



Review of the NSW Rail Access Undertaking

Hunter Rail Access Taskforce submission
in response to the Draft Report

16 December 2022

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1 Executive Summary

The Hunter Rail Access Taskforce (**HRATF**) welcomes the opportunity to comment on IPART's Draft Report on its review of the NSW rail access undertaking (**NSWRAU**).

HRATF is a user group comprising coal producers operating mines in the Hunter Valley, including Bengalla, Bloomfield Group, Glencore Coal, Idemitsu Australia, Hunter Valley Energy Coal (BHP), Mach Energy, Peabody Energy, Whitehaven Coal and Yancoal Australia.

All of HRATF's members rely on access to the Hunter Valley coal rail network (**HVCN**).

For over a decade, HRATF has been the collective user group through which industry has engaged with the Australian Rail Track Corporation (**ARTC**), the Australian Competition and Consumer Commission (**ACCC**) and IPART in relation to access arrangements for the HVCN.

1.1 HRATF's interest in this review

Although access to most parts of the HVCN is currently regulated by the ACCC under the Hunter Valley Access Undertaking (**HVAU**) – an undertaking voluntarily submitted by ARTC and approved by the ACCC under Part IIIA of the *Competition and Consumer Act 2010* (**CCA**) – the NSW rail access undertaking (and the NSW regime more generally) plays an important role in shaping access arrangements for the HVCN and regulating the behaviour of ARTC:

The NSW undertaking effectively provides a 'backstop' set of access arrangements which would apply in the event that the HVAU expires or is withdrawn. The HVAU is a voluntary undertaking, and ARTC has a degree of optionality under this framework, particularly as the current HVAU approaches expiry. ARTC could choose not to renew its current undertaking and instead revert to regulation under the NSWRAU, simply by allowing the existing HVAU to expire.

The strength of regulatory controls under the NSW regime is therefore a key factor driving ARTC's incentives to maintain its voluntary ACCC undertaking.

In the event that the HVAU falls away and the HVCN reverts to IPART regulation, HRATF has a strong interest in ensuring that the NSW regime is effective and that there are appropriate transitional arrangements.

1.2 HRATF strongly supports this review and many of the recommendations in the Draft Report

HRATF strongly supports IPART's review of the NSW rail access regime. We have been of the view for some time that the regime is out of date. This review presents an important opportunity to update the regime and bring it into line with current regulatory best practice.

In our submission on IPART's Issues Paper dated December 2021 (**December 2021 Submission**), we made a number of suggestions for improvements to the NSW rail access regime.

We support many of the recommendations in the Draft Report and note that many are consistent with our December 2021 Submission.

In particular, we strongly support IPART's position on the need for individual access undertakings approved by IPART, as well as appropriate transitional arrangements to deal with 'regime switching'.

In this submission we provide some limited comments on the proposed principles to apply under the NSW regime. Our main interest is in ensuring that these can accommodate 'transitional' situations and provide for regulatory continuity in such situations.

1.3 We agree that the form of regulation should be calibrated to the economic characteristics of the relevant rail infrastructure

HRATF agrees that the form of regulation under the NSW regime should be appropriately calibrated to the risk of market power (or monopoly power) being exercised.

We therefore support the proposed principles-based approach to establishing regulatory arrangements for each part of the NSW rail network, and agree that it is appropriate for separate undertakings to govern access to different parts of the network, to accommodate differences between them.

While we support the proposed principles-based approach, including a common set of requirements for all access undertakings codified in the *Transport Administration Act (TAA)* and/or regulations, we consider that IPART should retain flexibility to impose stricter regulation where this is necessary.

In particular, any requirements in the TAA and/or regulations relating to pricing provisions of an undertaking should be sufficiently flexible to accommodate different forms of price control. In some cases (e.g. where there is competition from road), it may be appropriate for a rail operator to be subject to broad pricing constraints only – including floor and ceiling limits, non-discrimination, etc. However in cases such as the HVCN where there is no competitive constraint, a stronger form of price control – e.g. an IPART-approved reference tariff – is likely to be warranted.

