

# IPART DRAFT REPORT ON REVIEW OF NSWRAU

ARTC SUBMISSION – DECEMBER 2022

ARTC



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# **EXECUTIVE SUMMARY**

## ***NSWRAU BREADTH***

The NSWRAU, as a single instrument, covers all rail lines in NSW. The instrument therefore must deal with significant variation in use, location and quality; from lightly used regional lines to metropolitan passenger networks and provide appropriate mechanisms for regulating access for all categories of line with varied ownership and use.

This breadth of coverage provides guiding principles for how the NSWRAU should be constructed in order to be effective in the 21st Century and help rail deliver on its role in the transport task to move freight and passengers more efficiently, safely and with lower emissions.

## ***PRESCRIPTION***

Given its breadth of coverage, the fundamental principle must be that the NSWRAU cannot be a prescriptive document, as this will limit its effectiveness across the range of networks covered. The prescription in the current NSWRAU in respect of the calculation of depreciation, highlights how, over time, such prescription can limit necessary flexibility to provide fair and balanced outcomes.

## ***ACCESS FRAMEWORK***

ARTC strongly supports the proposed NSW access framework (NSWRAU) that provides for each network manager submitting a proposed access undertaking (that details the proposed principles for negotiating access in the circumstances of their specific network) for review; and a default mechanism to apply in the absence of such a submission. This process allows for the removal of prescription from the NSWRAU, but with regulatory oversight and requirements on elements that are common to networks generally.

## ***TREATMENT OF KEY PARAMETERS***

In respect of key parameters that underpin the ceiling calculations, ARTC supports their calculation at a network specific level. The network specific assessment process should allow for negotiated outcomes that trade off service risk and return to ensure the operational efficiency of the network is maximized. ARTC further supports the recommendation that the framework allow for determinations at the point in time at which they are required, rather than specific review dates defined in the NSWRAU. ARTC does not support, however, a framework that allows for reopeners beyond exceptional circumstances to avoid the introduction of market volatility into the ceiling calculations.

ARTC believes that the current IPART process for WACC methodology is appropriate. ARTC would, however, highlight the growing instance of commodity-based debt premia being applied in funding rounds and recommends such additional costs be considered in future WACC determinations.

ARTC recommends IPART also remove any definitional elements of parameters items from the NSWRAU.

## ***REVERSION OF UNDERTAKINGS***

ARTC welcomes clarity on the transition of any voluntary undertaking back under the NSWRAU and ensuring that the NSWRAU remains uncertified to maximize the flexibility of voluntary undertakings under the Commonwealth Competition and Consumer Act (CCA).

The Hunter Valley Access Undertaking (HVAU) has developed over time as a negotiated package which has allowed ARTC and its customers to negotiate on significantly increased service quality with ARTC accepting more risk in exchange for improved returns. The transition of such negotiated outcomes back to a regulated environment is a complicated process, and ARTC supports the transparent approach outlined by IPART. However, whilst noting ARTC never intends for negotiations to fail and the HVAU to revert back under the NSWRAU, any such transition must account for these negotiated outcomes. That is, the service quality cannot default to an undertaking without specific allowance for those increased risk elements being reflected in the network specific return calculation. ARTC is happy to work with IPART and other stakeholders on the wording to apply to the process to ensure it delivers an efficient outcome for all.

## ***TRANSPARENCY***

The provision and transparency of information is another area where excess prescription in the NSWRAU can have adverse and unintended consequences through the imposition of excessive regulatory burden on network managers with no corresponding benefit. Given the defined process for the provision and approval of access principles, ARTC believes that this is the appropriate document to define information transparency and compliance provisions rather than the NSWRAU. That way, IPART can ensure that those provisions are fit for purpose for the network being covered and specifically address the value, and purpose, of the information which is being collated and reviewed.

## ***DISPUTE RESOLUTION***

ARTC believes that as the transport market grows and innovates, the need for commercial flexibility and innovation in rail's service offerings will substantially grow and this in turn requires a framework that supports commercial negotiation. Where disputes arise in this circumstance, they will be commercial in nature which will be most efficiently resolved via a commercially focused dispute resolution process.

## ***INTEROPERABILITY***

It is also critically important that the framework for the NSWRAU is focused on the purpose of the document being the promotion of open and non-discriminatory access. Although it is a document that covers all rail segments across NSW, it is focused on access at a network specific level. It is therefore not a document which can address issues of interoperability and harmonization as these cross over access to individual networks, and it is critical that the NSWRAU not impose obligations on a network owner that are not fully in their control to meet. Therefore, whilst ARTC acknowledges the importance of these issues and the need for solutions to resolve them, the NSWRAU is not the document to do this.

