



AUSTRALIAN RAIL TRACK CORPORATION LTD

Application by ARTC to vary the ARTC Interstate Access Undertaking to include the Southern Sydney Freight Line (SSFL)

1 Application

1.1 Application

This is an application to the ACCC for consent to vary the ARTC Interstate Access Undertaking (IAU) under section 44ZZA(7) of the *Competition and Consumer Act 2010* (Cth) (CCA), and as contemplated by sections 2.1(c) and 2.4(b) of the IAU. The IAU was accepted by the ACCC on 15 July 2008 with a Commencement Date of 6 August 2008.

Section 2.1(c) of the IAU provides for the IAU to be extended to include the Southern Sydney Freight Line (SSFL) when:

- a) the SSFL is completed and commissioned for rail operations; and
- b) the Indicative Access Charge (IAC) applicable to the SSFL has been submitted by ARTC to the ACCC (at least 6 months prior to the commissioning of the SSFL) and accepted by the ACCC in accordance with section 2.4(b). ARTC expects that the SSFL will be fully completed and commissioned for rail operations at or around the end of February 2013.

1.2 Criteria for approving variation

Pursuant to sections 2.4(e) of the IAU, and section 44ZZA(7) of Division 6 of Part IIIA of the CCA, variation of the IAU by ARTC is subject to the ACCC's consent.

The ACCC may only consent to a variation if it considers it appropriate to do so having regard to the matters set out in section 44ZZA(3) of the CCA. These matters include:

- a) the objects of Part IIIA of the CCA;
- b) the pricing principles specified in section 44ZZCA;
- c) the legitimate business interests of ARTC;
- d) the public interest, including the public interest in having competition in markets;
- e) the interests of Access Holders and Operators; and
- f) any other matters that the ACCC thinks are relevant.



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ARTC considers it appropriate for the ACCC to consent to ARTC's proposed variation for the reasons set out in section 2 below.

2 Proposed IAC applicable to the SSFL

2.1 *The SSFL*

ARTC commenced a lease of substantial parts of the NSW rail network in September 2004 (**Lease**). The Lease covers the non-urban interstate network in NSW extending to the southern outskirts of the Sydney metropolitan area to Macarthur and the Hunter Valley coal network. The Lease does not cover the Sydney metropolitan commuter network, used predominantly by passenger commuter services and shared in parts with regional and interstate freight services.

A major bottleneck in the rail freight network has existed in southern Sydney as freight trains share existing rail lines with the Sydney metropolitan passenger services and as a result of a curfew on freight trains during morning and afternoon peak periods freight services are prohibited from operating at optimal times. This has historically represented a substantial impediment to the competitiveness of interstate rail freight in markets where its main competitor, road transport, does not face such impediments.

To alleviate bottlenecks on the interstate rail network ARTC undertook to construct the SSFL from the South of Sydney to the metropolitan freight terminals. The SSFL will provide a dedicated freight line for a distance of around 35 kilometres between Sefton Park East Junction (inner metropolitan Sydney near Chullora) and Macarthur in southern Sydney, allowing passenger and freight services to operate independently.

Figure 1 shows a map of the SSFL alignment.

