

# **ARTC ACCESS UNDERTAKING: INTERFACE ISSUES WITH ACCESS TO THE TARCOOLA-DARWIN RAILWAY**

## **Introduction**

On 22 February 2001, under Part IIIA of the *Trade Practices Act 1974* (Cwth), the Australian Rail Track Corporation (ARTC) lodged an access undertaking with the Australian Competition and Consumer Commission (ACCC).

The undertaking covers terms and conditions of access to rail tracks owned or leased by ARTC. The tracks are part of the interstate mainline standard gauge track linking Kalgoorlie in Western Australia, Adelaide, Wolseley and Crystal Brook in South Australia, Broken Hill in NSW and Melbourne and Wodonga in Victoria. ARTC owns the line in South Australia (including the track to Kalgoorlie in Western Australia) and has control over the track in Victoria where it has a lease agreement in place.

Currently, ARTC also owns the track linking Tarcoola and Alice Springs. ARTC is to lease this section of its current network to the Asia Pacific Transport Consortium as part of the arrangements for construction of the Alice Springs to Darwin railway. Under the lease terms, the Consortium will assume responsibility for the ongoing maintenance and management of the railway between Tarcoola and Alice Springs, effectively excising the railway from the rest of the ARTC network.

Access to the Tarcoola-Darwin railway is to be subject to the rail access regime certified by the Commonwealth Treasurer as an effective State regime in accordance with section 44N of the Trade Practices Act on 23 March 2000. The certified regime is set out in the AustralAsia Rail Access Code ("the Code").

The South Australian Independent Industry Regulator (SAIIR) is assigned the role of regulator under that regime.

The Tarcoola-Darwin regime is to commence operations when some services on the new part of the line from Alice Springs to Darwin can be provided – this might occur before the full line is completed. When these services can be provided, the regime will also apply to the existing line from Tarcoola to Alice Springs.

The undertaking will apply to the Tarcoola-Alice Springs track until such time as responsibility for that track transfers to the Consortium.

Access to parts of the interstate network owned by Queensland, New South Wales and Western Australia are subject to access regimes in those States. Presently, none of these rail access regimes are certified "effective" under Part IIIA of the Trade Practices Act.

## **Role of 'interface issues'**

Prior to commencement of negotiations for access to use the Tarcoola-Darwin railway, the Code requires SAIIR (among other things) to develop and publish certain guidelines to be observed by the below-rail service provider when preparing information to be made available to access seekers on:

- relevant prices and costs [under clause 9(1)(e) of the Code]; and
- time-path allocation policies for the railway and service standards [clause 9(3)].

Moreover, under clause 45A(2) of the Code, when preparing such guidelines, SAIR is required to take into account “interface issues” that may arise under any corresponding access regime (insofar as this may be relevant and insofar as this is consistent with, and not in derogation of the operation of, the other provisions of the Code).

Interface issues are defined as those issues (including pricing) which directly affect two or more railways (including the railway to which the Code applies). Such issues arise because anyone wishing to operate a rail service on the Tarcoola-Darwin railway is likely to need access both to this infrastructure and also to infrastructure owned by ARTC and, depending on the corridors used, other track owners (Rail Access Corporation of New South Wales, Westrail and Queensland Rail (QR)).

The potential for interface issues requires a co-ordinated approach to interstate rail services, and consistency between the various access frameworks.

The Draft Undertaking contains no explicit recognition of such interface issues. Clause 2.1(c) make clear that the Undertaking does not extend to the track and infrastructure of other track owners that may connect to the ARTC interstate network. While clause 6.1 appears to place some limits on what ARTC terms “adjoining infrastructure”, this may relate more to privately-owned (minor/new) connections to the network.

