Australian Government
Department of Infrastructure and Regional Development

Land Transport Market Reform

Independent price regulation of heavy vehicle charges

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Discussion Paper

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Director - Publishing and Communications
Communications Branch
Department of Infrastructure and Regional Development
GPO Box 594
Canberra ACT 2601
Australia

Email: publishing@infrastructure.gov.au
Website: www.infrastructure.gov.au

Purpose of this paper

This paper seeks stakeholder views on establishing independent price regulation for heavy vehicle charges. In particular, the Australian Government would like views from stakeholders about which entity or entities should perform the function. Three potential options are outlined in the paper.

Key dates

Due date for submissions	Friday, 14 July 2017

Submissions can be made:

By email:	HVRR@infrastructure.gov.au
By post:	Land Transport Market Reform Branch Department of Infrastructure and Regional Development GPO Box 594 CANBERRA CITY ACT 2601

Introduction

What is independent price regulation?

Independent price regulation typically refers to a system in which infrastructure access prices are set by an agency or organisation, at arm's length from government. In the heavy vehicle context, this would mean prices would be set by an agency which is separate from, and independent of, those parts of government (state and federal) which are responsible for:

- delivery and/or funding of road services to the heavy vehicle industry;
- development, setting and/or operation of government budgets; and
- monitoring and compliance of safety outcomes for the heavy vehicle industry.

Such a structure would also mean that the independent price regulator would not face:

- the political and or fiscal pressures that exist under current arrangements; and
- conflicting responsibilities such as maximising revenue vs setting a fair and efficient price.[1]

Why independent price regulation?

The system we presently use for setting the heavy vehicle user charge is not working well. While the National Transport Commission produces a recommended price in accordance with its stated principles, usually this recommendation is not accepted by governments and, instead, a price is agreed through political negotiation.

Moving to an independent price regulator would be a fairer and more transparent way to set prices which properly recover the cost of building, maintaining and operating roads. This is an objective which federal, state and territory governments have agreed to pursue in accordance with their December 2015 decision to reform the way the heavy vehicle user charge is set and collected. Establishing an independent price regulator is an important element of a better system to set and collect the heavy vehicle user charge. In December 2015, the Council of Australian Governments agreed to accelerate Heavy Vehicle Road Reform (HVRR)[2] and investigate the next steps to transition to independent price regulation of heavy vehicle charges.

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[1] Revised pricing principles to guide the decisions of an independent price regulator would need to be agreed by governments.

[2] The HVRR roadmap sets out the steps which form the Government's plan to turn the provision of heavy vehicle road infrastructure into an economic service where feasible. The roadmap is discussed in the Transport and Infrastructure Council's *Heavy Vehicle Road Reform – What we are doing and why we are doing it* paper, accessible at: <http://transportinfrastructurecouncil.gov.au/publications/heavy_vehicle_road_reform.aspx>.

The distinction between price and economic regulation

Beyond the short-term benefits of independent price regulation, such a function would also lay the groundwork to transition to economic regulation.

Economic regulation is the key source of supply-side efficiencies, including through the development of service quality standards and scrutiny of the timing, level and type of road expenditure. The distinctions between price and economic regulation are outlined at table one. While this paper seeks views on which entity should perform the function of independent price regulation, an important consideration is the capacity for a price regulator to evolve into an economic regulator. The evolution of the price regulator to an economic regulator is one of the main transitions from phase two to phase three of the HVRR Road Map.

Table one – the distinction between price and economic regulation

Function	Price regulator	Economic regulator
Sets heavy vehicle charges based on agreed principles and methodology	Yes	Yes
Audits input data to ensure it is within scope of charge setting methodology (i.e. relevant road related expenditures only)	Yes	Yes
Defines efficient, prudent or otherwise recoverable (e.g. CSOs if cross-subsidies in place) expenditure	No	Yes
Scrutinises data to ensure only efficient, prudent or otherwise recoverable expenditures flow through to user charges	No	Yes
Develops and sets agreed service levels	No	Yes
Monitors delivery of agreed service levels, including community service obligations	No	Yes
Conducts ex-post evaluation of investments	No	Yes

What prices would be regulated?

