



Australian  
Competition &  
Consumer  
Commission

# **Australian Rail Track Corporation**

## **Access Undertaking**

### **Issues Paper**

**June 2007**



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# **1. INTRODUCTION**

## **1.1 Background**

On 8 June 2007, the Australian Rail Track Corporation Ltd (ARTC) lodged an access undertaking with the Australian Competition and Consumer Commission (ACCC). The Undertaking sets out the terms and conditions for providing access to the interstate mainline standard gauge track linking Kalgoorlie in Western Australia, Adelaide, Wolseley and Crystal Brook in South Australia, Melbourne and Wodonga in Victoria, and Broken Hill, Cootamundra, Albury, Macarthur, Moss Vale, Unanderra, Newcastle (to the QLD border) and Parkes in New South Wales.

Part IIIA of the *Trade Practices Act 1974* (TPA) requires the ACCC to assess the Undertaking. If the ACCC accepts the Undertaking then the services covered by the Undertaking cannot be declared and the Undertaking forms the basis for third parties to negotiate access to these services.

An undertaking approved by the ACCC in 2002 for tracks controlled by ARTC in SA, Victoria and up to Broken Hill in New South Wales and Kalgoorlie in Western Australia, expired on 1 June 2007.

The ACCC is required under section 44ZZBC of the TPA to use its best endeavours to make a final decision within six months of receiving the application, that is, by 7 December 2007.

## **1.2 The Issues Paper**

Section 44ZZBD of the TPA provides that in assessing an access undertaking, the ACCC may undertake a public consultation process. Through this Issues Paper, the ACCC seeks comments and feedback from interested parties on the ARTC Undertaking and invites submissions. The ACCC will assess the Undertaking having regard to comments in submissions. Unless a submission is marked confidential, it will be made available to any person or organisation on request. The sections of submissions that are confidential should be clearly identified.

The purpose of this Issues Paper is to assist interested parties prepare submissions to the ACCC. It provides information on the Undertaking, on the ACCC's assessment processes and on the issues that are likely to be relevant to the ACCC's decision to accept or not accept ARTC's access undertaking.

The issues raised in the Issues Paper are provided for guidance only. Interested parties making submissions to the ACCC need not limit their comments to the questions in the Issues Paper and are welcome to raise other relevant issues not specifically mentioned in the Issues Paper. Interested parties are encouraged to provide as much information and evidence as possible in support of their views.

The rest of the Issues Paper is structured as follows. Background information on access undertakings and an overview of the ACCC's assessment framework are presented in Section 2. Section 3 describes the assessment process the ACCC will adopt for the ARTC undertaking. Details of the ACCC's mailing and electronic mail addresses for the lodging of submissions are provided in Section 4. Finally, Section 5 summarises each part of the undertaking and identifies relevant issues about which interested parties may wish to express views to the ACCC.

## 2. PART IIIA OF THE TRADE PRACTICES ACT AND ACCESS UNDERTAKINGS

Part IIIA was introduced in 1995 as part of the competition policy reforms adopted by the Council of Australian Governments (COAG). The purpose of Part IIIA is to promote the efficient provision and use of a limited class of infrastructure facilities by establishing a statutory basis for users to gain access to the services provided by those facilities. Facilities covered by Part IIIA generally exhibit the following features:

- natural monopoly characteristics;
- a strategic position in an industry with the potential to affect competition in upstream or downstream markets; and
- national significance<sup>1</sup>.

The service defined in Part IIIA is a service provided by means of a facility. Part IIIA provides third-parties the legal right to negotiate terms and conditions of use of such services but does not guarantee that access will be granted, nor does it give third-parties the right to the facility itself. Included in the definition of an infrastructure facility is the use of a railway line.

Part IIIA contains three main avenues for dealing with access issues:

- *Declaration, arbitration and enforcement.* Applications for a service to be declared, that is to be made available for access, can be lodged with the National Competition Council (NCC) by any person. The NCC recommends to the relevant Minister whether or not the facility should be declared. The final decision on declaration rests with the relevant Minister. Once declared, the facility owner is obliged to negotiate access with the access seeker. If the facility owner and access seeker cannot agree on terms and conditions for access, then the matter may be referred for arbitration to the ACCC or another arbitrator. Arbitration determinations by the ACCC are enforceable through the courts.
- *Undertakings.* The owner of a facility, or prescribed industry body, can offer an undertaking to the ACCC stipulating the terms and conditions upon which it is willing to provide access to third parties. Once an undertaking is accepted by the ACCC, the service in question cannot be declared and the undertaking is enforceable through the courts.
- *Effective regimes.* Part IIIA allows for States and Territories to have their own access regimes recognised as “effective” and thus exempted from the further provisions of Part IIIA. To clarify whether the national regime or a State regime governs access to a particular service, the TPA permits State and Territory governments to ask the NCC to recommend to the Federal Treasurer that their regimes are certified effective.

Access undertakings provide an alternative mechanism to declaration of a service under Part IIIA. Undertakings have the advantage that they ‘provide a means by which the owner or operator of a

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<sup>1</sup> Under section 44G in Part IIIA, the concept of national significance encompasses matters such as size, and importance to trade, commerce and the national economy.

facility can obtain certainty about access arrangements, before a third party seeks access<sup>2</sup>. Once accepted, the services covered by the Undertaking cannot be declared. Undertakings thus avoid the possibility of time consuming and expensive processes about whether to declare a service and then establishing the terms and conditions of access through arbitration.

## 2.1 Assessment of Access Undertakings

If the ACCC accepts an undertaking from ARTC then the terms and conditions in the undertaking form the basis on which rail operators can obtain access to ARTC's rail network. Accordingly, in considering an undertaking the ACCC is likely to be concerned to ensure that the proposed undertaking provides a clearly enforceable basis by which third parties can gain access to such services on reasonable terms and conditions (whether set out in the undertaking or to be negotiated).

