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negotiated settlement

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Abstract

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Keywords regulation, negotiated settlement

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1. Introduction

On 29 June 2011 the Australian Competition and Consumer Commission (ACCC) accepted an access undertaking from Australian Rail Track Corporation (ARTC) in relation to the Hunter Valley rail network. The present note examines the process by which the content of the undertaking evolved over time, leading to the ACCC's ultimate decision to approve it. Rather than the ACCC taking its decision simply on the basis of evidence and views submitted by ARTC and its customers, the ACCC encouraged the parties to discuss and negotiate the detail of the undertaking. At the final stage the parties were indeed able to resolve their differences and put an agreed undertaking to the ACCC. This undertaking differed in certain critical respects from the ACCC's previously indicated stance, but the ACCC nonetheless deemed it appropriate to accept.

The regulatory process thus had elements of a negotiated settlement, as observed in various other jurisdictions around the world. The aim of this paper is to describe and discuss how the process worked, with a view to adding to understanding of the circumstances under which negotiated settlements can work effectively, and the differences that settlements can make.

2. Industry context

ARTC is an Australian Government-owned corporation, established in 1998 for the purpose of managing and providing access to the Australian Interstate Rail Network. It was established in the context of National Competition Policy reforms introduced in Australia in the mid-1990s which sought in part to introduce competition into previously non-contestable markets. In infrastructure industries this involved separating the potentially competitive services from the natural monopoly ones, and introducing access arrangements for essential inputs and bottleneck services. Rail was part of this reform program, and separation occurred between the monopoly 'below-rail' service (provision and management of the rails and other railroad infrastructure) and the potentially contestable 'above-rail' train services (such as haulage provided by locomotives and rolling stock).¹ ARTC provides 'below-rail' track access services but not 'above rail' services.

The Hunter Valley rail network is located in eastern New South Wales. It is predominantly used to transport coal from mines in the Hunter Valley region to the Port of Newcastle for export. Approximately 16 coal producers have either existing or planned operations in the region, and it has been estimated that the coal shipped on the network equates to around \$9 billion worth of export earnings per annum. The rail network is also used by non-coal traffic, including general and bulk freight services (such as grain) and passenger services. It is also

¹ Everett (2006) provides a somewhat critical review of deregulation and rail reform in Australia. For recent discussion of regulatory design in a railway network characterised by such upstream and downstream separation, see De Fraja et al (2011).

used to ship coal from the region's mines to major domestic (i.e. Australian) customers, such as power stations.

ARTC manages the Hunter Valley rail network under a lease with the State Government of New South Wales. The lease was entered on 4 September 2004 and is for 60 years, and includes a requirement that ARTC submit an access undertaking to the ACCC. Prior to the ACCC accepting an undertaking in June 2011, the network was regulated under an access regime administered by the NSW Independent Pricing and Regulatory Tribunal (IPART). As a consequence of the decision to accept the June 2011 HVAU, access regulation is now governed by the ACCC.²

The ACCC's assessment of the HVAU occurred in the context of attempts by coal industry participants to implement a 'long term solution' to capacity constraints that had adversely impacted the performance of the Hunter Valley coal chain over a number of years. Inefficiencies in supply chain coordination had contributed to significant ship queues and demurrage costs for coal producers seeking to satisfy the increased international demand for coal associated with the mining boom.³

An independent review of coal chain performance (the 'Greiner Review') recommended a number of reforms to address the constraints. These included changes to capacity management arrangements at the export terminals at the Port of Newcastle, and the introduction of an ability for coal producers to contract directly with ARTC for rail access rights (which would then be exercised via a rail operator). These and other measures would help the producers coordinate logistics across the whole supply chain, and also facilitate long term contracting to underpin investment in new capacity. The direct contracting model in particular was a notable departure from the traditional contract structure whereby a track access provider would contract with a rail operator, who would then contract with end customers such as the coal producers.⁴

Prior to the HVAU the ACCC had played a role in facilitating the objectives of the coal industry's 'long term solution.' In December 2009 the ACCC had 'authorised' capacity management arrangements at the export coal loading terminals at the Port of Newcastle. The ACCC's assessment of ARTC's access undertaking complemented this earlier process, and the aligned interaction between the rail network access undertaking and the authorised capacity arrangements at the port was a key issue in the ACCC's assessment.

² Cf ACCC, Decision In relation to Australian Rail Track Corporation's Hunter Valley Rail Network Undertaking, 29 June 2011, s 1.1.1, pp 5-6.

