Submission by Freight Rail Corporation and Toll Rail concerning the Australian Rail Track Corporation Access Undertaking

June 13, 2001

363 George Street Sydney NSW 2000
Tel: 61 2 9993 6600 Fax: 61 2 9993 6650
www.andersenlegal.com

Contents

1 Background and Summary

The Australian Rail Track Corporation (**ARTC**) has lodged with the Australian Competition and Consumer Commission (**ACCC**) an access undertaking for a non-declared service. The access undertaking is in respect of access to the interstate mainline standard gauge track linking Kalgoorlie in Western Australia, Adelaide, Wolseley and Crystal Brook in South Australia, Broken Hill in New South Wales and Melbourne and Wodonga in Victoria (**Network**).

The ACCC is assessing the access undertaking. In accordance with section 44ZZA(4)(a) of the *Trade Practices Act 1974* (**TPA**) the ACCC has published the undertaking and invited submissions on the undertaking. To assist people in making submissions the ACCC published an Issues Paper on the undertaking (**Issues Paper**). It is noted that in Section 2.1 of the Issues Paper, the ACCC states that:

> "… in considering an undertaking [it] 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)."

Further it is noted that the ACCC's publication "Access Undertakings" states that :

> "As a starting point for negotiations undertakings should:
>
> - clearly specify what services are subject to the undertaking;
> - specify what terms and conditions are open for negotiation;
> - provide a framework for negotiations including clearly defined boundaries for the negotiations;
> - provide relevant information necessary for meaningful negotiations;
> - include effective provisions for dispute resolution;
> - provide for potential third party users to be fully informed about non-negotiable terms and conditions; and
> - specify an expiry date for the undertaking."

This submission will refer to and reflect on these statements on a number of occasions not least because the Issues Paper raises questions that echo these statements.

Freight Rail Corporation (**FreightCorp**) and Toll Rail (**Toll**) are existing users of the Network, and as such are persons who might want access to the service (the subject of the access undertaking) in the future. FreightCorp and Toll are members of the Interstate Rail Operators Group (**IROG**), and as such have been consulted by ARTC on a number of matters, including the form of the standard access agreement. It will be apparent that FreightCorp and Toll consider that the Indicative Access Agreement (contained in Schedule D of the

access undertaking) does not reflect fully their recollection of positions settled upon through the consultation with IROG.

Accordingly it is the view of FreightCorp and Toll that the Indicative Access Agreement does not provide "reasonable terms and conditions" of access.

Summary

Whilst FreightCorp and Toll consider that each Recommendation should be read with the remainder of this submission set out below are the specific recommendations made in the text of this submission.

Recommendation 1: Because the Preamble is relevant in deciding disputes, it should be viewed critically to ensure that it does not lead to an imbalance as between the legitimate business interests of ARTC as the provider, the public interest and the interests of persons who might want access to the service.[1]

Recommendation 2: The undertaking should make it clear what constitutes an extension and what constitutes Additional Capacity.

Recommendation 3: To achieve a level playing field, the access undertaking should allow operators with existing access agreements the option to bring their existing access agreements into conformity with Schedule C or the Indicative Access Agreement to ensure that they are not disadvantaged. In allowing operators with existing access agreements to do this, the access undertaking will safeguard the public interest of having competition in markets.

Recommendation 4: It is suggested that the access undertaking should state what is meant by consultation, further it is suggested that the access undertaking state that Operators and interested parties may make submissions to the ACCC in respect of the proposed variation.

Recommendation 5: It is suggested that the access undertaking should state that no variation to the access undertaking may vary, or require any Operator to agree to vary, an access agreement. (Note that clause 2.5 does not do this clearly.)

Recommendation 6: FreightCorp and Toll consider that it is appropriate for the access undertaking to provide that it will be reviewed 12 months after it is accepted by the ACCC.

Recommendation 7: A mutual obligation to negotiate in good faith should be imposed on ARTC and each Applicant.

Recommendation 8: FreightCorp and Toll suggest that the findings of the QCA should be considered closely, in particular, that "… QR should disclose sufficient capacity information to allow access

[1] See the matter stated in section 44ZZA(3) of the *Trade Practices Act* 1974 (Cth) (**TPA)**

seekers to conduct their own capacity analysis".[2] This approach will provide access seekers with "relevant information necessary for meaningful negotiations".

Recommendation 9: FreightCorp and Toll question whether ARTC should have the right to require an Applicant to demonstrate that it is Solvent unless it has a reasonable apprehension that the Applicant may not be Solvent.

Recommendation 10: FreightCorp and Toll commend to ARTC and the ACCC the findings of the QCA.

Recommendation 11: FreightCorp and Toll consider that it is appropriate for the access undertaking to state the consequences of the ARTC's refusal to negotiate.

Recommendation 12: FreightCorp and Toll consider that it is appropriate for the access undertaking to state the consequences of a determination against ARTC in respect of the subject matter of clauses 3.3 (f), 3.3 (g), 3.7 (b) or 3.7 (e). This is necessary to provide "effective provisions for dispute resolution".

Recommendation 13: FreightCorp and Toll consider that it is appropriate for the access undertaking to provide a process whereby when any matter the subject of clauses 3.3 (f), 3.7 (b) and 3.7 (e) is in dispute can be resolved on an expedited basis.

Recommendation 14: FreightCorp and Toll consider that it is appropriate for the access undertaking to contain an obligation on ARTC to be bound by an Indicative Access Proposal for a period of time and to inform Applicants immediately if it no longer wants (after that time), or is no longer able (after an auction), to provide access in accordance with an Indicative Access Proposal.

Recommendation 15: FreightCorp and Toll consider that clause 3.9 (e) of the access undertaking should be deleted and replaced by a provision that acknowledges that if agreement is not reached within three months, either party may refer the matter to dispute resolution.

Recommendation 16: Having regard to the interests of persons who might want access[3], FreightCorp and Toll consider that if an auction process is to be considered the basis upon which it is to be conducted is critical, and in this regard that the QCA Draft Decision should be considered.[4] Further, FreightCorp and Toll consider that the criteria for assessment of each bid must be prescribed. This prescription should be included in the undertaking and must go beyond the "highest present value" to state how that value is determined.

---

[2] QCA Draft Decision, Volume 2, Chapter 4.6.2, p.184

[3] See the matter stated in section 44ZZA (3)(c) of the TPA

[4] QCA Draft Decision, Volume 2, pp.282-286

Recommendation 17: FreightCorp and Toll consider that the access undertaking should be amended to provide a clear base case for Applicants representing reasonable "terms and conditions", and as such "what terms and conditions are open for negotiation".

FreightCorp and Toll consider that the access undertaking should be amended to provide a clear statement of provisions that ARTC must not seek to include in any Access Agreement.

(For further detail see the comments on Schedule C below.)

Recommendation 18: FreightCorp and Toll consider that the access undertaking should be amended so that it does not provide for compulsory mediation. Further, if the ACCC is to act as arbitrator, FreightCorp and Toll consider that it is appropriate for either party to ask the ACCC to determine whether it is appropriate for mediation to occur.

Recommendation 19: FreightCorp and Toll suggest that to achieve effective provisions for dispute resolution it is critical that the dispute resolution process allows for:

- ARTC and the Applicant to be able to assess whether it is appropriate to proceed to arbitration, and, if so, on which issues;
- Safeguards to ensure that ARTC and Applicants do not proceed to the dispute resolution process precipitously (the access undertaking contains these[5]), but once they do proceed to dispute resolution that the process allows resolution as quickly as possible; and
- A suitably qualified entity or person to be the arbitrator or that such an entity or person has the ability to appoint the arbitrator.

2 Form of this submission

This submission contains 4 Sections. Sections 1 and 2 deal with Background and the Form of this submission. The remaining Sections deal with the following matters:

- Section 3 - Comments on issues identified by the ACCC in Section 3 of the Issues Paper, and answers the questions raised by the ACCC and suggests issues in addition to those identified by the ACCC;
- Section 4 - Suggests an approach to progressing a number of issues that arise from comments made in Section 3.

Annexure 1 to this Submission contains a "Submission on ARTC Access Undertaking: Asset Valuation and Revenue Limits" prepared by NECG.

Annexure 2 to this submission contains a copy of the undertaking. The copy of the undertaking has been annotated. The annotations are

[5] Clause 3.9 of the access undertaking

intended to reflect the comments made in the body of this submission, and to make further comments. FreightCorp and Toll believe that the annotated copy of the undertaking will assist in assessing the undertaking.

Annexure 3 contains a flow diagram intended to illustrate a not unlikely time line for the negotiation and arbitration process.

3 Issues of importance

Objective of Section 3

It is noted that whilst the objective of Section 3 of the Issues Paper is to highlight for comment and discussion issues that the ACCC has identified as important comments on other matters of relevance to the assessment of the access undertaking are welcome.

3.1 Preamble

Comments of FreightCorp and Toll

It is noted that the Preamble is a provision of the access undertaking and as such is relevant for the purposes of clause 3.11.4(b)(vi) of the undertaking that prescribes the matters that an arbitrator must take into account in deciding a dispute. (See clause 3.11.4(b)(vi)(A).)

Recommendation 1: Because the Preamble is relevant in deciding disputes, it should be viewed critically to ensure that it does not lead to an imbalance as between the legitimate business interests of ARTC as the provider, the public interest and the interests of persons who might want access to the service.[6]

The annotated copy of the access undertaking brings together comments on the Preamble.

Questions raised by the ACCC

The ACCC asks:

> "Is the ARTC undertaking accommodating of possible moves by other States or Territories to establish an appropriate interface with their respective access regimes?"

The access undertaking does not anticipate expressly moves by States or Territories. Whilst clause 6.1 of the access undertaking deals with Network Connections, it does not do so in the context of interface with other access regimes, it deals with physical interface only. FreightCorp and Toll deal with variation of the access undertaking in section 3.2, and note that it may be appropriate to anticipate interface issues under a formal consultation process that would allow Operators and other interested parties to make submissions.

[6] See the matter stated in section 44ZZA(3) of the *Trade Practices Act* 1974 (Cth) (**TPA)**

3.2 Scope and Administration

3.2.1 Application

Comments of FreightCorp and Toll

Like the ACCC, FreightCorp and Toll note that the access undertaking:

- applies to the Network, not to any extension of it or to any other track (interstate or otherwise) that may be owned by ARTC;[7]
- applies to access agreements executed after it becomes effective, not to any existing access agreement.[8]

Application to the Network

The obvious consequence of the access undertaking not applying to any extension or any other track is that terms of access to and use of any such extension or any such other track will have to be negotiated without reference to an open access regime providing structure for negotiation and arbitration and a reference point for price.

It is noted elsewhere in this submission that it is difficult to discern the difference between what constitutes an "extension" of the Network and what constitutes "additions to the Network or other enhancement of Capacity", ie Additional Capacity as defined.

Recommendation 2: The undertaking should make it clear what constitutes an extension and what constitutes Additional Capacity.

The annotated copy of the access undertaking points out apparent inconsistencies in the undertaking in respect of the treatment of extensions and suggests that ARTC clarify its intention in relation to them. These inconsistencies are not of themselves noteworthy. What is noteworthy is the lack of clarity as to the application of the undertaking and the basis upon which increased capacity may be charged for. This is dealt with in more detail elsewhere.