Figure 1

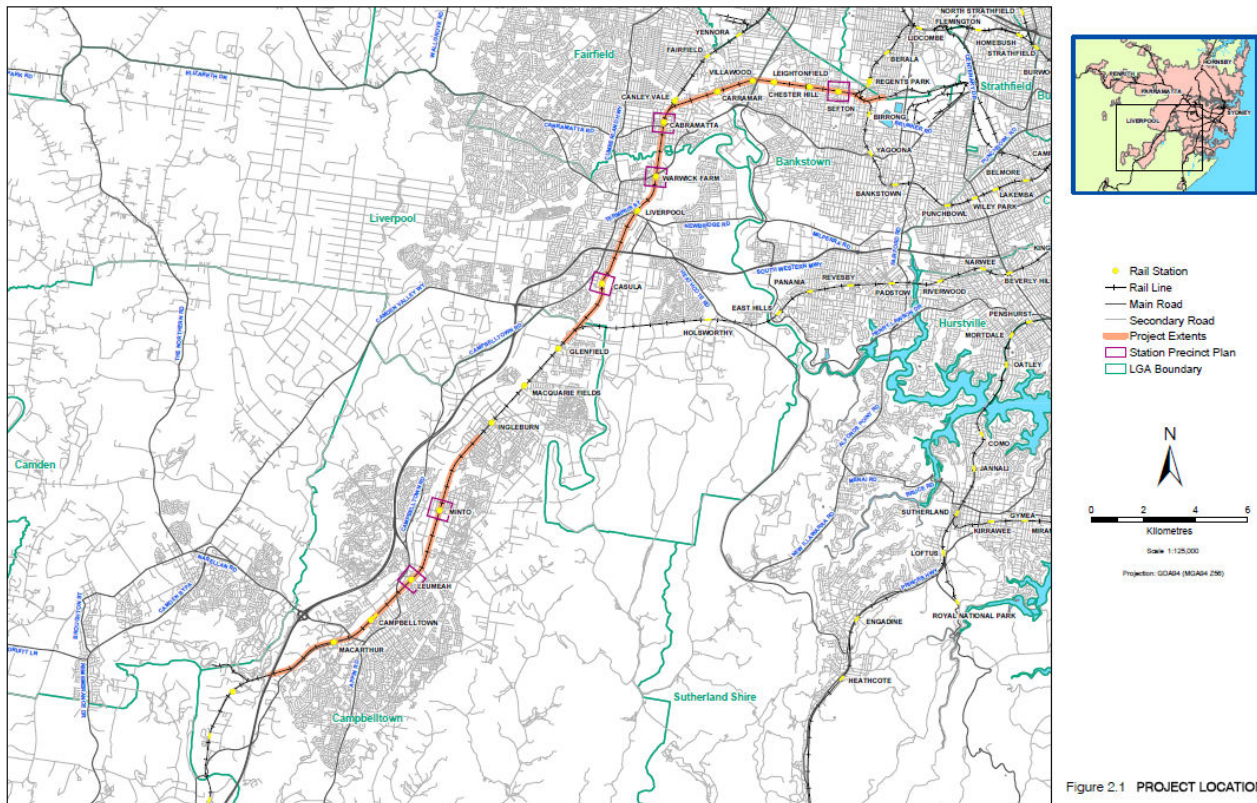


Figure 2.1 PROJECT LOCATION

When the IAU was originally accepted by the ACCC on 30 July 2008, the SSFL had not been completed and could therefore not be included for coverage under the IAU. However the IAU was accepted by the ACCC on the condition that, upon completion and commissioning of operations of the SSFL, and upon ACCC acceptance of the proposed IAC, the IAU would be expanded to include the SSFL as contemplated by clause 2.1(c).

2.2 Clause 2.4(b) Proposed IAC

ARTC is required to develop an indicative access charge applicable to the indicative service operating on the SSFL for submission to the ACCC in accordance with section 2.4(b) of the IAU. In determining the proposed IAC, ARTC has considered the Pricing Principles set out at section 4 of the IAU.

In support of the proposed IAC, ARTC has provided a supporting document to this application included at **Attachment B** that sets out the process used by ARTC to develop and determine the proposed IAC including ARTC’s confidential financial modelling.



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The proposed IAC will be effective on and from 1 March 2013 and is the sum of the following flagfall and variable components:

Segment	Variable \$/kgtkm (exclusive of GST)	Flagfall \$/km (exclusive of GST)
Southern Sydney Freight Line	8.564	3.426

ARTC has not proposed to include an excess network occupancy component in the proposed IAC as contemplated under section 4.5(a)(iii) of the IAU for the reasons set out in section 2.3 (a) of this application.