³ ACCC, Australian Rail Track Corporation Ltd Hunter Valley Coal Network Access Undertaking Draft Decision, 5 March 2010, s 3.3.1, pp 41-47.

⁴ ACCC, 29 June 2011, s 5.2.2, p. 40.

3. The legal test for assessment

Part IIIA of the *Competition and Consumer Act 2010* contains the 'National Access Regime', a legislative scheme by which parties may seek access to services provided by significant infrastructure facilities. One access pathway under Part IIIA is the 'access undertaking', which a service provider may put forward to the ACCC and which, if accepted, sets the terms of access third parties may obtain. In the present case, ARTC was required, pursuant to an obligation in the lease of the Hunter Valley network, to put forward an access undertaking for the ACCC's consideration.⁵

Under Part IIIA, the ACCC may accept an access undertaking if it thinks it appropriate to do so, having regard to (in summary):

- promoting the economically efficient operation of, use of and investment in the infrastructure, thereby promoting effective competition;
- the principles that access prices should generate revenues to cover efficient costs, and include a return on investment commensurate with the risks involved;
- the legitimate business interests of the access provider;
- the public interest, including in competitive markets;
- the interests of potential accessors of the service; and
- any other matter the ACCC thinks is relevant.⁶

4. The accepted undertaking

The HVAU accepted by the ACCC in June 2011 is a detailed and complex document, running to 270 pages. It includes:

- a process for parties to apply to ARTC for access, negotiate an access agreement and, in the event of a dispute, have recourse to binding ACCC arbitration;
- an indicative access contract, which the parties may either take up without modification or use as the basis for negotiation;
- a revenue cap and pricing methodologies to regulate ARTC's access prices;
- liability and performance incentive measures with implications for both ARTC and access seekers;
- protocols regulating management of capacity on the rail network, including provisions designed to facilitate alignment of capacity management across the Hunter Valley coal chain; and
- processes for the investment in and creation of additional network capacity.

The HVAU has a term of five years.

⁵ Australian Rail Track Corporation Ltd, *Hunter Valley Access Undertaking 2009 – Explanatory Guide* (Submission to Australian Competition and Consumer Commission, 13 May 2009) <http://www.accc.gov.au/content/index.phtml/itemId/917837> at 16 July 2011, 13.

⁶ Competition and Consumer Act 2010 s 44ZZA(3).

5. The substantive issues and the agreed solutions

The appropriate cost of capital to include in the 'building block' calculation of allowed revenues, the duration of the initial agreement, and the nature of the transitional arrangements, were important issues that are discussed later in this paper. In order to indicate the commonality of the situation to that of other network infrastructure situations, including electricity, natural gas, airports, etc., it may be helpful to say a little more about three of the other major substantive issues that the parties had to address, and the solutions that they agreed.

1. How to ensure that the management of existing capacity and the investment in new capacity would be conducive to 'supply chain alignment', that is, end-to-end efficiency of the whole coal supply chain comprising coal mines, below-rail, above-rail and ports?

Coal producers wished to see efficient operation and investment in the rail network in coordination with mine and port operation and expansion. ARTC recognised these objectives but sought sufficient flexibility to manage its commercial operations.

Operational issues considered and ultimately addressed in the HVAU include:

- the accurate calculation of available network capacity, including the development of 'System Assumptions' to ensure rail capacity aligned with port terminal capacity;
- protocols for addressing shortfalls of capacity and for resumption of unused capacity; and
- a system for trading capacity between network users.

As regards new investment, the HVAU provides that ARTC may propose and fund capital projects, but there is a customer engagement process, the 'Rail Capacity Group', by which capital projects must be endorsed by users in order to proceed. If users do not endorse a particular project, ARTC may seek the ACCC's assessment of whether it is 'prudent' and appropriate to proceed with. On the other hand, if users seek a particular project but ARTC is unwilling to fund it, the HVAU sets out a 'user-funding' process by which users may pay for the project, and where ARTC is effectively obliged to undertake construction, subject to the project meeting certain safety and technical requirements.

2. How to set prices to ensure that ARTC made efficient use of its network, and how much flexibility to provide for the recovery of the costs of new investment?

Pricing under the HVAU is by reference to 'Indicative Services', which at the time of acceptance reflected the most common train configurations used on the Hunter Valley network. In order to promote efficient use of the network, stakeholders sought to have the Indicative Services defined (and hence prices set) by reference to the most efficient train configuration that could conceivably be run on the network. The HVAU includes processes to incorporate prices set by

reference to the efficient configuration, once it is determined by ARTC and industry, as well as grandfathering provisions to smooth the transition.