This type of flexibility is typically provided for in other negotiate / arbitrate regimes, including the Queensland rail access regime and the gas pipelines access regime.

1.4 Relationship between the NSW and Commonwealth regimes

HRATF supports the approach adopted in the Draft Report to addressing interactions between the NSW and Commonwealth regime. In particular:

- we agree that there should continue to be scope for ARTC to maintain a voluntary undertaking under the national access regime; and
- we support transitional arrangements designed to maintain continuity of access and avoid any regulatory gap.

From HRATF's perspective, the ability of IPART to impose a default undertaking modelled on the existing undertaking is a particularly important part of any transitional arrangement. HRATF notes that the concept of a default undertaking is referred to in the Draft Report but does not form part of the formal recommendations for transitional arrangements. This important element of the transitional arrangements should form part of IPART's final recommendations.

HRATF also wishes to ensure that there is sufficient flexibility in the NSW rail access regime to allow key elements of an existing undertaking to be maintained as part of a transition. This would include, for example, existing RAB values, user consultation forums, investment frameworks and capacity management mechanisms.

1.5 Principles for the NSW regime

For reasons set out in our December 2021 Submission, HRATF supports IPART's objective of updating and strengthening the NSW regime.

In particular, we generally support:

- stronger information disclosure obligations for service providers;
- statutory timeframes and guidance for negotiation and arbitration;
- updating the pricing principles;
- clarifying IPART's approach to depreciation and alignment of asset lives with *useful* lives (rather than just mine lives);
- clearer guidance around minimum non-price terms of access (including capacity allocation, expansion principles and KPIs); and
- stronger enforcement powers for IPART.

We note that some of these matters are addressed in the HVAU. Among other things, the HVAU includes a bespoke capacity management framework for the HVCN, an investment framework and performance indicators.

In the case of a transition from the HVAU to a NSW undertaking, there may need to be some flexibility around application of any principles set out in the NSW regime, in order to maintain continuity of these existing arrangements. In particular:

- **Roll forward of existing regulatory asset base (RAB) values.** It is unlikely to be necessary or appropriate to determine a new DORC asset value for rail infrastructure that has previously been regulated, either by IPART or under an ACCC undertaking. In such cases the existing RAB could just be rolled forward from the previously determined value.
- **Use of existing capacity allocation mechanisms.** As noted in our December 2021 Submission, sophisticated frameworks have been developed in the HVAU for industry consultation around capacity management and investment. HRATF would support these elements of the HVAU being brought across to any NSW undertaking applying to the HVCN, without having to satisfy the principles that would ordinarily apply under the NSW regime.

It may also be that existing elements of the HVAU (e.g. existing performance indicators) could be used as a foundation for an undertaking under the NSW regime, to avoid the need to build an undertaking from scratch.

2 Form of regulation

The Draft Report recommends a principles-based approach to establishing regulatory arrangements for each part of the NSW rail network.¹

HRATF strongly supports this approach. In particular, we agree that it is appropriate for separate undertakings to govern access to different parts of the network, to accommodate differences between them.

2.1 We agree that the regulatory arrangements applying to each part of the network need to be appropriately tailored

The Draft Report correctly observes that the HVCN is different to many other parts of the NSW rail network.² Unlike many other parts of the NSW rail network, the HVCN is subject to no meaningful competitive constraints. This is because, as noted by IPART, coal is prohibited from being transported by road.

Another potential difference between parts of the NSW rail network is the prospect of privatisation. Recent experience at the Port of Newcastle has shown that the risk of monopoly power being exercised is likely to increase when assets are privatised. Therefore, where a part of the NSW rail network is likely to be privatised, it may be appropriate for tighter regulatory controls to be imposed **prior** to this occurring.

