

31 August 2018

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Dear Sir or Madam

## FORG submission to the consultation regulation impact statement: HVRR Phase 2 Independent Price Regulation of Heavy Vehicle Charges

### Introduction

The Freight on Rail Group (FORG) of Australia welcomes the opportunity to make a submission to the HVRR's Consultation Regulation Impact Statement (RIS).

FORG strongly supports the work undertaken by Marsden Jacobs and the acceleration of HVRR implicit in this work and in particular FORG supports the proposed timeframe of 2020 for implementation. This acceleration provides the best opportunity for the benefits identified in the RIS to be achieved.

FORG is a rail freight focused industry advocacy group established in 2015 to engage with government and key stakeholders on major public policy issues relating to rail freight. It consists of Australia's seven largest rail freight businesses. The businesses contribute \$11 billion each year to the Australian economy and employ almost 20,000 people, many of them in regional Australia.

The rail freight industry directly competes with heavy road vehicle freight in some freight supply chains but the road and rail freight industries also act as complements in other freight supply chains. Given this, FORG has had a strong interest in the current Commonwealth Government heavy vehicle road pricing policy process. This policy process provides an important opportunity to address competitive neutrality issues between road freight and rail freight.

Throughout this process FORG has held positions that:

- The different pricing frameworks for using transport infrastructure that apply to heavy road freight and rail freight negatively impact on the efficiency of Australian freight markets and the regulation of heavy road freight and rail freight should move to a consistent regulatory and pricing framework; and
- This consistent regulatory and pricing framework should be regulated by an appropriate independent regulator.

While FORG continues to strongly support the current Commonwealth Government HVRR policy process FORG has some comments on elements of the RIS as outlined in this submission.

This submission is public.

Please note that responses to the RIS Appendix 3 Guide Questions are Contained in Attachment 1 to this letter.

## FORG Comments on the RIS Proposals

The RIS focuses on two main elements:

- The establishment of the independent pricing regulator; and
- The implementation of the forward-looking cost base (FLCB) which will result in heavy road vehicles to be based on expected future costs.

### *Independent Price Regulator*

The RIS puts forward three options for the independent price regulator<sup>1</sup>:

- Rejection of Reforms - Business as usual;
- Option A - Simple price regulation by an independent price regulator; and
- Option B - Price regulation by an independent price regulator but with increased powers for the regulator to scrutinise cost proposals, consider user input and alter pricing structures (while remaining revenue neutral).

In relation to the establishment and powers of the independent price regulator FORG is a supporter of Option B for the independent price regulator as this Option is more likely to result in improved price signals and accountability. It is also closer to the end-state of the HVRR policy reform than Option A and is consistent with regulatory approaches that apply to rail freight.

However FORG believes any independent price regulator must have powers beyond those outlines in Option B, including powers to disallow costs, establish levels of service quality and alter pricing structure to reflect efficient economic cost structures even if this impacts on revenue neutrality.

Furthermore, to minimise the potential for economic inefficiencies, the independent regulator must have a national approach and act to ensure consistency of pricing frameworks across freight supply chains. FORG strongly prefers the independent pricing regulator has a national scope (i.e. not state based regulation or pricing) and has the ability to ensure consistent regulation across freight supply chains.

If FORG's objective of moving towards a consistent regulatory and pricing framework for road freight and rail freight pricing is achieved then productive efficiency gains can be expected in both the rail freight and road freight sectors. These benefits are likely to be maximised if the consistent framework is overseen by a single independent economic regulator.

FORG recommends realising these efficiency gains should be identified as an explicit policy objective of the HVRR process. Furthermore, this objective should be included in the any objectives established for the independent price regulator.

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<sup>1</sup> Regulatory Impact Statement pp14-15

### *Forward Looking Cost Base*

The RIS<sup>2</sup> states that under both Option A and Option B the proposed reform will “apply a building block model (BBM) to determine allowed revenue”.

This implies the FLCB is a building block model. However, in other sections of the RIS<sup>3</sup> the FLCB seems to only focus on future road investment and maintenance plans rather than the current road asset base, investments and maintenance costs that would be expected in a building blocks model.

FORG is unclear as to the detail of what is being proposed for the FLCB model. FORG believes building block models imply an element of backward looking cost assessment as the capital base is established via a depreciated optimised replacement cost (with the depreciation being backward looking) but the FLCB implies that costs are forward looking only. FORG strongly believes the nature and details of the cost base should be further clarified in some detail prior the Decision RIS.

The RIS<sup>4</sup> indicates there will be one building block model for each state and territory. While FORG recognises that separate road segments will have separate costs FORG is seeking that these costs all be subject to the same regulatory approach from a single regulator.

### *Reform pathway*

In addition to the Reform Options A and B, the RIS sets out two future reform scenarios, namely:

- Scenario 1 – No further reform undertaken
- Scenario 2 – Further reform undertaken, consistent with phases 3 and 4 of the HVRR program (where these phases are returning revenue to the asset owner based on use and implementing more direct user charging).

FORG very strongly supports Scenario 2. This is the scenario which results in the greatest benefit and it is the scenario which most closely aligns with the FORG position that road and rail pricing should be subject to a consistent regulatory framework.

FORG notes the RIS<sup>5</sup> considers whether the reform would have any adverse impact on competition and the RIS concludes that no adverse competition impacts would arise.