Application to access agreements executed after the undertaking is effective

FreightCorp and Toll note that it is possible that the access undertaking may allow access seekers that contract with ARTC to achieve more favourable terms than operators with existing access agreements with ARTC. Operators with existing access agreements could be disadvantaged.

[7] Clause 2.1(b) of the access undertaking

[8] Clause 2.5 of the access undertaking

Recommendation 3: To achieve a level playing field, the access undertaking should allow operators with existing access agreements the option to bring their existing access agreements into conformity with Schedule C or the Indicative Access Agreement to ensure that they are not disadvantaged. In allowing operators with existing access agreements to do this, the access undertaking will safeguard the public interest of having competition in markets.[9]

In other open access regimes it is not unusual for the regimes to apply only to the negotiation of new access agreements and the negotiation of rights additional to those the subject of an existing access agreement. The position taken is that operators with existing access agreements do not have rights and obligations under those agreements varied by virtue of the access undertaking. This ignores the possibility that some of them may want to benefit from the more favourable terms available to operators that enter into access agreements under the access undertaking.

Questions raised by the ACCC

The ACCC asks:

> "Does the undertaking clearly define the relevant terms and conditions which enable a prospective operator to be sufficiently well informed before making a specific access request?"

FreightCorp and Toll consider that the undertaking should oblige ARTC to make available information, amongst other things, to enable an Applicant to calculate the floor and ceiling prices.

In consideration of clause 3.10(b) (see **Access Agreement** below) and the annotated copies of Schedule C and the Indicative Access Agreement, FreightCorp and Toll stress the importance of recognising a base case for each Applicant and what it is reasonable for ARTC to seek in negotiation. Given the comments on these matters, FreightCorp and Toll do not consider that the access undertaking defines clearly relevant terms and conditions.

Further, in the ACCC's publication "Access Undertakings", the ACCC anticipates that undertakings should "specify what terms and conditions are open for negotiation". The access undertaking does not do this.

Further the ACCC asks:

> "Is the proposed term for the undertaking appropriate given the nature of the services and of the industry more generally? Would a longer term be more appropriate?"

FreightCorp and Toll consider that on balance the term of the access undertaking is appropriate. This said, FreightCorp and Toll would welcome debate as to whether it is appropriate in the access

[9] See the matter stated in section 44ZZA(3)(b) of the TPA

undertaking to anticipate an extension to the undertaking, and the consultation process to be followed.

FreightCorp and Toll note however that given the term of the access undertaking it is appropriate to have a review of the access undertaking after 12 months. This is addressed in more detail below under **Variation**.

3.2.2 Variation

It is noted that ARTC only may initiate a review of the access undertaking.

The annotated copy of the access undertaking seeks clarification of a number of issues in relation to clause 2.4 of the access undertaking, including whether clause 2.4 (a) is intended to define the only circumstance in which ARTC may seek review. As drafted it is not clear, and rules of construction allow one to conclude that clause 2.4 is not exhaustive. (The annotated copy also seeks clarification as to what ARTC means by "no longer commercially viable for ARTC" being the circumstance in which ARTC states it may seek review.)

It is noted that the access undertaking[10] provides that prior to seeking the approval of the ACCC to vary the access undertaking it will consult with Operators regarding the proposed variation.

Two issues arise from this; first, what is meant by consultation, and secondly, is it intended that on any variation access agreements negotiated and executed pursuant to the access undertaking may be varied.

In relation to the first issue:

Recommendation 4: It is suggested that the access undertaking should state what is meant by consultation, further it is suggested that the access undertaking state that Operators and interested parties may make submissions to the ACCC in respect of the proposed variation.

In relation to the second issue:

Recommendation 5: It is suggested that the access undertaking should state that no variation to the access undertaking may vary, or require any Operator to agree to vary, an access agreement. (Note that clause 2.5 does not do this clearly.)

It is noted that the Queensland Competition Authority (**QCA**) in its draft decision on the Queensland Rail (**QR**) access undertaking (**QCA Draft Decision**) accepted that QR should conduct a review of the QR undertaking after 12 months.[11] The term of the QR access undertaking is three years. FreightCorp and Toll consider that this is an appropriate approach for all concerned.

---

[10] Clause 2.4(b) of the access undertaking

[11] QCA's Draft Decision, Volume 2, Chapter 2.4, p. 64.

Recommendation 6: FreightCorp and Toll consider that it is appropriate for the access undertaking to provide that it will be reviewed 12 months after it is accepted by the ACCC.

3.3 Negotiating for access

Comments of FreightCorp and Toll

The ACCC identifies issues by reference to the headings to sub-clauses 3.3, 3.7, 3.8 and 3.11 in clause 3 of the access undertaking - Negotiating for access. FreightCorp and Toll consider that issues of importance arise from all clauses in clause 3, with the possible exception of clause 3.2. On this basis, FreightCorp and Toll comment on clause 3 in its entirety.

Introduction - clause 3.1

It is noted that state based access regimes impose obligations on access providers and access seekers. FreightCorp and Toll consider that it is appropriate for the access undertaking to impose like obligations on ARTC and each Applicant.

Recommendation 7: A mutual obligation to negotiate in good faith should be imposed on ARTC and each Applicant. [12]

It should be noted that the access undertaking imposes an indirect obligation on Applicants to negotiate in good faith by virtue of clause 3.11.4(b)(v); the arbitrator may terminate the arbitration if the party who notified the dispute has not engaged in negotiations in good faith. As noted in respect of **Dispute resolution** below, access seekers only, not access providers, will have a commercial imperative to arbitrate, and one access regime reflects this [13]. Other regimes anticipate that both access providers and access seekers may initiate arbitration[14], but it is submitted that access providers have no commercial imperative to do so, not least because arbitration does not provide the means by which they may impose their terms on access seekers.

It is noted that ARTC undertakes not to seek to frustrate the negotiation process. This should not be mistaken for an obligation to

[12] See clauses 3.1 and 3.6 of the NSW Rail Access Regime, sections 99 and 100 of the *Queensland Competition Authority Act* 1997 (Qld) (**QCAA**), clause 13 of the Railways (Access) Code 2000 (WA) and section 11 of the *Australasia Railway (Third Party Access) Act* (NT).

[13] See section 14 of the *Australasia Railway (Third Party Access) Act* (NT) and clause 26 of the Railway (Access) Code 2000 (WA).

[14] In Queensland, section 11 of the QCA provides that the access provider or the access seeker may notify the authority that a dispute exists and section 115G provides that a party to mediation (either the access provider or seeker) may by further access dispute notice refer the dispute to arbitration. In NSW, clause 6.4 of the NSW Rail Access Regime provides that the Arbitrator in the exercise of its discretion takes into account any submissions made by the parties to the dispute.

negotiate in good faith by some other name. Note that there is the world of difference between an obligation to do something and an obligation not to do something. In this context, ARTC is agreeing not to do something. This is unsatisfactory. Also note on closer inspection of what ARTC is agreeing not to do - it is agreeing not to seek to frustrate the negotiation process that it has devised; this is a lesser obligation than ARTC saying that it will comply with its negotiation process. As will be noted, the negotiation process itself is not satisfactory.

In addition to an obligation to negotiate in good faith, state based regimes impose an obligation of the access provider to use reasonable endeavours to comply with a request for access.[15] The access undertaking does not impose such an obligation on ARTC. Sometimes this obligation is mutual.[16] FreightCorp and Toll consider that such an obligation, whether imposed on ARTC alone or mutual, is appropriate.

a) State based open access regimes impose obligations on access providers to provide information on request.[17]

The access undertaking does not impose such an obligation on ARTC.

Recommendation 8: FreightCorp and Toll suggest that the findings of the QCA should be considered closely, in particular, that "… QR should disclose sufficient capacity information to allow access seekers to conduct their own capacity analysis".[18] This approach will provide access seekers with "relevant information necessary for meaningful negotiations".

Further, FreightCorp and Toll consider that ARTC should be obliged to report on its performance providing information.

A critical element on the negotiation of an access agreement is the length of time that the process takes; this is critical to both transaction costs and entering the market to service the needs of end users.

FreightCorp and Toll note that the NSW Rail Access Regime provides for the reporting of negotiations that take in excess of three months to the responsible Minister.[19]

---

[15] See clauses 7.1(b) of the NSW Rail Access Regime ("reasonable endeavours"), clause 16 of the Railways (Access) Code 2000 (WA) ("reasonable endeavours"), section 101 of the QCAA ("reasonable efforts") and section 11(1) of the *Australasia (Third Party Access) Act* (NT).

[16] See section 11 of the *Australasia (Third Party Access) Act* (NT)

[17] For example, section 101 of the QCAA and the QCA Draft Decision, Volume 2, Chapter 4.6.2.

[18] QCA Draft Decision, Volume 2, Chapter 4.6.2, p.184

[19] Clause 3.5 of the New South Wales Rail Access Regime

FreightCorp and Toll consider that it is appropriate for ARTC to report on two measures with respect to the length of time negotiations are conducted for access agreements:

(a) the average length of time for completion of negotiations; and

(b) specific reporting of all negotiations that exceed three months.

(Note these measures assume that comments of FreightCorp and Toll on **Negotiation Process** are accepted.)

FreightCorp and Toll consider that it is in the interests of persons who might want access[20] to include provisions of this kind. Further, FreightCorp and Toll consider that provisions of this kind "provide a framework for negotiations".

(The annotated copy of the access undertaking contains further comments on clause 3.1.)

Parties to Negotiation

Comments of FreightCorp and Toll

It is noted that ARTC reserves the right not to continue negotiations:

> "If an Applicant does not comply with the relevant obligations and processes, and ARTC considers that such non-compliance is material … ."

FreightCorp and Toll consider that it is appropriate for ARTC to be asked why it requires this right, this is unusual, though not unique[21] and at exactly what point does the right arise in the negotiation process. FreightCorp and Toll are concerned that the access undertaking is far from clear on when the negotiation process commences. As noted in the annotated copy of the access undertaking, if ARTC is to have a right to refuse to negotiate the basis of that right should be prescribed clearly. Further, consistent with what position of the QCA[22], ARTC must have entered into negotiations before it may demonstrate that the circumstances prescribed in the undertaking exist.

Clarity as to when negotiation commences is also relevant to the duty as to confidentiality, and is discussed in detail below under **Confidentiality**. Whilst it is possible to discern when the negotiation

---

[20] See the matter stated in section 44ZZA(3)(c) of the TPA

[21] The Railways (Access) Code 2000 (WA), the NSW Rail Access Regime and the *Australasian Railway (Third Party Access) Act* (NT) do not provide that negotiations between the rail provider and rail seeker may be discontinued where the access seeker fails to comply with its obligations. The QCA Draft Decision anticipates accepting an undertaking that allows QR the right to refuse to negotiate but on a basis considerably at variance from that in the ARTC access undertaking - see Chapter 4.5, Volume 2, pp.168 to 171.

[22] QCA's Draft Decision on QR's Draft Undertaking, Volume 2, Chapter 4.5, p.171.

process commences, it is far from clear when negotiations commence and therefore at which point ARTC may exercise a right not to continue them.

FreightCorp and Toll agree that is appropriate for ARTC to have a right not to commence or to continue the negotiation process if an Applicant is not Solvent.