ARTC has proposed to commence application of the proposed IAC on 1 March 2013. Whilst ARTC expects that there will be some operations conducted on the SSFL prior to this date, there will be significant remaining activity required until February in order to complete a project of this magnitude. The proposed IAC, with respect to the SSFL, will be offered to operators and applicants seeking access to an Indicative Service with the following characteristics:

1. maximum axle load of 21 tonnes;
2. maximum speed of 110 km/h; and
3. length not exceeding 1800m.

2.3 Development of the proposed IAC

In developing the proposed IAC, ARTC has had regard to the following:

- the Pricing Principles set out at section 4 of the IAU;
- views expressed by the ACCC in its decision¹ to accept the IAU;
- the benefits accruing to users of the SSFL in terms of improved competitive position;
- existing Indicative Access Charges applicable to other relevant parts of the Network; and

¹

<http://www.accc.gov.au/content/item.phtml?itemId=837579&nodeId=3f518aeaac1751aac80d538994c38a6c&fn=ACCC%20final%20decision%20on%20the%20ARTC%20Interstate%20Rail%20Access%20undertaking.pdf>



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- ARTC's understanding of applicable markets and intermodal competition.
- a. Pricing Principles set out at section 4 of the IAU**

In support of this application, ARTC has provided to the ACCC confidential financial modelling to demonstrate that, in developing the proposed IAC, it has complied with Pricing Principles set out at section 4 of the IAU.

In accordance with section 4.4(a) of the IAU, the IAC has been determined such that revenue generated by ARTC for a Segment, including the SSFL, is not higher than the Ceiling Limit for that Segment and not lower than the Floor Limit for that Segment. Figure 2 below sets out the existing and forecasted levels of access revenue, the Floor Limit and the Ceiling Limit for the remaining term of the IAU.

In developing the Ceiling Limit for the SSFL, ARTC has used its current best estimate as to the final cost of construction as the relevant asset value (depreciated optimised replacement cost). This is because the SSFL is yet to be completed. In this application ARTC has sought ACCC approval with respect to the IAC applicable to the SSFL and ARTC recognises that it must demonstrate that the IAC is such that revenue derived on the SSFL will not exceed the Ceiling Limit. As part of the ACCC's assessment of the 2008 IAU, ARTC provided estimates of Capital Expenditure at the time (Schedule H of the 2008 IAU) and used those estimates in confidential financial modelling provided to the ACCC to demonstrate that indicative access charges were developed in accordance with the Pricing Principles in the 2008 IAU. The ACCC conducted a high level review of ARTC's approach and procedures prior to accepting the 2008 IAU.

ARTC has adopted the same approach in this application.

ARTC has already indicated to the ACCC that it will be providing cost information as a package under Schedule H of the IAU once all works are complete.

In accordance with sections 4.5(a)(i) and 4.5(a)(ii) of the IAU, the IAC comprises a variable component (\$/gtkm) and a flagfall component (\$/km). At this time, ARTC has not proposed to include an excess network occupancy component in the proposed IAC as contemplated at section 4.5(a)(ii) because an excess network occupancy component already applies to the Melbourne – Macarthur Segment. Inclusion of this component for the SSFL is unlikely to result in any significant intended incentives, and there is little opportunity or reason for spending excess time on this part of the Network..

The proposed IAC will be revised annually in accordance with section 4.6(d) during the term of the IAU.

b. Views expressed by the ACCC in its decision to accept the IAU

In developing the proposed IAC, ARTC considered the views expressed by the ACCC in its decision to accept the IAU. Considering that there have not been



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substantial changes in the economic and operational circumstances that apply to rail operations on the Network, ARTC considers that the views expressed by the ACCC in its decision to accept the IAU are still relevant. The views that ARTC consider to be particularly relevant to the development of the proposed IAC include:

‘The ACCC also conducted a high level review of ARTC’s price level and structure and the assumptions ARTC used to predict revenue growth and concluded that by the end of the Undertaking’s term revenues may be sufficient to cover operating and maintenance costs and contribute to a return on capital on some lines. It is unlikely, however, that revenues would reach the regulatory ceiling on any line segment.’^{2,3}

‘ARTC currently sets market based, rather than cost based prices. Given this approach to pricing, and the fact that revenues are well below the regulatory ceiling, the ACCC has not conducted a detailed assessment of ARTC’s price structure based on cost. It did, however, conduct a high level review, primarily to highlight whether there are issues that may need to be addressed going forward.’