Following the receipt of submissions and other information, the ACCC will analyse the undertaking, guided by the legislative criteria for assessing an undertaking and the comments of interested parties. In deciding whether to accept or reject the proposed undertaking the ACCC is required under section 44ZZA to take into account the following:

- the objects of Part IIIA;
- the pricing principles specified in section 44ZCA;
- the legitimate business interests of the service provider;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of the persons who might want access to the service;
- whether the undertaking is in accordance with an access code that applies to the service;
- whether access to the service is already the subject of an access regime; and
- any other matters that the ACCC thinks relevant.

The requirement on the ACCC to take into account the objects of Part IIIA and pricing principles follows the amendments introduced to Part IIIA on 1 October 2006. The relevant provisions in sections 44AA and 44ZZCA are presented in Box 1.

To assist the ACCC in its assessment of an undertaking, submissions from interested parties should, as far as practicable, include references to the legislative criteria.

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2 Second Reading Speech accompanying the Competition Policy Reform Bill 1995

## **Box 1 – Amendments to Part IIIA**

### **Section 44AA - Objects of Part IIIA**

The objects of this Part are to:

- (a) promote the economically efficient operation of use of and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets; and
- (b) provide a framework and guiding principles to encourage a consistent approach to access regulation in each industry.

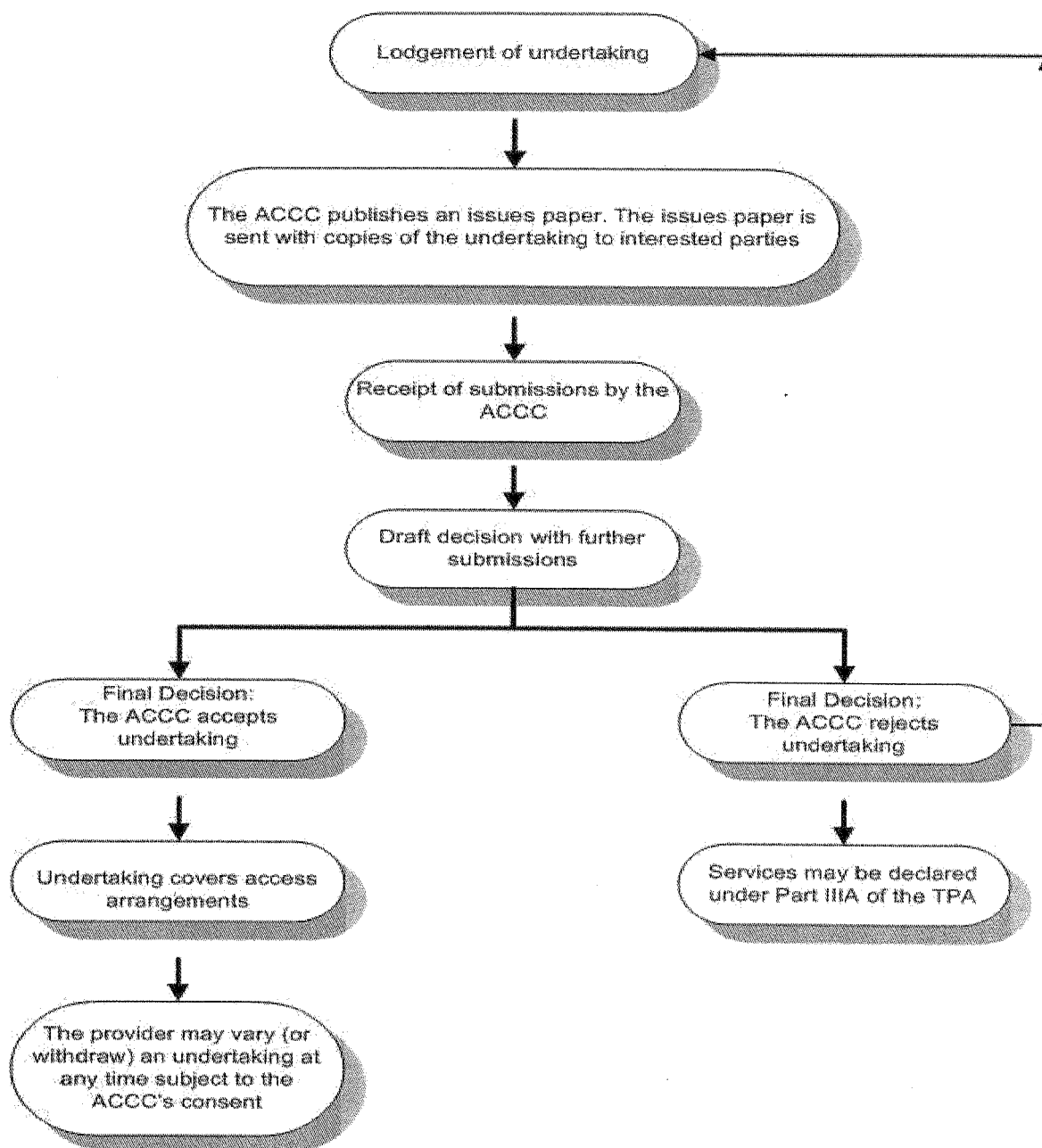
### **Section 44ZZCA - Pricing principles for access disputes and access undertakings or codes**

The pricing principles relating to the price of access to a service are:

- (a) that regulated access prices should:
  - (i) be set so as to generate expected revenue for a regulated service or services that is at least sufficient to meet the efficient costs of providing access to the regulated service or services; and
  - (ii) include a return on investment commensurate with the regulatory and commercial risks involved; and
- (b) that the access price structures should:
  - (i) allow multi-part pricing and price discrimination when it aids efficiency; and
  - (ii) not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, except to the extent that the cost of providing access to other operators is higher; and
- (c) that access pricing regimes should provide incentives to reduce costs or otherwise improve productivity.

### 3. ASSESSMENT PROCESS FOR ARTC UNDERTAKING

Figure 1 summarises the procedures for the ACCC's assessment of the ARTC Undertaking. The process is designed to be transparent and public, relying on input from interested parties as well as the lodger of the undertaking.