Recommendation 9: FreightCorp and Toll question whether ARTC should have the right to require an Applicant to demonstrate that it is Solvent unless it has a reasonable apprehension that the Applicant may not be Solvent.

FreightCorp and Toll do not agree that it is appropriate for ARTC to have a right not to commence or to continue the negotiation process if the Applicant is in breach of another access agreement whether it is with ARTC or with another access provider.

This is an intrusive process. Further, and without compromising their objection in principle to this right, FreightCorp and Toll note that the definition of Material Breach, by the use of the phrase "… any breach of … a[n] essential term …", provides ARTC with considerable scope to exercise this right.[23]

Recommendation 10: FreightCorp and Toll commend to ARTC and the ACCC the findings of the QCA.[24]

Note that the consequences of ARTC exercising any of its rights not to continue to negotiate are unclear. Does the Applicant have to remedy the situation that gives rise to the exercise of the right and then proceed with negotiations? Or does the Applicant have to commence the process again? One may conclude, though the conclusion is by no means certain, from clause 3.3 (f) that unless an Applicant proceeds to arbitration the Applicant will have to commence the process again.

Recommendation 11: FreightCorp and Toll consider that it is appropriate for the access undertaking to state the consequences of the ARTC's refusal to negotiate.

A further point of clarification arises in relation to the right of the access seeker to refer matters to an arbitrator under clause 3.3 (f). Note that clause 3.11.4 only anticipates reference of matters in dispute to an arbitrator on the expiry of one month after the appointment of a mediator. Clause 3.11.4 does not therefore allow an access seeker to refer a matter straight to an arbitrator under the dispute resolution process in these circumstances. Is it the intention therefore that compulsory negotiation and mediation must take place

[23] Essential terms are "minimum terms which must be agreed [completely] to give effect to the commercial purpose of the transaction." (See Gillard J at 569 in *Powercor Australia v Pacific Power* (1999) VSC (18 November 1999).) A breach of an essential term does not of itself give rise to a right of termination or any loss.

[24] QCA's Draft Decision, Volume 2, Chapter 4.5, pp.168 to 171.

before an access seeker may refer a matter the subject of clause 3.3 (f) to an arbitrator? This would be odd, given the subject matter of the clause.

The same issue arises in relation to clauses 3.3 (g), 3.7 (b) and 3.7 (e).

Further, the arbitration process, and the matters that an arbitrator must take into account are not relevant to a referral to an arbitrator under these clauses. In this regard, the access undertaking is incomplete.

The access undertaking is unclear whether the consequence of a determination against ARTC would allow the Applicant to proceed against ARTC for the consequences of ARTC actions under section 44ZZJ of the TPA.

Recommendation 12: FreightCorp and Toll consider that it is appropriate for the access undertaking to state the consequences of a determination against ARTC in respect of the subject matter of clauses 3.3 (f), 3.3 (g), 3.7 (b) or 3.7 (e). This is necessary to provide "effective provisions for dispute resolution".

It should be noted that the "remedy" of referral to an arbitrator risks being illusory; as is noted elsewhere the commercial imperative for an access seeker is to execute an access agreement on reasonable terms as quickly as possible and to start running trains. The prospect of having to arbitrate, with the time and expense taken to do so, to resolve matters the subject of clause 3.3 (f) and clauses 3.7 (b) and 3.7 (e), may act to discourage access seekers from proceeding. If access seekers were so discouraged this could work against the public interest of having competition in the provision of haulage services. These issues need to be resolved to ensure that the access undertaking contains "effective provisions for dispute resolution".

Recommendation 13: FreightCorp and Toll consider that it is appropriate for the access undertaking to provide a process whereby when any matter the subject of clauses 3.3 (f), 3.7 (b) and 3.7 (e) is in dispute can be resolved on an expedited basis.

Questions raised by the ACCC

The ACCC asks four questions in respect of **Parties to Negotiation**. Taking the questions and answers in order, FreightCorp and Toll comment as follows:

a) "Are the processes for the initial phase of negotiations reasonable?"

It follows from what is said above and below that, as things stand, FreightCorp and Toll do not think that processes are reasonable.

b) "Are the criteria that ARTC intends to use to "screen" applicants appropriate?"

It follows from what is said above that FreightCorp and Toll do not consider that the all criteria provided for in the access undertaking are appropriate. FreightCorp and Toll do consider, however, that the solvency of an applicant is an

appropriate criterion, but the burden should be on ARTC to demonstrate a reasonable apprehension of insolvency. This is consistent with the approach suggested by the QCA in its Draft Decision on the QR Undertaking.

c) "Do these criteria encourage potential operators to apply for a request for access?"

FreightCorp and Toll consider that the process will not encourage potential operators, rather, they will view it as a hindrance.

FreightCorp and Toll note however that depending on the approach taken on Applicants seeking mutually exclusive paths (first come first served as opposed to the auction process suggested by ARTC), it may be appropriate to provide more criteria to screen Applicants. (See below under **Negotiation Process**.)

d) "Does the undertaking provide adequate detail on what is expected of an Accredited Operator?"

FreightCorp and Toll consider that an Applicant should have to submit with its Application a conceptual operating plan detailing, in broad terms, key operational information.

Confidentiality

FreightCorp and Toll note that the confidentiality obligation relates to Confidential Information:

> "… exchanged as part of the negotiation for Access under this agreement …"

As noted above, there is an issue as to when negotiation commences, and whether it commences at the same time as the "negotiation process" commences (whenever that commences) or at the same time as the "negotiation period" commences (see clause 3.9). The access undertaking should provide that all Confidential Information must be kept confidential and not disclosed. This obligation does not need to be referrable to any process or time.

(The annotated copy of the access undertaking provides further comments on clause 3.4.)

Access application

Clause 3.5(c) provides that:

> "Prior to submitting the Access Application, the Applicant may seek initial meetings with ARTC to discuss the Access Application and seek clarification of the processes as outlined in this Undertaking and in particular, the information requirements set out in Schedule B."

It is noted that ARTC has no obligation, not even a reasonable endeavours obligation, to meet with an Applicant within a reasonable time. If this clause is to have meaning, such an obligation needs to be included.

Acknowledgment

Clause 3.6 represents the start of the Access Application process proper. As a general comment in relation to the Access Application process as a whole, FreightCorp and Toll are concerned that it could easily take over 12 months to get to a decision.

Set out as Annexure 3 is a flow chart that illustrates this.

FreightCorp and Toll consider that it is in the interests of persons who might want access[25] for the Access Application process to proceed as quickly as possible. This is consistent with statements elsewhere in the submission that the commercial imperative for access seekers is to execute an access agreement on reasonable terms as quickly as possible and to start running trains.

Further, FreightCorp and Toll consider that it is in the public interest to ensure that the benefits of competition should be realised as soon as possible, and that with these benefits in mind, the Access Application process should proceed as quickly as possible. To achieve this, FreightCorp and Toll consider that it is appropriate for ARTC to assume a more rigorous time line than the one currently proposed. In Section 4, FreightCorp and Toll suggest that this be considered in an industry forum to determine how best to foreshorten the time line.

Indicative Access Proposal

Given what is said above under **Acknowledgment** about the time line, no comment is made about the time periods suggested in clause 3.7.

FreightCorp and Toll note that:

> "The Indicative Access Proposal will, unless it contains specific provisions to the contrary, contain indicative arrangements only and does not oblige ARTC to provide Access in accordance with specific terms and conditions, including Charges, contained within it."[26]

Whilst FreightCorp and Toll consider that it is inappropriate for ARTC to be bound by any Indicative Access Proposal on any open ended basis, they do consider, however, that it is appropriate for ARTC to be bound by an IAP for a period of time and for ARTC to inform Applicants immediately if it no longer wants (after that time), or is no longer able (after an auction), to provide access in accordance that Proposal. This is important because it is on the basis of the Indicative Access Proposal that an Applicant will make its decision of whether to proceed to negotiation.

[25] See the matter stated in section 44ZZA(3)(c) of the TPA

[26] Clause 3.7(d) of the access undertaking

Recommendation 14: FreightCorp and Toll consider that it is appropriate for the access undertaking to contain an obligation on ARTC to be bound by an Indicative Access Proposal for a period of time and to inform Applicants immediately if it no longer wants (after that time), or is no longer able (after an auction), to provide access in accordance with an Indicative Access Proposal.

(The annotated copy of the access undertaking provides further commentary on clause 3.7.)

Questions raised by the ACCC

The ACCC asks:

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

Subject to the point made in the annotated copy of the access undertaking, FreightCorp and Toll consider that the detail contained in the Indicative Access Proposal is sufficient provided that the comments and the recommendations made elsewhere in this submission (in particular in relation to information provision) are accepted.

Further, the ACCC asks:

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

FreightCorp and Toll are concerned that ARTC may change its position at any time. The Indicative Access Proposal is just that "indicative", and as such, and given that ARTC may change its position does not provide a certain starting point for negotiation. There is a risk therefore that Applicants may engage in negotiations only for ARTC to change the Proposal.

Negotiation

Comments of FreightCorp and Toll

As noted in relation to the comments on clause 3.7 (**Indicative Access Proposal**), given what is said above under **Acknowledgment** about the time line, no comment is made about the potential impact on the time line of clause 3.8.

FreightCorp and Toll are concerned that ARTC is seeking to impose time limits on the time frames for action by Applicants.

Clauses 3.8 (a) and 3.8 (b) provide for notification of intention to proceed with negotiation within 30 Business Days. Clause 3.8 (c) provides for notification of concerns about the Indicative Access Proposals within 30 Business Days. And Clause 3.8(d) provides for the notification of an intention to proceed to dispute resolution.

This level of prescription is unusual, indeed unique, and may be contrasted with the flexibility that ARTC is allowing itself on time frames in clause 3.8, and elsewhere in the access undertaking. FreightCorp and Toll recognise that access seekers will be seeking to proceed as quickly as possible, and will no doubt give notices within the

prescribed time frames, but if, for whatever reason they do not, they should not have to start the Access Application process again.

Accordingly, having regard to the interests of persons who might want access[27], FreightCorp and Toll suggest that no limits be placed on the time frames within which Applicants must act.

Finally, FreightCorp and Toll question whether it is necessary to be prescriptive as to the negotiation process.

Questions raised by the ACCC

The ACCC asks:

"Are the various negotiation steps reasonable?"

It follows from what is said under the heading **Negotiation** and elsewhere that FreightCorp and Toll have serious reservations about the access undertaking, not about the steps as such, but the fact that an Applicant may lose its right to proceed.

Further, the ACCC asks:

> "Do they provide the framework for negotiations and allow meaningful negotiations to occur?"

FreightCorp and Toll do not consider that the framework for negotiations allow meaningful negotiations to occur. For meaningful negotiations to occur, FreightCorp and Toll consider that their comments on clauses 3.9 and 3.10 (and thereby Schedules C and D) need to be reflected in the access undertaking.

Finally, in respect of **Negotiation** the ACCC asks:

> "Are they likely to lead to outcomes that are beneficial to both ARTC and access seeker?"