In the short term, heavy vehicle charges would continue to be collected through the existing mechanisms (outlined in text box one below) and the regulator would have responsibility for setting the level of these charges.

Over the longer term, a more direct form of user charging would replace these charge collection mechanisms. Governments have not yet made a decision on the specific form this more direct user charging may take (distance-location, mass-distance-location etc.). The replacement of the current charges with more direct user charges is the key transition from phase three to phase four of the HVRR Road Map.

As the Australian Government noted in its response to Infrastructure Australia's Australian Infrastructure Plan, it will be establishing a study, led by an eminent Australian, into the potential benefits and impacts of road user charging for light vehicles on road users.

While governments have not made a decision to pursue light vehicle charging at this time, it is incumbent upon those designing heavy vehicle reform to consider how such a system might be used for light vehicle reforms in the future to avoid sunk cost and duplication.

Text box one - Mechanisms used to charge heavy vehicle operators

The ***Road User Charge (RUC)*** *is levied by the Commonwealth Government under the* Fuel Tax Act 2006*. It establishes a mechanism for collection by reducing the fuel tax credit that eligible sole traders, businesses and non-profit bodies are entitled to claim for the excise paid on each litre of fuel.*

Registration charges *are levied by state and territory governments by adopting laws consistent with the Model Heavy Vehicle Charges Act (except in WA and NT). The* National Transport Commission Act 2003 *and the Inter-Governmental Agreement on Regulatory and Operational Reform in Road, Rail and Intermodal Transport (the Transport IGA) provide the authority for the National Transport Commission (NTC) to recommend registration charges for heavy vehicles.*

The Commonwealth also collects registration charges through the Federal Interstate Registration Scheme (FIRS). FIRS provides uniform charges and operating conditions for heavy vehicles engaged solely in the interstate carriage of passengers or goods, in trade or commerce, or for any purpose that is incidental to the carriage of that kind. Using a methodology, revenue generated through FIRS is redistributed to the states and territories.

How would prices be calculated?

An independent price regulator would set prices based on principles agreed by governments.[3] Broadly, governments would set principles for determining charges, including cost-reflective charges and recovery of common costs in a way that supports fairness and avoids distorting efficient price signals. This will be achieved by implementing another major element of phase two of the HVRR Road Map: a forward-looking (lifecycle) cost base (FLCB) for heavy vehicle charges. Independent price regulation and a FLCB are complementary and would position the regulator to transition from price to economic regulation and progress HVRR.

Establishing an FLCB would involve a fundamental change in the current arrangements for managing road assets, bringing them into closer alignment with arrangements in other infrastructure sectors. It involves moving from a backward looking approach based on calculating past expenditure to a forward looking approach shifting the focus to the expenditure required to maintain and expand roads in light of forecast demand and subject to service and technical standards. The use of forward-looking or historical costs can impact investment incentives. Adopting a forward-looking cost base may be particularly important

[3] Governments will need to revisit the existing COAG pricing principles for heavy vehicle charges as part of the process of moving to independent price regulation.

with the growing freight task and demand for road services, and given the 'lumpy' and long-lived nature of road infrastructure.

Under the current system for calculating heavy vehicle charges, states and territories provide expenditure data to the NTC. The NTC runs this data through the PAYGO[4] model to allocate costs and calculate recommended charges for different classes of heavy vehicle. The process is light touch in ensuring accuracy and quality of the inputs into the model, with periodic data checks and guidance provided to states and territories with the expenditure template.

Both independent price regulation and a FLCB would require more rigorous processes to give industry and governments confidence about the automatic application of charges. For example, an independent price regulator would need to have the ability to scrutinise the asset, expenditure and road usage data inputs to a forward-looking model and to 'true up' charges caused by discrepancies between forecast and actual data.