### **Various roles of ARTC**

While the ARTC is solely a below-rail service provider (rather than an integrated above- and below-rail business like some other infrastructure operators including the Consortium operating the Tarcoola-Darwin railway), the ARTC nevertheless performs several distinct – and possibly conflicting – roles as a below-rail service provider:

- Most obviously, ARTC is the provider of below-rail services on the interstate rail network.
- Under the undertaking provisions of Part IIIA of the Trade Practices Act, and once its undertaking is approved, ARTC will effectively be a self-regulator, not subject to the oversight of an independent regulator.<sup>1</sup>
- Finally, ARTC is expected to be a wholesaler of access to the Tarcoola-Darwin railway, given the scope which exists for ARTC to conduct a “one stop shop”. The Code provides that wholesalers, such as the ARTC, can pre-purchase blocks of access, by purchasing blocks of generic time-paths for trains carrying any combination of non-bulk freight and then on-selling that access to above-rail operators.<sup>2</sup>

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<sup>1</sup> Once the Undertaking is approved, the ACCC’s role is limited (see clause 3.11.4(b)(vii)) to making determinations where there have been “manifest errors” in an arbitrator’s decision in respect of any dispute arising under the undertaking or in relation to negotiating an access agreement. It is in this sense that, once its Undertaking is approved by the ACCC, ARTC will effectively be self-regulating.

<sup>2</sup> Clause 3(3) of the Code notes that an access seeker includes “a reference to a person seeking access on behalf of another person or other persons”. Clause 10(2)(b) notes that an access proposal

As a below-rail service provider, issues of cross-subsidisation of affiliated above-rail operations (and the associated distortions to competition) do not arise. However, potential exists for ARTC's stance as a self-regulator to be influenced by its wholesaler role, let alone its monopoly position as provider of interstate rail access services.

ARTC's wholesaler role is not a trivial possibility. Initially at least, most train operations using the Darwin to Tarcoola railway will be interstate. Interstate above-rail operators will have a choice of negotiating directly with both below-rail service providers or rely on the ARTC to negotiate a package on their behalf. Hence, if the ARTC wants to sell rail services to Darwin, it will need to negotiate with the below-rail service provider of the Tarcoola-Darwin railway. Likewise, the operator of the Tarcoola-Darwin railway's above-rail business will need to negotiate an access contract with the ARTC for services beyond Tarcoola.

ARTC has had some experience with what it terms the "adjoining infrastructure" issue in the context of negotiating wholesale arrangements with intrastate below-rail service providers like QR (which lay out the terms and conditions under track used for transportation between different State networks are accessed by interstate rail services and how these services will interact with intrastate movements).

### **Codification of policies and methodology**

Clause 1.2(b) of the Draft Undertaking refers to the intent of the undertaking being to:

*"use transparent and detailed methodologies, principles and processes for determining access price limits, terms and conditions".*

Appendices A and B attached provide a broad comparison of the access pricing and service quality determination processes envisaged under the Draft Undertaking with those for the Tarcoola-Darwin access regime. While there is some commonality between the principles to be applied in each access regime, it is apparent that the nature and level of detail explicitly guiding the respective below-rail service providers is quite different. Unlike the ARTC regime, the Tarcoola-Darwin regime requires the below-rail service provider to adhere to certain guidelines issued by SAIIR detailing such things as:

- the application of the DORC methodology to asset valuation;
- the methodologies for determining various capital cost components;
- the timeframes within which costs could be avoided; and
- the meaning to be attached to efficient, forward-looking costs.

Also, while the Draft Undertaking provides quite a deal of information on ARTC's proposed time-path management and service quality policies, there are principles and methodologies not explicitly treated in the Draft Undertaking which SAIIR will wish to make explicit in the guidelines to be put in place for the Tarcoola-Darwin below-rail service provider.