FreightCorp and Toll consider that unless their comments on clauses 3.9 and 3.10 are reflected in the access undertaking, there will be an increased likelihood of disputes and ultimately arbitration. FreightCorp and Toll do not consider that this will benefit anyone, certainly not persons who might want access.[28]

Negotiation Process

FreightCorp and Toll note that on:

> "the expiration of three (3) months from the commencement of the negotiation period, or if both parties agree to extend the negotiation period, the expiration of the agreed extended period."[29] "… ARTC will be entitled to cease negotiations with the applicant."[30]

---

[27] See the matter stated in section 44ZZA(3)(c) of the TPA

[28] See the matter stated in section 44ZZA(3)(c)

[29] Clause 3.9(b)(iv) of the access undertaking

[30] Clause 3.9(c) of the access undertaking

In the ordinary and usual course, three months might be regarded as the time that parties must negotiate in good faith in order to be able to proceed to arbitration, or, as is the case in Western Australia[31], as an appropriate period for negotiation, and if agreement is not reached before the termination of the period provided for negotiation, to treat the access seeker as in dispute with the railway owner, and therefore triggering the dispute provisions. This of itself is acceptable, but taken with clause 3.9 (e) is troubling to FreightCorp and Toll[32].

FreightCorp and Toll consider that this will force access seekers to proceed to dispute resolution (because of clause 3.9 (e) within the negotiation period) rather than risk having to start the Access Application process again.

This is not appropriate or sensible and means that the negotiation is flawed.

Recommendation 15: FreightCorp and Toll consider that clause 3.9 (e) of the access undertaking should be deleted and replaced by a provision that acknowledges that if agreement is not reached within three months, either party may refer the matter to dispute resolution.

Expiry of the negotiation period is one of the circumstances in which the negotiation period may cease, there are six others. All but two of the other five are, as they stand, inappropriate. The annotated copy of the access undertaking provides detail as to why clauses 3.9(b)(iii), (vi) and (vii) are inappropriate.

FreightCorp and Toll note the intention of ARTC to realise "the highest present value of future returns to ARTC after considering all risks associated with the Access Agreement" where Applicants are seeking mutually exclusive Access Rights.

FreightCorp and Toll note that through TROG discussions with ARTC they understood that auctioning was something that ARTC had agreed not to pursue. If auctioning is to be pursued FreightCorp and Toll consider that it needs greater consideration. For example, what would the consequence be of an auction that realised a bid at a charge lower than a charge being paid be a comparable operative? Applying the "most favoured nation" provisions to charges paid by the comparable operator should fall.

[31] Section 20(3) of the Railway (Access) Code 2000 (WA)

[32] Clause 3.9(e) of the access undertaking provides: "If, at any time during the negotiation period, a dispute arises … either party may seek to resolve the dispute in accordance with the dispute resolution process …".

Recommendation 16: Having regard to the interests of persons who might want access[33], FreightCorp and Toll consider that if an auction process is to be considered the basis upon which it is to be conducted is critical, and in this regard that the QCA Draft Decision should be considered.[34] Further, FreightCorp and Toll consider that the criteria for assessment of each bid must be prescribed. This prescription should be included in the undertaking and must go beyond the "highest present value" to state how that value is determined.

(The annotated copy of the access undertaking provides further comments on clause 3.9(d).)

Finally, in relation to clause 3.9, FreightCorp and Toll emphasise the effect of clause 3.9(e) which provides:

> "If, at any time during the negotiation period, a dispute arises between the parties which, after reasonable negotiation, the parties are unable to resolve to their mutual satisfaction, then either party may seek to resolve the dispute … ."

To emphasise the point once again, what this clause does is to force Applicants to proceed to dispute resolution before ARTC has the right to cease negotiation pursuant to clauses 3.9(b)(iv) and 3.9(c). Note that if an Applicant does not proceed in this way, it will have no right to proceed to dispute resolution, and consequently have to start the Access Application process again.

Having regard to the public interest and the interests of persons who might wants access, FreightCorp and Toll consider that any time limit on proceeding to dispute resolution should be removed. Further, this does not provide "effective provisions for dispute resolution".

Access Agreement

FreightCorp and Toll consider that it is critical for the effect of clause 3.10 to be considered in detail by the ACCC.

Clause 3.10 (b) of the access undertaking provides that:

> "The Access Agreement must, unless otherwise agreed between ARTC and the Applicant, be consistent with the principles outlined in the Indicative Access Agreement and must address at least the matters set out in Schedule C. The details of Schedule C do not provide an exhaustive list of the issues that may be included in an Access Agreement."

Reference back to what the ACCC states in its Issues Paper, ie that it " … 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 …" is helpful at this point.

---

[33] See the matter stated in section 44ZZA(3)(c) of the TPA

[34] QCA Draft Decision, Volume 2, pp.282-286

Neither FreightCorp nor Toll consider that clause 3.10(b) will allow them to negotiate access on reasonable terms unless the Indicative Access Agreement and Schedule C provide:

(a) reasonable terms, and those reasonable terms represent the starting point for the access agreement that ARTC will put to each Applicant. (The reasonable terms represent the least that each Applicant can expect.); and

(b) ARTC is required by the access undertaking not to seek to include provisions that are inconsistent with the reasonable terms. (This is important to limit transaction costs for Applicants, and for ARTC.)

(The comments on Schedule C and the annotated copy of Schedule D provides some guidance of what FreightCorp and Toll consider to represent reasonable terms. Further the comments of FreightCorp and Toll on Schedule C provide some guidance as to provisions that should be included and which ARTC should not seek to include.)

FreightCorp and Toll consider that rather than requiring each access agreement to be consistent with the Indicative Access Agreement that the requirement should be that each Access Agreement should not be inconsistent with the Indicative Access Agreement. If this were the case, an Applicant (or for that matter ARTC) could seek something not included in the Indicative Access Agreement. This allows what are reasonable terms for Applicants to change over time. Ultimately, what is reasonable will be an issue to be determined by arbitration. This is not a bad thing, it allows change over time but off a base case.

Recommendation 17: FreightCorp and Toll consider that the access undertaking should be amended to provide a clear base case for Applicants representing reasonable "terms and conditions", and as such "what terms and conditions are open for negotiation".

FreightCorp and Toll consider that the access undertaking should be amended to provide a clear statement of provisions that ARTC must not seek to include in any Access Agreement.

(For further detail see the comments on Schedule C below.)

Dispute Resolution

Too many steps

FreightCorp and Toll note that the ACCC characterises the dispute resolution process as a four-step approach.

Each step apart from what the ACCC describes as the fourth step is compulsory. FreightCorp and Toll consider that this is inappropriate for two related issues, one relating to timing, the other relating to the appropriateness of further negotiation and mediation where a party has decided to proceed to arbitration.

In the experience of FreightCorp and Toll, access seekers do not proceed to dispute resolution (in particular, arbitration) precipitously. It is not in the best interests of access seekers to proceed to dispute resolution at all; it is in the best interests of an access seeker to negotiate an access agreement, on reasonable terms, as quickly as

possible and to start running trains. It is only if an access seeker does not consider that it is able to get reasonable terms that it will proceed to dispute resolution, because by its nature it is an expensive process with an uncertain outcome. An access seeker never wants to proceed to arbitration; arbitration requires the access seeker to incur further cost and expense without any guarantee that it will get reasonable terms. As noted elsewhere, it is access seekers that will initiate dispute resolution, there is no reason (commercial or otherwise) for an access provider to proceed to dispute resolution. However, if an access seeker initiates the dispute resolution process it is most likely that it will have determined that it is prepared to arbitrate, and it wants to see resolution of the dispute as quickly as possible.

This leads to the second, and related, point of whether it is appropriate to have compulsory steps of further negotiation and mediation.

From experience, FreightCorp and Toll know that they would not proceed to arbitration without senior management, probably CEO to CEO, meeting. On this basis, and on the basis that the time frame for further negotiation does not impede the resolution of the dispute as quickly as possible, FreightCorp and Toll accept compulsory negotiation. This is a pragmatic rather than a principled acceptance.

From experience, FreightCorp and Toll do not favour compulsory mediation. Given that senior management has met and that mediation is by its nature a consensual process - both parties must want it to work for it to be successful - there is a fundamental issue as to whether compulsory mediation is appropriate.

Again from experience, FreightCorp and Toll view mediation as providing the access provider with another opportunity to test the mettle of access seekers. This works against the resolution of disputes as quickly as possible. The state-based regimes do not provide for compulsory mediation, rather they allow the regulator with jurisdiction over disputes to refer a dispute to mediation. In the context of comments below about the involvement of the ACCC as arbitrator, FreightCorp and Toll suggest that mediation should occur if agreed to by ARTC and the Applicant or if the ACCC considers it appropriate.[35]

Recommendation 18: FreightCorp and Toll consider that the access undertaking should be amended so that it does not provide for compulsory mediation. Further, if the ACCC is to act as arbitrator, FreightCorp and Toll consider that it is appropriate for either party to ask the ACCC to determine whether it is appropriate for mediation to occur.

[35] Given that there is persuasive authority that agreements to mediate are unenforceable as such, and that the most they afford a person seeking to rely upon them is the ability to stay an arbitration until the period provided for the mediation has expired, there is a real issue as to the appropriateness of compulsory mediation

ACCC to be arbitrator

Recommendation 19: FreightCorp and Toll suggest that to achieve effective provisions for dispute resolution it is critical that the dispute resolution process allows for:

- ARTC and the Applicant to be able to assess whether it is appropriate to proceed to arbitration, and, if so, on which issues;
- Safeguards to ensure that ARTC and Applicants do not proceed to the dispute resolution process precipitously (the access undertaking contains these[36]), but once they do proceed to dispute resolution that the process allows resolution as quickly as possible; and
- A suitably qualified entity or person to be the arbitrator or that such an entity or person has the ability to appoint the arbitrator.

Taking the first and third points together (the second point is dealt with above) it is the view of FreightCorp and Toll that the ACCC should be the arbitrator.[37] The state based open access regimes provide for "regulation" of arbitration by the entity or the office of one person that has responsibility for regulating price.[38] The procedures to be adopted by the ACCC in any arbitration is clearly a matter for discussion, but Part IIIA of the TPA may be regarded as providing a useful starting point for discussion, as may the procedures provided for in the state and territory regimes.[39]

One of the important consequences of this approach is that one entity or the office of one person becomes the repository for determinations and the basis upon which they are made. This approach will also lead to a consistent view of the arbitrator on the matters that the arbitrator must take into account in making a determination. Which leads to our next suggestion.

All determinations of the arbitrator should be published. It is unclear from the access undertaking whether it is intended that determinations

---

[36] Clause 3.9 of the access undertaking

[37] See the matter stated in section 44ZZAA(6) of the TPA

[38] The New South Wales Access Regime is regulated by the Independent Pricing and Regulatory Tribunal. The Queensland access regime is regulated by the Queensland Competition Authority. The Australasian access regime is regulated by the South Australian Independent Industry Regulator. The Western Australian access regime is regulated by the Director General for Transport.

[39] **Western Australia**: Part 3, division 3 of the Railway (Access) Code 2000 (WA);
Northern Territory: Part 2, division 3 and 4 of the *Australasian Railway (Third Party Access) Act* (NT);
Queensland: Part 5, division 5 subdivision 3 of the *Queensland Competition Authority Act* 1997 (QLD); and
New South Wales: Clause 6 of the NSW Rail Access Regime states that Part 4A of the *Independent Pricing and Regulatory Tribunal Act* (**IPART** Act).

will be published. Publication of determinations is importance for two reasons.

