

**AUSTRALIAN COMPETITION & CONSUMER COMMISSION
AUSTRALIAN RAIL TRACK CORPORATION – ACCESS UNDERTAKING**

SCT SUBMISSION

1. Executive Summary

The ARTC Access Undertaking does not properly take into account the interests of existing users who have invested considerably in terminals and rolling stock.

The Access Undertaking in its present form will reduce investor confidence and adversely affect competition.

The Access Undertaking as presently drafted should not be accepted by the Australian Competition and Consumer Commission.

2. Specialized Container Transport

SCT has been invited by the Australian Competition & Consumer Commission (ACCC) to provide comments and submissions on the ARTC Access Undertaking.

We request the ACCC to consider our comments and submissions in light of the following:-

- SCT was the first private company to commence an interstate freight train service between Melbourne, Adelaide and Perth in July 1995;
- SCT is still a small family owned company operating up to three train services per week in the east/west corridor;
- Since SCT entered the rail freight services market in 1995, freight rates have decreased by more than 30% directly attributable to the introduction of SCT's train services. This is one of the most significant benefits that have been delivered to Australian consumers following the Hilmer report;
- Since 1995, SCT has been operating train services pursuant to terms and conditions agreed to with the various track access providers including ARTC's predecessor, Australian National Railways Commission;
- SCT has invested in excess of 50 million dollars in new rail infrastructure and rolling stock. In particular, SCT has constructed new terminals in Perth and Melbourne and is presently completing construction of a rail terminal in Adelaide. SCT has also invested in new state of the art refrigerated rolling stock;

- SCT has no current interest in acquiring National Rail Corporation Limited;
- Eighty percent (80%) of SCT's business involves rail; and
- SCT is also involved in local and interstate road transport and sea transport and as such, is aware of the cost differentials between modes.

3. Other Relevant Considerations

We also request the ACCC to consider our comments and submissions in light of the following:-

(a) ARTC is a Monopoly

ARTC is a monopoly and has used its monopoly power in the past as a negotiating tool.

On 2 June 2000, operators were advised that access to the network would only continue subject to terms and conditions which were different to those terms that had previously applied.

If this monopoly power is not contained by an appropriate Access Undertaking, giving specific rights to the other party, then investment confidence will be adversely affected.

(b) Infancy of Access Arrangements

In view of the infancy of access arrangements in the rail industry in Australia, it is not appropriate for an access undertaking of this type to contain broad principles.

Further, given the infancy of rail access arrangements, significant difficulties will arise with the ACCC considering this Access Undertaking prior to the Productivity Commission completing its Review of the National Access Regime.

(c) Existing Operators

It is important for the Access Undertaking to recognize that there are existing operators who (like in SCT's case) have invested considerably in rail infrastructure and equipment.

Part IIIA of the Trade Practices Act 1974 (as amended) (TPA) provides that the ACCC must not make a determination (in the case of an arbitration of an access dispute) which would, amongst other things, prevent an existing user from obtaining a sufficient amount of the service to meet reasonably anticipated requirements.

The Access Undertaking does not properly differentiate between existing operators and prospective access seekers nor does it take into account the interests of existing users.

(d) Operator's Accreditation Requirements

Operators are required to have appropriate accreditation in order to operate train services. This accreditation is maintained by operators regularly undergoing internal and external audits.

It is important that the Access Undertaking not allow ARTC to question the capabilities of an accredited operator.

We comment below on the unsatisfactory termination clause that allows ARTC to terminate the access agreements of operators on the basis of accreditation related matters and in circumstances where an operator continues to maintain its accreditation.

(e) Three Roles

In considering the Access Undertaking, it is clear that ARTC believes it has the following three roles:-

- (i) A profit maker;
- (ii) An access provider; and
- (iii) To some degree, as a regulator which, as noted earlier, we oppose.

It is important to recognize the conflict in the roles of ARTC and the fact that there are many non-price issues that can be barriers to the optimal use of the network by operators.

The Access Undertaking needs to effectively deal with these issues so that operators are also protected.

4. Access Undertaking

It is SCT's submission that the undertaking submitted by the Australian Rail Track Corporation (ARTC) should not be accepted by the ACCC for the following reasons:-

(a) Term

The term of the Access Undertaking which is five years is not appropriate given the investment required by operators in order to access the rail track, the time necessary to recover such investment, the development of business goodwill and continuity of service required to be provided by operators to their customers.