We agree with IPART that the form of regulation needs to be appropriately tailored to reflect the different characteristics of rail infrastructure in NSW. A stronger form of regulatory oversight needs to apply to parts of the network where there is a greater risk of market power (or monopoly power) being exercised – as is the case for the HVCN.

We therefore agree that individual access providers should be required to offer an undertaking that is tailored to their particular network, with these undertakings to be approved by IPART.

We also agree that it is important for IPART to have powers to prepare and approve an undertaking itself, in circumstances where the access provider fails to submit an acceptable undertaking. This is consistent with the approach adopted in other access regimes, including the Queensland rail access regime³ and the gas pipelines access regime.⁴

2.2 There should be flexibility for IPART to impose stricter tariff regulation where there is a greater risk of monopoly power being exercised

While we support the proposed principles-based approach, including a common set of requirements for all access undertakings codified in the TAA and/or regulations, we consider that IPART should retain flexibility to impose stricter regulation where this is necessary.

In particular, any requirements in the TAA and/or regulations relating to pricing provisions of an undertaking should be sufficiently flexible to accommodate different forms of price control. In some cases (e.g. where there is competition from road), it may be appropriate for a rail operator to be subject to broad pricing constraints only – including floor and ceiling limits, non-discrimination, etc. However in cases such as the HVCN where there

¹ Draft Report, pp 20-21.

² Draft Report, p 20.

³ QCA Act, ss 135, 136A, 141.

⁴ National Gas Rules, r 64.

is no competitive constraint, a stronger form of price control – e.g. an IPART-approved reference tariff – is likely to be warranted.

This type of flexibility is typically provided for in other negotiate / arbitrate regimes. For example:

- Under the Queensland rail access regime, reference tariffs are approved by the QCA for some services (including coal services), while pricing for other services is subject to floor and ceiling constraints only. Typically those services that are subject to competition (non-coal services) are subject to the lighter form of constraint. This flexibility to deal with different degrees of market power is provided for in the governing legislation.⁵
- Under the gas access regime, a pipeline may be subject to either ‘full’ or ‘light’ regulation, depending on its economic characteristics. Under ‘full’ regulation (but not light regulation), the AER-approved access arrangement must include a reference tariff.⁶

HRATF considers that the NSW rail access regime should similarly provide flexibility for IPART to impose an appropriate level of price control.

The Draft Report indicates a preference to retain the current ‘floor’ and ‘ceiling’ principles in the NSW rail access regime. HRATF agrees that these are appropriate economic principles. However in some cases the form of tariff control may need to go beyond these principles and include an IPART-approved reference tariff. This may be the case where there is a large pool of common costs (meaning a wide range between the floor and ceiling limits for individual services or segments) and the potential for these common costs to be allocated in a way that distorts usage. In such cases, it may be necessary and appropriate for IPART to have the flexibility to impose a stronger form of tariff control.

3 Relationship between the NSW and Commonwealth regimes

HRATF supports the approach adopted in the Draft Report to addressing interactions between the NSW and Commonwealth regime.

3.1 We agree that there should continue to be scope for ARTC to maintain a voluntary undertaking under the national access regime

As previously noted, the current Part IIIA undertaking for the HVCN has generally worked well for all parties. The current Part IIIA undertaking is the product of more than a decade of negotiations between ARTC and users, overseen by the ACCC.

We therefore support IPART’s draft recommendation that the NSW regime remain uncertified under the national access regime, to allow ARTC to maintain its voluntary Part IIIA undertaking.⁷

3.2 Importance of transitional arrangements

While we see benefits in ARTC being able to maintain its voluntary Part IIIA undertaking, it is critical that there be appropriate transitional arrangements to deal with situations where this voluntary undertaking is withdrawn or allowed to expire. Without appropriate transitional arrangements, a sudden shift back to the state-based regime would be

⁵ QCA Act, s 137.

⁶ National Gas Rules, r 48(d).