Hence, there is limited codification of many of the principles and methodologies inherent in ARTC's approach to setting reference prices and terms and conditions of access. ARTC considers its situation requires relatively light-handed regulation. ARTC appears to hold this view for two main reasons:

- ARTC implies that it has little scope to exploit any market power:

*"[Given] ARTC operates in a competitive environment where competitive pressure from other modes of transport (particular road) places constraints on rail freight and access pricing ..., in ARTC's view, it is unlikely to be able to price any of its markets at levels which fully recover the full economic cost of its assets" (clause 1.1(e)).*

- Also, ARTC distinguishes its 'open' access regime from 'third-party' access regimes involving vertically integrated rail operators:

*"ARTC is of the view that distinctly different regimes apply depending on the commercial motivation and market position of the access provider.*

*A 'third party' access regime would apply where the provider is related in some way to a downstream operator and has the ability to distort normal competitive forces. Such a provider has a commercial imperative to reduce competition and, as such, a regime needs to be quite prescriptive and focus heavily on restricting anti-competitive activities. The QR regime falls into this category.*

*On the other hand, an 'open' access regime would apply where the provider has no downstream affiliation, and has access revenue as its only source of income. Such a provider has commercial incentive to promote competition and utilization of the facility. This type of regime can be more light handed and need not focus on restricting anti-competitive activity. Where the facility displays monopoly characteristics and lacks competition with other facilities, the regime needs to focus more so on restricting monopoly pricing. Where the access provider is operating under competitive pressure, the regime can be even less intrusive. (ARTC, Submission on QCA Draft Decision, April 2001, p.3)*

SAIIR acknowledges that the latter consideration is an important one, which *other things being equal* might justify less codification of principles and methodologies under an 'open' access regime than under 'third-party' access regime.

However, other circumstances associated with ARTC's access arrangements give rise to the need for the ARTC undertaking to involve a degree of codification similar to that necessary in third-party access regimes like that applying to the Tarcoola-Darwin railway.

First, the access arrangements applying with respect to the interstate rail network are pivotal (just as the regime applying to an electricity transmission network has important consequential influences upon the regimes for connecting electricity distribution networks). In particular, the arrangements applying to the interstate rail network give rise to interface issues common to all connecting State access regimes.

Secondly, given that the interstate access regime will be the first approved under Part IIIA of the Trade Practices Act, the role to be played by codified principles and

methodologies in ARTC's undertaking is all the more important in establishing precedents and the like.

### **Issues arising for SAIIR**

It is not clear from the Draft Undertaking whether – and how – interface issues are to be taken into account. While this may reflect that the interstate access regime will be the first regime to be approved under Part IIIA of the Trade Practices Act to become operational, this is not a sufficient ground for neglecting such issues, or for assuming that a “first-in, best-dressed” approach is warranted.

Nor is it apparent how ARTC intends to handle possible conflicts between its various roles. It should not be permitted to conduct its activities in implementing the access undertaking to the interstate network in a way that is influenced by its role as a wholesaler of access to the Tarcoola-Darwin railway.

Of most concern to SAIIR is the fact that many of the principles and methodologies to be applied by ARTC which parallel those to be subject to guidelines developed by SAIIR are not codified in the Draft Undertaking.

While the fact that ARTC can be distinguished from vertically-integrated rail operators, the precedents to be set and pivotal role to be played by access arrangements involving the interstate rail network mean that SAIIR considers it inappropriate to be put in a position where it might be constrained by either:

- ‘principles’ [desired outcomes statements] put in place by ARTC once its undertaking commences, without reference to an ACCC-approved framework for the development of such principles; or
- ‘methodologies’ put in place by ARTC as a below-rail service provider once its undertaking commences, without articulation (transparency) of the underlying principles.

Just because ARTC is not a vertically integrated track owner and above-rail operator is sufficient justification in ARTC's circumstances for differences in clarity and transparency between ‘open’ and ‘third-party’ access regimes, including because of:

- ARTC's role as the provider of interstate network access services; and
- the fact that its regime will be the first to be operational under Part IIIA of the Trade Practices Act.

