RAIL SERVICES

QUBE LOGISTICS (RAIL) PTY LTD
ABN 63 082 313 415

9 Stonny Batter Road
Minto NSW 2566

PO Box 512
Matraville NSW 2306

T: 02 9603 0960
F: 02 9603 0950

qube.com.au

17 July 2018

Ms Natalie Plumridge
Senior Analyst
Mr Grant Kari
Director Infrastructure & Transport – Access & Pricing
Infrastructure Regulation Division
Australian Competition & Consumer Commission
Level 17, Casselden
2 Lonsdale Street
Melbourne VIC 3000

Re: Interstate Rail Interstate Access Undertaking 2018

Dear Natalie and Grant,

Thank you for your 3 July letter giving rail operators the opportunity to submit assessments of the proposed ARTC Interstate Access Undertaking.

The attached pages contain a brief, but considered summary of Qube's assessment.

We trust that our paper is helpful and look forward to learning more about further opportunities to contribute to the IAU.

Yours sincerely,

Ross Nacey
General Manager Commercial

Introduction

On 15 June 2018 Qube wrote to the ACCC suggesting that an extension of time for submissions would facilitate a more detailed understanding of how proposed changes to the ARTC Interstate Access Undertaking (IAU) would impact rail operators using the interstate network. Qube advised it intended to conduct a detailed review that included further meeting(s) with the ARTC to understand the proposal in greater detail.

The provision of a formal consultation period and negotiation of a four month extension with the ACCC was subsequently advised in correspondence of 3 July.

During the consultation period Qube has:

1. Reviewed the proposed IAU and made comparisons to the previous version,
2. Assessed the undertaking against present published access tariffs,
3. Met with ARTC on two occasions at a commercial level, and
4. Formed conclusions and recommendations that are the basis of this submission.

It should be noted that the ARTC has shown a preparedness to engage with freight rail operators in order to reach a workable outcome from the current process and this conduct has been helpful in preparing this submission.

Analysis of the Undertaking

Previous Undertakings

The proposed IAU is not hugely different from previous ones and it is worth understanding why rail operators are now contesting it when in the past they have not. Certainly there is a view amongst most network owners that previously agreed provisions should not be contested now.

The rail freight industry is in a process of accelerated change. The recent closure of Aurizon's interstate business is of clear significance. Alongside that event is an industry that has substantially evolved away from public ownership into a group of commercially driven enterprises. Where access agreements and undertakings were not seen as negotiable in the past, their reassessment is now rightly seen by participants as a crucial part of their ongoing viability.

As a result all network owners in Australia need to expect that their handling of monopoly assets with be scrutinised by participants and their proposed contracts tested for commercial veracity. It seems reasonable that rail operators, whose shareholders invest large amounts of capital into rail, should be given that opportunity.

Method of Asset Valuation & Rate of Return

The Initial Regulatory Asset Base (RAB) method employed to identify the ceiling limit (and presumably Return On Capital Employed (ROCE)) simply put is set on the basis of:

- Replacement cost of the domestic rail network
- Plus capital expenditure (maintenance and improvements)
- Less depreciation
- The total of the above multiplied by 1 + CPI
- To give an annual value

The result of this method is that the ceiling price is always going to be high and the ARTC is unlikely to ever achieve its WACC or any other reasonable rate of return.

Commercial operators are justified in contending that other methods of valuation would produce a substantially different result.

Indicative Services & Indicative Access Charges
The Indicative Service method is based on Interstate Super Freight trains; the largest train type (by size, frequency and weight) operated on the interstate networks.

Floor & Ceiling Pricing Methodology
While parts of the IS method are described, it is unclear exactly how the floor and ceiling charges are identified. *Although the ARTC has offered to provide Qube with more detailed information if required.*

Current Tariff
The present published tariff(s) are higher than the IAC floor and substantially (4 – 5 times) lower than the ceiling.

There is no method or process offered that bridges the IACR to the present tariff.

Thus the IAU allows the ARTC to set tariffs unencumbered by any commercial tension. It only needs to ensure it does not exceed the ceiling prices which, as stated above, are several times higher than the present tariff.

There is no recourse available to freight rail operators or the industry if the costs are considered too high. The IAU includes a negotiation process (including dispute resolution) as part of an Access Application, but neither is offered in relation to the setting of tariffs.

Summary of Analysis
There is nothing in the IAU that provides any rigour in the application of actual tariffs and, as a result, there is nothing that prevents the ARTC from arbitrarily increasing its charges up to the proposed ceiling.

ARTC Engagement
Qube has attended meetings with ARTC at a commercial level and discussed aspects of the IAU.

Negotiation & Application of Rates
ARTC has offered to negotiate the present tariff. When pressed on this, it is unclear whether a negotiation would be with Qube, with all operators singularly, or with rail operators as a group. As the tariff is published, it is not expected that there would be competition concerns with a group negotiation.

Given the opportunity, Qube would advocate an approach to negotiation that involves ARTC and all freight rail operators. The task for this group would be to amend the proposed IAU to include a bridge from the existing, proposed document to future tariffs and, in the process, identify some key improvements including:

- An annual review mechanism that is market driven,
- An opportunity for rail operators to negotiate,
- A cost based continuous improvement approach and
- A dispute resolution procedure.

CPI Approach
ARTC's annual CPI increase approach is at best an arbitrary approach to annual adjustments. There is, for example, no review to market (such as a comparison to road haulage costs) or cost down continuous improvement program.

Existing annual cost increases are neither negotiated nor disputed.

Return on Capital

ARTC provides an argument that its business doesn't achieve an ROCE commensurate with what would be required of it if it were not a government owned corporation. This contention is hard to reconcile given the RAB method of valuing ARTC assets.

Summary of Analysis

The ARTC has tabled its view that any move to substantially increase pricing would threaten its share of the national domestic freight market. Further, the ARTC has reasserted that it is an absolute proponent for growth in freight rail volumes.

While both may be true, the IAU should not as a matter of principle rely on the goodwill of present management to control future tariff increase excesses. It is publicly known that the Federal Government recently considered privatising the ARTC and, while that initiative is on hold, it is reasonable to assume that it will be considered again in the future and possibly within the life of the proposed IAU.

Qube considers that while the opportunity exists and while the ARTC is showing a preparedness to negotiate, the rail freight industry has an opportunity to modernise the IAU to reflect present day circumstances including the needs of rail freight users.

Conclusion & Recommendations

Qube has intentionally responded succinctly to the ACCC's consultation letter in order to only address key points.

Qube's conclusion is that the existing IAU doesn't go far enough to protect rail freight operators and users from unjustifiable access cost increases or provide sufficient transparency in the way in which those access rates are determined.

It is recommended that the rail freight industry and ARTC are tasked with negotiating an undertaking that amends the proposed IAU to include a bridge from the existing approach to a new modernised process for determining future tariffs that reflects present day circumstances and the needs of rail freight users.