The National Competition Council in its Reasons For Decision dated 16 June 1997 concerning SCT's Application for Declaration of a rail service (provided by Rail Access Corporation as it was then known) stated the following:-

“The Council believes that the duration of declaration should be fifteen years. The Council considers that this time period takes into account the infancy of access arrangements in the rail industry of Australia and the need to review these arrangements over a reasonable period of time. This period also provides a suitable length of time for consideration of changes in the market for transport services given the dynamics associated with the industry. The Council also considers that fifteen years provides an appropriate level of certainty to industry”.

We submit that the term is not appropriate having regard to ss44ZZA (3) (b) and (c) of the TPA.

(b) Pricing Principles

We submit that the ACCC should not accept the Access Undertaking having regard to ss44ZZA (3) (a), (b) and (c) of the TPA, and in particular, for the following reasons:-

(i) Efficient Infrastructure

It is not clear whether the access costs reflect the cost of efficient provision of infrastructure. This is especially important while “below rail” costs are not contestable the same way that “above rail” operations are.

Whilst the Preamble provides that maintenance services will be outsourced and managed pursuant to a competitive tender process, the Access Undertaking does not:-

- refer to the standard to which the Network must be maintained. The reference in the Indicative Track Access Agreement to the standard is unsatisfactory and we refer to our comments in point 5 of Attachment “A” in this regard;
- apart from the Preamble, refer to the manner in which the maintenance will be managed and in particular, whether a competitive tender process will be employed.

We would submit that the Access Undertaking should impose a requirement on ARTC to demonstrate efficiency improvements by:-

- introducing market based efficiency measures (ie Key Performance Indicators relevant to the market place) otherwise there is no accountability;
- comparing these agreed measures to relevant targets within agreed time frames; and
- regularly reporting the results of actual performance compared to targets.

It is not sufficient for the annexed Access Agreement to make reference to certain Key Performance Indicators. These measures should form an integral part of the pricing principles.

(ii) Sub-Standard Infrastructure

The Access Undertaking does not ensure that the access provider's costs do not reflect the cost of maintaining sub-standard infrastructure. The additional component of current maintenance costs that arises from past decisions to reduce maintenance resources should not be borne by parties presently granted access.

Further, if it is determined in the future that a higher standard needs to be applied compared to the present standard, it appears that the access price would be increased as a consequence. Booz Allen & Hamilton in its report on DORC state that the "*cost of investment to raise standards will be allowed into the optimized asset base once the raised standards are in place (and users ability to pay higher charges is enhanced)*". We submit that this should not be the case unless those higher standards directly benefit operators and they are not the result of past neglect.

(iii) Cross-Subsidization

The Access Undertaking does not prevent the ARTC from cross subsidizing other rail corridors. In particular, the Access Undertaking does not prevent the ARTC from applying the revenue from one segment to another segment.

The ARTC has indicated in the past that income it has received from the east/west corridor may be potentially used for purchases and investments in other corridors of Australia. The access fee represents a cost to rail operators, and that cost translates into price signals. There is no cross subsidization by road competitors in this corridor and therefore, the ARTC, if they were to operate truly in a competitive environment with road, which they are, should not also cross subsidize other rail corridors.

The Access Undertaking should expressly prohibit cross-subsidization of other rail corridors/segments.

(iv) Increased Rail Usage

The Access Undertaking does not allow for the access price to be regularly reviewed so as to require the ARTC to reduce the access prices in circumstances where ARTC has achieved benefits from increased rail usage.

The Access Undertaking needs to recognize that the rail market in certain segments has been continually growing since 1995. There has been no significant reduction in the access price as a consequence of this increased usage. Our concern is that the Access Undertaking does not recognize the past benefits of increased rail usage or address, in terms of pricing principles, how these benefits will be passed on to operators in the future.

In the absence of a requirement for the profits (arising as a consequence of increased rail usage) from a particular segment to be returned to operators, we risk replicating the New Zealand model.

Anecdotal evidence suggests that the New Zealand model, that has been in place for some time, is not working to match the outcomes expected by the New Zealand Government.