The issues would be clearer for all concerned if SAIIR was able at this time to advocate the detailed principles and methodologies which it considered to be appropriate. However, it is likely to be at least a year before SAIIR is in a position to finalise the various guidelines it is required to develop and publish. Moreover, SAIIR does not wish to pre-empt its own consultative processes for developing such guidelines.

Where jurisdictional regulators are involved, there are accepted channels for consultation, and a shared acceptance of the importance of regulatory consistency. In the case of ARTC's regime, however, ARTC is self-regulated once its undertaking is approved by the ACCC. In effect, ARTC will play the role of both regulator and service provider.

If all the principles and methodologies determining ARTC's approach to reference pricing and time-path allocation and management are not to be codified beyond that currently evident in the Draft Undertaking, at the very least ARTC's undertaking may need to incorporate an obligation on the part of ARTC to consult with interfacing jurisdictional regulators, both to reveal its approach on certain issues beyond that provided in the letter of the undertaking and to enter into dialogue with a view to achieving mutually acceptable regulatory outcomes.

Such obligations should mirror those on SAIIR under the Tarcoola-Darwin access regime. Related changes may also be necessary. For example, clause 3.4(a) limits disclosure of confidential information. Consideration could be given to extending the exclusion provisions in sub-clause (c) to instances where appropriate material is being shared (under a duty of confidentiality) with interfacing jurisdictional regulators.

If appropriate provisions cannot be included in ARTC's undertaking for coordination with interfacing jurisdictional regulators, it would be essential for the approval of the undertaking to be delayed until such time as all principles and methodologies were codified and subject to the ACCC's assessment against national competition principles.

SAIIR  
July 2001

## **Appendix A: A Comparison of Pricing Principles**

### **Tarcoola-Darwin regime**

On receipt of an access proposal, a freight service will be tested to see if it meets the Code's "sustainable competitive" pricing criteria.

If the rail service meets these criteria, access prices to be charged by the below-rail service provider are capped by prices set by competing transport modes (in accordance with the competitive imputation pricing rule) rather than by prices established by SAIIR.

In particular, a formula, using the price of a competing non-rail freight as its benchmark, is to determine the total freight price. This is to be adjusted to ensure comparative integrity – for instance deductions necessary to reflect the additional transport costs required to deliver the freight "door to door". From this benchmark, the access price payable is determined by deducting the above-rail avoidable costs of the incumbent above-rail operator. This price must lie between a floor/ceiling band, calculated on the basis of forward-looking, efficient costs.

In this situation, instead of directly regulating access prices *per se*, SAIIR's primary role is to develop and publish certain guidelines to be observed by the below-rail service provider when preparing information to be made available to access seekers on relevant prices and costs (clause 9(1)(e)).

If the service does not meet the "sustainable competitive" criteria, it is to be priced under a "floor/ceiling" approach applied by the below-rail service provider within guidelines made by SAIIR and based on the forward-looking efficient costs of the infrastructure necessary to provide the service. Passenger services will always be priced under the floor/ceiling approach.

Among the guidelines to be developed by SAIIR for these various purposes are:

- an approach for valuing capital assets [section 1(7)(a) of the Pricing Principles Schedule attached to the Code];
- the meaning and measurement of 'avoidable cost', including the timeframes within which costs could be avoided [sections 1(7)(b) and 3(4)(b)]; and
- the meaning of "forward-looking and efficient" costs [section 3(2)].

### **ARTC Draft Undertaking**

Section 4 of the Draft Undertaking sets out the principles used by ARTC to derive access charges.

The stated objective is to apply access charges which aim to achieve a practical balance between the legitimate business interests of ARTC, the interests of operators wishing to have access to the services provided by ARTC and the interests of the public.

Access pricing will be subject to floor-ceiling revenue limits. The floor is given by the incremental or avoidable costs of providing a service, excluding depreciation and a return on assets employed. The ceiling is defined as the full economic cost of providing a service including the costs specific to a service, depreciation and an allocation of indirect costs, and a return on assets employed. ARTC states that costs would be forward looking and include planned efficiency improvements.

