IPART

Independent Pricing and Regulatory Tribunal
New South Wales

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25 January 2017
Mr Matthew Schroder
General Manager
Infrastructure & Transport – Access & Pricing Branch
Australian Competition and Consumer Commission
GPO Box 520
Melbourne VIC 3001

Dear Mr Schroder

IPART submission to ACCC on ARTC HVAU 2017

Thank you for the opportunity to comment on your Consultation Paper on the 2017 ARTC Hunter Valley Access Undertaking (HVAU).

IPART was responsible for price regulation of ARTC's Hunter Valley coal network between 2004 and 2011. Prior to that, IPART was responsible for regulating the NSW Government entities that provided access to this infrastructure network. Our experience in regulating rail networks makes us well placed to comment on your Consultation Paper.

We provided our response to your initial consultation paper in February 2016. We raised suggestions in relation to the form of regulation, pricing principles and mechanisms to deal with the possible privatisation of ARTC.

Overview

The combinatorial ceiling test at the heart of price regulation in the Hunter Valley is counterintuitive and potentially complex to apply. Nevertheless, its in-principle superiority to alternative pricing rules justifies the effort required to apply it.

The potential welfare losses from adoption of a simpler, more uniform pricing scheme are large (potentially tens of millions of dollars per year, depending on the alternative scheme).

When ARTC transitioned from IPART to ACCC jurisdiction, it retained the essential features of the NSW Rail Access Regime, including the combinatorial ceiling test.

Several of the proposed changes to the ceiling test operation would weaken the test and remove efficient pricing flexibility, as noted below. In this submission, we provide comment on the changes proposed by ARTC in its 2017 version of the HVAU concerning floor and ceiling revenue limits. Our comments concern the following three issues:

1. IPART supports the continued use of the combinatorial ceiling test, however we do not support the proposed dual ceiling limit approach to creating two constrained networks. Maintaining a ceiling test that is flexible will account for the possibility that the constrained combination of mines might change over time.
2. We do not support any firm rule that sets a maximum of Incremental Cost for Pricing Zone 3 producer payments for the use of Pricing Zone 1.
3. We do not agree that usage charges paid by Pricing Zone 3 producers for use of Pricing Zone 1 should be levied on a take-or-pay basis.

Dual ceiling limit

Maintaining a ceiling test that is flexible will account for the possibility that the constrained combination of mines might differ from any grouping of the current pricing zones. The dynamic nature of the coal mining industry, and of costs to serve it, implies that a full combinatorial test should be done every year.

At its simplest, the ceiling test ensures that no group of access customers pays more than the stand-alone cost of the network it requires. If any group of customers were to pay more than the stand alone network costs, then that group could build and operate its own network at lower cost.[1]

In order to thoroughly test whether this condition is met, it is necessary to consider a wide range of possible customer groups. The constrained group is not a fixed set of mines or track segments. Therefore, the ceiling test should not be simplified by limiting it to the group that is currently constrained. By placing arbitrary constraints on the groups of customers that are tested (for example, by performing separate ceiling tests for Pricing Zones 1/2 and 3) some instances of pricing above stand-alone costs for a group of customers might not be identified.

Under a dual ceiling limit approach, separate ceiling tests for pricing zones 1 and 2 and pricing zone 3 would be calculated to detect any constrained groups of customers. The current constrained group contains mines from both Pricing Zone 1 and 2.

The current constraint on access prices would be weakened by this dual ceiling approach. If dual ceiling tests were to be calculated it would be necessary to allocate costs across the networks to particular mines. If a single universal ceiling test were applied to every possible combination of mines across all three pricing zones, then there would be no need for arbitrary cost allocations. That is the current situation. There is no good reason to depart from it in our view.

Maximum of incremental cost

In principle, pricing zone 3 producers should contribute no less than their incremental costs when traversing pricing zone 1 and no more than their stand alone costs. Under current conditions it may be appropriate for these producers to contribute only their incremental costs, however in our view this outcome should not be codified as a firm rule.

1 If entry barriers did not exist for infrastructure ownership.

It is likely that the use of the rail network will change over time. In particular, when older mines with lower transport costs become exhausted, and their output is displaced by newer mines which have higher transport costs but lower mining costs, it may be appropriate for pricing zone 2 and 3 producers to pay up to their full stand-alone efficient costs for use of the pricing zone 1 track.

Take-or-pay usage charges

ARTC is proposing to provide pricing certainty to customers, by requiring pricing zone 3 producers' incremental costs of using pricing zone 1 be recovered on a take or pay basis. Previously pricing zone 3 producers only contributed their own direct costs for the use of pricing zone 1. These were variable costs that were avoidable if pricing zone 3 trains did not run.

However, the June 2016 ACCC Final Determination for the 2013 Annual Compliance process held that pricing zone 3 producers must also contribute toward pricing zone 1 capital costs they cause. These capital costs, once sunk, are not avoidable if pricing zone 3 producers' trains do not run.

In our view, a more cost reflective approach would be to continue to base the recovery of direct costs on actual usage, and to base the recovery of capital costs on contracted commitments. This approach represents a small change to the proposal by ARTC. It would lead to more efficient prices because they would reflect the extent of cost variability that ARTC actually experiences.

By charging a fixed price (through take-or-pay arrangements) for a variable cost (for example, usage-based wear and tear on pricing zone 1 track caused by pricing zone 3 producers) the ACCC might make the price structure more inefficient by making it less responsive to changes in usage.

Please contact Mike Smart on 02 9113 7728 if you have any questions about this submission.

Yours sincerely

Hugo Harmstorf
Chief Executive Officer