(v) Ceiling Limit

The Access Undertaking is not satisfactory because:-

- In the definition of Economic Cost in sub-clause 4.4(d), “*non-segment specific costs*” (referred to in sub-clauses 4.4(d)(v)) could include costs which are not in any way related to the segment(s) used by operators. For example, it could include the cost of investigating a new rail corridor. It would not be acceptable for such a cost to be taken into account;
- In calculating the depreciated optimized replacement cost, it is not appropriate to attribute a replacement value to an asset for which the ARTC incurred no cost in acquiring or constructing. We submit that an historical cost approach such as a depreciated actual cost methodology would be appropriate. Similarly, where assets have been constructed as a result of Government grants, there should be no costs attributable to these assets;
- We do not believe Booz Allen & Hamilton is sufficiently independent given that ARTC engaged that firm. Operators, like SCT, who do not have sufficient skills to assess a report such as that prepared by Booz Allen & Hamilton, need

to feel comfortable that certain information provided by the ARTC (or ARTC's other consultants) has been tested;

- In relation to the Rate of Return used, we do not believe that appropriate consideration has been given to the fact that certain Segment specific assets have been transferred to ARTC debt free. We also submit that appropriate consideration has not been given to the fact that there is a negligible risk of certain Segment specific assets being duplicated and therefore a negligible risk of ARTC facing competition from another access provider in respect to those Segment specific assets. We submit that the ACCC should commission an independent analysis in this regard;
- The Access Undertaking needs to set out the actual calculations used in order to arrive at the ceiling price (as referred to in the graphs dealing with each segment).

An independent analysis of the Economic Cost taking into account the matters we have raised above is required because:-

- ARTC's published Annual Report shows that ARTC is earning a significant profit;
- However, in relation to a number of ARTC's most utilized Segments, the revenue ARTC is receiving is significantly below the Economic Costs (as shown in ARTC's graphs).

(vi) Price Determination/Indicative Access Charge

Sub-clause 4.2 of the Access Undertaking is not satisfactory because it would not be possible for an operator or proposed operator to assess how the charge was formulated by ARTC. This becomes an important issue when one considers the significant variance between the floor and ceiling limits for certain Segments (as shown by the graphs submitted by ARTC).

What impact does the term of the agreement have on the charge? What impact does the market value of the train path sought have on the charge? What is the opportunity cost to ARTC?

Sub-clause 4.2 (e) provides for the ARTC to have regard to "other contributions by the Applicant to ARTC's costs" when formulating charges. What does this mean?

In ARTC's Explanatory Guide, ARTC state that "the Indicative Access Charge is market based rather than cost based". However, the Access Undertaking does not provide that the access price must be calculated having regard to the price offered by other transport modes in that rail corridor.

The uncertainty caused by these price principles will adversely affect investor confidence and consequently have an adverse impact on competition.

We submit that at the very least, ARTC must, in determining the charges, only have regard to matters relating to a particular Segment.

Alternatively, we submit that the proposed pricing principles (using a Floor and Ceiling limit) are not appropriate for this Access Undertaking having regard to the following:-

- ARTC's statement that the indicative access charge is market based rather than cost based; and
- The fact that there is a significant variance between the Ceiling Limit and the revenue ARTC receives in relation to a number of ARTC's most utilized Segments.

(vii) Floor Limit

The Access Undertaking needs to set out the actual calculations used in order to arrive at the floor price (as referred to in the ARTC graphs).

(viii) Transparency

The Agreement is not transparent.

In the absence of transparency or openness, operators are not in a position to know:-

- Whether the access price has been calculated in accordance with the Access Undertaking; or
- Whether some operators and not others have benefited from price and non-price conditions.

(ix) ARTC's Dividend Distribution Policy

The Access Undertaking is not satisfactory because:-

- Operators are not in a position to consider the Access Undertaking in its entirety whilst the ARTC distribution dividend policy has not been disclosed;
- We do not see where there has been an allowance in the calculations for ARTC's Dividend Distribution Policy; and

- The Access Undertaking should preclude the payment of a dividend by ARTC to its shareholders. Any funds recovered, over and above ARTC's operating costs and appropriate return on investment, should be returned to the network.

(x) Price Discrimination

Sub-clause 4.3 of the Access Undertaking allows the ARTC to unfairly discriminate between operators when pricing train paths.

The ARTC may determine, for example, that two train paths are not alike because the term of one agreement is five years and the term of the other agreement is 7 years.

This will lead to uncertainty and adversely affect the interest of operators and adversely affect competition.

(xi) Cancellation Fees

Sub-clause 4.5(b) of the Access Undertaking inappropriately provides for the flag fall component to be charged irrespective of whether a train path is utilized.

The Access Undertaking should provide that cancellation fees will not be imposed in the event an operator does not use a scheduled train path.