The key justification for an FLCB is that it would represent a far more efficient mode of charging for road use and is a more sustainable way to fund road construction and maintenance into the future. It achieves this through forecasting asset costs, with the capital costs of a road recovered over its 'economic' life. This provides for a truer reflection of the cost of an asset, rather than expenditure, and helps to smooth the cost base/revenue requirement over time if the asset expenditure is lumpy and/or cyclical.

The benefits of an FLCB include:

- more efficient cost allocation as the life cycle of an asset is known and planned in advance;
- an evidence base for investment reform to support maintenance funding determined by efficient lifecycle management rather budget allocations;
- greater certainty for industry as charges will be forward looking and planned rather than ad hoc.

Consideration of an FLCB is being undertaken through a separate, albeit parallel, process to this discussion paper.

[4] The primary objective of PAYGO is to deliver a nationally consistent set of heavy vehicle charges that efficiently recover the cost of providing and maintaining the road network. Each year, jurisdictions provide the NTC with a completed road expenditure template which covers all road construction and maintenance costs (light and heavy vehicles). A cost base is then established with the heavy vehicle portion recovered via heavy vehicle charges. The cost base is calculated by taking a 7-year average of the historic financial costs of providing roads.

Benefits of independent price regulation for industry

Independent price regulation would create a direct and automatic link between the charges that are imposed on heavy vehicles and the costs of road provision. Independent price setting would benefit the heavy vehicle industry by:

1. providing greater certainty around the process for determining charges – by separating the price setting process from government budget considerations; and
2. improving transparency – by providing clear guidance on how charges are set.

Independent price regulation would provide a foundation for full market reform

On 24 November 2016, the Hon Paul Fletcher MP, Minister for Urban Infrastructure, announced that the Australian Government would establish a study, led by an eminent Australian, into the potential benefits and impacts of road user charging for light vehicles.

An independent price regulator for heavy vehicles would provide a foundation of expertise and organisational capacity that could be harnessed for the establishment of a broader regulatory role in the future, should Australia choose to progress reforms to road governance, and institutional and investment arrangements for all road users.

The capacity to regulate across potentially substitutable transport modes also needs to be considered in moving to independent price regulation for heavy vehicle charges as a step in improving the efficiency of land transport services. As outlined at table 2, the existing approach to price and economic regulation across the land transport sector is fragmented.

Table two. Overview of how charges are set and/or regulated across the transport sector

Sector	Current approach to regulation
Road users – heavy vehicles	National Transport Commission – undertakes price determinations for heavy vehicle charges (RUC and registration). The Transport and Infrastructure Council (Transport Ministers) decides whether to implement NTC charges determinations.
Road users – light vehicles	Road services to light vehicles are delivered as a public good with the Commonwealth, state and territory governments setting the rates of indirect charges and taxes (fuel tax & registration), with no link to expenditure and/or investment. Instead, revenues may be applied to a range of essential service, including road infrastructure funding. State and territory road agencies act as asset managers for roads, but the final decision on road expenditure rests with the governments of the day.

	State and territory based regulators (e.g. the Independent Pricing and Regulatory Tribunal, the Queensland Competition Authority) play a role in regulating taxi and ridesharing services. For example, in NSW the Independent Pricing and Regulatory Tribunal have a role in monitoring taxi fare levels and the number of licenses.
Public Transport users – road and rail	Regulation varies across States and Territories. State and territory governments generally manage public transport charges and investment. For example, in NSW the Independent Pricing and Regulatory Tribunal determines maximum public transport fares to apply in Sydney and surrounding areas.
Toll road users – light and heavy vehicles	The process for setting tolls is based on separate commercial agreements between the governments and the private sector for the concession to deliver, operate and maintain each road infrastructure asset.
Rail freight	Ownership and management arrangements are generally divided into “below” rail (track management) and “above” rail (operators of trains and rolling stock). A mix of government and private sector operators perform these functions. There is a multi-jurisdictional state based system of governance for access arrangements in the rail industry. A number of state based regulators oversee access regimes for Australia’s rail network, including a mix of cost recovery systems and non-cost recovery systems. At the national level, the ACCC has functions regulating rail, which arise from the National Access Regime in Part IIIA of the *Competition and Consumer Act 2010*. The ACCC’s regulatory work in rail includes: • assessing Part IIIA undertakings submitted by rail access providers in relation to rail track infrastructure; and • carrying out functions under accepted undertakings (which includes, if required, arbitrating access disputes).

