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Land Transport Market Reform Branch  
Department of Infrastructure and Regional Development  
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## **Independent price regulation of heavy vehicle charges discussion paper**

Thank you for the opportunity to provide feedback on the discussion paper titled 'Independent price regulation of heavy vehicle charges' dated May 2017. The main body of this submission outlines the NTC's comments on a number of reform and transition issues. In addition, the NTC has sought to correct inaccuracies in the discussion paper related to the NTC. We also provide specific responses to a number of the consultation questions in the Attachment.

### **Complexity of reform**

The discussion paper notes that utilities such as electricity and gas are structured differently to the road sector and operate in a more mature and clearly defined market (p10). This is in part because of the nature and multiple uses of road corridors, their non-exclusive nature, the multiple road funding sources and the intrinsic link of roads to land property laws and therefore real property rights. As acknowledged in the discussion paper, this will make reform of road charging more complex than it was with other industries.

While other utilities generally went through full market reform, the level of complexity for heavy vehicle price regulation, as a partial market reform, will be more complex again (p10).

This complexity is acknowledged in the implicit sequence and timelines outlined in the discussion paper which acknowledges that the "new price regulator function would require agreement across governments, legislation and take time to establish". The discussion paper also notes that there will need to be a transition from the existing heavy vehicle charges system administered by the NTC to a new independent price regulator.

### **Potential transition**

The discussion paper canvasses the steps to establish an independent price regulator and actions required before it can set heavy vehicle charges.

Based on the discussion paper, the NTC assesses the following as minimal sequential steps:

- a) Transport and Infrastructure Council
  - i. agrees to establish an independent price regulator
  - ii. notes the prototype model for a Forward Looking Cost Base
- b) Transport and Infrastructure Council subsequently agrees:
  - i. Revised pricing principles to guide the decisions of an independent price regulator (p4)
  - ii. Legislative amendments to confer the price regulation function on the independent price regulator (p10)
- c) Legislation is passed by the Commonwealth and state and territory parliaments.
- d) A new entity is established or new powers are conferred on an existing entity.
- e) Possibly, governments agree to the appointment of Commissioners and give effect to the appointments.
- f) Entity develops and provides the new charge setting methodology and associated documentation to State and Territory road agencies.
- g) Entity requests State, Territory and local government information on road expenditure and assesses if this expenditure data is appropriate for the charge setting methodology.
- h) Entity sets charges and communicates the charges to governments.
- i) Governments implement the new charges and collect the revenue.

### **NTC role during transition**

Given the complexity of the potential reform and the likely timeline until new heavy vehicle charges are set by an independent regulator, the NTC could assist governments in moving toward the successful commencement of an independent price regulator in the following ways:

1. Assisting the nascent independent regulator with establishing its processes by:
  - a. Continuing to develop the Forward Looking Cost Base through its parallel process (p7).
  - b. Applying the NTC's industry specific expertise and expertise in road charging (p12) in data collection, developing a method to compare the varying road system nomenclature and funding approaches across states and territories.
2. Continue its role through the current heavy vehicle charges determination process (p8) until the new independent entity is in a position to set new charges. This will provide a safeguard to allow heavy vehicle road charges to continue to be adjusted before the independent regulator can set new charges.
3. Assisting governments by providing advice based on its broader reform experience and its experience with the PAYGO heavy vehicle charging mechanism.
4. Supporting and enabling a smooth transition to the new arrangements.

### **Knowledge of pricing**

The discussion paper notes, on page 15, that a potential disadvantage of the NTC is that its expertise in calculating prices is limited to the heavy vehicle sector. The NTC considers that this is not accurate for the following reasons:

- Setting prices involves applying economic principles to recovering the costs of building and operating a network from users. Typically, there are significant common costs, and marginal costs can vary between different types of users. The skills and expertise required for such a task are transferrable, and apply equally across vehicle types or networks.

- Price calculation for shared networks requires a sound understanding of the whole market. Prices for individual groups of users (e.g. vehicle classes) cannot be set in isolation from each other.
- There are no significant differences between light and heavy vehicles in a charging context in that charges for both currently consist of a two-part tariff consisting of a fixed access charge and a variable charge levied on fuel.

NTC staff members have experience with pricing and economic regulation in other industries. Therefore, it would be incorrect to argue that the NTC has only limited experience in pricing and that this would be an obstacle to it being in a position to perform a price regulation role. Similarly, it would not be correct to argue that the ACCC would not have the knowledge or expertise to perform the economic regulation role for roads, simply because its responsibilities currently do not cover this particular sector.

### **Conflicts of interest**

The paper notes on page 15 that, the potential choice of the NTC as a price regulator may create a real or perceived conflict of interest for the NTC due to involvement in the development of other heavy vehicle policy and regulation.

A conflict of interest arises where:

1. a person is in a position to derive personal benefit from actions or decisions made in their official capacity; or
2. the concerns or aims of two different parties are incompatible.

There would appear to be no suggestion that item 1 is of concern in this circumstance.

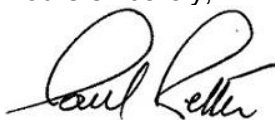
In relation to potential incompatible organisational aims, the NTC has a statutory role in making recommendations to the Council on heavy vehicle charges. The NTC has no other interest in the matter: it derives no revenue from heavy vehicle charges, and neither benefits nor experiences any detriment based on the outcome.