First, publication provides context to the negotiation of access agreements, and as such will facilitate the negotiation of access agreements; parties to negotiations will not waste time negotiating issues if the arbitrator has expressed a clear view on it.

Secondly, and consistent with the first point, publication allows ARTC and the Applicant to assess whether it is appropriate to proceed to arbitration; neither ARTC nor an Applicant will proceed to arbitration on issues that it is clear from previous arbitrations provide no chance of success. Overtime this will mean that fewer disputes proceed to arbitration.

It is noteworthy that if the intention of those drafting the access undertaking is that determinations of arbitrators should not be published and that they should remain confidential, this will provide ARTC with a distinct advantage in negotiation and any dispute resolution process. ARTC will be a party to all disputes. ARTC will be party to all arbitrations. ARTC will become the repository for determinations of arbitrators. This is inappropriate. FreightCorp and Toll consider that the arbitrator should be empowered by the arbitration provisions (to be developed) to determine that certain parts of its decision should not be published, but only where the information the subject of the sensitivity is truly confidential and proprietorial in nature.

In addition to borrowing from procedures for arbitration from state and territory regimes to develop arbitration procedures, it is also appropriate to have regard to those regimes in developing provisions for inclusion in the access undertaking defining the decisions that may be made and that the Applicant may elect not to be bound by an award.

It follows from what is suggested above that FreightCorp and Toll consider the arbitration process contained in the access undertaking is inappropriate and requires considerable amendment to make it an effective regime.

(The annotated copy of the access undertaking provides further, but limited, comments relating to the form of the dispute resolution process. The limited nature of those comments reflects the extent of the above comments.)

Questions raised by the ACCC

The ACCC asks a number of questions. Taking the questions in order FreightCorp and Toll answer and comment as follows:

a) "Are the dispute resolution processes reasonable, appropriate and adequate?"

   It follows from what is said above that FreightCorp and Toll do not consider the process to be reasonable, appropriate or adequate.

b) "Does the undertaking clearly describe the various stages of the process for resolving disputes?"

FreightCorp and Toll consider that the stages are clear, but as noted above, have reservations about compulsory mediation.

c) "Is there sufficient detail on the nature of the issues that may be subject to the dispute resolution process?"

There is no detail on the nature of issues that may be the subject of dispute resolution. It follows from what FreightCorp and Toll state in relation to clause 3.10(b) and Schedule C, that certain terms should be non-negotiable and, as such, not capable of being matters the subject of arbitration.

d) "Are the powers, functions and jurisdictions of the dispute resolution bodies appropriate and clearly defined?"

It follows from what FreightCorp and Toll say above, that they have fundamental reservations about any primary resolution body other than the ACCC.

e) "Are the enforcement mechanisms adequate and clearly defined?"

FreightCorp and Toll assume that this question relates to clause 3.11.4(b)(v) and, as such, answer "yes".

f) "Are the time frames at each stage of the process of an appropriate length?"

It follows from what FreightCorp and Toll say about compulsory negotiation that negotiation between CEOs should last a maximum of seven days after which either party may notify the other of the intention to proceed to arbitration.

g) "Does the overall approach provide an appropriate balance between the need for timeliness, on the one hand, and efficient and fair outcomes on the other?"

It follows from what is said above that FreightCorp and Toll do not consider that an appropriate balance is achieved.

3.4 Pricing Principles

Rather than answer the questions raised by the ACCC that FreightCorp and Toll have commissioned NECG to consider the Pricing Principles and that the following represents NECG's view.

Objectives

The objectives as set out in clause 1.2 (c) regarding the need for balance between the interests of ARTC, the general public, and access seekers, are supported.

Charge Differentiation and its Limits

Price differentiation within the limits allowed by the Trade Practices Act, as regards pricing which discriminates between competing access seekers, is necessary and desirable. While ARTC professes

not to price differentiate between end markets, the practical effect of decisions to permit differentiation based on non-cost factors (market value of the train path; opportunity cost to ARTC) is to permit implicit price differentiation based on ability to pay.

A potential concern with this discretion to price differentiate on the basis of demand characteristics of end markets is that it makes pricing outcomes more uncertain. In order to alleviate that uncertainty it would be desirable if ARTC were to articulate in the Undertaking how it intends to take account of demand factors in its price differentiation.

Revenue Limits

ARTC's general approach is to confirm that pricing sits between floor and ceiling revenue limits. The floor and ceiling revenue limits are established in a manner consistent with practice in other jurisdictions, most notably the NSW Rail Access Regime, and are consistent with economic tests to ensure that the track owner's market power is not being misused. The floor test should be the same as the NSW Rail Access Regime, ie, direct cost as the absolute floor and incremental cost as an objective. The flow test should be the same as the NSW Rail Access Regime, ie, direct cost as the absolute floor and incremental cost as an objective.

However, the vast distance between floor and ceiling makes these limits nearly useless as a means of creating price certainty for rail traffics, like interstate general freight, which face vigorous road competition. Some further source of certainty is required. Within the proposed Undertaking, the only other indication of future pricing is the ARTC commitment to increase prices by CPI – 2% or 2/3 of CPI, whichever is greater.

This CPI-linked price escalation formula is unlikely to achieve the desired balance between the interests of ARTC, the public generally, and Applicants. Applicants and the public generally are sensitive to the fact that general freight prices are not keeping pace with inflation, and that CPI-linked increases to input prices, such as the rail access price, will work against rail's viability as a transport mode for general freight.

Conversely, it would not be correct to assume that ARTC's commercial interests are necessarily prejudiced if its prices are unable to rise at 2/3 of CPI. According to its own projections, ARTC's traffic levels are expected to rise sufficiently to increase real returns despite decreasing real prices over the next 5 years.

In any case, it is a fact that ARTC's asset base is largely "gift-funded" by the Commonwealth. That is the case both historically and with respect to ongoing investments. Arguably the Commonwealth's intention is to donate assets to ARTC to improve rail's viability versus road, rather than to make commercial investments in a business which is earning less than 2% return on (DORC-valued) assets.

Given these interstate general freight industry characteristics, the fact that ARTC may have correctly applied the CAPM in deriving a

maximum permitted rate of return to apply to a DORC valuation of its assets is nearly irrelevant to the question of what is the likely effect of the proposed approach to access pricing on intra and intermodal competition.

The automatic CPI-linkage of nominal price increases is likely to hinder rail's ability to compete effectively with road and coastal shipping. This aspect of the Undertaking should be replaced with either a commitment to maintain constant nominal prices or, if an index must be used, that index should be related to interstate general road freight pricing.

Structure of Charges

The proposed two-part tariff structure is in common use for interstate general rail freight across Australia, and the underlying principle is relatively uncontroversial. The flagfall component is usually assumed to provide train operators with an incentive to run more efficient, longer trains.

An important question concerns the application of the two-part tariff: is the weight placed on the flagfall component adequate, or excessive? To some extent train operators already have incentives to operate longer trains as the crew cost per tonne of freight carried is reduced with longer trains. There are practical reasons for not wishing to make the incentive to run longer trains too strong. Operators sacrifice the flexibility to accommodate casual or variable freight movements when they are constrained to run long trains. This loss of flexibility may make it impractical to accommodate on rail some freight flows which would otherwise be winnable. Additionally, long trains impose additional terminal costs, as longer marshalling tracks and a greater degree of train splitting and rejoining is required to run long trains. Ultimately these terminal costs and terminal size constraints will determine maximum train lengths, irrespective of access price signals.

In the view of Toll and Freight Corp, the current weighting on the flagfall in ARTC's reference tariffs is too heavy. If that is not changed in the reference tariffs, then at least there should be an opportunity to negotiate a more flexible balance between flagfall and gtk price components.

Indicative Access Charge

ARTC's indicative access charges raise the following concerns:

- the future evolution of those price levels given the inappropriate reliance on CPI-linked price adjustment formulae,
- the excessive weighting given to the flagfall component of prices,
- and the lack of an indicative quality service standard to accompany them.

The first two points have already been discussed. Regarding the third, clause 4.6 sets out that indicative charges apply to a train meeting

certain specified maximum limits. However these touch only peripherally on the key question of service quality. Key quality indicators, such as sectional running times and a maximum level of temporary speed restrictions, are notably absent from the Undertaking.

The concerning point about the absence of a standard service quality specification is that price-regulated firms have a strong incentive to maximise profitability by sacrificing service quality when quality standards are not clearly established and monitored.

Limits on Charge Differentiations

In order for any most favoured nation provision to work[40], each Applicant and Operator must be able to determine the Charges of existing Operators. This necessitates the publication of Charges. FreightCorp and Toll consider that all access agreements should be published, subject to ensuring that truly confidential and proprietorial information in not published.

(The annotated copy of the access undertaking provides further comments on clause 4.)

[40] Clause 4.3(b) of the access undertaking

3.5 Management of Capacity

Comments of FreightCorp and Toll

In relation to clause 5.2 (blind auction process), FreightCorp and Toll repeat their earlier comments.

(The annotated copy of the access undertaking provides further comments on clause 5.2.)

Auctioning will be required increasingly as capacity is constrained. Given that one of ARTC's stated objectives is to stimulate growth in the rail industry, this auction process gives raise to a certain tension.

In relation to clause 5.3, FreightCorp and Toll suggest that ARTC be required for present purposes to explain the economic basis for the use-or-lose provisions suggested in clause 5.3(a). Use-or-lose provisions should relate to the economic benefit that ARTC forgoes by virtue of the non-utilisation or under utilisation of contracted entitlements. If the flagfall covers fixed costs of ARTC and continues to be payable where there is non or under utilisation, there is no economic basis for the use-or-lose provisions unless ARTC can demonstrate that there is an Applicant ready and waiting to pay more for the non or under utilised entitlement.

Questions raised by the ACCC

The ACCC asks a number of questions. FreightCorp and Toll answer the questions in order as follows:

a) "Does the undertaking provide sufficient detail on how ARTC proposes to assess capacity?"

   The access undertaking provides no detail on how ARTC proposes to assess capacity. FreightCorp and Toll consider that the basis upon which the analysis is undertaken should be public.

b) "Can operators be satisfied that the approach taken by ARTC to assess capacity is appropriate?"

   It follows from the answer to the first question, that neither Applicants nor Operators can be satisfied as to the appropriateness of the assessment.

c) "Is there sufficient transparency about the process that ARTC will use to assign access rights in the case of applications for mutually exclusive rights?"

   No, but FreightCorp and Toll have suggested elsewhere an appropriate point of reference in the QCA Draft Decision.

d) "Is the proposed method of granting access on the basis of the "highest present value of future returns" appropriate?"

Given what is said above, by reference to the findings of the QCA[41] it is the FreightCorp and Toll view that the basis upon which the value is determined must be stated.

e) "Are sufficient details provided about the circumstances in which ARTC will withdraw access rights?"

As the access undertaking stands it does not contain sufficient detail. If the comments made by FreightCorp and Toll in relation to Schedules C and D are accepted the access undertaking will contain enough detail, and clause 5.3 will have to be amended.

3.6 Network Connections and Additions to Capacity

Comments of FreightCorp and Toll

The annotated copy of the access undertaking provides [further] comments on clause 6 of the access undertaking.