Overall, the ACCC observes that for most key segments of ARTC’s interstate rail network, revenue from variable charges is considerably higher than variable costs. While, with the exception of Adelaide to Kalgoorlie, revenue from the flagfall is less than fixed costs (excluding a return on capital). Over the term of the Undertaking, the gap between variable access charges and average variable costs on most segments increases.’

The data indicate that there may be a question about whether the structure of ARTC’s access charges appropriately matches cost drivers and revenue sources, given the heavy reliance on the variable charge. That said, the ACCC’s analysis is preliminary only and, as the levels of cost recovery improve, a more detailed investigation is needed before it could be concluded that ARTC’s price structure is inappropriate. Overall, the ACCC considers that the structure of ARTC’s prices warrants further investigation over time and suggests that when ARTC considers future changes to indicative prices that it should also look at whether it is appropriate to re-balance the price structure.’⁴

ARTC has undertaken a similar approach to developing the proposed IAC and has provided a similar level of detail by way of confidential financial modelling to the ACCC as provided during the ACCC’s original assessment of the IAU. As shown in Figure 2 below, revenue received by ARTC from the IAC on the SSFL will be at a level that is well short of the regulatory ceiling for the term of the IAU.

² The indicative service broadly equates to intermodal freight, that is, general non-bulk freight (for example manufactured goods) that is transported from its origin to destination using two or more modes, such as road and rail and accounts for about 60 per cent of ARTC’s revenue. Non-indicative services cover all other freight including steel, minerals, passenger services and grain.

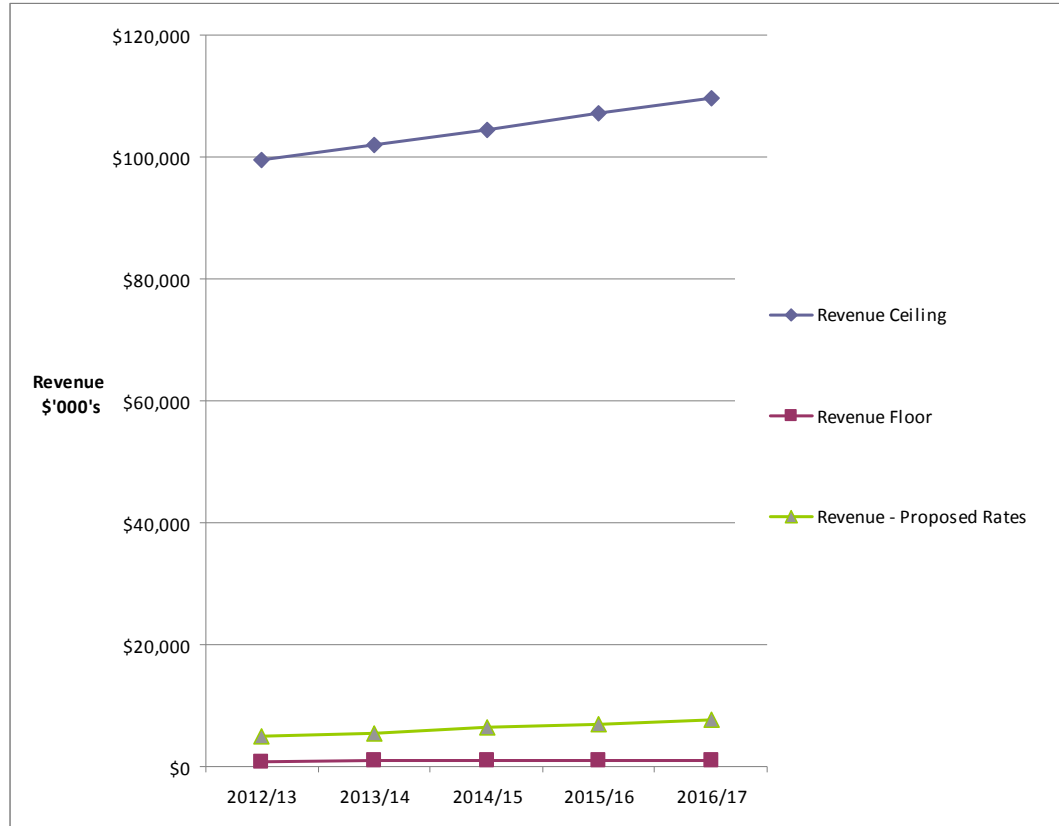
³ ACCC, Final Decision, Australian Rail Track Corporation. Access Undertaking – Interstate Rail Network, p 39.