### **3.1 *ACCC Time Lines***

The legislative regime provides for the ACCC to use its best endeavours to complete the assessment of an undertaking within six months of receipt of the application. The ACCC received the ARTC Access Undertaking on 8 June 2007. For the purposes of the ARTC Undertaking, the ACCC has developed the following indicative timetable:

- publication of the undertaking and issues paper on 22 June 2007
- receipt of submissions by 20 July 2007
- ACCC draft decision by 13 September 2007
- receipt of submissions on draft decision by 12 October 2007 and
- ACCC final decision by 7 December 2007.

### **3.2 *Interested Parties***

The ACCC has compiled a list of parties who may have an interest in the undertaking and has sent copies of the Issues Paper and a copy of ARTC's Access Undertaking to those parties to assist them to prepare submissions. The ACCC will also make the material available to other parties on request. A copy of the Issues Paper and the Access Undertaking are available on the Commission's web site at [www.accc.gov.au](http://www.accc.gov.au).

Copies of submissions will be made available on request to interested parties, unless the author of the submission has sought confidentiality for the submission. ARTC may be asked to comment on submissions where this would assist the ACCC's evaluation of the Undertaking.

In addition to submissions the ACCC may seek information through inquiries, usually by interview, with interested parties and others who may be able to provide information to assist its assessment of the Undertaking.

#### **4. SUBMISSIONS**

Submissions should be forwarded by **Friday 20 July 2007** to:

Margaret Arblaster  
General Manager – Transport and Prices Oversight  
Regulatory Affairs Division  
ACCC  
GPO Box 520  
MELBOURNE VIC 3001

Electronic versions should be emailed to

[transport.prices\\_oversight@acc.gov.au](mailto:transport.prices_oversight@acc.gov.au)

Unless a submission is marked confidential, it will be made available to any person or organisation on request. The sections of submissions that are confidential should be clearly identified.

Further inquiries:

Telephone	Renato Viglianti (03) 9290-1847
Fax	(03) 9663-3699

## 5. ISSUES

This section describes the key features of the ARTC Undertaking and poses questions that may assist interested parties present their views about the Undertaking. The objective is to highlight for comment and discussion issues that the ACCC has identified as important. However, it is not intended to limit the debate to these issues. Comments on other matters of relevance to the assessment of the Undertaking are welcome.

The Undertaking is the second access undertaking submitted by ARTC for approval under Part IIIA. In May 2002, the ACCC approved an undertaking in respect of tracks in Victoria, South Australia and up to Broken Hill in New South Wales and Kalgoorlie in Western Australia. The new undertaking replaces the 2002 undertaking in respect of tracks owned or managed by ARTC in South Australia and Victoria and, in addition, contains terms and conditions of access to tracks leased by ARTC in New South Wales. In the new undertaking ARTC has adopted a largely similar approach to the 2002 undertaking with many of the provisions in both undertakings being very similar, and in some cases, identical.

**The ACCC will assess whether it is appropriate to accept the Undertaking, having regard to the matters in s. 44ZZA(3). The Undertaking is composed of a number of parts that deal with different aspects of the terms and conditions for negotiating and providing access. Since the provisions in the Undertaking form a package, the ACCC will assess each provision in the context of the Undertaking as a whole and consider whether in combination these provisions are appropriate having regard to the matters in s. 44ZA(3).**

### 5.1 Part 1 'Preamble'

This section of the Undertaking provides background information on ARTC, and its objectives and functions pursuant to the Intergovernmental Agreement of November 1997 under which it was established. It outlines the reasons why ARTC is submitting an undertaking to the ACCC under Part IIIA of the TPA and the general objectives of the Undertaking.

Key points in Part I of the Undertaking are:

- ARTC was established to manage the process of granting access to the interstate rail network consistent with the Competition Principles Agreement.
- The Undertaking covers terms and conditions of access to 'the Network', that is those parts of the interstate rail network which ARTC either owns or leases, and for which it has responsibility for managing access. The Network comprises the interstate mainline standard gauge track linking Kalgoorlie in Western Australia, Adelaide, Wolseley and Crystal Brook in South Australia, Melbourne and Wodonga in Victoria, and Broken Hill, Cootamundra, Albury, Macarthur, Moss Vale, Unanderra, Newcastle (to the QLD border) and Parkes in New South Wales.
- ARTC states that it intends to provide processes for negotiating access that are workable, transparent and non-discriminatory. ARTC aims to encourage growth of the rail industry, stimulate customer confidence and promote competition.

- The Undertaking seeks to achieve outcomes that strike a balance between the interests of ARTC, potential access seekers and the public.

**Questions:**

*Does the Undertaking provide sufficient clarity about the broad approach to negotiating access and the proposed terms and conditions of access?*

*Does the Undertaking provide the basis for outcomes that balance the interests of ARTC, potential access seekers and the public interest?*

*Is there sufficient clarity about the tracks and other infrastructure that the Undertaking applies to now and will apply to during the term of the Undertaking?*

**5.2 Part 2 ‘Scope and Administration’**

This section defines the scope of the Undertaking and notes that it applies only to services defined in the Undertaking. Access under the Undertaking is to the tracks in the defined Network and to the benefit of Associated Facilities required to facilitate access. The Undertaking does not apply to parts of the interstate network not included in the definition of the Network, to extensions of the network, or to tracks that other track owners may connect to the Network. The Undertaking will, however, extend to the Southern Sydney Freight Line when completed. The Undertaking will also apply to additions to capacity of the Network.

Part 2 of the Undertaking sets out the term of the Undertaking, which is five years from one month after approval by the ACCC. There is provision for variations to the Undertaking at ARTC’s discretion and subject to consent from the ACCC.

The Undertaking does not affect existing access agreements.