Indicative access charges for standard services in specific segments would be published by the ARTC as a basis for negotiation of pricing between the floor and ceiling revenue limits. Departures from these indicative charges would take account of the characteristics of individual services, including technical aspects, the particular segments of the network to which access is sought, the opportunity costs to ARTC, the impact on other traffic on the network (including system capacity and flexibility) and the market value of the particular time path being sought.

In other respects, access pricing would be uniformly applied and would not differentiate between types of operators or type of service operating within the same market segment.

### **Pricing differences**

While the floor/ceiling test is common in the two regimes, there is no explicit role for competitive pricing in ARTC's Draft Undertaking. However, Clause 1.1(e) alludes to competitive pricing, with:

*"...other modes of transport (particular road) plac[ing] constraints on rail freight and access pricing ..."*

Likewise, Booz Allen & Hamilton, in a report prepared for ARTC and submitted to the ACCC, stated that:

*"In the ARTC context, it is unlikely the ceiling test will be a binding constraint on pricing. Freight rates are set by the market and competition from road and sea transport, and consequently this ultimately sets the maximum price able to be charged for access."*

The ARTC regime places reliance instead on limits on charge differentiation (clause 4.3).

In the ARTC context, reference prices are guided solely by the limits on charge differentiation, whereas the competitive pricing rule (to be applied in accordance with guidelines developed and published by SAIIR) is applicable in the case of the Tarcoola-Darwin regime.

Compared with the requirements under the Tarcoola-Darwin access regime, and other than the independent reports on DORC value and the WACC, ARTC's Draft Undertaking provides minimal detail on the principles and methodologies underlying its approach to:

- asset valuation (apart from general definition in clause 4.4(c));
- the derivation of depreciation expenses;
- the setting of the return on capital, which is instead largely at ARTC's discretion (clause 4.4(f));



- the meaning of “efficient, forward-looking costs”, with ARTC content to stress the role played by its outsourcing of infrastructure maintenance in generating efficient costs, supplanting the need to an independent assessment of efficient cost levels, let alone references to costs incurred by an efficient network operator:

*“ARTC’s maintenance services are outsourced and managed under maintenance contracts entered into on commercial terms as a result of a competitive tendering process. ARTC has adopted this practice with a view to ensuring that its costs reflect efficient practice.” (ARTC, Submission on QCA Draft Decision, April 2001, p.10);*

- the quantification of the cost allocators in clause 4.4(e):
  - “...non-Segment specific costs will be allocated to Segments in proportion to:*
    - (i) gtkm with respect to 60% of the track maintenance cost;*
    - (ii) track kilometres with respect to 40% of the track maintenance cost; and*
    - (iii) Train kilometres with respect to all other costs”;*
- the meaning of (stand-alone) “economic cost” in clause 4.4(g), with:
  - “...Economic cost means:*
    - (i) costs specific to a segment;*
    - (ii) the costs of Additional Capacity;*
    - (iii) Depreciation; Return on Segment specific assets; and*
    - (iv) an allocation of non-Segment specific costs including Train control, Depreciation and a Return of non-Segment specific assets and other overheads of ARTC.” (clause 4.4(d))*

ARTC itself has suggested (in the QR undertaking context) that:

*“The application of ‘stand-alone’ as a costing basis for individual services is likely to result in some double-dipping ... [associated with the possibility] that there are costs jointly shared by geographical areas” (June 1999, p.11); and*

- the meaning of avoided cost in clause 4.4(b), other than a very general definition that:

*“...incremental costs means the costs that could have been avoided if a Segment [i.e. defined component of the network] was removed from the Network excluding Depreciation and a return on assets employed...”*

While maintenance and operating costs are central, there may be a role for the incremental capital costs associated with the cost of providing paths. Also, ARTC’s Draft Undertaking provides no definition of the time frame appropriate to avoided/incremental cost, other than it is to be “reasonable” (clause 4.4(f)).