We submit that cancellation fees are not appropriate given that:-

- A cancellation fee is a penalty;
- If an operator does not use a train path, ARTC will not incur certain costs;
- If an operator does not use a particular train path, it will most likely be the case that the freight will still travel on the ARTC network giving ARTC its revenue;
- Commercially, operators are not in a position to impose such penalties on their customers;
- An operator is otherwise prevented from hoarding unused train paths because of the under utilisation provisions; and
- These fees will hinder the attempts by companies to promote rail growth and consequently will adversely impact on competition.

(xii) Variation of Charges

Sub-clause 4.5 (c) of the Access Undertaking provides that the Indicative Access Charges will be varied annually by ARTC with the ARTC not being required to take into account any other matters when considering whether to vary the charge.

We submit that in respect to any decision to vary the charges, there should be a requirement for ARTC to reasonably take into account other relevant factors including whether the increase in the charge will cause a shift of freight from rail to another mode or whether it will hinder the promotion of rail growth. There should also be an independent review of any decision to increase the charges.

In response to the ACCC's specific questions on page 11 of the Issues Paper concerning the Pricing Principles, we note the following:-

- The general approach to access pricing does not achieve the stated objective of striking a balance between the business interests of ARTC, access seekers and the general public. This is mainly because the undertaking does not require the price to be market based;
- SCT does not have the necessary skills to comment as to whether the “floor” and “ceiling” revenues are appropriate. However, we do note that the undertaking does not show the calculations used to arrive at those revenues;
- In relation to the question as to whether ceiling revenues have been defined in such a way that ARTC cannot exercise market power, we see no evidence in the undertaking to suggest that ARTC cannot exercise market power. To the contrary, we have referred above to a specific example where ARTC has recently exercised market power in relation to non price conditions;
- The pricing principles do not contain sufficient incentives for the efficient maintenance and investment in infrastructure by the ARTC. The undertaking should impose requirements on ARTC to demonstrate efficiency improvements;
- The uncertainty in relation to the pricing principles and the application of non-price conditions will hinder competition;
- The indicative access charge does not provide a reasonable basis for the setting of indicative access prices because the manner in which that charge is determined is neither market based nor clear and the access arrangements are not transparent in terms of price and non-price conditions. There is also not sufficient clarity about how ARTC would deal with deviations from the indicative access charge;

- The allocation of non-segment specific costs is not soundly based and would not contribute to efficient outcomes;
- SCT is not in a position to know whether the Capital Asset Pricing Model has been properly used to arrive at the Weighted Average Cost of Capital. We are not skilled to know whether the appropriate assumptions have been used;
- We are not appropriately skilled to comment as to whether DORC is the appropriate valuation methodology to apply in the case of ARTC's assets. However, as noted above, we submit that the ARTC should not be entitled to a return on certain assets which have been transferred to the ARTC at no cost to the ARTC.

(c) Dispute Resolution

We submit that the ACCC should not accept the Access Undertaking having regard to ss44ZZA (3) (b) and (c) of the TPA and in particular, for the following reasons:-

- (i) The Access Undertaking does not expressly provide for the arbitrator to take into account the legitimate business interests and investments by operators already using the network where these operators do not have current contracts; and.
- (ii) The Access Undertaking does not expressly set out the actual standards (eg AS4292 if this is applicable) that an arbitrator must refer to when resolving a dispute. We also have this same concern in relation to the Arbitration clause in the Indicative Track Access Agreement.

(d) Train Path Auctioning and Re-negotiation of Long-Term Contracted Paths

We submit that the ACCC should not accept the Access Undertaking having regard to sub-section 3.9 (d) (ii) of the Undertaking and ss44ZZA (3) (b) and (c) of the TPA.

By definition, an auctioned train path would go to the highest bidder. This will favour larger companies, reduce the number of smaller companies wishing to enter this sector and consequently reduce competition.

Further, sub-section 3.9 (d) (ii) of the Access Undertaking would:-

- (i) allow ARTC to auction train paths with no regard to the fact that operators currently using those train paths may require those paths for the continuation of their business; and
- (ii) allow ARTC to auction train paths with no regard to the investment already made by operators currently using those train paths; and

- (iii) consequently be a barrier to small companies remaining in this market.

It is not acceptable that operators who have built their business around their train paths face such uncertainty following the expiration of those long-term train paths. At the very least, those operators require a continuation of the then current terms and conditions whilst the parties negotiate in good faith on new terms and conditions if reasonably required.