Questions raised by the ACCC

The ACCC asks:

> "Is there sufficient detail provided on how ARTC proposes to determine the need for additional capacity to meet an operator's needs as opposed to new investment to meet ARTC's own overall requirements?"

FreightCorp and Toll consider that considerable clarification is required in respect of:

1) additional capacity, and the basis for payment/recovery of its cost; and

2) dealing with constrained capacity through any auction process.

As things stand, ARTC has the ability to achieve prices higher than the ceiling through the auction process and to require Applicants to pay for additional capacity that may or may not be used by other operators.

Further, the ACCC asks:

> "Is the undertaking clear on whether the access pricing principles that apply in respect of additional capacity will be the same as existing facilities?"

It follows from the answer to the first question that FreightCorp and Toll do not consider that the undertaking is clear.

3.7 Network Transit Management

FreightCorp and Toll consider that it is appropriate for the Network Management Principles to be considered in an industry forum. The annotated copy of the access undertaking sets out the matters that the

[41] QCA Draft Decision, Volume 2, pp.282-286

Principles should cover. FreightCorp and Toll, in their comments on Schedule F, provide suggestions as to the starting for consideration of these issues in an industry forum.

The ACCC asks:

> "Are the Network Management Principles clearly stipulated and likely to be well understood by operators?"

As noted in the comments on Schedule F below, FreightCorp and Toll consider that it is appropriate for the Network Management Principles to be reconsidered, and developed, in an industry forum.

Further the ACCC asks:

> "Are they generally conducive to efficient management of traffic movements?"

It follows from the answer to the first question that FreightCorp and Toll consider that this issue should be considered in an industry forum.

3.8 Definitions and Interpretation

The annotated copy of the access undertaking provides comments on clause 8 of the access undertaking.

Schedule A to the access undertaking

No comment.

Schedule B to the access undertaking

Other than as noted in the body of the submission, FreightCorp and Toll have no comment.

Schedule C to the access undertaking

As noted above, the access undertaking provides that:

> "The Access Agreement must, unless otherwise agreed between ARTC and the Applicant, be consistent with the principles outlined in the Indicative Access Agreement and must address at least the matters set out in Schedule C. The details of Schedule C do not provide an exhaustive list of the issues that may be included in an Access Agreement."[42]

Two related things are worth noting from this. First, Schedule C is intended as a list of matters that must be addressed in an access agreement. Secondly, Schedule C is not intended to limit matters that may be addressed in an access agreement.

If Schedule C is to be used as a checklist of matters that must be addressed, it needs to be clear and to be complete. Neither FreightCorp nor Toll consider that it is either clear or complete as it stands. (The annotated copy of the access undertaking provides comments on Schedule C as it stands.)

FreightCorp and Toll consider that the following should be considered as the basis for Schedule C. Note that each suggestion provision is characterised as one of the following:

Base Case Provision which characterisation connotes a provision that must be included in each access agreement, unless the Applicant of its own volition informs, in writing, ARTC that it does not want the provision to be included. Effectively, these are non-negotiable terms;

Restricted Provision which characterisation connotes a provision that ARTC must not seek to include in the access agreement or any draft of it, but which the Applicant of its own volition informs, in writing, ARTC that is wants to be included; or

ARTC Base Case Provision which characterisation connotes a provision that ARTC may seek to include in each access agreement.

1. Each access agreement should provide for non-exclusive access to and use of the Network and any Associated Facilities for the purpose of running train services. [**Base Case Provision**]

   Commentary: The Indicative Access Agreement appears to contemplate this; see clause 2.2 of the Agreement but note the comment in the annotated copy of the Indicative Access Agreement.

2. The entitlement to train services must be stated clearly. [**Base Case Provision**]

[42] Clause 3.10(b) of the access undertaking

Commentary: The Indicative Access Agreement contemplates this, though the amount of flexibility sought by ARTC means that a train service entitlement could not be characterised as "firm".

3. The entitlement to train services must not be capable of variation without the agreement of the parties. This will require a clear statement of a firm obligation to provide access to and use of the Network and Associated Facilities to enable the Operator to use its train service entitlements. The circumstances in which ARTC is relieved from this primary obligation must be clearly stated, and limited to force majeure events. [**Base Case Provision**]. (Variation to contractual train service entitlements, should be distinguished from variations to train service entitlements on a day to day basis pursuant to scheduling principles, train control principles and planned maintenance program, together with the network management principles.) ARTC must not seek to agree on any provision that relieves it from this primary obligation. [**Restricted Provision**]

   Each access agreements must state that ARTC will apply the Scheduling Principles to schedule train service entitlements. [**Base Case Provision**] ARTC must not seek to schedule otherwise. [**Restricted Provision**]

   Commentary: The Indicative Access Agreement is inconsistent with the terms of this paragraph 3.

4. Each access agreement must contain a clear statement of the condition of the Network and the Associated Facilities that are necessary to enable ARTC to fulfil its obligation to make the Network and those Facilities available to the Operator such that it may use its train service entitlements. [**Base Case Provision**] ARTC must not seek to agree an access agreement that provides for any lesser condition. [**Restricted Provision**]

   Commentary: The Indicative Access is inconsistent with the terms of this paragraph 3.

5. ARTC may seek to include a provision providing that if a train service entitlement is not utilised or is under utilised:

   (a) for a specified period of time or on more than a specified number of occasions within a specified period of time;

   (b) ARTC demonstrates that all the train service entitlements not so used or so under utilised are needed to allow another operator to run train services; and

   (c) ARTC demonstrates that within [#] days after the resumption of those train service entitlements, another operator, on no less favourable terms to ARTC, will commence operation of train services on a sustainable basis,

ARTC may require the Operator to demonstrate that it has a continued need for the train service entitlements that are not being used or are being under-utilised. If the Operator demonstrates a continued need, the train service entitlements the subject of the notice may not be resumed. If the Operator does not demonstrate a continued need, the train service entitlements the subject of the notice may be resumed if within [#] days another operator is to commence the operation of train services. Any dispute between the parties will be determined by reference to the ACCC. [**ARTC Base Case Provision**] The determination to be made on an expedited basis. ARTC must not seek a resumption right that provides for any lower threshold than that stated in this paragraph 5. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

Each access agreement must include provisions that allow the Operator to relinquish train service entitlements permanently on reasonable notice. [**Base Case Provision**]

Commentary: The Indicative Access Agreement provides a relinquishment regime but the notice periods are over long. The annotated copy of the Indicative Access Agreement provides more detail on this.

6. If the charges agreed between the parties contain a flagfall component (see paragraph 7 below), ARTC may seek to agree that the flagfall component will be payable by the Operator if the Operator does not use or under utilises train service entitlements. [**ARTC Base Case Provision**]. ARTC must not seek to agree provisions requiring the Operator to pay any flagfall component in any other circumstances. These other circumstances would include where the Operator does not use or under utilises its train service entitlements because they are not available in accordance with the access agreement including by reason of force majeure events (see 30 below). [**Restricted Provision**]

Commentary: The Indicative Access Agreement does not in clear terms deal with this issue in this way.

7. Charges agreed between the parties must be stated clearly. [**Base Case Provision**]

Commentary: The Indicative Access Agreement anticipates this.

If charges (including any overload charges) are payable by reference to mass, the access agreement must contain provisions addressing how mass is to be determined, and, in the case of overload charges, when those charges are payable. As with other charges, overload charges must be referrable to a cost or expense of ARTC. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

8. Each access agreement must provide for the periodic review of access charges. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

9. All amounts payable under access agreements are exclusive of GST. [**Base Case Provision**]

Commentary: The Indicative Access Agreement appears to anticipate this.

10. Parties may dispute, in good faith, amounts payable, and will not be in breach of the access agreement. [**Base Case Provision**]

Commentary: The Indicative Access Agreement does not provide for this as a contractual right.

11. If a party does not make payment of any amount due and owing under an access agreement, the other party may require that party to pay interest at a default rate that must not exceed a specfied overdraft rate plus 2%. [**Base Case Provision**]

Commentary: The Indicative Access Agreement anticipates this.

12. ARTC is responsible for train control and for giving train control directions in accordance with Train Control Principles. [**Base Case Provision**] In giving train control directions, ARTC may vary train service entitlements in accordance Train Control Principles. [**Base Case Provision**] ARTC must not seek to agree that train control directions may be given or that train service entitlements may be varied in any circumstances other than as provided for in the Train Control Principles. [**Restricted Provision**]

Commentary: The Indicative Access Agreement does not anticipate that train control must take place in accordance with Train Control Principles as such. (The Indicative Access Agreement anticipates that ARTC must comply with the Network Management Principles, but as noted elsewhere in the submission there may be sense in revisiting those Principles. In addition, there is no clear connection between the Principles and train control).

13. The Operator must comply with train control directions given by ARTC. [**Base Case Provision**]

Commentary: The Indicative Access Agreement appears to anticipate this.

14. In addition to other obligations referred to elsewhere, ARTC may seek to impose on the Operator obligations:

(a) to comply with all laws applicable to the running of trains;

(b) to comply with any Rollingstock Interface Standards, Safety Standards developed in accordance with paragraph 15 below;

(c) to comply with any environmental management plan developed in accordance with paragraph 23 below; and

(d) to comply with any safety risk management plan developed in accordance with paragraph 24 below.

[**Base Case Provision**]

ARTC must not seek to impose any other obligations on the Operator. [**Restricted Provision**]

Commentary: The Indicative Access Agreement includes some but not all of these obligations and includes others, and on this basis is inconsistent with this paragraph 14.

15. ARTC may seek to agree standards with which the Operator must comply. These standards may relate to the track-wheel interface (**Rollingstock Interface Standards**) and to safety (**Safety Standards**). Each such standard must be referable to a duty or obligation of the Operator under a law applicable to the Operator and must be reasonable and proportionate. [**ARTC Base Case Provision**] ARTC must not seek to agree standards otherwise. [**Restricted Provision**] If the Operator and ARTC do not agree on the Standards either of them may refer the matter to an expert for determination under the Dispute Resolution Regime.

Rollingstock Interface and Safety Standards may be varied:

(a) by the agreement of both parties; or

(b) by ARTC on safety grounds (safety grounds to relate to new requirements imposed by law).

If ARTC varies Standards on safety grounds, the costs incurred or increased costs incurred by the parties (to comply with the varied Standards), will be borne by them as agreed by them or, if they do not agree, by an expert. [**Base Case Provision**]

ARTC must not seek to agree to variation otherwise. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

16. ARTC may seek to agree a provision allowing it to inspect the rollingstock of the Operator if:

(a) it has a reasonable apprehension that the Operator is not complying with a Rollingstock Interface or Safety Standard;

(b) that non-compliance is putting at risk the safety of any person or property;

(c) ARTC has given the Operator notice specifying the apprehended non-compliance and the risk to safety and the remedial action that must be undertaken within a specified time frame; and

(d) the Operator does not acknowledge and confirm that it will comply with the notice or the Operator does not accept that there is non-compliance within three days of receipt of the notice.

The right to inspect is separate from any right of suspension. [**ARTC Base Case Provision**]

ARTC must not seek a right of inspection otherwise. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

17. In addition to obligations referred to elsewhere, ARTC must:

(a) comply with all laws applicable to ownership and operation of the Network and the Associated Facilities;

(b) comply with Network Management Principles;

(c) comply with its Safety Standards; and

(d) comply with an environmental management plan.