ARTC commends IPART for the open and consultative process it has run in respect of the review of the NSWRAU and is supportive of the overall framework and recommendations subject to the concerns above being addressed. If there are any questions in respect of this submission, please do not hesitate to contact Jonathan Teubner, Head of Economic and Regulatory Development on [REDACTED] to discuss them.

## BACKGROUND

In its December 2021 submission to the Issues Paper released by IPART to inform its review into the NSW Rail Access Undertaking (NSWRAU), ARTC concluded the following:

*The NSWRAU should allow for the maintenance of negotiated service characteristics and provide for a process of dispute resolution on accepted economic parameters and depreciation against those service risks.*

*The preferred regulatory framework should therefore:*

- *Support commercial negotiations between Network Owners and Users on key matters of service and risk, including the treatment of stranding risk via depreciation in a world of demand uncertainty;*
- *Provide outlet to independent dispute resolution processes, with such disputes focused on either:*
  - *Economic cost matters, including depreciation recovery, that derive the ceiling where revenue is above the 80% of cost benchmark (as a proxy for meeting a coverage test) based on service risk; or*
  - *Commercial arbitration where revenue is below that mark.*
  - *Note that access to independent dispute resolution has been recognized as a significant constraint on the use of market power in negotiations;*
- *Promote transparency of pricing and network performance;*
- *Ensure continuation of historic negotiated outcomes in existing contracts (in respect of both service offerings and relative pricing) even where those contracts have been negotiated outside the NSWRAU; and*
- *Ensure decisions in respect of revenue over or under recovery in instances that require heavy regulation are enforceable.*

*Such a framework is consistent with all the key principles outlined in the Issues Paper and, critically, provides a base to pursue the critical goal of national consistency.*

## **CONSISTENCY OF RECOMMENDATIONS WITH THE PREFERRED REGULATORY FRAMEWORK**

Following its review of IPART's Draft Report of its Review of the NSWRAU, ARTC believes that the recommendations in respect of changes to the NSWRAU are largely consistent with its preferred regulatory framework. Importantly, ARTC believes that the recommended changes support a framework that:

- Promotes efficiency through encouraging negotiated outcomes whilst providing access to a balanced dispute resolution process;
- Constrains any potential use of market power through a focus on transparency of access principles and pricing methodologies; especially in respect of the justification of price increases;
- Pragmatically balances the impact of transparency and the regulatory burden felt by participants by ensuring that reporting and transparency requirements are fit for purpose given the particular market dynamics applying to a specific network (subject to some areas of concern raised below); and
- Provides clarity on the process by which a network may revert back under the coverage of the NSWRAU if it has been subject to a voluntary undertaking under Commonwealth legislation, subject to the implementation of recommended changes to ensure consistent methodologies are applied; and



- Importantly the recommended framework does not constrain this ability to have networks covered under voluntary provisions of the CCA.

## **AREAS OF CONCERN**

Whilst ARTC is generally supportive of the proposed changes, it does hold some areas of concern in respect of the presence of some prescription in the NSWRAU which could constrain the NSWRAU's operation in the future and create regulatory uncertainty.

The proposed framework has largely been developed to ensure its longevity by avoiding reference to specific methodologies and approaches that could become redundant over time. However, there are areas (such as the treatment of sustaining capital) which still provide a level of prescription in the NSWRAU.

Other areas of concern for ARTC include:

- The transition process for undertakings that revert under the NSWRAU;
- Information and compliance obligations for existing segments;
- Commercial v Economic arbitration; and
- Network interoperability

## **TREATMENT OF CAPITAL IN THE CALCULATION OF RAB'S**

ARTC firmly believes that a consistent approach should be adopted to prescription across all areas in the NSWRAU, and any areas of specific definition and methodology, such as the treatment of aspects of capital should, like the WACC approach, not be defined in the NSWRAU itself.

ARTC supports the proposed application of economic lives to the calculation of depreciation periods for networks. This proposal is consistent with ARTC's preferred approach to capital definition as it removes prescription and definition from the NSWRAU and transfers them to the access principle determination and assessment process.

ARTC would note that differences between the ACCC and IPART in respect of the approach to calculate an economic ceiling create uncertainties in respect of any transition of the HVAU back under the NSWRAU. These uncertainties arise because key parameters, such as the RAB and over/under balances, would be required to be reformulated based on consistent methodologies.