**Questions:**

*Is the scope of the Undertaking sufficient to cover all facilities necessary for effective access?*

*Is the Undertaking sufficiently clear about the difference between extensions to the network and expansions to the network’s capacity?*

*Is the proposed term for the Undertaking appropriate, given the nature of the services covered by the Undertaking and of the industry more generally?*

*Is there sufficient clarity about how the Undertaking will extend to the Southern Sydney Freight Line? Are the arrangements in the Undertaking related to the new Line appropriate?*

*Are there any aspects of the Undertaking that should be taken into account in considering the objects clause 44AA(b), dealing with “a consistent approach to access regulation in each industry”?*

### 5.3 Part 3 'Negotiating for Access'

This section sets out the framework within which ARTC intends to negotiate with operators wishing to access the services provided by its Network. It covers the initial negotiation processes and procedures, provision of information, confidentiality, the application requesting access, negotiations following the lodgement of an application, the finalisation of an access agreement and dispute resolution.

The principle issues for Part 3 of the Undertaking are set out below:

1. **Provision of Information.** The Undertaking describes information that ARTC will provide to an applicant to facilitate access negotiations.

**Question:**

*Is the information that ARTC commits to provide to an access seeker sufficient/appropriate to enable meaningful access negotiations?*

2. **Parties to Negotiation.** The applicant must meet certain criteria to commence negotiations, including prudential and financial criteria. ARTC may refuse to negotiate with the applicant if it considers that the applicant has failed to meet these criteria. Among other things, ARTC reserves the right to satisfy itself that the applicant has sufficient resources to meet financial obligations that may arise from an Access Agreement. If the applicant considers that ARTC has unreasonably refused to negotiate, or has negotiated in a manner that is inconsistent with the provisions in the Undertaking, the matter may be referred to arbitration. Likewise, ARTC may request arbitration if it wishes to cease negotiations because it considers that the applicant's request for access is frivolous.

**Questions:**

*Is the Undertaking sufficiently clear about the processes for the initial phase of negotiations? Do these processes balance the interests of the access provider and access seekers?*

*Are the prudential and financial criteria that ARTC intends to use to "screen" applicants appropriate?*

*Is there sufficient clarity about the standards that ARTC intends to use to decide whether an applicant meets the prudential criteria?*

*Does the Undertaking provide ARTC an appropriate level of discretion in applying the prudential criteria?*

*Does the Undertaking provide adequate detail on what is expected of an Accredited Operator?*

3. **Indicative Access Proposal.** Within 30 days of acknowledging the applicant's request for access ARTC undertakes to provide an Indicative Access Proposal to facilitate negotiations. Among other things, the Indicative Access Proposal states:

- the extent of available capacity;
- details of the nature and cost of additional capacity that may be required to meet the demands of the applicant if existing capacity is insufficient;
- whether access applications exist from other operators which may reduce available capacity for the applicant;
- a copy of ARTC's standard terms and conditions of access;
- access charges; and
- indicative train path availability.

The Undertaking does not oblige ARTC to provide access on the terms and conditions set out in the Indicative Access Proposal.

**Questions:**

*Does the Indicative Access Proposal contain sufficient information and details to enable the access seeker to adequately evaluate the proposal?*

*Does the Indicative Access Proposal provide an adequate basis for meaningful negotiations?*

4. **Negotiation.** The Undertaking requires both parties to negotiate in good faith. Negotiations towards an access agreement may commence as soon as the applicant notifies ARTC of its intention to do so, following receipt of the Indicative Access Proposal by the applicant. The applicant may advise ARTC of its concerns if it considers that ARTC has not prepared it in accordance with the Undertaking. ARTC will take all reasonable steps to address those concerns in a reasonable time frame. If the applicant considers that the revised Indicative Access Proposal is not satisfactory it can refer the matter to dispute resolution.

Negotiations may be affected by several factors, including when available capacity is affected by another mutually exclusive application for access. Where two or more applicants seek mutually exclusive access rights, ARTC intends to grant access to the application with the "highest present value of future returns after considering all risks associated with the Access Agreement." (clause 3.10(d)(ii)).

The Undertaking does not contain provisions regarding the re-negotiation of expiring contracts. However, clause 2.9(c) of the Indicative Track Access Agreement provides that ARTC "may consent to the renewal of the scheduled train paths".

The Undertaking enables ARTC (and the access seeker) to cease negotiations after three months unless both parties agree otherwise. ARTC can also cease negotiations if it considers that negotiations are not progressing in good faith.

## Questions:

*Does the Undertaking provide sufficient detail about how ARTC intends to negotiate on access?*

*Does the negotiation process achieve an acceptable balance among the interests of ARTC and access seekers?*

*Is there sufficient clarity and transparency about the method that ARTC proposes to use for choosing among competing access applications?*

*Is there sufficient clarity about the instances in which ARTC can cease negotiations?*

*Is the level of discretion allowed to ARTC to cease negotiations appropriate?*

*Do operators have sufficient certainty about prospects for the long-term utilisation of the network and their on-going access to train paths when re-negotiating existing train schedules? Does ARTC have sufficient flexibility when re-negotiating existing contracts to encourage above rail competition?*

5. **Dispute Resolution.** The Undertaking provides for a three step approach to dispute resolution.

- **Negotiation** between the parties.
- **Mediation** by a person appointed by agreement between the parties or by the President of the Law Society of South Australia if the parties cannot agree on a mediator.
- **Arbitration** by the ACCC. The arbitration determination must take into account the objectives and principles in Part IIIA of the TPA and the Competition Principles Agreement.

Any dispute that arises under the Undertaking can be referred to the dispute resolution process. In addition, a number of sections in the Undertaking contain specific reference to parties being able to refer disputes to the dispute resolution process.

The proposed Undertaking does not provide the option of referring the dispute to a “conflict manager” prior to resorting to arbitration. The Undertaking provides for a number of notification/grace periods as part of the dispute resolution process.