[**Base Case Provision**]

ARTC must not seek to agree on different, fewer or lesser obligations. [**Restricted Provision**]

Commentary: The Indicative Access Agreement anticipates some but not all of these obligations, and includes other obligations.

18. ARTC is responsible for the maintenance of the Network and the Associated Facilities to no lesser standard than that required to enable it to maintain the condition referred to at paragraph 4 above. [**Base Case Provision**]

ARTC must not seek to agree to maintain the Network and the Associated Facilities to any lesser standard. [**Restricted Provision**]

Commentary: The Indicative Access Agreement may result in maintenance to this standard but only if that standard exists at the date of the access agreement or ARTC agrees. On this basis the Indicative Access Agreement is inconsistent with this paragraph 18.

19. Each access agreement must provide for ARTC to consult with the Operator in accordance with the Planned Maintenance Program. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this; this is because the Planned Maintenance Program is a new concept.

20. ARTC is responsible for maintenance of the Network and the Associated Facilities in accordance with the Planned Maintenance Program. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this; this is because the Planned Maintenance Program is a new concept.

21. ARTC is responsible for incident management. On the occurrence of an incident ARTC must manage the incident in such a way that the Network and Associated Facilities are cleared such that disruption to train services is minimised. [**Base Case Provision**] ARTC may develop emergency procedures that are to be followed on the occurrence of incidents. [**ARTC Base Case**]

Commentary: The Indicative Access Agreement is inconsistent with this.

22. For the purposes of:

(a) Planned Maintenance, and in accordance with the Planned Maintenance Program;

(b) Unplanned Maintenance [to be defined]; and

(c) ensuring safety to persons and property, in the context of an incident or otherwise,

ARTC may impose operational constraints (which must be reasonable and proportionate) on access to and use of the Network and the Associated Facilities. In imposing operational constraints ARTC must seek to minimise disruption to train services. [**Base Case Provision**] ARTC must not impose operational constraints otherwise. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

23. ARTC may require the Operator to develop an environmental management plan to address environmental risks that arise by reason of the operation by the Operator of train services on the Network.

[**ARTC Base Case Provision**] If ARTC requires the Operator to develop an environmental development plan, the Operator must do so. The development of a plan may be a condition precedent to the operation of train services. [**Base Case Provision**]

Commentary: The Indicative Access Agreement anticipates this.

24. ARTC may require the Operator to develop a safety risk management plan to address the risks to people and to property that arise by reason of the operation by the Operator of train services on the Network. [**ARTC Base Case Provision**] If ARTC requires the Operator to develop a safety risk management plan, the Operator must do so. The development of a plan may be a condition precedent to the operation of train services. [**Base Case Provision**]

Commentary: The Indicative Access Agreement does not anticipate this.

25. Each access agreement must contain a limitation of liability provision in favour of the Operator. The limitation of liability provision must provide that to the extent permitted by law, the Operator is not liable for breach of contract or under the tort of negligence in respect of any damage or loss suffered or incurred by ARTC that may be characterised as:

(a) an economic or a financial loss; or

(b) a loss arising by reason of liability of ARTC to any third person, other than for death or personal injury.

[**Base Case Provision**]

Subject to what is stated in paragraph 26, ARTC may seek a limitation of liability clause in similar terms. [**ARTC Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

(a) Each access agreement must impose an obligation on ARTC to effect and to maintain

(b) in respect of liability to the public.

Commentary: The Indicative Access Agreement anticipates this.

ARTC may seek to impose an obligation on the Operator to effect and to maintain public liability insurance in an amount not exceeding a reasonable amount. [**ARTC Base Case Provision**] ARTC must not seek to impose an obligation on the Operator to effect or maintain insurance otherwise. [**Restricted Provision**]

Commentary: The Indicative Access Agreement anticipates public liability insurance, but also insurance for claims under the indemnity, and as such is inconsistent with this.

26. ARTC may seek to include in access agreements reciprocal indemnities under which each party will indemnify the other for:

(a) damage to, destruction of or loss of property of the other party caused by the negligence of that party; and

(b) liability of the other party to any third person that is caused by the negligence of that party.

[**ARTC Base Case Provision**]

ARTC must not seek to include any indemnity otherwise. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this providing a "no fault" indemnity.

27. Each access agreement must provide that the Operator is entitled to receive liquidated amounts in accordance with the KPI Regime. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this; there is no contractual consequence of compliance with the KPI Regime.

28. Each access agreement must provide that disputes are to be resolved in accordance with the Dispute Resolution Regime. [**Base Case Provision**]

Each access agreement must contain a Dispute Resolution Regime as follows:

a) disputes relating to pricing (including on any review by the parties following the 12 month review or by virtue of the application of the "most favoured nation" clause) must be referred to the ACCC;

b) disputes relating to compliance with terms of the access agreement must be referred to arbitration; and

c) disputes relating to provisions that anticipate that the parties will seek to agree on an issue must be referred to expert determination.

[**Base Case Provision**]

The access agreement may anticipate referral of disputes to CEOs and to mediation on agreement of the parties at the time, but not on a compulsory basis. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this, though it is noted that helpfully the Agreement anticipates

a role for the ACCC as arbitrator. FreightCorp and Toll are very positive about this.

29. ARTC may seek to include force majeure provisions that excuse non performance of obligations that result from:

(a) events or circumstances beyond the control of the party with the obligation; and

(b) which events or circumstances could not have been avoided by the taking of any action that it would be reasonable to expect that party to take to guard against those events or circumstances.

Commentary: The Indicative Access Agreement is inconsistent with this.

30. Each access agreement must include suspension and termination provisions consistent with the following principles:

Suspension

Each access agreement must provide for suspension in the following circumstances only:

a) the Operator does not pay when due any amount payable under the access agreement and the default continues for seven days after notice from ARTC to the Operator of the default and no security is given;

b) the Operator does not comply with obligations described in the paragraph 16 above and that default has caused or is likely to cause risk to the safety of any person or material risk to property;

c) the Operator ceases to be Solvent;

d) the Operator's accreditation is suspended, cancelled or amended so that it cannot lawfully perform its obligations under the access agreement; or

e) the Operator does not effect or maintain the insurances required under the access agreement and the default continues for seven days after notice from ARTC to the Operator of the default.

[**Base Case Provision**].

ARTC must not seek any right of suspension otherwise. [**Restricted Provision**]

Termination

Termination by ARTC

Each access agreement must provide for termination in the following circumstances only:

a) the Operator does not pay when due any amount payable under the access agreement and the default continues for thirty days after notice from ARTC to the Operator of the default and no security is given;

b) the Operator ceases to be solvent;

c) the Operator's accreditation is suspended, cancelled or amended so that it cannot lawfully perform its obligations under the access agreement, and the default continues for thirty days after notice from ARTC to the Operator of the default; or

d) the Operator does not effect or maintain the insurances required under the access agreement and the default continues for thirty days after notice from ARTC to the Operator of the default.

[**Base Case Provision**]

ARTC must not seek any right of termination otherwise. [**Restricted Provision**]

Termination by the Operator

Each access agreement must provide the Operator with a right of termination as follows:

a) ARTC ceases to be Solvent;

b) ARTC's accreditation is cancelled such that it cannot perform lawfully its obligations under the access agreement, and such default continues for thirty days after notice from the Operator to ARTC of the default;

c) ARTC does not effect or maintain the insurances required under the access agreement and such default continues for thirty days after notice from the Operator to ARTC of the default; or

d) ARTC fails to pay when due any amount payable under the access agreement and such default continues for thirty days after notice from the Operator to ARTC of the default.

[**Base Case Provision**]

Each access agreement must state that no right of termination will arise other than as provided for in the access agreement. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

31. Each access agreement must include provisions requiring each party to keep confidential and not to disclose or to use confidential information other than as permitted under the access agreement.

Commentary: The Indicative Access Agreement anticipates this.

32. Each access agreement must include provisions that allow the Operator to transfer train service entitlements. The transfer provisions must allow the Operator to deal with all its train service entitlements temporarily or permanently. If the Operator deals with another operator (ie an operator with an access agreement with ARTC) it may do so without the permission of ARTC. If the Operator wants to deal with an operator that does not have an access agreement with ARTC it must obtain ARTC's prior consent. If the Operator deals with train service entitlements it remains responsible for the payment obligations in respect of those entitlements, but not otherwise. [**Base Case Provision**]. ARTC must not seek to include transfer provisions on any other basis. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

33. Each access agreement must include assignment provisions that are the same for both ARTC and the Operator.

Each access agreement will allow assignment of the benefit of rights and the transfer of obligations with the consent of the other party, such consent not to be withheld unreasonably.

Each access agreement will describe objective criteria which if satisfied will require consent to be given and those criteria are:

a) the assignee/transferee has an acceptable credit rating (ie, the same or better than the assignor/transferor); and

b) the assignee/transferee holds all accreditations and licences required by law to enable it lawfully to perform obligations under the access agreement.

Each access agreement must allow assignment of the benefit of rights by way of security to financiers.

[**Base Case Provision**]

ARTC must not seek to include assignment provisions otherwise. [**Restricted Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

34. Each access agreement must contain a provision that allows either party to initiate review of the agreement by the parties (to determine whether the agreement needs to be varied, and, if so, how) if the ARTC access undertaking is varied. If the parties do not agree on whether or not the agreement needs to be varied or how it needs to be varied, either party may refer the matter to an expert. [**Base Case Provision**]

Commentary: The Indicative Access Agreement does not contain such a provision, this is because the access undertaking as suggested by ARTC does not anticipate a review.

35. Each access agreement must contain a "most favoured nation" provision that allows the Operator to initiate a review of the agreement by the parties if the Operator has a reasonable apprehension (the basis of a reasonable apprehension will be demonstrated easily if access agreements are public) that another operator is afforded more favourable terms than the Operator. [**Base Case Provision**]

Commentary: The Indicative Access Agreement is inconsistent with this.

Schedule D to the access undertaking

Comments of FreightCorp and Toll

As noted above, the access undertaking provides that:

> "The Access Agreement must, unless otherwise agreed between ARTC and the Applicant, be consistent with the principles outlined in the Indicative Access Agreement … ."[43]

Also as noted above, two key issues arise from this.

First, should access agreements have to be consistent with the principles or not inconsistent with the principles outlined in the Indicative Access Agreement?

Secondly, if access agreements must be consistent or not inconsistent with the Indicative Access Agreement, the Indicative Access Agreement should provide reasonable terms for both Operators and ARTC.

If these issues are dealt with effectively, negotiation of access agreements will be facilitated and limit the scope for disputes between Applicants and ARTC. If these issues are not dealt with effectively, Applicants will face an uphill struggle to achieve reasonable terms through negotiation with ARTC, and will face an uncertain outcome if they seek to achieve reasonable terms through arbitration.

FreightCorp and Toll consider that the Indicative Access Agreement does not provide reasonable terms for Operators. This is of concern to both FreightCorp and Toll.

In many ways the comments made in respect of Schedule C indicate what FreightCorp and Toll consider represent reasonable terms. The annotated copy of the Indicative Access Agreement provides detailed comments as to why the Indicative Access Agreement does not represent reasonable terms, by reference to Schedule C. The annotated copy of the Indicative Access Agreement is set out in Annexure 2.