Avoiding definitions in the NSWRAU would therefore provide IPART the necessary, and valuable flexibility, to assess any proposed reversion framework and could include a transition from the current approach to IPART's preferred outcome over time. Defining the capital process to apply in the NSWRAU reduces that flexibility, introducing uncertainty in any transition and would therefore appear inconsistent with a principle of increasing regulatory certainty.

***ARTC would therefore strongly recommend that the proposed treatment of categories of capital be excluded from the NSWRAU itself.***

## **THE ABILITY TO REVIEW DEPRECIATION PERIODS AND WACC'S**

As highlighted above, ARTC strongly supports the proposal that IPART's ability to review depreciation periods and WACC's not be limited to fixed 5 year periods as well as the recommendation that such reviews be based on the particular circumstances of specific networks. This not only removes prescription from the NSWRAU but also ensures that where

a network comes under the coverage of the NSWRAU, the depreciation and WACC that apply to the calculation of the economic ceiling would be assessed at the point at which the network is covered. ARTC believes this is a balanced and fair outcome.

Given that both of these parameters are subject to market conditions that are constantly changing, there will always be an incentive for one side of the calculation to seek a review based on the direction of those movements. ARTC believes that introducing this market volatility into the parameters that underpin revenue will increase uncertainty and hence reduce the efficiency of the regulatory framework. Therefore, ARTC would suggest that whilst the framework should allow for the review of the parameters at a relevant point in time rather than a specific point of time as currently applies, the ability to consistently review these numbers should be constrained and only be permitted in exceptional circumstances that could not have been predicted at the time of the decision and not be allowed purely to address market volatility or opposing views. This would ensure there is no overarching right to constantly seek review and import market volatility into arrangements that are not part of the proposed framework.

The process whereby IPART consults on its preferred WACC methodology and determines that methodology to apply based on periodic reviews (and publishing of updates of what a determination would deliver biannually) is strongly supported by ARTC. It delivers certainty and transparency to market participants on the broad WACC approach, allows for change to reflect changing conditions, and importantly is defined outside the NSWRAU. Recent versions of this methodology provide for the use of a trailing debt average to provide a more accurate cost of debt outcome for network owners over the term of a decision; noting it does require annual changes to the WACC used in ceiling calculations. ARTC agrees with IPART that this approach, as well as that for key asset terms such as economic life of assets, need to allow for network specific determinations given the differences in service quality and utilization that apply. Further, these network specific determinations need to allow for the negotiated outcomes that trade off service risk and return, which outcomes have underpinned the development of the Hunter Valley coal network.

ARTC supports a principle of the provision of a more accurate cost of debt assessment. This process should also incorporate specific commodity-based debt premia that network owners are due to fund. A reality of the current financial environment is that debt related to coal networks has a coal premium applied to that cost of debt, over and above any credit rating premium or equity risk and the changing nature of debt markets related to fossil fuels needs to be reflected in updated WACC calculation methodologies.

***ARTC supports the calculation of key parameters at the relevant point in time an application is made that define the revenue ceiling at a network specific level based on overarching methodologies determined via a separate IPART processes whilst promoting negotiated outcomes that improve network efficiency. These applications must not allow for reopeners beyond exceptional circumstances to avoid the introduction of market volatility into the ceiling calculations.***

## **TRANSITION OF VOLUNTARY UNDERTAKINGS**

ARTC appreciates the recognition that voluntary undertakings under the CCA can lapse which would result in reversion under the NSWRAU, and the process to provide a degree of regulatory certainty in such an event.

ARTC would note that voluntary undertakings, such as the HVAU, can reflect negotiated outcomes between itself and its customers that allocate service quality, risk and return to deliver improved outcomes to both sides. Whilst it is never ARTC's intention to revert back to the NSWRAU, it is always a potential outcome of a voluntary process that reflects a

negotiated outcome. Any transition of these undertakings back under the NSWRAU must account for these negotiated outcomes. That is, the service quality cannot default to an undertaking without specific allowance for those increased risk elements being reflected in the network specific return calculation. ARTC notes the principles underpinning the provision of access principles 12 months ahead of any potential reversion, but also notes such a timeframe may be a challenge. ARTC is happy to work with IPART and customers on this process to maximize the efficiency of any reversion. However, ARTC does not agree that the current HVAU service offering should underpin this transition unless there is allowance made for the risk-return trade-offs that have underpinned that service.