The suggestion that the NTC may have at least a potential conflict of interest, or possibly a perceived conflict of interest, could possibly be made if the NTC also had a different (e.g. safety) regulatory role. In this situation, it could be recommending charges at the same time as being a safety regulator. However, the NTC has no direct regulatory role at all. Its role is limited to making recommendations to the Council.

On this basis, the NTC considers that neither the NTC nor the ACCC could have a conflict of interest, or be reasonably perceived to have a conflict of interest, if appointed as price regulator or economic regulator.

If you have any questions regarding this submission, please feel free to contact Ramon Staheli, Project Director Pricing on (03) 9236 5028.

Yours sincerely,



**Paul Retter AM**  
Chief Executive and Commissioner

cc: Mike Mrdak AO, Secretary, Department of Infrastructure and Regional Development

## Responses to specific consultation questions:

Q1: Do you have any comments, concerns or observations in relation to the transition from the current process to independent price regulation

The paper states that: “An independent price regulator for heavy vehicles would provide a foundation for expertise and an 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 investment arrangements for all road users.”

Overall, the discussion paper notes that the price regulator should be chosen from the perspective of being the best option to evolve into an economic regulator.

The NTC believes additional considerations should be taken into account when deciding on the transition path and the identity of the price regulator. Transition costs and uncertainty about the timing and nature of the reform path are also relevant considerations. It is possible that one organisation is a better fit for the price regulator role while a different organisation would be a better fit for the economic regulation role.

If this is the case, then an alternative transition path could be considered. That is, the price regulation role could be performed by one organisation, with the economic regulation role being performed by a different organisation at a later point in time. The transfer of responsibility from one organisation to the other would then occur as part of the implementation of economic regulation.

This approach could offer the following advantages:

- The price regulator and economic regulator could each be chosen with a view to being best placed to perform each role.
- It avoids the risk of incurring unnecessary transition costs, or potentially making a sub-optimal decision on price regulation, based on the requirements of the possible (uncertain) future implementation of economic regulation. This is particularly important if economic regulation is never implemented, or implemented in the distant future.
- Depending on the organisations chosen to perform each role, the time required to implement independent price regulation could be reduced.

It is important to ensure a successful transition to independent price regulation, regardless of the organisation chosen to perform the task. The NTC proposes that the following issues need to be considered in developing the transition path:

- The need to complete development of the prototype forward looking cost base (FLCB) model following consideration by the Transport and Infrastructure Council (the Council) in November 2017. It is unlikely that the initial prototype could immediately be used to set heavy vehicle charges. A number of issues identified during the development of the prototype will require further work and testing beyond November 2017.
- Approaches to data standardisation, collection and reporting will need to be agreed to and implemented before a price setting regime based on the FLCB can be implemented.

- The information and knowledge transfer requirements are likely to be significant. For example, the process of setting heavy vehicle charges is not simply an adjustment of current charges to reflect changes in the cost base (annual adjustments). The process also includes periodic determinations which involve reviewing and potentially revising all aspects of the charges methodology such as road wear measures for vehicle types and setting the relative levels of registration charges across different heavy vehicle types.

The NTC is looking forward to working constructively with governments on designing and implementing a transition path.

Q3: 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?

Regulators make their decisions based on a number of inputs, including data, assumptions and theoretical concepts which are open to question or dispute. The key role of any appeals process should be to build confidence in the regulatory regime by ensuring that disagreements over the regulator's decisions can be aired, tested and resolved openly.

The NTC considers that the following issues need to be addressed when designing an appeals process:

- A decision needs to be made whether the review process involves judicial review or merits review. Each approach has different advantages and disadvantages.
- Judicial review alone may not be sufficient to give governments and users alike sufficient confidence that relevant aspects of the regulator's decision can be reviewed. This could suggest that merits review would be a more suitable option.
- If a merits review process is adopted, the review scope may vary. The review could either be required to consider the regulator's decision as a whole, or it could be possible that parties would seek to review specific parts of the regulator's decision only, for example, the approved rate of return on capital. The risk with the latter approach is that appeals tend to selectively focus on the part of a decision that may have been unfavourable to the appellant whereas the regulator's decision may have been balanced and appropriate when viewed in its entirety. The NTC recommends that any review process should require the regulator's entire decision to be reviewed.
- Where there are a large number of consumers with diverse interests, it has been challenging to achieve meaningful consumer representation in regulatory and appeals processes. Careful consideration would need to be given on how to ensure that the interests of consumers are represented.

The discussion paper suggests an alternative approach, using regulatory rules such as maximum allowable charge increases, will reduce cost and complexity. This can create problems. For example, under the PAYGO methodology, annual adjustments of charges were at one stage limited to a maximum rate linked to the rate of inflation and could not be negative (i.e. charges could not decrease). The result of this approach was that increases in charges did not keep up with increases in the cost base, resulting in an under-recovery of the identified costs. As a result, this approach was abandoned as part of the 2007 Determination. In light of this experience, the NTC recommends that firm limits on price changes should not be considered as part of a simplified review process (if achieving full cost recovery is seen as essential).

Q7: Does there need to be a structural separation in the roles of price development and price regulation?

In Australia, economic regulation frequently employs the 'propose-respond' methodology where a regulated entity proposes an allowable revenue requirement to the regulator, and the regulator reviews the proposal and responds with amendments. This process could also apply under price regulation or economic regulation for roads.

A key advantage of separating the functions of price development and price regulation in the early phases of reform is that the 'propose-respond' approach could be developed and implemented early.