## Questions:

*Does the absence of a conflict management phase affect the overall effectiveness of the dispute resolution process?*

*Do the references to the rights of parties who are in dispute to use the dispute resolution procedures provide an adequate basis for access to these procedures? Conversely, does the absence of a specific reference to dispute resolution in some provisions of the Undertaking affect the way that ARTC may negotiate with access seekers? Does it encourage or discourage use of dispute resolution procedures?*

## **5.4 Part 4 'Pricing Principles'**

The section outlines the Undertaking's proposed pricing principles. Access charges for indicative services are structured as a multi-part tariff comprising fixed and variable components. The multi-part prices for indicative services are a variable charge, based on use, and two fixed components.

All elements of the access fee are subject to negotiation between ARTC and train operators.

The regime also introduces a new methodology for establishing revenue ceilings, the key feature of which is a new approach for rolling over the Regulatory Asset Base (RAB).

### **Price Structure and Differentiation**

The variable component of the access price is related to distance and mass and is levied in terms of \$/gtkm. One of the fixed components is a flag-fall charge levied on a \$/km basis and is specific to each train service type and segment. It is proposed that the flag-fall component would be levied irrespective of usage. If a service is cancelled, then the flag-fall component is payable during the cancellation notice period and acts as a cancellation fee.

Additionally, ARTC proposes to introduce a new fixed component into the tariff: an excess network occupancy charge. The excess network occupancy charge would be applied as a function of time, on a \$/hr basis, to reflect planned use of the network in excess of "a reasonable allowance for section run times for the applicable Train service type, dwells for crossing and passing of other Trains, and a specified allowance for the reasonable requirements for operational activities". ARTC states that the excess network occupancy charge may normally arise as a result of the operator requiring excessive time for above rail requirements (slower section run times, operator required dwells) in the scheduled path sought from ARTC. The excess network occupancy charge would be a fixed charge levied regardless of whether the train operator utilises the train path or not.

ARTC proposes to set access charges based on an Indicative Access Charge that ARTC publishes for train services in specific segments that have the following characteristics:

- (i) maximum axle load of 21 tonnes;
- (ii) maximum speed of 110 km/h; and
- (iii) length not exceeding:
  - a) 1800 metres west of Adelaide and Parkes,
  - b) 1500 metres east of Adelaide and Parkes (until Capital Expenditure is commissioned on the Segment Melbourne – Macarthur),
  - c) 1800 metres on the Segment Melbourne – Macarthur and on the Segment Parkes – Cootamundra (following commissioning of Capital Expenditure on the Segment Melbourne – Macarthur).

Departures from these indicative charges 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. The Undertaking does not otherwise state how these factors will be taken into account.



In other respects, access pricing is uniformly applied and does not differentiate among types of operators or services operating within the same market segment.

### Price Escalation

ARTC proposes to set the maximum annual variation of the Indicative Access Charges using a CPI-based cumulative approach. The approach is given by the following formula:

$$AC_t = AC_{t-1} * (1 + TV_i)$$

Where

AC is the Indicative Access Charges for Indicative Services following the relevant Review Date;

AC<sub>t-1</sub> is the Indicative Access Charges for Indicative Services immediately preceding the relevant Review Date;

TV<sub>i</sub> is the greater of

$$(((CPI\ Index_i / CPI\ Index_0) / CV_{i-1}) - 1) * 100, \text{ and Zero}$$

Where

TV<sub>i</sub> is the maximum variation (%) to Indicative Access Charges that may be applied;

CPI Index<sub>i</sub> is the All groups Consumer Price Index, Weighted Average of Eight Capital Cities, Index Number for the March quarter of the year preceding the relevant Determination Date;

CPI Index<sub>0</sub> is the All groups Consumer Price Index, Weighted Average of Eight Capital Cities, Index Number for the March quarter of 2006;

CV<sub>i-1</sub> is the cumulative impact of the application of variations actually applied by ARTC to the Indicative Access Charges for Indicative Services between the first Determination Date (1 July 2007) and the relevant Determination Date. The cumulative impact would be determined in accordance with the following formula:

$$CV_{i-1} = (1 + V_1) * (1 + V_2) * \dots * (1 + V_{i-1})$$

Where

V<sub>1</sub>, V<sub>2</sub>, V<sub>i-1</sub> are the actual % variations which have been applied from the first Determination Date (1 July 2007) to the relevant Determination Date.

The CPI adjustment formula applies only to indicative services. It does not include an efficiency discount, allows full CPI pass-on and permits rises not applied in any one year to be accumulated and applied in later years.

## Revenue Limits

The Undertaking constrains ARTC's ability to earn revenue above that necessary to generate a normal rate of return over the life of its assets. This is achieved through the use of a model that capitalises economic losses into the Regulatory Asset Base (RAB). ARTC recognises that this approach is different from the conventional approach used to regulate infrastructure (see Box 2):

### **Box 2 – Regulatory Models<sup>3</sup>**

#### **Conventional approach to defining a revenue limit - 'Building Block Model'**

Sets the revenue limit equal to the sum of the 'return on capital' (WACC times RAB) plus depreciation 'return of capital' plus operating expenditure.

The RAB is rolled forward as the sum of the previous RAB, less depreciation plus net capital expenditure.

However, the conventional 'Building Block Model' may not be suitable on all networks. When revenue earned falls short of the 'Building Block' revenue limit, the access provider is earning below-normal returns in this period. To ensure that normal returns are allowed to be earned over the life of the asset, the access provider should be allowed to earn above-normal returns in some other period.

Also, demand may be variable. It may be economically efficient to charge higher prices for services in years when demand is strong, and lower prices in other years, while still earning normal returns on average overall.

#### **Proposed ARTC approach - 'RAB Capitalisation Model'**

This approach seeks to allow an access provider a greater degree of flexibility than is normally possible under the building block approach.

The access provider is allowed to 'capitalise' economic losses incurred over time, provided its RAB is above a specified lower limit, so the access provider is allowed to earn a regulated return on these losses in the future.