## **Appendix B: A Comparison of Time-Path Allocation and Service Quality Principles**

### **Tarcoola-Darwin regime**

Under clause 9(3) of the Code, the below-rail service provider is required to make information available to access seekers on time-path allocation and reallocation policies for the railway – and service quality and train management standards developed and maintained by the below-rail service provider – in accordance with guidelines developed and published by SAIIR.

Time-path management involves a range of matters but includes:

- the below-rail service provider's general allocation policies;
- its approach to day-to-day management matters; and
- its policy to transfers or reallocations of time-paths between above-rail operators.

Time-path management significantly influences the quality of service provided and passed on to final customers, and therefore is important in influencing the relative competitiveness between above-rail operators and between rail and non-rail transport. For instance, persistent delays will undermine customer confidence in an operator's ability to travel within the advertised time. If delays occur across all operators then only the relative competitiveness between rail and non-rail transport will be affected. However, if only some above-rail operators are delayed, those operators' costs will increase, affecting their competitiveness relative to those operators not experiencing delays. As time-path management is in the hands of the below-rail service provider, it has important implications for competitive neutrality principles – the below-rail service provider has an incentive to give its own operator a competitive edge.

Clause 9 of the Code requires the below-rail service provider to give access seekers information on service quality, day-to-day time-path management, time-path allocation and reallocation policies. These are to be developed and maintained in accordance with guidelines prepared by SAIIR. SAIIR is to establish these guidelines, through public processes, prior to commencement of access negotiations.

### **ARTC Draft Undertaking**

Part 5 of the Draft Undertaking deals with 'management of capacity', and Part 7 with 'network transit management'.

Part 5 sets out the processes that ARTC would follow in dealing with capacity issues. ARTC's initial 'indicative access proposal' would include an assessment of capacity to ascertain the extent to which the applicant's requirements can be met within existing capacity constraints.

Little guidance is given as to how ARTC will undertake such assessment. Instead, the focus is on instances where two or more applicants seek access to mutually exclusive access rights, in which case ARTC undertakes to grant access to the

above-rail operator which offers the most favourable terms and conditions. In such a case, ARTC would base its decision on the basis of “the highest present value of future returns” that an access agreement would produce having regard to the relevant costs and risks.

Access rights to train paths may be cancelled by the operator or assigned to another party, subject to certain conditions including the approval of ARTC. The Draft Undertaking also provides for ARTC to withdraw assigned access rights to specific train paths where these have been under-utilised.

Part 7 sets out ARTC’s objectives in train management which is to exit trains according to their contracted exit time. In the case of conflicts between trains in transit, the ‘network management principles’ set out in Schedule F would apply. These principles are designed to ensure that there is a focus on on-time exit, and train performance by operators is appropriately reflected in the management of trains.

### **Time-path allocation/standards differences**

While the Tarcoola-Darwin Access Code requires SAIIR to establish principles for both:

- the conversion of an above-rail service provider’s capacity entitlement into specific train paths on a daily train plan; and
- traffic coordination/control aimed at the running of train services and the commencement and closures of track possessions as scheduled in the daily train plan

the train management principles stated in ARTC’s Schedule F are restricted to the latter.

There is no doubting that ARTC has significant discretion in allocating train paths. However, in restricting ARTC’s use of this discretion, it would seem unwise to place sole reliance on ARTC not being vertically integrated with any of the above-rail operators. It still has substantial market power in its own right.

Separation of principles from procedural matters has the attraction that it provides increased transparency and greater certainty in respect of scheduling and train control outcomes. The ACCC has therefore appropriately raised as an issue whether the principles and methodologies governing ARTC’s management of capacity and network transit management are sufficiently transparent or clearly stipulated (ACCC, Issues Paper, pp.12,14).