In response to the ACCC's question in relation to this issue, there is insufficient transparency in this process and the method of granting access on the basis of "highest present value of future returns" is not appropriate for the above reasons.

Existing operators have, for a considerable period of time, opposed ARTC auctioning train paths in this manner. ARTC had removed from an earlier draft track access agreement an auction clause.

(e) Network Connections

Having regard to ss44ZZA (3) (a), (b) and (c) of the TPA, we submit that the ACCC should not accept the undertaking because sub-clause 6.1 is not satisfactory. In particular, we note the following:-

- (i) A connection will, by virtue of its existence, reduce capacity. Capacity cannot be used as a measure to determine whether or not a connection should be allowed. Capacity in a matter that will properly be taken into account when considering train path management under an access agreement;
- (ii) In relation to sub-clause 6.1 (c), there is no requirement for ARTC's existing interface arrangements to be reasonable;
- (iii) In sub-clause 6.1 (e), there is no requirement for ARTC's engineering and operational standards to be reasonable;
- (iv) In relation to sub-clause 6.1 (f), there is no requirement for the initial and continued cost associated with constructing and maintaining the connection to be reasonable;
- (v) To allow ARTC to improperly hinder a company's ability to connect to a network would be to reduce the number of operators connecting to a network and consequently reduce competition.

(f) Indicative Track Access Agreement

The terms and conditions in the Indicative Track Access Agreement are not appropriate having regard to ss44ZZA (3) (b) and (c) of the TPA.

SCT has, for almost two years, been negotiating with ARTC in order to secure an appropriate track access agreement. There remain a number of outstanding issues in SCT's negotiations. Attachment "A" lists those outstanding issues.

A number of these issues, such as the indemnity provisions, are likely to affect whether an operator would seek access or to continue accessing the track. This is an example of a non-price condition referred to earlier that could be a barrier to entry or continued use of the network.

The terms and conditions in the draft Track Access Agreement which are unsatisfactory are as follows:-

- (i) It is not clear whether ARTC is in a legal position to agree to a term beyond 30 June 2003;
- (ii) The clause providing that there will be no discrimination between operators with "like" train paths is not satisfactory because it may be the case that two train paths may not be alike because the terms of two access agreements may differ;
- (iii) In relation to the notification of environmental conditions, an operator must be allowed an opportunity to challenge the direction of a competent authority before being required to follow ARTC's requirements;
- (iv) The present "causal" based indemnity clauses are not satisfactory because:-
 - These clauses would operate against generally accepted principles of law and require operators to contract into a liability that operators are finding uninsurable;
 - This clause has been inappropriately drafted as an umbrella liability clause that would expose operators to liabilities that would otherwise be dealt with elsewhere in the agreement or at common law.
- (v) The standard to which ARTC is obliged to repair and maintain the network is not satisfactory;
- (vi) It is not satisfactory for ARTC to have a right to terminate an access agreement on the basis of an accreditation related matter, whilst that operator continues to maintain accreditation;
- (vii) The obligation of an operator not to materially change the network should be amended so as to be an obligation not to "willfully" change the network;
- (viii) There must be an obligation on ARTC to act reasonably when requiring operators to upgrade communications equipment;

- (ix) When renegotiating a long-term contracted path, there needs to be a requirement for ARTC to act reasonably in the absence of an undertaking accepted by the ACCC;
- (x) In relation to the variation of charges clause, there should be an independent review;
- (xi) The clause allowing for ARTC to pass onto an operator any new charges or increases or decreases in new charges is too wide and too ambiguous;
- (xii) The clause concerning a review of the security arrangements needs to be subject to the dispute resolution clause;
- (xiii) ARTC should provide a warranty to the effect that the operators have uninterrupted access to the network subject to the Network Management Principles;
- (xiv) In relation to the provision concerning the removal of a train path for under-utilization, it is not satisfactory for a train path to be classified as an under-utilized train path only because it has entered the ARTC network late through no fault of the operator;
- (xv) In relation to the cancellation of the train paths, the agreement needs to make it clear that operators will be permitted to transfer allowable cancellations between its existing train paths. Under the agreement, it is not clear that the existing train paths are “like” train paths;
- (xvi) The provision dealing with release of information from monitoring equipment is not sufficient;
- (xvii) The decision to insist on an insurance cover of \$200,000,000 is arbitrary;
- (xviii) It is not necessary for the agreement to include a “change of circumstances” clause.

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