail competition.

2.2.2 Questions

3. To what extent are there conflicts over access to train paths on the regional rail network?
4. What is an appropriate way to deal with concerns about conflicts between passenger and freight train priorities?
5. Does the current access regime provide an effective way of reconciling freight access priorities with the principle of passenger priority?
6. Does the current access regime promote competition?

2.2.3 Metropolitan network

The metropolitan network is leased to the metro passenger service provider, MTM. MTM holds both a lease over the network and a franchise to deliver passenger services. MTM does not provide above rail freight operations, but provides paths to freight trains passing through its network.

As for the regional rail network, the 2010 review concluded that MTM's market power is constrained, however the same concerns about its integration as a passenger service provider were voiced.

The Department is not aware of disputes or conflicts over access to train paths on the parts of the metropolitan network controlled by MTM. However, the metropolitan network is likely to be more capacity constrained than the regional network because of the higher frequency and growing demand for metropolitan passenger train services and the additional requirement to maintain the system during periods when passenger services are not running, which could give rise to conflicts over train paths.

The Department also notes concerns that in 2011, MTM indicated a view to the ESC that a legitimate price for access to the metropolitan network could be around $17 per GTK ('000). However MTM did not seek to set prices at this level, in recognition of their interest in growing the Victorian rail industry and that it would be uneconomical for potential freight operators to seek access under and not in the best interests of promoting customer confidence and further use of the metro network.

2.2.4 Questions

7. To what extent are there conflicts over access to train paths on the metropolitan rail network? Is capacity likely to be more constrained in the future?
8. What is an appropriate way to deal with concerns about conflicts between passenger and freight train priorities?
9. Does the current access regime provide an effective way of reconciling freight access priorities with the principle of passenger priority?
10. Does the current access regime promote competition?

2.2.5 Terminals

Terminals are key parts of a freight supply chain and can represent bottleneck infrastructure. In their 2010 review the ESC concluded that there was a case to retain access regulation over South Dynon as it has a bottleneck nature and there is vertical integration of the terminal operator such that in the absence of access obligations, competition in long haul containerised freight and in intrastate containerised freight could be impeded.

It was however noted that there are existing leasehold obligations for terminal operators to provide open access and that the application of an access regime to South Dynon terminal does not appear to have made a material difference to the number of access seekers gaining access to that facility. The Department is not aware of any disputes in relation to access to South Dynon terminal.

Furthermore, the fact that there are a number of port terminals, some underutilised, implies that there is choice and competition between facilities and the threshold criteria of the facilities being uneconomic to duplicate may not be met.

There is considerable uncertainty regarding how these facilities might develop in the future, and proposals for greater use of rail for metropolitan intermodal distribution could trigger a greater requirement for open access facilities.

If the case for some form of regulation of access at key terminals is considered strong, there may be a number of options for the type of regulation. One option is for the service providers to voluntarily lodge an access undertaking under the National Rail Access Regime administered through the ACCC. Another would be for an access seeker to apply to the National Competition Council to have the facility declared, which would enable the ACCC to arbitrate in the event of a dispute. This would only occur if the terminals were assessed as meeting the criteria for declaration.

2.2.6 Questions

11. To what extent are there conflicts over access to port rail terminals? Are there capacity constraints at the current port rail terminals? Is capacity likely to be more constrained in the future?

12. What is an appropriate way to deal with concerns about access to terminals?

13. Would an undertaking under the national access regime be an option to consider for South Dynon Terminal?

2.3 Policy context and commitment to open access

The Victorian Government has adopted a number of policy settings which are aimed at promoting competition in the rail freight sector and ensuring that access to rail freight remains affordable for rail freight customers.

This is balanced together with the need to ensure that public resources are managed appropriately and to provide value for money for taxpayers. The maintenance of rail infrastructure is not costless and investment in new infrastructure to provide additional capacity incurs an opportunity cost.