⁷ Draft Report, p 27.

potentially disruptive to the industry and undermine the stable and effective regulatory and commercial framework that has developed under the HVAU.

Transitional arrangements should be designed to ensure that, where ARTC intends to switch between the Commonwealth and NSW regimes:

- there is continuity of access arrangements and protections for access seekers; and
- there is no 'gap' left between expiry of the ACCC undertaking and commencement of a NSW undertaking.

We generally support the proposed transitional arrangements set out in the Draft Report, including:⁸

- the requirement for an access provider to give IPART advance notice of their intention to withdraw a voluntary undertaking, or to not replace one when it expires; and to submit an undertaking under the NSW regime;
- if IPART has not finalised its assessment of the undertaking before the network switches to the NSW rail access framework then IPART could impose a default undertaking; and
- scope for IPART to use the existing voluntary undertaking as the basis for the default undertaking, at least for a period following the regime change.

From HRATF's perspective, the ability of IPART to impose a default undertaking modelled on the existing undertaking is particularly important – we see this as a key part of any transitional arrangement to maintain continuity of access and prevent any regulatory gap. The concept of a default undertaking is referred to in the Draft Report but does not form part of the formal recommendations for transitional arrangements. This important element of the transitional arrangements should form part of IPART's final recommendations.

HRATF also wishes to ensure that there is sufficient flexibility in the NSW rail access regime to allow key elements of an existing undertaking to be maintained as part of a transition. This would include, for example, existing RAB values, investment frameworks and capacity management mechanisms. This issue is discussed in the next section.

4 Principles for the NSW regime

HRATF supports IPART's objective of updating and strengthening the NSW regime. In our December Submission we expressed the view that the regime is now out of date, and we suggested a number of improvements to the regime to bring it into line with current regulatory best practice.

We have just a few comments on the proposed principles to apply under the NSW regime, set out in sections 4.2 to 4.6 below. Our main interest is in ensuring that these can accommodate 'transitional' situations and provide for regulatory continuity in such situations.

⁸ Draft Report, p 133.

4.1 HRATF supports many of the recommended principles relating to the negotiation process, information disclosure and application of the ceiling test

HRATF supports many of IPART's draft recommendations, noting that many of these are in line with our December 2021 Submission.

In particular, we support:

- **Clarity around the negotiation process.** We agree that all stakeholders would benefit from greater clarity around key actions and timeframes in the negotiation process, particularly obligations and timeframes for provision of information and access offers.
- **Facilitating collective negotiations.** HRATF agrees that the access regime should accommodate collective negotiations, where lawful. Consistent with this, access seekers engaged in collective negotiations should be able to participate in a joint arbitration of any dispute.
- **Stronger information disclosure obligations for service providers.** HRATF generally supports the recommended information disclosure obligations, subject to two comments:
 - In addition to information on how prices have been calculated, service providers should also be required to publish information to demonstrate that those prices comply with the pricing rules specified in their access undertaking. This should include relevant revenue and/or tariff models demonstrating compliance with tariff rules, as well as an explanation of key inputs.
 - HRATF queries whether it is necessary for service providers to publish individual prices paid by all customers. While it may be appropriate for IPART to collect this information in order to audit compliance with non-discrimination obligations, it would seem unnecessary for it to be published. In other regimes, service providers are typically required to publish **weighted average prices** (and standing offer prices), not individual prices.⁹
- **Clarifying IPART's approach to depreciation and asset lives.** We agree that asset lives should be aligned with *useful* lives for the relevant assets, which in some cases may be longer than mine lives (e.g. where there is an anticipated alternative use for the assets beyond the mine life).
- **Clearer guidance around minimum non-price terms of access.** HRATF generally supports clearer guidance around minimum non-price terms of access, including capacity allocation, expansion principles and KPIs. As discussed below, many of these matters are already addressed in the HVAU. Among other things, the HVAU includes a bespoke capacity management framework for the HVCN, an investment framework and performance indicators. In any transition from the HVAU to the NSW regime, it is likely to be appropriate to build on these existing frameworks in developing an undertaking for the HVCN.
- **Stronger enforcement powers for IPART.** We support bringing IPART's compliance and enforcement powers into line with those available to regulators under other access regimes. This should include IPART investigative powers, and an ability to issue directions, seek court orders and penalties.

