SYDNEY PORTS
FIRST PORT, FUTURE PORT

13th November 2012

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Australian Competition & Consumer Commission
Level 37 360 Elizabeth Street
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Dear Dijana

VARIATION TO THE INTERSTATE RAIL NETWORK ACCESS UNDERTAKING: SUPPLEMENTARY SUBMISSION.

Thank you for the opportunity to elaborate on Sydney Ports' submission[1] during discussions between ACCC and Sydney Ports on 1 November 2012. This letter provides more details in respect of application of Pricing Principles and also potential for opportunity pricing to maximise the efficiency of the SSFL.

Pricing Principles

<u>Preamble</u>

Ceiling Charges have applicability in high volume capacity constrained supply chains to attract capacity enhancing investment to the benefit of end users. The return on investment is amortised across significant volumes. An example of this type of model is the rail network used in the Hunter Valley Coal Chain.

Where volumes are not constrained by the available infrastructure a Ceiling Charge would recoup investment across a sub optimal task (ie across fewer tonnes) leading to uneconomic outcomes for users.

This type of excess capacity is usually the result of legacy network development. Pricing methodologies, usually regulated, takes this into account so as not to disadvantage current users while ensuring the network owner is not disadvantaged for any tonne of traffic via application of a Floor Charge.

Nevertheless Network Owners are incentivised to maximise revenues to offset at least in part their significant fixed costs. This can and should only be done in the context of the modal competitive environment. Where the road modal option enjoys significant benefit via under recovery of their fixed infrastructure network, the rail network cannot recover commensurately more without impacting efficiency by sub optimal modal balance.

[1] Sydney Ports Corporation submission to the ACCC re: Proposed Variation to the Interstate Rail Network Access Undertaking

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Current Status

The SSFL has been provided by ARTC not because of capacity constraints but as an imperative to remove rail commuter conflicts with freight services and to increase time of day options for users. It will also increase utilisation and therefore revenues from the current Interstate Rail Network by feeding and taking traffic across more hours of the day.

ARTC have proposed through their Variation to Interstate Rail Network Access Undertaking (*Variation*) to set their Access Charges (Proposed Revenues) at around 5% of the stated Ceiling Revenue or 700% of the Revenue Floor (ie incremental cost). The graphical display in the Variation serves to illustrate;

- compliance with the Pricing Principles; and
- that the Proposed Revenues at 5% of Ceiling Revenues are a modest imposition.

The doubling of the current Access Charge available on the adjacent RailCorp Network is not addressed in the Variation and the impact on rail competitiveness, particularly in the Port Metropolitan market, nor the stated benefits of the SSFL quantified such as reduced transit times, improved flexibility and improved reliability.

Observations

Modelled Ceiling Revenue is a function of forecast traffic volumes, operating costs, ROI and asset base. Sydney Ports accepts it is improbable that any review would result in the proposed Access Charges breaching Ceiling Revenues. However if an independent review were to find the Ceiling Revenue to be significantly less than submitted in ARTC's Variation, the Proposed Revenues would therefore exceed the stated 5% of fixed infrastructure costs. In a modal contestable environment the Proposed Revenue may not be a modest imposition and indeed may greatly exceed fixed infrastructure costs recovered from the road alternative.

In this respect it is worthwhile examining the modelled Ceiling Revenues.

Ceiling Revenues

Sydney Ports is not in possession of data, nor in a position to comment on rail network operating costs, ROI, and the impact of forecast volumes on proposed Access Charges. However it is Sydney Ports view that one of the main drivers of Ceiling Revenues, the $1 billion asset base of the SSFL, be reviewed by ACCC as below.

SSFL Asset Base

Sydney Ports requests the ACCC examine the economic value of the SSFL with respect to determining an appropriate asset base. This analysis may involve some of the following aspects.

- Identifying SSFL costs incurred that are additional to an Optimised Network built on a green field site.

   - Reconfiguring or augmenting RailCorp assets to facilitate continued passenger access and the SSFL. These included new station buildings, maintenance facilities and overbridges.
   - Access constraints to SSFL worksites posed by the existing RailCorp network.
   - Accommodating the existing RailCorp network by additional works such as the Casula Flyover and signalling separation.
   - Land acquisitions at a premium cost due to Sydney property prices and developed land values.
   - Redevelopment of roads, retail and industrial premises to accommodate the SSFL.

   An optimised replacement cost assessment may discount these uneconomic cost imposts for end users.

- Asset Base benchmarking
   - The RAB for the Hunter Valley Coal Network is currently $1.019 billion for approximately 570 track kms[2]. Assuming the current asset is 60% depreciated this equates to an ORC of $1.7 billion or $3 million per km. Applying this rate to the SSFL would deliver the SSFL an asset base in the order of $100 million for the purposes of determining a ceiling price.
   - ARTC submitted[3] to ACCC that an upper limit ORC is approximately $0.6 million per track kilometre plus earthworks.

   In the same submission earthworks were quoted from $0.3 million to $1.5 million per track kilometre depending on topography. (Recent Hunter Valley works of $2 million per kilometre for a relatively short 7km section was used to justify this benchmark.)

   Using upper limits of these benchmarks (adjusted to 2012) would provide an asset base in the order of $85 million for the SSFL.

- Industry Consultation.
   - The original press release[4] quoted $192 million would be expended on the SSFL.
   - Subsequently Schedule H of ARTC's 2008 Access undertaking shows total expenditure on SSFL at $250 million.

   It is noted that there was no subsequent consultation process as is practiced for example in the Hunter Valley Coal Chain or notice given before presenting the asset base as $1 billion in the Variation.

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[2] '1 July to December 31 2011 Submission to ACCC in respect of Hunter valley Access Undertaking – Roll Forward Asset Base Ceiling Test Unders and Overs Account.' by ARTC
[3] 'ARTC Standard Gauge Rail Network DORC Australian Rail Track Corporation June 2008'
[4] http://www.artc.com.au/library/agreement_syd.pdf

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Opportunity Pricing

Sydney Ports understands the SSFL will accommodate a mix of traffics with different on track performances in terms of train length and acceleration. This range of traffics is also provided with varying train control priorities by ARTC. Sydney Ports is of the view that opportunities exist to maximise the efficiency of the SSFL by differentially pricing metropolitan port traffics on the following basis.

- Longer freight services typically have loads matched to their motive power providing slower acceleration curves.
- Conversely Metropolitan Port traffic trains are shorter with motive power potentially in excess of loads.
- Metropolitan Port traffic trains may therefore be slotted in between other freight services on an opportunity basis.
- In terms of network efficiency it may be desirable to price differentially to encourage fulfillment of these opportunities.
- Any pricing in this regard would also take into account where port traffic trains sit within ARTC's Train Priority Matrix[5].

In concluding Sydney Ports believes there is significant benefit to be derived from the SSFL with the appropriate settings in place. These settings must recognise but not exceed benefits flowing to users including improved train reliability where economic benefits accrue and time of day flexibility where demand exists. Indeed ARTC itself derives network synergy benefits including increased utilisation of the current ISRN. In this context Sydney Ports does not believe a doubling of the currently available Access Charge is warranted and indeed will provide inefficient outcomes with respect to modal choice, particularly in the Sydney Port Metropolitan market.

Sydney Ports looks to forward to the release of ACCC's Draft Decision on this matter.

Yours sincerely

Lachlan

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[5] ARTC Access Agreement – Schedule 4: Network Management Principles

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