Policy settings include:

- Separation of below rail management from above rail freight operations
- Government direction to V/Line with regard to track access charges – to maintain rates at affordable levels
- The Mode Shift Incentive Scheme – a competitively allocated regional container subsidy that recognises the value to Government and community from rail transport compared to road transport
- Support for capital investment in regional container terminals and regional track upgrades

The objective of growing freight on rail is also balanced with obligations to meet passenger needs on the shared rail network. Hence there is a principle of passenger priority contained in the *Rail Management Act* 1996 which applies to considerations of capacity allocation and network management.

Rail track access charges do not cover the costs of maintenance of the freight only network. For example, in financial year 2012-13, the Government will spend approximately $20 million on freight only network maintenance (which is below the preferred level of investment). Forecasts for revenue in this period are around $5 million.

According to recent Access determinations by V/Line:

- The 'efficient' access charge for the V/Line network would be around $22 per GTK ('000). This compares to current V/Line charges of $4.187 for grain and $1.669 for other freight.
- The efficient access charge for the MTM network is around $6 per GTK ('000) which is the price charged to freight operators.

Whatever changes to the VRAR are adopted, they will need to align to Government's policy objectives of growing freight on rail and ensuring that there is continued open access to the network infrastructure and competition in the rail freight sector.

2.4 Options for consideration and comment

2.4.1 Do nothing

One option is not to make any changes to the current VRAR.

Stakeholders may consider that the current regime is meeting their needs and there are no compelling reasons for change.

However, there may be concerns that the current regime imposes undue compliance costs on access providers and inhibits innovation.

2.4.2 Questions

14. What are the costs to stakeholders of administering the current access regime? How could these costs be reduced?
15. What benefits do access seekers obtain from the current access regime?
16. Are access seekers satisfied with the current regime? What could work better? What features would access seekers want to preserve?
17. Are access providers satisfied with the current regime? What could work better? What features would access providers want to preserve?

2.4.3 Amend legislation to 'light handed' regime

In this context a 'light handed' regime means a 'publish, negotiate, arbitrate' regime with the features of:

- The regulator does not control or approve prices directly
- The access provider publishes prices and service standards available for access seekers
- There is an emphasis on commercial negotiation and information transparency
- Regulatory intervention focuses on arbitration or dispute resolution where access seekers are unable to reach agreement.

Such a regime may be more likely to conform to the *Competition Principles Agreement*.

This option would remove the upfront involvement of the ESC in approving and setting access prices, but their involvement would be triggered in the event of a dispute. In reviewing a dispute, the ESC could be expected to apply the pricing principles which are set out in the *Essential Services Commission Act* 2001. The pricing principles are relevant where an entity is operating commercially and seeking a commercial return on investment from their infrastructure, but less relevant to the V/Line situation as described above. Unless Government is explicit about its policy and subsidy intentions, there could be a risk that this regime would result in pricing that is unlikely to support affordability in the rail freight sector.

There would be many design issues associated with a new regime to be resolved. For example, there will need to be a process for determining which facilities are covered by the regime. This could be assigned to an independent party such as the ESC, or could remain a decision solely of the Minister for Transport on the advice of the Department.

2.4.4 Questions

18. What are the pros and cons of a publish, negotiate, arbitrate regime? Would access seekers consider themselves disadvantaged by such a regime?

19. What would be the compliance costs of such a regime on access managers?

20. Would Government still need to direct V/Line with regard to pricing in order to achieve its policy outcomes?

2.4.5 Policy or governance arrangement

It may be possible to repeal the VRAR and to provide for access to the below rail network to be managed through amended leases between PTV and the network managers. Current leases do not require infrastructure managers to provide access for freight users.

For example, PTV could amend the lease with V/Line, who manages the regional network, to require that access to the below rail network is provided to access seekers on terms and conditions, some of which may be specified in the lease or subject to approval by PTV. This arrangement would require Government to be transparent about the pricing and subsidy settings for the rail network.

This requirement would not have the backing of law but would be embedded in a contract and subject to oversight through normal contractual relations.

A dispute resolution mechanism would need to be developed and specified as part of this arrangement. This could involve independent mediation or it may be possible to assign a role to the ESC in the event that agreement cannot be reached.