⁹ National Gas Rules, r 552, 556.

4.2 In transitional situations, it is likely to be appropriate to draw on existing governance frameworks

Through the various collective negotiation and ACCC approval processes under Part IIIA, sophisticated frameworks have been developed for industry consultation around capacity management and investment. Section 5 of the HVAU sets out the capacity management framework and provides for engagement by ARTC with the Hunter Valley Coal Chain Coordinator (**HVCCC**) and other supply chain participants around determination of system parameters, capacity analysis and management of capacity shortfalls. The capacity investment framework is set out in sections 7 – 11 of the HVAU, and includes detailed processes for consultation with industry (represented by the Rail Capacity Group) and options for user funding.

The HVAU also includes a set of minimum terms and performance standards for the ARTC-operated portions of the HVCN. These include:

- an indicative access holder agreement setting out standard terms of access, and an obligation on ARTC to offer access in accordance with these standard terms;¹⁰
- frameworks for capacity management, capacity trading, network connection and network transit management;
- requirements for ARTC to periodically report on its network performance against a set of key performance indicators that are set out in Schedule D of the undertaking;¹¹ and
- a framework for ARTC and access seekers to negotiate KPIs to be included in an access agreement, guided by a set of principles.¹²

HRATF considers it critical that, in the event that the ARTC-operated portions of the HVCN come under the NSW rail access regime, these elements of the HVAU framework be preserved.

This may mean that there needs to be some flexibility for IPART in transitional situations. For example, it may be that where key non-price elements of an existing undertaking are endorsed by all stakeholders, there will be a presumption that these elements should be approved as part of a new NSW undertaking (i.e. these elements would not need to satisfy the usual criteria for approval).

It may also be that existing elements of the HVAU could be used as a foundation for an undertaking under the NSW regime, to avoid the need to build an undertaking from scratch.

Some specific examples of how this principle could apply are discussed below.

4.3 Use of existing capacity allocation mechanisms

Capacity allocation is one area in which the HVAU has generally worked well. The HVAU includes processes for developing system assumptions, undertaking capacity analysis, identifying shortfalls, and allocating capacity in the event of a shortfall.¹³

¹⁰ HVAU, cl 3.14 and Annexure A.

¹¹ HVAU, cl 13.1.

¹² HVAU, cl 13.2.

¹³ HVAU, cl 5.

The HVAU also includes a capacity investment framework, including requirements for industry consultation and options for user funding. This framework has been developed over the past decade by ARTC and users, and includes the following elements:¹⁴

- **Regular engagement between ARTC and users through the Rail Capacity Group (RCG).** ARTC meets on a monthly basis with the RCG, which includes one representative of each Access Holder, major Operators and the HVCCC. The purpose of these regular meetings is to consult on (and obtain endorsement for) expansion and sustaining capital expenditure. ARTC also uses the RCG as a forum to keep users informed about its maintenance plans and operational performance.
- **Process for RCG endorsement of capacity investment.** The HVAU (cl 9) includes a process for development and implementation of capacity investment projects, in consultation with the RCG. At each stage of project development, RCG is asked to endorse the project proceeding to the next stage.
- **User funding option (cl 10 of the HVAU).** Where ARTC elects not to fund all or part of a capacity investment project, there is scope for users to fund the project (in which case ARTC will have an obligation undertake the project pursuant to a user funding agreement).
- **Maintenance plans and updates (cl 9.11 of the HVAU).** Each year, ARTC must prepare a maintenance plan and budget for the following year. This must be circulated to the RCG and consulted on prior to ARTC publishing its Standard Access Charges for the relevant year. ARTC is also required to update the RCG on its maintenance activities and costs on a quarterly basis and after major closedowns.
- **Operational performance updates.** At each meeting of the RCG, ARTC is required to provide an update on the operational performance of the HVCN.