The model also allows ARTC to under-recover its costs in relation to certain parts of the network for a preliminary period, and then to recover the relevant shortfall at a later date, a mechanism referred to as 'loss capitalisation.' The intent of this approach is to facilitate new investment in assets where there is limited initial demand, by recoupment of full revenues when demand has increased. (The ACCC cautiously accepted this device, noting its novelty and limiting its application to only part of ARTC's network where new investment was likely to occur and where demand was initially likely to be low.)

3. How to ensure that ARTC would meet its obligations under the agreement?

The HVAU incorporates a complex set of arrangements governing ARTC's liability for performing its obligations. These include contractual provisions in the access agreements, provision for ARTC to report against key performance indicators and to develop incentives to improve performance, as well as a mechanism known as the 'true-up test' by which ARTC would pay a rebate in the event that capacity on the network was not made available. The HVAU also includes detailed processes and binding timelines for ARTC to develop and implement performance incentives.

The ACCC noted that these features all contributed to the extent to which ARTC was incentivised to operate the network efficiently. The ACCC considered the liability and performance arrangements holistically, and ultimately gave qualified approval. The ACCC noted that the true-up test was a complex and novel device, and that if practical experience did not demonstrate it to be effective, the ACCC might require different arrangements in future.

6. The sequence of draft undertakings

From mid-2008 to early 2009 ARTC developed successive drafts of an access undertaking in consultation with industry participants, including coal producers and rail operators. On 22 April 2009 ARTC submitted a draft HVAU to the ACCC. This initiated a formal statutory assessment process including public consultation. ARTC provided relevant pricing information (indicative access charges) on 13 October 2009.

On 23 February 2010 the ACCC released a Position Paper setting out its preliminary views on the non-price aspects of the April document. On 5 March 2010 the ACCC issued a full Draft Decision in which it outlined its preliminary view that it would reject the April 2009 HVAU. It also indicated modifications that would enable it to accept the undertaking.

ARTC withdrew its draft undertaking, engaged in discussions with ACCC staff, and submitted a revised access undertaking on 7 September 2010. The ACCC

consulted on this revised draft, and in response to numerous requests from stakeholders agreed to extend the consultation period from three and a half weeks to five and a half weeks. The ACCC issued a second Position Paper on 21 December 2010, indicating that, while the September 2010 HVAU represented an advance on the April 2009 version, further changes would be necessary before the ACCC could accept it.

ARTC had further discussions with ACCC staff. On 7 April 2011 ARTC provided a further revised (third) undertaking that sought to implement the views in ACCC's December 2010 Position Paper. The ACCC then engaged in a formal consultation process, seeking views of interested parties on the extent to which this third version of the HVAU appropriately implemented the ACCC's December 2010 views. Responses were due by 11 May 2011.

After discussions with stakeholders, ARTC offered a further package of revisions that it claimed addressed their concerns. It understood that, in return, they would accept the April HVAU including ARTC's proposed rate of return. These revisions were circulated to stakeholders and posted on the ACCC website on 18 May 2011. Given these developments, the ACCC continued to accept submissions beyond the original deadline date. After yet more discussions, ARTC lodged a correspondingly revised (fourth) version of the HVAU on 23 June 2011, which the ACCC accepted on 29 June.

7. Negotiations and the settlement

The interested parties – ARTC, coal producers and other users – submitted their views to ACCC throughout the assessment process. The ACCC repeatedly encouraged the parties to discuss and negotiate with each other. Where this did take place, there was initially limited success. (ARTC says that this understates the amount of discussion with stakeholders and the extent of amendments that were agreed with them throughout the process.)

After ARTC's third undertaking of 7 April 2011, ARTC and the NSW Minerals Council (NSWMC), a representative body for the existing coal producers using the Hunter Valley rail network, began to engage more constructively. The revisions that ARTC posted on 18 May 2011 were a first reflection of this. A letter from the NSWMC on 20 May 2011 identified seven (or ten) outstanding issues.⁷ The letter also indicated that if ARTC did not incorporate NSWMC's proposed amendments, then NSWMC would only accept the revised HVAU if the rate of return did not exceed the ACCC's proposed 8.57%, but that if ARTC agreed to NSWMC's approach then NSWMC would not object to a higher rate of return as proposed by ARTC.