RAB annual roll-forward formula:

$$RAB_{t \text{ start}} = RAB_{t-1 \text{ end}} = (1 + WACC) * RAB_{t-1 \text{ start}} - \text{Out-turn Revenue}_{t-1} + \text{Out-turn Opex}_{t-1} + \text{Net Capex}_{t-1}$$

Under the proposed approach, if the access provider is earning insufficient revenue to cover operating expenditure and capital costs, the RAB will increase over time, reflecting the need to recover larger amounts of revenue in the future in order to achieve normal returns over the life of assets.

3 From ARTC Access Undertaking, June 2007, p 20.

Rather than describing a path for regulated revenues, the RAB capitalisation model establishes a path for the RAB. The choice of asset valuation methodology can affect the value assigned to the initial RAB. ARTC has established the initial RAB valuation for the ARTC network using a Depreciated Optimised Replacement Cost (DORC) methodology. An independent valuation of ARTC's assets was conducted by Booz Allen Hamilton. The optimised replacement cost for ARTC's assets was estimated at \$7 billion and the discount for the current condition of the assets was assessed at 47 per cent, giving a DORC value of \$3.7 billion. The formulae for determining a path for the RAB and the RAB floor for each network segment are as follows:

### **RAB Roll Forward**

$$RAB_t = (1+WACC) * RAB_{t-1} + \text{Out turn Opex}_{t-1} + \text{Net Capex}_{t-1} - \text{Out turn Revenue}_{t-1}$$

where: WACC is the estimated weighted average nominal cost of capital

Out turn Opex is the operating costs incurred in period t-1

Net Capex is the net capital expenditure (net of asset disposals) in period t-1

Out turn Revenue is the earned access revenue in period t-1

### **RAB "Floor" Roll Forward**

$$RAB \text{ Floor}_t = \text{Initial RAB}$$

$$RAB \text{ Floor}_t = (1+CPI_{t-1}) * RAB \text{ Floor}_{t-1} + \text{Net Capex}_{t-1} - \text{Depreciation}_{t-1}$$

where: CPI is the inflation rate with reference to the March Quarter All Groups Consumer Price Index of period t-1

Depreciation is the depreciation with respect to the RAB floor in period t-1.

ARTC proposes to apply the RAB capitalisation model to individual segments.

While the model includes a revenue floor and a revenue ceiling for each rail segment or group of rail segments, the revenue ceiling acts as a constraint on revenues only when the RAB reaches the minimum floor level. The revenue ceiling at this point is determined under the conventional building block model. At other times, the RAB capitalisation model does not impose revenue constraints on ARTC. The model, however, ensures normal returns over the life of ARTC's assets.

The revenue floor is defined as the incremental costs that would be avoided if the rail segment or group of segments is removed from the rail network. Incremental costs include segment specific costs and non-segment specific costs relating to the following activities:

- track and signalling and communication maintenance;

- maintenance contract management and project management;
- train control and communication;
- train planning and operations administration; and
- system management and administration.

Incremental costs exclude depreciation and return on assets relating to segment specific assets and non-segment specific assets.

ARTC propose that, where possible, non-segment specific costs (and non-segment specific assets) will be allocated, in the first instance, to a rail corridor(s), and, secondly, to individual segments within those corridors. The basis of the allocation of non-segment specific costs and assets is:

- gross tonne kilometres with respect to non-segment specific costs as well as depreciation of, and return on non-segment specific assets associated with train maintenance; and
- train kilometres with respect to non-segment specific costs as well as depreciation of, and return on non-segment specific assets not associated with track maintenance.

Clause 4.4(g) of the Undertaking states that “costs are reasonably anticipated costs over a reasonable future timeframe.”

Returns on assets are calculated by applying ARTC’s weighted average cost of capital (WACC) to the value of the assets employed, based on a DORC valuation.

ARTC applies a straight line method of depreciation for those assets with a finite economic life.

The Undertaking includes information on ARTC’s proposed capital expenditure programme for its Network.

ARTC’s WACC was assessed by Synergies. The parameters and final WACC are as follows:

	%
<b>Cost of Equity</b>	
Nominal Risk Free Rate of Return	5.99
Market Risk Premium	6.50
Beta	1.29
Gamma	0
<b>Cost of Equity</b>	<b>14.35</b>
<b>Cost of Debt</b>	
Borrowing Margin	1.19
Debt Raising Costs	0.125
Borrowing Rate	-
Tax Rate	30.0
Debt as % of Debt plus Equity	50.0
<b>Cost of Debt</b>	<b>7.30</b>
<b>WACC nominal post tax</b>	<b>10.83</b>

ARTC's WACC has been estimated using the Capital Asset Pricing Model. The nominal post-tax WACC is given by the following formula:

$$\text{WACC} = K_e \times \frac{E}{V} + K_d \times \frac{D}{V}$$

Where,

$K_e$  = after tax cost of equity = {(Market Risk Premium x  $\beta$ ) + Risk Free Rate of Return}

$\beta$  (beta) = systematic risk of equity

$K_d$  = nominal pre tax debt rate = (Risk Free Rate + Borrowing Margin)

$D$  = market value of interest bearing debt

$E$  = market value of equity

$V$  = market value of entity ( $V=D+E$ )

The risk-free rate has been set at 5.99 per cent which was equivalent to the average yield to maturity on ten year Commonwealth bonds for the 20-day period ending on 30 April 2007. The market risk premium is a measure of the risk involved in investing in equity in Australia and has been set at 6.5 per cent. The beta is a measure of the risk that can not be diversified away and has been applied at 1.29. The borrowing margin applicable to ARTC over the risk-free rate has been estimated at 1.19 per cent. The gearing ratio used is 50 per cent. The corporate tax rate is 30 per cent. The gamma is set at zero.