Given that no certified legislative access regime will operate over the infrastructure, it may be possible for access seekers to seek to have infrastructure declared under the national access regime, potentially resulting in conflicting or inconsistent arrangements.

Government does not directly control contractual arrangements over some currently declared infrastructure (South Dynon for example). Therefore in the absence of an access regime, such infrastructure may not be covered.

2.4.6 Questions

21. What are the pros and cons of a governance or policy arrangement? Would access seekers consider themselves disadvantaged by such a regime?

22. How practical is it to embed the principle of open access in contracts rather than legislation? What are the risks of doing so?

23. What would be a suitable dispute resolution process that could apply in this model?

24. What are the risks associated with not having a legislated and certified access regime? How large are those risks?

25. What concerns might arise if South Dynon were no longer covered by an access regime?

2.4.7 Other options

There may be other options that have not been canvassed.

It may be that one approach is more suited to one piece of infrastructure than another, or a hybrid approach may be considered a possibility – for example, making use of both contractual or leasing instruments combined with legislation.

At any time it would remain an option for service providers to voluntarily lodge an access undertaking with the ACCC. Alternatively, the Victorian Government could require its franchisees or leaseholders to submit an undertaking to the ACCC.

2.4.8 Questions

26. How important is it to have a consistent approach to rail access for all relevant rail infrastructure in Victoria?
27. Are there other options that should be investigated?
28. In the absence of regulation, how likely is it that service providers would lodge voluntary undertakings with the ACCC?

2.5 Future requirements for access

There may be some infrastructure or policy developments in the future which could give rise to a need for access to essential infrastructure.

For example, a future reintegration of below rail management with above rail operations in the regional rail sector (such as occurred when PN ran the network), could give rise to greater market power and the need to strengthen protections for other operators to gain open access to the network.

Similarly, the development of coal as a viable export from the Gippsland region coupled with significant private sector investment in transport infrastructure (including ports), could give rise to the need to consider how and when an access regime should apply.

The third scenario could be the development of a Metropolitan Intermodal System of metropolitan freight shuttles operating on the Melbourne metropolitan network. If freight traffic increases significantly on the metropolitan network and capacity is constrained, there may be a need to review or strengthen the access arrangements that apply.

One consideration in relation to possible future developments is that the current VRAR may be suitable to future circumstances, so therefore should be retained in case it will be needed.

Another view is that each situation will bring with it its own complexities and the policy considerations at the time will need to give detailed consideration to the appropriate frameworks.

In the case of significant infrastructure associated with mining developments, it may be that the national access framework offers the best arrangement to apply.

One way to handle future market uncertainty may be to build review dates in to whatever framework is settled, to enable new developments to be considered at a future date. The *Port Management Act* 1995 is an example of this approach.

2.5.1 Questions

29. Are there other future scenarios which should be considered when reviewing the VRAR? What are they?
30. What is the best way to prepare for the future and handle the changing nature of markets?

Appendix

Extract from *Competition Principles Agreement*

Access to Services Provided by Means of Significant Infrastructure Facilities

(3) For a State or Territory access regime to conform to the principles set out in this clause, it should:

(a) apply to services provided by means of significant infrastructure facilities where:

(i) it would not be economically feasible to duplicate the facility;

(ii) access to the service is necessary in order to permit effective competition in a downstream or upstream market; and

(iii) the safe use of the facility by the person seeking access can be ensured at an economically feasible cost and, if there is a safety requirement, appropriate regulatory arrangements exist; and

(b) reasonably incorporate each of the principles referred to in subclause (4) and (except for an access regime for: electricity or gas that is developed in accordance with the Australian Energy Market Agreement; or the Tarcoola to Darwin railway) subclause (5).

There may be a range of approaches available to a State or Territory Party to incorporate each principle. Provided the approach adopted in a State or Territory access regime represents a reasonable approach to the incorporation of a principle in subclause (4) or (5), the regime can be taken to have reasonably incorporated that principle for the purposes of paragraph (b).