FORG strongly believes the reform outlined in the RIS will have positive competitive impacts as long as the infrastructure pricing approaches that currently apply to heavy road vehicles and rail freight move towards a consistent regulatory framework. This consistent framework will minimise the potential for market distortions and allow the different transport modes to compete on an even playing field.

The pricing structure that is applied is critical to the economic efficiency of HVRR. A well-designed pricing structure will ensure alignment between cost causality and pricing thus minimising cross subsidies.

<sup>2</sup> Regulatory Impact Statement p16 Table 1

<sup>3</sup> Regulatory Impact Statement p23

<sup>4</sup> Regulatory Impact Statement p16 Table 1

<sup>5</sup> Regulatory Impact Statement pp 62-63

Therefore, FORG seeks that the position on pricing structure be clarified in some detail prior the Decision RIS, noting that FORG has previously supported Mass Distance Location pricing as a critical feature of HVRR.

FORG notes the RIS<sup>6</sup> suggests that governments would set potentially prescriptive principles for pricing. While broad principles, such as those embodied in the Competition Principles Agreement, would be reasonable, any principles that constrained the independent pricing regulator from applying good economic practice would undermine the intent of the reform and the independence of the regulator.

FORG seeks that if the HVRR process contemplates proceeding down this path then this should would be subject to a separate consultation process.

### Conclusion

FORG continues to strongly support the current Commonwealth Government heavy vehicle road pricing policy process. In particular, FORG very strongly supports:

- Reform Option B - Price regulation by an independent price regulator with increased powers for the regulator; and
- Scenario 2 - Further reform is undertaken consistent with phases 3 and 4 of the HVRR program.

FORG has some concerns about the nature of the FLCB and seeks that the FLCB be further clarified, perhaps via worked examples or additional detail about how the costs in the FLCB will be calculated and then developed into prices.

Through the involvement of FORG's members in the regulation of rail infrastructure, FORG has extensive experience with different pricing and regulatory models and their success in driving efficient and competitive outcomes. FORG members would welcome the opportunity to discuss their expertise and insights in order to ensure an optimal HVRR outcome is achieved.

FORG seeks that Option B be adopted as soon as possible so that a road access pricing model that reflects costs and promotes efficiency can be developed as soon as possible.

If you wish to discuss this submission please contact me on 0455 455 844.

Yours sincerely



Andrew Huckel  
FORG Secretariat

<sup>6</sup> Regulatory Impact Statement p74

**Attachment 1: FORG Responses to RIS Appendix 3 Guide Questions****1. Is the reform objective appropriate?**

FORG strongly supports the broader heavy vehicle reform objectives of the government and believes that they are appropriate.

As FORG understands it, the objectives of the RIS are more focussed on:

- establishing an independent price regulator - FORG strongly supports the establishment of the independent price regulator as an interim step to full economic regulation;
- implementing an FLCB – FORG has some concerns regarding the implied elements of FLCB as described in the body of the submission and notes there has not yet been any public consultation on this subject.

**2. In general, do you support the program of heavy vehicle road reform?**

FORG strongly supports the program of heavy vehicle reform and has consistently done so since the formation of FORG.

**3. Of the reforms considered in this Consultation RIS, which reform option(s) do you support? What are your reasons/concerns?**

FORG strongly supports Reform Option B as put forward in the RIS. This option establishes the strongest base to allow the HVRR process to move to steps 3 and 4.

**4. Do you think that the preliminary analysis presented in this RIS understates or overstates the costs of any of the options? If so, by how much and in what ways?**

FORG has no detailed independent knowledge of the costs of the options but FORG believes the analysis presented in the RIS is consistent with FORG's expectations as to which reform options and scenarios would produce the highest benefits.

**5. Do you think that the preliminary analysis understates or overstates the benefits of any of the options? If so, by how much and in what ways?**

- a. What impact will Reform option A or B have on road maintenance costs?
- b. What impact will Reform option A or B have on road capacity expansion costs?
- c. What impact will Reform option A or B have on road quality and levels of service?

FORG has no detailed knowledge of road maintenance costs, road capacity expansion costs and road quality and as such has no comment on this detailed analysis.

**6. Do you believe that any of the reform options will result in other impacts (such as regulatory burden, competition impacts or increased risks) compared to the current arrangements?**

Adopting Reform Option B and then moving to steps 3 and 4 of the HVRR will have positive a positive impact on competition as it will allow road and rail freight to compete in a more consistent regulatory pricing framework.

**7. Thinking of your preferred reform option, are there particular elements that you feel strongly about and either support or oppose?**

FORG strongly opposes any option which rejects the reform or which does not allow the reform to follow through to steps 3 and 4 of the HVRR.

**8. What other matters should decision-makers take into account when considering whether to implement an IPR and FLCB?**

FORG believes that the FLCB needs to be further clarified, without clarification no informed comment on this matter can be provided. FORG's support for reform Option B should not be taken as an endorsement or rejection of any FLCB pricing approach.

**9. Can you identify particular changes for which a different transitional arrangement would provide a benefit**

Implicit in the logic of the RIS benefit calculation is the position that the faster the transition to a full economic regulation model the greater the community benefit will be. The current process timetable is unnecessarily protracted and should be accelerated.