⁷ NSWMC, *Letter to the ACCC on ARTC Hunter Valley Rail Network Access Undertaking – Attachment 2 – Issues List*, 14 May 2011. Section 3 and appendix 2 of the letter list seven outstanding issues, but issues numbered 1, 2 and 4 each include two items, hence a total of ten.

Negotiations between the parties then reduced the outstanding differences to four critical issues. In simple terms, these were as follows:

- 1) Term of undertaking: ARTC was proposing a 10 year term, to give it and the industry a longer period of certainty. The NSWMC was initially comfortable with a 10 year term, but became unsure how the arrangements would work and more concerned about lock-in, and later argued for 5 years.
- 2) Transition plan: Proposed arrangements were quite different from what had happened before. For example, previous arrangements had not involved coal producers contracting directly with the railroad. ARTC was to set out a transition plan in a letter, but views differed as to what that plan should contain.
- 3) System Assumptions: The coal producers wanted calculations of rail capacities to be based on common assumptions applicable across the whole supply chain, and which would match rail capacity with recently agreed port capacities. ARTC was not prepared to have System Assumptions imposed upon it by another party, when ARTC's performance would be measured, and financial penalties applied, based on those System Assumptions.
- 4) Rate of return: ARTC was seeking a higher rate of return (originally over 10% real pre-tax WACC, later 9.16% and by this time 9.10%) than the return that the ACCC had set out (originally 7%, then 8.57% in its second Position Paper).

On 13 June 2011, the NSWMC advised the ACCC that, although ARTC had not yet addressed all its concerns, if appropriate changes were made to address the first three points then it would not object to the rate of return for ARTC that the company was seeking.⁸

On this basis, ARTC accepted the NSWMC's three points. Its June 2011 HVAU reflected this agreement: the term was reduced to 5 years, a transition plan was settled, a (finely balanced) compromise position was reached on the System Assumptions issue, and the rate of return was left at 9.1%.

8. ACCC acceptance

During the final negotiations, ACCC staff had indicated to ARTC that an agreed outcome, including the proposed higher rate of return, might be acceptable to the Commission, provided that other (non-export coal) users would not be worse off. Nevertheless, the ACCC had to consider this agreement very carefully. The Commission had expressed reservations about a ten year term of undertaking, so the proposed five year term was acceptable to it. The now-proposed transition plan and system assumptions were not inconsistent with what the ACCC had previously said, though it seems unlikely that the ACCC would have felt justified

⁸ NSWMC, Letter to the ACCC on ARTC Hunter Valley Rail Network Access Undertaking, 13 June 2011.

in imposing them on ARTC.⁹ However, the ACCC had already “arrived at a view on an appropriate rate of return”, using “a standard regulatory approach”. How could it justify allowing a higher return? It argued that the negotiated settlement made all the difference:

“However, the endorsement of ARTC’s higher proposed rate of return by the majority of access seekers in this context is an important additional consideration, as it essentially reflects an agreement between ARTC and the largest group of users of the network. The ‘premium’ proposed to the ACCC’s view on the rate of return also does not of itself appear unreasonable or excessive, as it reflects that ARTC has in turn agreed to assume additional obligations. While the financial analysis outlined above provides a proxy for what would be an efficient return in a competitive environment, in this case the agreement between ARTC and users adds an empirical dimension, in part reflecting a commercial agreement. The ACCC considers this to be a beneficial contribution to the rate of return assessment.” (s 5.3.4 p 48)

The ACCC nonetheless noted that agreement of the parties would not necessarily have been sufficient on its own, and that issues of market power and the interests of consumers were also relevant:

“It is important to emphasise though that had the ACCC not previously conducted its own analysis of the rate of return, it would have had reservations with merely accepting an ‘agreed’ position, as it is not true that in all circumstances an agreed rate of return between an access provider and a group of access seekers will be appropriate to accept. For example, an agreed rate of return may not necessarily promote the efficiency and competition objectives of Part IIIA, the public interest, or the interests of all access seekers if, for instance, it would merely exemplify an exercise of market power by the access provider, or be passed through as significant price increases for downstream consumers.” (s 5.3.4 p 49)

9. Interests of other parties

The agreement was negotiated between ARTC and NSWMC, with the latter in essence representing the major (incumbent) coal producers who were coal exporters. The ACCC concluded that the agreement would promote the efficient use of the Hunter Valley rail network, and facilitate alignment between elements of the Hunter Valley export supply chain, and thereby promote the objectives of

⁹ “ ... the ACCC recognises that there may be points at which the regime created by Part IIIA cannot oblige the ARTC to go further. This does not, however, prevent the ACCC from accepting the June 2011 HVAU, which incorporates further revisions to promote supply chain alignment that ARTC has chosen to put forward following discussions with industry.” ACCC, 29 June 2011, para 1.2.3.4 pp 16-17.