### Questions:

#### *ARTC Pricing Objectives*

*Does the general approach to access pricing achieve the stated objective of striking a balance among the business interests of ARTC, access seekers and the general public?*

*Is there sufficient clarity about the way that the various components of access charges are intended to be applied?*

#### *Efficient Pricing in Relation to Efficient Use of the Network, and Efficient Investment in the Network*

*Does the proposed multi-part access pricing structure encourage efficient operation and use of the network by train operating companies, for all types of rail traffics?*

*Does the proposed application of the new fixed access price component relating to network occupancy, the Excess Network Occupancy charge, encourage efficient provision and use of capacity in the network by train operators for all types of rail traffics?*

*Is there sufficient clarity in the Undertaking about the nature of ARTC's commitments on capital expenditure?*

#### *Encouragement of Inter-Modal and Intra-Modal Competition*

*Does the proposed level and structure of indicative access charges promote effective and sustainable competition among operators as well as between rail freight operators and road and sea freight haulage companies?*

*Are there any pricing considerations that could potentially affect above rail competition and entry into the above rail market by access seekers?*

#### *Revenue Floors and Revenue Ceilings*

*Is the Undertaking sufficiently clear about how revenue floors and ceilings are defined?*

*Are the objectives of the RAB capitalisation approach clearly set out?*

*Is the RAB capitalisation model an appropriate basis for regulating the ARTC network? Any comments on the factors that ARTC has taken into account in determining whether the RAB model is appropriate?*

*Is the definition of the segment revenue floor appropriate? Should the floor include non-segment specific costs and assets? Is there sufficient clarity about the non-segment specific costs and assets that ARTC intends to allocate to individual segments? Is the Undertaking sufficiently clear about how non-segment specific costs will be allocated to individual segments?*

*Are the proposed cost allocators for non-segment specific costs to segments soundly based? What impacts, if any, do they potentially have on usage patterns of different traffics? What implications does the use of such cost allocators have for encouraging efficient investment in the network by ARTC?*

#### *DORC and Valuation of Network Assets*

*Given the use of the RAB capitalisation model, what issues should be taken into consideration in establishing the initial RAB?*

*Is DORC the appropriate valuation methodology for ARTC's assets? Are there other models that should be used to value ARTC's assets, such as historical cost, reproduction cost or deprival value?*

*Is the approach to calculating DORC, used by ARTC in the Undertaking, appropriate?*

*Is there sufficient clarity about the way that ARTC will allocate assets under its control between the Hunter Valley coal network and the interstate network and among segments in the interstate network?*

*Any comments on the treatment of government capital contributions, including infrastructure assets and financial capital, in the RAB?*

#### *Weighted Average Capital Cost Derivation and Capital Asset Pricing Methodology*

*Has the Capital Asset Pricing Model been properly used to arrive at the Weighted Average Cost of Capital for ARTC?*

*How appropriate are the parameters and the assumptions that have been used to derive the components of the WACC?*

#### *Indicative Access Prices*

*Does the Indicative Access Charge provide a reasonable basis for setting of access prices for indicative services? How appropriate is the definition of indicative service used by ARTC for the purposes of setting indicative charges?*

*Is the method for setting prices of non-indicative rail services clearly set out? Is there sufficient guidance about how deviations from the indicative service will be taken into account in setting access prices? Does the Undertaking provide access seekers with an appropriate level of certainty about how non-reference services will be priced?*

*Is there sufficient clarity about how the proposed access prices escalation approach will work in practice? To the extent that the proposed escalation formula allows ARTC to maintain the real level of access prices and to accumulate increases over time, does this represent an acceptable balance of interests, as required under Part IIIA?*

*What is the conceptual rationale for the Excess Network Occupancy charge? Is it clear why the Excess Network Occupancy charge has been introduced? To the extent that the charge is intended to reflect consumption of capacity that is greater than average or "normal" consumption, is the Undertaking sufficiently clear about how capacity is measured? Does the charge promote sound decisions on the optimal size and timing of additions to capacity? Is there sufficient clarity about how the Excess Network Occupancy charge will be adjusted over time to reflect changes in actual consumption of capacity relative to changes in "normal" capacity consumption? Is there sufficient clarity about variances in the Excess Network Occupancy charges across segments?*

## *Incentives to Reduce Costs and Encourage Productivity Growth*

*Is there sufficient detail in the Undertaking about ARTC's approach to operating and maintenance expenditures?*

*Does the Undertaking contain sufficient incentives to encourage ARTC to undertake efficient operating, maintenance and capital expenditures and to pursue efficiency gains?*

*Are there sufficient incentives to encourage ARTC to provide an efficient level of service quality, including investment in improving service quality?*

## *Other Issues*

*Are there any other issues of concern arising from the proposed access pricing, cost allocation and/or asset valuation methodologies?*

## **5.5 Part 5 'Management of Capacity'**

Part 5 of the Undertaking deals with capacity issues. ARTC's initial Indicative Access Proposal includes an offer to undertake an assessment of capacity to ascertain the extent to which the applicant's requirements can be met within existing capacity constraints.

A major new feature of the capacity management provisions in the proposed Undertaking is the ability for an Access Agreement to be executed more than 6 months prior to the commencement of the actual Services, subject to there being sufficient Available Capacity to accommodate the Services until the commencement of operating the services; and subject to the applicant agreeing to pay a Reservation Fee. In determining the Reservation Fee, ARTC would have regard to the opportunity cost of reserving that capacity and would reduce the Reservation Fee to the extent of any utilization of the reserved capacity during the reservation period. ARTC does not propose to limit price differentiation for reserved capacity as it does for indicative services.

Where two or more applicants seek access to mutually exclusive access rights, ARTC undertakes to grant access to the application that represents the "highest present value of future returns after considering all risks associated with the Access Agreement" (clause 5.3(b)).

Access rights to train paths may be cancelled by the operator or assigned to another party, subject to conditions, including the approval of ARTC. ARTC allocates train paths for indicative services on the basis of fixed pathing schedules, that is, pre-determined entry and exit time slots. The Undertaking also provides for ARTC to withdraw assigned access rights to train paths that have been under-utilised ("use or lose" provisions). The Indicative Access Agreement defines "under-utilised" as a service that is not used more than seven times out of twelve scheduled such services.