Issues for Consideration

Transition

Any new price regulator function would require agreement across governments, legislation and take time to establish. A transition path for the current system of setting heavy vehicle charges would need to be determined and the body that administers the current system (the NTC) would need to be actively involved in any transition arrangements, regardless of which entity becomes the independent price regulator.

Q.1 Do you have any comments, concerns or observations in relation to the transition from the current process to independent price regulation?

Level of independence

As outlined in this paper, a regulator would need to be sufficiently independent from decisions within government around budgets, funding and service delivery to the heavy vehicle sector.

An issue related to the level of independence is role clarity. An independent price regulator for heavy vehicle charges should have a clear role and non-conflicting objectives. International best practice is to separate price and economic regulation from other types of regulation that address critical areas of public interest, particularly related to safety.[5] For this reason, the National Heavy Vehicle Regulator (NHVR) is not considered an appropriate option.

Q.2 What do you understand independent to mean? Do the options presented in the paper accord with that understanding?

Review and appeals process

An issue to consider is whether an appeals process would be required under independent price regulation in the short term and/or economic regulation in the medium to longer term. While other regulated utility markets in Australia, such as gas and electricity, have independent appeals processes, these markets are structured differently to the road sector and operate in a more mature and clearly defined market. In contrast, heavy vehicle price regulation would be a partial market reform initially and the regulator would effectively be regulating government agencies. Therefore, normal administrative review may be satisfactory initially and an independent appeals process may not be appropriate. In this context it may be more appropriate to address concerns through regulatory rules (maximum allowed charge increases etc.), rather than an appeals process. However, appeals processes

[5] Organisation for Economic Cooperation and Development (2014), *The Governance of Regulators*

would need to be developed when the role of the regulator is expanded beyond price regulation and into economic regulation.

Q.3 In the short term, while the price regulator would only be regulating prices for heavy vehicle charges, could user concerns be adequately addressed through regulatory rules or is an appeal process needed?

National or state-based regulator

Heavy vehicle regulatory functions could be undertaken at the national or the state and territory level.

The cross-border, national nature of the road network and the heavy vehicle freight task supports the continuation of a national approach. A national approach is consistent with the policy basis of the cost recovery arrangements under PAYGO as well as the regulation of safety and other standards of heavy vehicles and drivers. It would facilitate development of more consistent technical standards and methodologies in managing road assets. It could leverage the existing set of regulatory experience, expertise and powers of a national economic regulator, such as the Australian Competition and Consumer Commission (ACCC).

As outlined at table two, some areas of the transport sector are regulated, in terms of both charges and service levels at the state level. However, state-based regulation would result in a fragmented approach to price regulation. It would detract from work to develop national data standards and the benefits from a nationally applied FLCB approach to asset management and funding.

Q.4 How important is a nationally consistent approach to the regulation of heavy vehicle charges?

'Purpose built' or 'multi-industry' regulator

Assuming a national regulator, an independent price regulatory function could be fulfilled either by a 'purpose-built' economic regulator or by an already established 'multi-industry' economic regulator.

Using an established economic regulator would enable the regulator to leverage the existing skills and experience of its staff, and the agency's regulatory powers, into the heavy vehicle sector.

For example, if the heavy vehicle regulatory functions were to be provided to the ACCC, the ACCC could leverage its existing infrastructure regulatory powers and experience from its current rail, telecommunications and aviation regulatory functions. The ACCC has extensive experience in utilising its regulatory powers effectively and appropriately.