(3A) In assessing whether a State or Territory access regime is an effective access regime under the Trade Practices Act 1974, the assessing body:

(a) should, as required by the Trade Practices Act 1974, and subject to section 44DA, not consider any matters other than the relevant principles in this Agreement. Matters which should not be considered include the outcome of any arbitration, or any decision, made under the access regime; and

(b) should recognise that, as provided by subsection 44DA(2) of the Trade Practices Act 1974, an access regime may contain other matters that are not inconsistent with the relevant principles in this Agreement.

(4) A State or Territory access regime should incorporate the following principles:

(a) Wherever possible third party access to a service provided by means of a facility should be on the basis of terms and conditions agreed between the owner of the facility and the person seeking access.

(b) Where such agreement cannot be reached, Governments should establish a right for persons to negotiate access to a service provided by means of a facility.

(c) Any right to negotiate access should provide for an enforcement process.

(d) Any right to negotiate access should include a date after which the right would lapse unless reviewed and subsequently extended; however, existing contractual rights and obligations should not be automatically revoked.

(e) The owner of a facility that is used to provide a service should use all reasonable endeavours to accommodate the requirements of persons seeking access.

(f) Access to a service for persons seeking access need not be on exactly the same terms and conditions.

(g) Where the owner and a person seeking access cannot agree on terms and conditions for access to the service, they should be required to appoint and fund an independent body to resolve the dispute, if they have not already done so.

(h) The decisions of the dispute resolution body should bind the parties; however, rights of appeal under existing legislative provisions should be preserved.

(i) In deciding on the terms and conditions for access, the dispute resolution body should take into account:

(i) the owner's legitimate business interests and investment in the facility;

(ii) the costs to the owner of providing access, including any costs of extending the facility but not costs associated with losses arising from increased competition in upstream or downstream markets;

(iii) the economic value to the owner of any additional investment that the person seeking access or the owner has agreed to undertake;

(iv) the interests of all persons holding contracts for use of the facility;

(v) firm and binding contractual obligations of the owner or other persons (or both)

already using the facility;

(vi) the operational and technical requirements necessary for the safe and reliable operation of the facility;

(vii) the economically efficient operation of the facility; and

(viii) the benefit to the public from having competitive markets.

(j) 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 and consistent with the safe and reliable operation of the facility;

(ii) the owner's legitimate business interests in the facility being protected; and

(iii) the terms of access for the third party taking into account the costs borne by the parties for the extension and the economic benefits to the parties resulting from the extension.

(k) If there has been a material change in circumstances, the parties should be able to apply for a revocation or modification of the access arrangement which was made at the conclusion of the dispute resolution process.

(l) The dispute resolution body should only impede the existing right of a person to use a facility where the dispute resolution body has considered whether there is a case for compensation of that person and, if appropriate, determined such compensation.

(m) The owner or user of a service shall not engage in conduct for the purpose of hindering access to that service by another person.

(n) Separate accounting arrangements should be required for the elements of a business which are covered by the access regime.

(o) The dispute resolution body, or relevant authority where provided for under specific legislation, should have access to financial statements and other accounting information pertaining to a service.

(p) Where more than one State or Territory access regime applies to a service, those regimes should be consistent and, by means of vested jurisdiction or other cooperative legislative scheme, provide for a single process for persons to seek access to the service, a single body to resolve disputes about any aspect of access and a single forum for enforcement of access arrangements.

(5) A State, Territory or Commonwealth access regime (except for an access regime for: electricity or gas that is developed in accordance with the Australian Energy Market Agreement; or the Tarcoola to Darwin railway) should incorporate the following principles:

(a) Objects clauses that promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.

(b) 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;

(iii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and

(iv) provide incentives to reduce costs or otherwise improve productivity.

(c) Where merits review of decisions is provided, the review will be limited to the information submitted to the original decision-maker except that the review body:

(i) may request new information where it considers that it would be assisted by the introduction of such information;

(ii) may allow new information where it considers that it could not have reasonably been made available to the original decision-maker; and

(iii) should have regard to the policies and guidelines of the original decision-maker (if any) that are relevant to the decision under review.