‘the long-term solution’. These coal producers accounted for 93% of ARTC’s volume and 99% of its revenue.¹⁰

What about other users of the network, who included those transporting coal to domestic locations, potential new entrants, non-coal users, and the operators of the above-rail services?

During the assessment of the drafts of the HVAU the ACCC contacted all potentially interested parties and took their views. Domestic coal users raised concerns following the ACCC’s Draft Decision in March 2010, and ARTC responded with revisions to the HVAU to accommodate their circumstances; these changes were acknowledged as appropriate by the ACCC in its December 2010 Position Paper. The ACCC and ARTC responded similarly to concerns raised by coal producers contemplating entry to the Hunter Valley industry.

Non-coal users made submissions during the ACCC’s public consultations that led to changes in subsequent drafts of the HVAU. The ACCC said in December 2010 that nothing in the then-proposed undertaking should operate to circumvent ARTC’s statutory obligation to prioritise passenger services. Although there was no standard access agreement for non-coal traffic per se, ARTC undertook to offer an appropriately amended version of the standard agreement for access to its interstate network. Non-coal applicants were also able to seek arbitration in the event of a dispute over access terms, and the ACCC considered that these factors contributed appropriate levels of certainty for non-coal users. Moreover, at the end of the process ARTC affirmed that “non-coal users will not have pricing adjusted as a result of the agreed rate of return”. (s 4.4.1.5 p 36)

Contentious issues around access pricing were the subject of significant debate with the incumbent above-rail operators, particularly as the outcome would have commercial and competitive implications for them. With the coal producers now able to negotiate access rights directly with ARTC, the above-rail operators would face a changed commercial environment once the HVAU was put in place. The resolution of these contentious issues involved elements developed by ARTC and coal producers, but more elements on which the ACCC had expressed a view. Rail operators remained concerned that ARTC did not negotiate adequately with them, and felt that the position accepted by the ACCC was inappropriate and likely to lead to inefficiencies. The HVAU in fact incorporated an ‘interim’ position on access pricing and included processes to resolve these issues at a later date. The ACCC accepted this staged approach partly in recognition of commitments that ARTC and other parties had made based on earlier pricing (and a consequent desire for a transition period to the new prices), and partly because of the need for further work by industry to model the most efficient outcome for the rail network and the supply chain.¹¹

¹⁰ ARTC 2011 Hunter Valley Access Undertaking – Rate of Return (ARTC submission to ACCC), 23 June 2011, p 3.

¹¹ Processes to resolve the access pricing issues are underway. On 1 December 2011 ARTC submitted to the ACCC a proposal for access prices for ‘Initial Indicative Services’, following

10. Factors conducive – or not - to negotiated settlement

What factors were or were not conducive to the eventual emergence of this negotiated settlement?

Importantly, there was a common interest, shared by all parties and government, in reforming the supply chain performance at the Port of Newcastle. The expectation (or at least possibility) that coal producers would negotiate access directly with ARTC also facilitated the parties coming together. At the same time, however, this broader focus also created a need to address relatively new and unique regulatory issues, such as how to reflect supply chain alignment within the terms of the HVAU. These factors perhaps extended the complexity and duration of the process beyond that which an economic regulator might normally consider.

The main users (the coal producers) were well-informed, with relatively homogeneous interests. In other contexts they had long experience of negotiating to achieve mutually satisfactory outcomes, and already had a representative trade body (NSWMC). Other users were small in number and their interests were adequately protected early on during the ACCC's formal regulatory processes. The general public were not involved as consumers.

This is not to say, however, that the coal producers always spoke with one voice. They were competing with one another and might have different, even contradictory, perspectives, so that the views expressed by the industry representative body might not always be fully representative of the industry. It would seem, however, that their views largely coalesced with the identification of the seven to ten outstanding issues in May 2011. Thereafter they negotiated more effectively with a single voice.