### **Questions:**

*Is there sufficient clarity about the rationale for the reservation fee and how the reservation fee policy would be applied?*



*Is it appropriate to “reserve” capacity from the date the access agreement is executed? Is there sufficient detail in the Undertaking about the how ARTC would measure capacity during the reservation period?*

*What signal is the reservation fee intended to give to access seekers? Is the Undertaking sufficiently clear on how the opportunity cost of reserved capacity would be estimated? What are the likely effects of introducing a reservation fee, particularly for entry by smaller operators?*

*What are the effects of the absence of limits on price differentiation on reserved capacity?*

*Is there sufficient clarity about ARTC’s proposal for awarding access rights in the case of applications for mutually exclusive train paths?*

*Are the provisions dealing with cancellation of paths in the event of underutilization (“use or lose” provisions) appropriate? Are the current “use or lose” provisions appropriate for all traffics?*

## **5.6 Part 6 ‘Network Connections and Additions to Capacity’**

The Undertaking does not impose an obligation on ARTC to build additional capacity. However, where additional capacity is necessary to meet the demands of an access seeker, ARTC would consider building the extra capacity provided it is in ARTC’s interests, bearing in mind ARTC’s overall business and the economic and technical feasibility of creating extra capacity.

Alternatively, ARTC would consent to the provision of the extra capacity if it is consistent with ARTC’s operational, engineering, and safety requirements and its overall business interests. The Undertaking provides for the applicant to meet the costs of the additional capacity by reimbursing ARTC as and when it meets the necessary costs or through increased access charges or other periodic payments. The addition to capacity is ultimately owned and managed by ARTC.

The Undertaking also provides for owners of other tracks to connect to ARTC’s Network, subject to certain conditions, including that the connections do not reduce network capacity, that there is satisfactory operational and procedural interface with ARTC’s overall network requirements, that track owners can ensure that users of the connection comply with ARTC’s train control protocols, and that the costs of building and maintaining the connections are borne by the other track owners.

### **Questions:**

*Are the obligations on ARTC to provide additional capacity appropriate, including the processes where an access seeker satisfies the additional capacity criteria in clause 6.2(a)?*

*Is it appropriate for ARTC to earn a rate of return on capacity funded by an operator?*

*Are the Undertaking provisions on ARTC’s commitments in respect of additions to capacity fully funded by an access seeker appropriate? Is there sufficient clarity about how capacity funded by an operator would affect that operator’s access charges?*

## **5.7 Part 7 'Network Transit Management'**

The Undertaking states that:

*ARTC's objective in Train management is to exit Trains according to their contracted exit time. Where conflicts arise between Trains in transit, Train management will be conducted according to the Network Management Principles.*

Schedule F of the Undertaking shows the traffic management decision matrices for train control. The matrices provide traffic management rules for dealing with late trains, delays, and entry and exit times for trains. ARTC has introduced a consistent set of network management rules across the Network largely the same as those currently used in New South Wales.

### **Question:**

*Do the traffic decision-making matrices in the Undertaking provide sufficient clarity about the way ARTC would make decisions about network transit movements?*

## **5.8 Part 8 'Key Performance Indicators'**

Part 8 (in conjunction with Schedule G) of the Undertaking includes a commitment by ARTC to maintain the network in a condition that is fit for use by above rail operators to provide rail transport services having regard to the terms of the Access Agreement.

Part 8 and Schedule G also set out commitments by ARTC to report on and publish certain performance indicators. Some of these performance indicators are based on the concept of a healthy service. A healthy service is defined at note 2 to Schedule G of the Undertaking. ARTC is obliged to arrange for an independent audit of the performance indicators.

### **Questions:**

*Is the system of KPIs proposed by ARTC in the Undertaking appropriate?*

*Do the KPIs provide information on those aspects of ARTC's performance that are most important to operators?*

*Any comments on the adequacy of KPIs dealing with ARTC's capacity to deal with delays due to operators entering the network late? How does the absence of a KPI relating to the exit from the network of an unhealthy service affect this? What should a system of KPIs include in order to measure the infrastructure owner's ability to respond to problems in the network caused by operators?*

*Is the unhealthy/healthy train approach used by ARTC appropriate? Are the indicators appropriate – for example, should the indicators reflect actual and planned transit times?*

## 5.9 Schedules

There are a number of schedules presented as part of the Undertaking. These are:

- Schedule A – Access application
- Schedule B – Information to accompany access application
- Schedule C – Essential elements of access agreement
- Schedule D – Indicative track access agreement as at commencement date
- Schedule E – Network
- Schedule F – Network management principles
- Schedule G – Performance Indicators
- Schedule H – Capital Expenditure
- Schedule I - Segments

Schedule D, the Indicative Track Access Agreement (ITAA), is an important element of the Undertaking. It sets out the terms and conditions of access to indicative services. One of the key aspects of the ITAA is the treatment of indemnities and, specifically, whether the ITAA clearly sets out the responsibilities of ARTC and access seekers (particularly in the case of accidents) and whether the assignment of responsibilities to the two parties is consistent with the objectives of Part IIIA. While clause 15 of the ITAA deals exclusively with indemnities, the issue of respective responsibilities arises in the context of other provisions, for example clause 9.4, which requires an operator to indemnify ARTC from any liabilities that may arise as a result of third-party works on the network.

In addition, ARTC's application to the ACCC for approval of its Undertaking includes details on asset valuation and Weighted Average Cost of Capital and other supporting documentation.

### Questions:

*Are the provisions in the Indicative Track Access Agreement consistent with the access Undertaking?*

*Are the provisions dealing with indemnities and assignment of responsibilities to ARTC and operators (in the Undertaking and in the Indicative Track Access Agreement) clearly set out and do they achieve an appropriate balance of interests as required under Part IIIA?*

*Is the Undertaking sufficiently clear on the segments that make-up the ARTC network?*

*Is there sufficient detail on the nature and extent of capital expenditure that ARTC commits to undertake during the term of the Undertaking?*