⁴ Op cit, Appendix B, p xiii.



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Figure 2



As a consequence of the proposed IAC pricing structure, ARTC will bear significant market risk on the interstate network as variable pricing is set at a level that exceeds variable cost. ARTC has historically taken this position on the interstate network in recognition of the economic and operational circumstances existing in relation to interstate rail operations and to support and encourage volume growth on the Network.

c. The benefits accruing to users of the SSFL in terms of improved competitive position.

In establishing the IAC for the SSFL, ARTC has sought to ensure that the competitive outcome for rail is maximised. The SSFL is part of a package of projects selected to optimise rail's ability to transfer market share from road. Quantification of the benefit of the SSFL as an individual project is complex. The results of ARTC modelling of transit times for the North South Corridor projects, including the SSFL, have been published in ARTC's North South Corridor



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Strategy⁵. Further specific benefits arising from completion of the SSFL include removal of the curfew for freight in to Sydney; improved reliability; additional capacity; and more flexibility in timetabling.

In addition to expected improvements in rail performance and competitiveness, benefits are expected to flow through to operational cost savings for rail users of the corridor. ARTC is seeking to set the IAC at around 20% higher than current market prices for rail access between Macarthur and Sefton Park East Junction in recognition of the added value that the SSFL provides to the North South corridor freight task in conjunction with the expected cost savings for rail users. The resulting IAC is not expected to therefore erode rail's competitive position on the North South corridor.

d. Existing Indicative Access Charges applicable to other relevant parts of the Network and ARTC's understanding of applicable markets and intermodal competition.

ARTC seeks to encourage volume growth on the interstate network in competitive freight markets. To achieve this ARTC sets access pricing at a level that it considers will enable rail to reasonably compete with other modes of transport such as road and sea.

In the past, when setting and annually varying access pricing, and particularly Indicative Access Charges, on the Network, ARTC has sought to identify and recognise impacts of intermodal competition. Relevantly, road transport is a particularly strong market that will compete with the SSFL.

In developing the proposed IAC, ARTC has considered the relevant markets and competitive circumstances including what it understands to represent existing access pricing between Melbourne, Sydney and Brisbane, and recognising that the utilisation of the SSFL will result in a significant improvement in the rail offering in relation to the market in, out and through the Sydney metropolitan area.

3 Proposed variation to the IAU

This application seeks the ACCC's approval of the proposed IAC and consent to vary the IAU to give affect to the proposed IAC and inclusion of the SSFL in the IAU.

The proposed IAC and associated amendments to the IAU and the Indicative Access Agreement (**IAA**) are set out in **Attachment A**.

⁵ <http://www.artc.com.au/Content.aspx?p=19>



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Attachment A

ARTC has prepared a mark-up of the IAU and IAA to reflect the proposed amendments. The mark-ups are attached as **Attachment A1** and **Attachment A2** respectively.



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Attachment A1

Mark-up of the IAU to reflect proposed variation amendments

***Please note that the illustrative map provided as part of this IAU mark up will be further refined and re-submitted for approval closer to completion of the SSFL.**



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Attachment A2

Mark-up of the IAA to reflect proposed variation amendments



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Attachment B

Supporting Submission