The sheer complexity of the undertaking and its implications may initially have deterred cost-effective negotiation. To illustrate, the ACCC's Position Papers and Draft Decision recommended several hundred revisions to ARTC's draft undertakings. Over the period, the ACCC's published material extended to over 1000 pages, and the final accepted HVAU was 270 pages. In contrast, ARTC's revised undertaking of April 2011, incorporating revisions to address most points raised by the ACCC's Position Papers and Draft Decision, reduced the challenge to more manageable proportions (7-10 issues). At that point, as noted, ARTC and NSWMC began to engage more constructively with each other. Further negotiations between the parties reduced the remaining differences to the four critical issues. At this point a deal was proposed and agreed.

ARTC was concerned that the issues seemed to change throughout the process. In ARTC's view, the coal industry initially identified concerns which ARTC then sought to resolve, either with the industry or the ACCC, to achieve what it

consultation with industry stakeholders (who included the above-rail operators). The ACCC will assess the proposal and also conduct its own consultation with interested parties.

considered was a reasonable balance of interests and risks across the undertaking as a whole. ARTC felt that a new set of concerns would then be raised, arising from the industry changing its views or the ACCC identifying other issues, and that these new issues would be pursued by the industry and the ACCC. ARTC felt that this process repeated several times, creating a continuously moving target for ARTC to deal with.¹²

An alternative view from among the coal producers was that the underlying principles that they sought to achieve remained consistent throughout the negotiations. Any negotiation process will involve a drafting stage that seeks to embody in writing the underlying agreement, and this in turn generally identifies new issues to be dealt with. Additionally, while the underlying principles remained constant, the commercial context was continually evolving, reflecting the implementation of reforms to the port arrangements.

The negotiating styles of the parties were also relevant, and not surprisingly the parties had different views of the styles of their counterparts. ARTC felt that initially, at least, there was very little negotiation with key industry stakeholders, who adopted a 'take it or leave it' attitude rather than showed a willingness to seek compromise outcomes. Additionally, in ARTC's view, the continually changing demands of the industry altered the balance of interests and risk, with each cycle favouring the industry and increasing risk for ARTC. ARTC felt that there was no recognition of this increasing risk in the rate of return until very late in the process.

Among the coal producers, on the other hand, a view was that ARTC was a very conservative organisation, with the mindset of a government-owned, risk-averse monopoly, which sometimes offered what they regarded as only cosmetic changes, and was not yet experienced at commercial negotiation. A key development for the coal producers was a change in senior management at ARTC, which in their view led to a greater preparedness to consider the requirements that they explained were critical to their businesses.

ARTC rejects such criticisms. It says that, irrespective of the ownership of a company, it would not be prudent to take on risk where that risk was not adequately compensated through return. ARTC suggests that many coal producers acted in a conservative and risk-averse way during the process: ARTC was willing to enter into access agreements with producers very early on in the process, and it was the producers who took a risk-averse position to hold back on entering into arrangements until the regulatory process was completed. Further, the extent of the changes made to ARTC's original 2008 proposals is evidence that the changes were not merely cosmetic or dependent on particular players. In ARTC's view, greater preparedness to work through the remaining issues primarily arose from a clearer and finite expression of the remaining

¹² ARTC instances the treatment of user-funded investments, where a brief and initially uncontroversial provision (two or three short clauses) grew eventually into a very detailed set of provisions on investment, funding and pricing. Against this, it might be argued that the ACCC's questioning served to bring out the significance of the user-funding option in terms of countervailing power, which had not previously been fully appreciated.

issues to be worked through, and an acceptance by the industry of the higher return required by ARTC and aligned to the increased risks. Management changes at ARTC at the time were coincidental.

Differences of perception are perhaps inevitable, but despite that, agreement was eventually reached. This makes it more important to ask how this happened. What enabled the final successful negotiations? How did the parties come to perceive that negotiation could result in a win for both sides?

The main factors seem to have been a) the coal producers settling upon a clearer and fixed specification of the central remaining issues; b) their willingness to accept, in return, a higher return for ARTC to reflect the risks involved; c) a new flexibility on the part of ARTC in relation to the key remaining issues, motivated in important part by the prospect of achieving the higher return it sought; d) an indication from the ACCC that it might consider a negotiated outcome including the higher return; and e) a mutual desire to end the regulatory uncertainty within a defined time frame, and thereby bring to an end a process that one participant described as “excruciating in the extreme”.