***ARTC supports the recognition of the reality that voluntary undertakings may revert to the NSWRAU and the attempts to provide some transparency on this process. There are issues of consistency in respect of both the economic methodology between undertakings and the treatment of negotiated services that would need to be addressed in any transition; however, these are network specific and not appropriate to address in the NSWRAU, beyond setting a time frame for transparency of relevant access conditions to apply.***

## **CURRENT NETWORK OBLIGATIONS**

ARTC acknowledges the value for IPART in assessing floor costs to identify any potential cross subsidies either between traffic types or between the community and rail users. However, in order for this analysis to make sense, IPART would need to consider the price paid across the full journey of the train, rather than a particular segment in isolation and noting that parts of the journey could be in other networks regulated by different instruments.

ARTC would propose that the relevance of testing the floor price should only apply where the full journey of the train under a network manager's control is under IPART coverage. If there are multiple networks involved, the analysis will not deliver any value based on IPART's aims whilst imposing a regulatory burden on network managers to develop and report on the cost. Such an action would be inconsistent with the stated aim of fit for purpose regulation.

The one exception to this would be where a network manager had denied access based upon a requested price being below a floor price level. In such a circumstance, ARTC believes it is incumbent on the network manager to support its position by demonstrating the floor price level.

Where a network has published pricing, the potential value of transparency of floor pricing providing an understanding to potential users of pricing in determining the commerciality of their access proposal is nil as the published pricing meets that analytical need.

This presence of published pricing also impacts on the need to provide information in response to an access application. ARTC notes that the value of much of that information is redundant in the presence of published pricing and indicative access agreements, with compliance processes also providing transparency on cost, revenue and performance outcomes. Similar to other issues, ARTC proposes that the detailed information requirements in response to access applications should not be defined the NSWRAU, but rather detailed in the proposed access principles and assessed by IPART under that review process.

Similarly, the requirement to provide detailed pricing methodologies for existing pricing should be removed; however, ARTC is supportive of a requirement to detail the commercial justification for real price rises. ARTC notes the discussion in the public forum where IPART expressed a view that these justifications be limited to cost increases. ARTC firmly believes



that increased risk is a justification for price increases as this reflects an increase in economic cost. The concept that higher risk begets a higher return (or price) is a fundamental principle in financial and regulatory theory and ARTC does not support any limitation on this principle.

This approach would deliver transparency and certainty via a fit for purpose regulatory mechanism; whilst also ensuring that the potential economic hold-up problem is addressed via the requirement to commercially justify price increases.

***ARTC supports the provision of transparency through published pricing and reporting on performance outcomes. The extent of information reported, and the information provided to an access seeker, is network specific and therefore should be defined in access principles and not in the NSWRAU to ensure the regulatory requirements are fit for purpose and do not impose unnecessary burdens on network managers that create no corresponding benefit.***

## **COMMERCIAL V ECONOMIC ARBITRATION**

Where there are price disputes that reflect commercial principles, such as differing values of risk in a negotiation, ARTC believes resolution of such disputes are best met by commercial arbitrators rather than economic regulators. This approach has underpinned the development of the arbitration framework applied under the National Gas Law and appears to have worked effectively in promoting commercially negotiated outcomes. Given the promotion of such outcomes is a goal of the regulatory framework, ARTC believes such an approach should be the default mechanism for dispute resolution.

The requirement to provide supporting reasons for price increases is consistent with this dispute resolution process as it provides the arbitrator with the necessary base information to determine what, if any, price is reasonable.

***ARTC strongly supports the use of commercial arbitration to resolve access disputes.***

## **NETWORK HARMONIZATION**

ARTC acknowledges the discussion in the public forum, consistent with the submissions made as part of the review process, by its customers in respect of the need for improved interoperability across rail networks with disparate ownership.

ARTC has provided significant support through a number of industry and government processes on the need for improved interoperability and harmonization across rail networks. However, ARTC does not support the use of economic regulation as the tool to enforce actions of network owners to deliver improved interoperability outcomes. This is because economic regulation must, by its very nature, be network specific and not impose obligations on a network owner/manager that it cannot completely control; and each network manager cannot control the actions of another.

ARTC therefore supports a focus on improved interoperability outcomes and is happy to engage on the actions it is taking to achieve this, but given they rely on actions of other players, it is not appropriate to place an economic regulatory burden to deliver an outcome it cannot control. These issues are better dealt with in operational fora or at a policy level, not in access frameworks specific to that network manager.

***ARTC would not support any introduction of regulatory requirements on interoperability into the NSWRAU on the basis that access principles are network specific and ARTC cannot accept an obligation it cannot 100% control.***