HRATF would support these elements of the HVAU being brought across to any NSW undertaking applying to the HVCN.

Provided that there continues to be support for the HVAU capacity management and investment frameworks (including the user consultation mechanisms), there could be a presumption that that these elements should be brought into any new NSW undertaking, without having to satisfy the principles that would ordinarily apply under the NSW regime.

4.4 Capacity resumption principles

The Draft Report includes recommended principles for the NSW regime dealing with capacity resumption, including that “*the access provider may revoke or curtail access rights if access holders persistently fail to use contracted paths*”.¹⁵ HRATF understands that this principle is intended to be consistent with the regulatory precedent cited elsewhere in the Draft Report, including the Aurizon Network Undertaking.¹⁶

As the Draft Report notes, capacity resumption can generally only occur where there is a sustained failure to use capacity entitlements **and** the access provider can demonstrate alternative demand for the capacity rights in question. For example under the Aurizon Network Undertaking, Aurizon Network must demonstrate a “*reasonable expectation of a sustained alternative demand for the Capacity used by the Access Rights in question*”.¹⁷

¹⁴ HVAU, cl 7, 8, 9 and 10.

¹⁵ Draft Report, recommendation 15(b).

¹⁶ Draft Report, p 67.

¹⁷ Aurizon Network Undertaking, cl 7.6.

HRATF would suggest that an equivalent principle be reflected in IPART's final recommendations for the NSW regime.

4.5 Rolling forward existing RAB values for transitioning networks

The Draft Report includes a recommendation that the RAB for NSW rail networks be valued using the DORC methodology.¹⁸

HRATF agrees that this is an appropriate principle to be applied when initially valuing the RAB (i.e. upon commencement of regulation).

However it is unlikely to be necessary or appropriate to determine a new DORC asset value for rail infrastructure that has previously been regulated, either by IPART or under an ACCC undertaking. In such cases the existing RAB could just be rolled forward from the previously determined value.

The purpose of DORC valuation in regulation is to set a starting value that is reflective of a workably competitive environment. That RAB is then used for the purposes of regulating revenue or prices reflective of a workably competitive environment.

The standard approach applied by economic regulators such as the AER, ACCC and QCA is to simply roll forward existing asset values once they have been initially set (updating for new capex, depreciation and inflation), rather than revaluing.¹⁹

Regular revaluations can lead to significant economic problems such as:

- windfall gains or losses due to adjustments to the RAB reflecting an exercise of regulatory judgement rather than investment or depreciation;
- greater price uncertainty where the RAB is subject to periodic revaluation; and
- increased regulatory risk due to the extent of regulatory judgement that must be applied.

In the case of the HVCN, there is an existing RAB value that was initially approved by the ACCC and has been rolled forward in accordance with standard regulatory principles. This value can and should be rolled forward to establish the RAB value under any NSW undertaking, in the event of a transition from the HVAU to the NSW regime.

4.6 Carrying forward the unders and overs account

The HVAU also provides clear guidance on the operation of the unders and overs account, including annual compliance testing.

As part of any transition from the HVAU to a NSW undertaking, there should be continuity in the unders and overs account (e.g. carrying forward any over-recovery balance accrued under the HVAU).

Consistent with this, any transition from the HVAU would need to allow for the completion of any outstanding ACCC compliance review processes. There would then need to be a mechanism to ensure that the outcome of these ACCC compliance processes is reflected in the carryover of any under/over-recovery balance and RAB values.

¹⁸ Draft Report, section 10.3.

¹⁹ For example: National Electricity Rules, cl 6A.2.1(e); National Gas Rules, r 77(2) and (3).