Alternatively, price regulation powers could be provided to a purpose-built single-role agency. The mandate of the NTC, for example, could be amended to give it deterministic powers in relation to price setting. In the case of the NTC, it would be beneficial to leverage the existing industry expertise within the organisation.

A newly established agency may need to upskill staff and develop an understanding of regulatory powers and functions if created from scratch. For this reason, and given the potential viability of the three options outlined in this document, a new regulator is not considered an appropriate option.

In any case, the framework that is to be enforced by a 'purpose-built' or a 'multi-industry' regulator would be designed to ensure it is clear, transparent and fit for purpose.

Q.5 What do you consider more important for establishing an independent price regulator for heavy vehicle charges, organisational capacity in economic regulation or industry specific expertise?

Q.6 What would be your preferred option for establishing an independent price regulator for heavy vehicle charges?

Separation of price development and price regulation functions

The Government is interested in the views of stakeholders on whether to split the roles of price development and price regulation. It is particularly interested in views on the perceived benefits and disadvantages of such a split.

In some regulated infrastructure sectors, there is a separation of functions between the regulator responsible for setting prices, and the agency or organisation responsible for making a pricing application. In relation to roads, the price development task could be carried out by:

- the independent pricing regulator (with no split),
- state and territory road management agencies,
- the NTC.

In all cases, it is envisaged that the independent price regulator's decisions would be influenced by inputs provided by state and territory governments. These inputs would underpin the workings of a forward looking cost base. There is a question as to whether these inputs should be provided directly to the independent price regulator, or, whether they should be provided to another independent agency such as the NTC, which would then make a recommendation to the independent pricing regulator.

Q.7 Does there need to be a structural separation in the roles of price development and price regulation?

Functions of an economic regulator

The issue of economic regulation is likely to be of significant interest to stakeholders. It would represent a major shift in the way road funding and maintenance is managed in Australia by requiring the regulator to scrutinise spending decisions and monitor service level standards. Governments have not yet finalised an approach to the role and nature of an economic regulator, but it would have features similar to those mentioned above in *table one.*

There are multiple options for assessing the transition of a price regulator to an economic regulator. One option would be for governments to review the performance of the price regulator after two years and industry's adjustment to the new pricing regime and assess whether it is appropriate to transition to economic regulation. In any case, state and territory governments would have to agree to transfer certain functions and decision making powers to the economic regulator and appropriate consultation would take place at the time.

The Government would be interested in alternative options in which to undertake this process.

Q.8 Are the functions of the economic regulator, as discussed in this paper at Table 1, appropriate in the heavy vehicle sector. What should/shouldn't an economic regulator do?

Appropriate regulatory and governance mechanisms

An independent price regulator would be expected to have powers to make pricing decisions which bind Commonwealth, state and territory governments. This is one of the underlying principles of independent price regulation, that is, governments would be bound by the decision of an arm's length regulator.

For an independent price regulator to be able to do this, states and territories will have to pass legislation conferring power on the regulator. Model legislation is likely to be the most effective and efficient method of bringing all states and territories under a single pricing regime, but there may be reasons why this is not suitable.

Q.9 Is a model law the best approach for bringing governments under the same regulatory model.

Examples – possible options for establishing an independent price regulator

Option 1: The Australian Competition and Consumer Commission (ACCC) would undertake independent price regulation of heavy vehicle charges

Under this option, the ACCC would undertake independent price regulation of heavy vehicle charges, with responsibility for developing binding heavy vehicle charges determinations.