11. The role of regulation and the ACCC

What about the regulatory framework and the regulatory stance? As the matter progressed, ACCC staff encouraged the parties to negotiate. This was not with a view to achieving a negotiated outcome that the ACCC could then endorse. Nor was it standard ACCC policy or practice. Rather, direct negotiation between the parties was seen as a more effective way to resolve some of the differing views of the parties in this case. It would provide an opportunity for the parties to better understand each other’s positions, and potentially to filter out the less contentious from the more intractable issues. Issues caused by misunderstandings or miscommunication for instance might fall away, and only where the parties reached an impasse would it then be necessary for the ACCC to make a call. Effective negotiation could therefore expedite the overall assessment process, and lead to a more timely and (for the parties) less costly outcome than a protracted process of formal submissions.

To this end, at the request of the parties, the ACCC was willing to extend its timetable on at least two occasions, in order to facilitate discussion. ACCC staff also played a pro-active role, acting where necessary as mediator and seeking to build consensus.¹³ (This is not to imply that the ACCC was present during ARTC’s consultation with stakeholders.)

The ACCC was able to encourage negotiation, rather than simply take its own decisions, because the majority of the issues it assessed (such as supply chain alignment, and provision for investment in the network) were those raised by stakeholders and identified by them as being critical. With those issues on the

¹³ FERC staff play a similar role with respect to rate applications by interstate pipeline and transmission networks in the US. (Littlechild 2011)

table, the ACCC considered the views of all parties, undertook its own analysis, and arrived at a position on what would be 'appropriate' for the HVAU to incorporate. In some cases this position was more reflective of the views of users; in others more reflective of ARTC's view; and in yet others more of a middle ground. Users would often express 'concerns' with the HVAU, but not necessarily offer solutions; in a sense the ACCC took on a mediating/problem-solving role to find a solution acceptable to all sides. Later in the process, parties were more forthcoming in offering solutions, particularly following prompting from the ACCC. Sometimes the ACCC took up these solutions (with or without modifications), though sometimes the ACCC considered that the solutions went too far.

In contrast, a much smaller group of issues were identified and addressed on the ACCC's own initiative. The main example was the term of the HVAU. Initially, the majority of stakeholders seemed to assume that the undertaking would be for 10 years. The ACCC's reservations about this duration (in the March 2010 Draft Decision) were largely of its own initiative. Other examples of the ACCC's own initiative were typically issues with the administration or mechanics of the undertaking (such as commencement), or issues that went to matters of precedent or practice in ACCC regulatory decisions more broadly (e.g. technicalities of the financial model). The rate of return was of concern to the ACCC (for its precedential value and implications for customers) and to the parties themselves.

The legal regime under Part IIIA is also relevant. On the one hand, it does not give the ACCC the power to dictate the terms or timing of an access undertaking; instead, the ACCC can only accept or reject an undertaking put to it. Some of the coal producers regard that as a weakness in the framework, which gives undue power to the facility owner and does not help timely progress.

However, the statute does give the ACCC a broad discretion in assessing an access undertaking. The ACCC may accept an undertaking 'if it thinks it is appropriate to do so', having regard to various matters, one of which is 'any other matter the ACCC thinks relevant.' This is in contrast to the Australian National Electricity Law, for instance, which is far more prescriptive about what the regulator can and cannot take into account in access decisions. Amongst ACCC project staff there was a view that this broad discretion gave the flexibility to pursue innovative and responsive approaches to issues, one of which was the agreed position on the rate of return.

In the event, the negotiation process did not turn out as ACCC initially envisaged. In the early stages of the process there was little negotiation between the parties to resolve different views, and the ACCC rather than the parties themselves had to filter out and resolve the majority of the issues. In contrast, when all this groundwork had been done, and the few main outstanding issues were identified, the parties themselves resolved them and proposed an agreed outcome rather than left this to the ACCC. It seems that the earlier work in clearing the ground and clarifying the options served to facilitate – indeed, make possible – the later and successful negotiation between the parties. It is also

arguable that such negotiation was more effective once there was a credible regulatory alternative. That is, a negotiated outcome became more achievable once the parties realised that the ACCC had reached its own view on all the issues, and was likely to accept ARTC's next iteration of its undertaking. The parties then realised that they could achieve a variation of that outcome that would be mutually beneficial to them.