Advantages

- Paves the way for full economic regulation of heavy vehicles (charging and investment), and of light vehicles in the long term;
- Draws on the capabilities and experience of the ACCC in economic regulation;
- Establishes the price regulator at a national level to achieve consistency across jurisdictions and minimise complexity for heavy vehicle operators;
- Resolves some of the current problems with the existing heavy vehicle charging system by improving the clarity and transparency of the charge setting process;
- Organisation is sufficiently removed from the delivery of heavy vehicle and road services and the development of government budgets to be considered independent;
- Potential to harmonise with rail regulation and incorporate lessons from other infrastructure sectors (aviation, telecommunications etc.);
- Would enable an experienced national regulator to develop, manage and administer the operation of a FLCB; and
- Potential to establish a separate/dedicated entity with access to the ACCC's resources and expertise (such as the Australian Energy Regulator).

Disadvantages

- Implementation may be resource intensive, particularly if new legislation is required; and
- Expertise in the heavy vehicle and roads sectors would need to be acquired.

Option 2. The National Transport Commission's (NTC's) price determinations would be automatically implemented by governments, provided certain criteria are met

Currently, the NTC collects road expenditure and usage data across jurisdictions and calculates the proportion allocated to heavy vehicle use before making a recommendation to transport Ministers on the amount that should be cost recovered from heavy vehicle users (known as a price determination). If governments were to agree to automatically implement the NTC's price determinations, this would effectively make the NTC a price regulator.

Advantages

- Can be implemented quickly for short-term price regulation, building on current processes;
- Establishes the price regulator at a national level to achieve consistency across jurisdictions and minimise complexity for heavy vehicle operators;
- Resolves some of the current problems with the existing heavy vehicle charging system by improving the clarity and transparency of the charge setting process; and
- The organisation has heavy vehicle expertise and experience in calculating heavy vehicle charges.

Disadvantages

- The organisation currently has limited capacity and experience in economic regulation;
- May create a real or perceived conflict of interest for NTC due to involvement in the development and implementation of other heavy vehicle policy and regulation;
- Expertise in calculating prices is limited to the heavy vehicle sector; and
- Less likely to be perceived as genuinely independent given its history of providing price ‘recommendations’ under the current system.

Option 3. State and Territory based economic regulators would undertake independent price regulation of heavy vehicle charges

Under this option, a national body such as the NTC would continue to undertake the price determination process.

However, the price review function would be devolved to state economic regulators. Under the current system, the Transport and Infrastructure Council reviews the NTC’s recommendations and assesses whether they should be accepted or rejected. Economic regulators are already established in most states and territories and would likely have capacity to undertake a price review function.

Advantages

- Builds on the expertise of existing economic regulators across jurisdictions;
- Improves transparency of the existing system through a published agreement to devolve pricing review to jurisdictions; and
- Potential for integration with public transport and toll roads within each jurisdiction.

Disadvantages

- Would likely lead to inconsistent heavy vehicle charges that may impose additional costs on heavy vehicle operators and/or result in ‘jurisdiction shopping’ and fractured national charges;
- Does not pave the way for full economic regulation of heavy vehicles (charging and investment) or of light vehicles; and
- Does not support a national freight and road transport system.

Questions for Discussion

- *Q.1 Do you have any comments, concerns or observations in relation to the transition from the current process to independent price regulation?*

- *Q.2 What do you understand independent to mean? Do the options presented in the paper accord with that understanding?*

- *Q.3 In the short term, while the price regulator would only be regulating prices for heavy vehicle charges, could user concerns be adequately addressed through regulatory rules or is an appeal process needed?*

- *Q.4 How important is a nationally consistent approach to the regulation of heavy vehicle charges?*

- *Q.5 What do you consider more important for establishing an independent price regulator for heavy vehicle charges, organisational capacity in economic regulation or industry specific expertise?*

- *Q.6 What would be your preferred option for establishing an independent price regulator for heavy vehicle charges?*

- *Q.7 Does there need to be a structural separation in the roles of price development and price regulator?*

- *Q.8 Are the functions of the economic regulator, as discussed in this paper, appropriate in the heavy vehicle sector. What should/shouldn't an economic regulator do?*

- *Q.9 Is a model law the best approach for bringing governments under the same regulatory model?*

- *Stakeholders should comment on any other matters they feel appropriate.*