Within the existing regulatory framework, could the ACCC have done more? Opinions differ. ARTC considered that the ACCC had done well. It saw the ACCC as willing to seek compromise, and on that basis ARTC made more progress working with the ACCC than with industry in the early stages. In contrast, a view from among the coal producers was that the ACCC was very risk averse, and not sufficiently pro-active in getting the parties to the table and stimulating negotiations. As a result the process was unduly prolonged. Both sets of parties urge that the ACCC be more willing to recognise particular industry circumstances and risks, and less concerned about maintaining uniformity between industries via precedent.

12. Effects of the settlement

Did the element of negotiated settlement change the outcome of the regulatory process? It remains an open question whether, absent the settlement, ARTC would have continued to propose a ten year term and how the ACCC would have responded. However, as noted above, it is reasonable to expect that the ACCC would not have insisted on the two additional amendments proposed by the producers. And in view of the ACCC's cited statement, it seems unlikely that, having calculated that 8.57% was the appropriate return, the ACCC would have had any basis for accepting a higher return.

The settlement therefore led to different terms and to a higher rate of return than would otherwise have been allowed. Experience here is thus consistent with experience elsewhere, that customers are often willing to pay a little more than the regulator deems appropriate, in order to secure a service better tailored to their needs than the regulator would otherwise specify. In short, both sets of parties secured a better outcome than they would have done with a regulatory decision.

Experience elsewhere (e.g. Doucet and Littlechild 2009) is that negotiated settlements tend to improve information flows in the sector, and also increase understanding and improve relationships. ARTC's press release on entering its first three contracts with coal producers following settlement of the HVAU is consistent with this.¹⁴ Looking further forward, the parties seem cautiously optimistic. The relationship between the parties is likely to have improved in the short term given the win-win outcome of the negotiation.

¹⁴ <http://www.artc.com.au/Article/Detail.aspx?p=6&id=347>

But these are early days. The HVAU incorporates many novel features, as well as processes to bed down issues left outstanding in June 2011 and reviews over the short and medium term to ensure that other elements are working effectively. It will thus take years for the full impact of the arrangements to be known and assessed.

Will this experience of a negotiated settlement influence the future regulatory process? It seems likely to do so. ACCC staff are minded to pursue a negotiated outcome strategy more deliberately in future processes. On the basis of recent experience, the parties may be more ready to negotiate earlier and more flexibly. Whether or how smoothly a subsequent five (or ten) year access undertaking is agreed remains to be seen. One may hope that the processes in the undertaking and agreements in the next few years enable ARTC and the industry to finalise acceptable arrangements, which would facilitate passage of the next undertaking. On the other hand, if the industry still has not achieved what it wants, the next undertaking consultation will present a further opportunity for debate, which may draw that process out.

13. Lessons from this experience

What lessons might be drawn from this experience? They seem to reinforce the lessons of experience elsewhere, especially in Canada and the USA. (Doucet and Littlechild 2009, Littlechild 2009a, 2009b, 2011)

- i) A negotiation process can be effective in a wide range of contexts, resulting in a win-win outcome for the parties involved.
- ii) Although previously state-owned monopoly networks may feel that they are engaged in innovative and risky commercial negotiation, customers and users negotiating with them tend to see them as conservative and risk averse. Greater flexibility seems helpful (i.e. conducive to securing a successful outcome).
- iii) Customers and users of a network can have diverse and possibly inconsistent demands and priorities that hinder negotiations. Greater and earlier agreement on the critical issues seems helpful (in the above sense).
- iv) A willingness by customers and users to accept a slightly higher rate of return for desired services seems to work wonders in facilitating negotiations. An early recognition of this seems helpful.
- v) A pro-active role for the regulatory body can be helpful. This is not simply to allow or encourage negotiations but also can include structuring the discussions, clarifying the issues, taking initial decisions on the less critical ones, insisting that the parties get round the negotiating table, giving a lead on what is or is not likely to be acceptable, taking a firm line where necessary with the regulated entity, and not allowing discussions and negotiations to drag on. Of course, during this process the regulatory body needs to be mindful of its statutory duties, not least to protect customers and other parties not at the negotiating table.

- vi) It seems helpful to allow the parties to focus on the particular circumstances of that industry at that time rather than to tie down the outcome too closely to previous decisions in that or other industries; to allow the parties to agree a mutually acceptable rate of return to reflect the services provided and the risks incurred; and not to leave doubt in the minds of the parties as to whether the regulator will accept an agreed outcome.
- vii) Finally, personalities matter. Leadership is required on all sides, including at the regulatory body, to see the scope for mutually beneficial negotiations, to coordinate the parties, and to drive forward the process of negotiation to a successful conclusion.

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