Questions raised by ACCC

The ACCC asks:

> "Are the terms and conditions of the Indicative Track Access Agreement appropriate and consistent with the access undertaking?"

It follows from Schedule C and the annotated copy of the Indicative Access Agreement that FreightCorp and Toll do not consider that taken as a whole that the terms and conditions of the Agreement are appropriate.

[43] Clause 3.10(b) of the access undertaking

Further the ACCC asks:

> "Is it appropriate for the Indicative Track Access Agreement to be part of the undertaking?"

FreightCorp and Toll consider that unless the Indicative Track Access Agreement provides reasonable terms (ie, not inconsistent with Schedule C), that given clause 3.10(b) of the access undertaking the Indicative Track Access Agreement should not form part of the access undertaking.

Schedule E to the access undertaking

FreightCorp and Toll consider that it is appropriate for ARTC to include line diagrams of the Network for the purposes of the access undertaking.

Schedule F to the access undertaking

The Network Management Principles were first developed for the early access agreements entered into by the Australian National Railways Commission. Following the introduction of Part IIIA of the TPA and greater use of the Network by various operators, it is now appropriate for the existing Network Management Principles to be reviewed to determine whether they are still appropriate.

FreightCorp and Toll consider that fuller Network Management Principles should be developed. The Principles will be constituted by:

- Scheduling Principles;
- Train Control Principles; and
- A Planned Maintenance Program.

The Network Management Principles should be developed in an industry forum overseen by the ACCC. An industry forum will allow input from all stakeholders and as such allow for the development of more effective Principles. FreightCorp and Toll consider that an appropriate point of reference for the development of Scheduling Principles and the Train Control Principles is the QCA's Draft Decision on QR's Draft Undertaking.

In respect of the Planned Maintenance Program, FreightCorp and Toll set out below what they consider to be a workable regime to allow ARTC to develop Planned Maintenance Programs.

Draft Planned Network Maintenance Principles

1. GENERAL

1.1 Introduction

a) ARTC is required to maintain the Infrastructure in order to comply with its duties and obligations pursuant to [the ARTC Access Undertaking][Access Agreements][and][Laws].

b) The purpose of these Principles is to ensure that ARTC maintains the Infrastructure in a way that:

i) minimises disruption to Train Services but maintains the integrity of the Infrastructure such that on an ongoing basis from Planned Maintenance Period to Planned Maintenance Period disruption is minimised;

ii) is consistent with the basis upon which ARTC is permitted to charge for access to and use of the Infrastructure;

iii) ensures that to the extent practicable, Planned Maintenance takes place at the same time as planned maintenance of Rollingstock and Private Facilities; and

iv) ensures that Operators are able to access and to use the Infrastructure in accordance with the contractual obligations of ARTC under its Access Agreements.

(**Planning Objectives**)

c) In consultation with each Operator, in respect of each Planned Maintenance Period, ARTC will establish a Planned Maintenance Program. Throughout each Planned Maintenance Period the Planned Maintenance Program may be amended in accordance with these Principles.

d) In undertaking maintenance in accordance with a Planned Maintenance Program or any amendment to it made in accordance with these Principles, ARTC's obligation to allow access to and use of the Infrastructure will be relieved, and the Performance Regime will not apply in respect of access and use that is not allowed by as a result of Planned Maintenance.

[It should be noted that this assumes that a Performance Regime will be formulated at an industry level]

2. DEFINITIONS

In these Principles:

Access Agreement means an agreement between ARTC and a Operator pursuant to which ARTC allows the Operator to access and to use Infrastructure.

Infrastructure means [include Network details].

Maintenance means [To be developed].

Operator means a person that is entitled to access and to use the Infrastructure pursuant to an Access Agreement.

Performance Regime means the performance regime incorporated by reference into each Access Agreement.

Planned Maintenance means Maintenance that is described in a Planned Maintenance Program.

Planned Maintenance Program means any program, as amended in accordance with Section 6.2 of these Maintenance Principles, for the maintenance of the whole or any part of the Infrastructure.

Planned Maintenance Period means the months of [January to December, inclusive in any year].

Private Facilities includes any infrastructure or real property including any mine, power station, [others?], storage facility, siding, loading or unloading facility and any other facilities of any kind owned, operated or used by any Operator or any end user of Train Services or supplier of goods or services to that end user which do not form part of the Infrastructure.

Train Services means the running of a train between specified origins and destinations by a Operator pursuant to an Access Agreement.

3. [STANDARD OF MAINTENANCE]

[Whilst arguably this is covered by the Planning Objectives it may be that ARTC or Operators want to include specific statements on this issue, this would tie back to the Performance Regime.]

4. ANNUAL PLANNING PROCESS

4.1 First draft Planned Maintenance Program

Not less than [six] months prior to the commencement of each Planned Maintenance Period, ARTC must provide to each Operator [with which it has an Access Agreement for that Period] the first draft of the Planned Maintenance Program for that Period. The first draft of the Planned Maintenance Program must contain the substance that must be contained in the Planned Maintenance Program.

4.2 Each Operator to make a submission

Within one month after publication of the first draft of the Planned Maintenance Program each Operator must make a submission to ARTC in respect of the first draft.

If the Operator has no comments on or agrees with the first draft, it must make a submission to ARTC to that effect.

If the Operator has comments on or does not agree with the first draft it must make a submission to ARTC to that effect. In making a submission, the Operator must explain the basis for its comments or its disagreement. In explaining the basis for comments and disagreement the Operator must seek to do so by reference to the Planning Objectives, the requirements of end users for Train Services and planned maintenance of Rollingstock and Private Facilities.

5. FINALISING PLANNED MAINTENANCE PROGRAMS

5.1 Second draft of the Planned Maintenance Program

Not less than [four] months prior to the commencement of each Planned Maintenance Period, ARTC must publish the second draft of the Planned Maintenance Program in respect of that Period. In preparing the second draft of the Planned Maintenance Program, ARTC must take into account the submissions received from Operators. ARTC must provide to each Operator a copy of the second draft of the Planned Maintenance Program. The second draft of the Planned Maintenance Program must contain the substance that must be contained in the Planned Maintenance Program.

5.2 Annual Planning Meeting

ARTC must convene a meeting to which all Operators are invited (**Annual Planning Meeting**). The meeting is to take place in [Adelaide] [Melbourne] not less than [three months] prior to the commencement of the Planned Maintenance Period. In addition to the Operators, the ACCC will be invited to attend.

5.3 Consultation with Operators

At the Annual Planning Meeting, the second draft of the Planned Maintenance Program will be considered by the Meeting. The Meeting will be chaired by ARTC. By reference to the Planning Objectives, ARTC must seek feedback from Operators as to how the Program might be improved, and must seek to determine whether it might be so improved. ARTC must seek to accommodate the requests of Operators and to resolve any differences of opinion that exist. Whilst ARTC must seek to accommodate the requests of Operators and must seek to resolve any differences of opinion, it is ARTC that must settle the Planned Maintenance Program. As with the first and second drafts of the Planned Maintenance Program, in settling the Planned Maintenance Program, ARTC must do so by reference to the Planning Objectives.

5.4 Confidentiality

[It may be that some participants might want to ensure that confidentiality of information provided in their submissions should be kept confidential; particularly relating to ends users. Given that these Planned Network Maintenance Principles are to be incorporated by reference into Access Agreements, the confidentiality of the submissions could be dealt with under those Agreements or in these Principles.]

5.5 Publication of the Planned Maintenance Program

Not later than [December 1] [one month] prior to the commencement of the Planned Maintenance Period, ARTC must publish the Planned Maintenance Program to apply for that Period.

5.6 Substance of the Planned Maintenance Program

Each Planned Maintenance Program must:

a) identify those parts of the Infrastructure that will be affected by Planned Maintenance;

b) in respect of each part of the Infrastructure so identified the Program must identify:

   i) the date on which Planned Maintenance will commence and the period of Planned Maintenance or an indicative estimate of the likely period of Planned Maintenance;

   ii) the nature and the estimated cost of the Planned Maintenance; and

   iii) the extent to which access to and use of the Infrastructure will be possible during the period of Planned Maintenance.

6. MAINTENANCE IN PRACTICE

6.1 Maintenance of Infrastructure in accordance with the Planned Maintenance Program

In carrying out Planned Maintenance, ARTC must adhere to the Planned Maintenance Program to the extent practicable.

[If ARTC conducts Maintenance in a manner other than provided for in the Planned Maintenance Program that Maintenance will not be Planned Maintenance and as such will be subject to the Performance Regime.]

6.2 ARTC may amend the Planned Maintenance Program

ARTC may amend the Planned Maintenance Program by providing for additional Maintenance or by varying the date on which the Planned Maintenance will commence. If ARTC wants to amend the Planned Maintenance Program it must give Operators that may be affected by the amendment not less than:

a) sixty days' notice prior to the date on which the additional Maintenance is to commence; or

b) in the case of Planned Maintenance that is to be deferred until a later date, as soon as possible after ARTC decides to defer but in any event not less than thirty days' notice prior to the date on which the Planned Maintenance was to have commenced;

c) in the case of Planned Maintenance that is to be commenced earlier than the date provided for in the Planned Maintenance, not less than thirty days' notice prior to the date on which the Planned Maintenance is to commence.

ARTC may not vary the Planned Maintenance Program other than in accordance with the above procedure.

6.3 Rights and remedies unaffected

Other than as expressly provided in these Principles, nothing in these Principles is intended to affect any right or remedy that any Operator may have against ARTC in respect of any duty or obligation imposed on ARTC under statute, [the ARTC Access Undertaking] otherwise at common law or in equity or under that Operator's Access Agreements.

Schedule G to the access undertaking

No comment

4 Assessment process for ARTC Undertaking

FreightCorp and Toll consider that it would be most helpful for a series of industry sessions to be held (to discuss matters raised in this submission) before the ACCC publises its Final Decision.

Annexure 1 - NECG - Submission on ARTC Access Undertaking: Asset Valuation and Revenue Limits

SUBMISSION on ARTC UNDERTAKING:

REVENUE LIMITS, ASSET VALUATION, and SERVICE QUALITY

Network Economics Consulting Group

12 June 2001

SUMMARY

This note comments upon pricing implications of the asset valuation methodology employed by ARTC in its Draft Access Undertaking, submitted to the ACCC under section 44ZZA of the Trade Practices Act. This work was commissioned by Toll Rail and Freight Rail Corporation and should be read alongside their submission on the matters raised in the ACCC's Issues Paper.

BACKGROUND

The objectives cited in the preamble to ARTC's Undertaking include, at 1.2 (c), the intent to "reach an appropriate balance between the legitimate business interest of ARTC, the interest of the public, and the interests of Applicants wanting Access to the network." There is a fairly obvious tension between ARTC's interest in obtaining a target rate of return on network investments (clause 1.2 (c) (i) (B)) and promoting other relevant social objectives, such as an increase of freight traffic from road to rail (clause 1.2 (c) (ii) (C)).

ARTC's Draft Undertaking proposed, among other things, that access prices be determined by the ARTC within floor and ceiling limits which are estimated on a track section basis. Indicative Access Charges, available to any access seeker, are to be posted and have been included in the Undertaking.

The asset valuation used to calculate ceiling revenues is based on a Depreciated Optimised Replacement Cost (DORC) methodology. ARTC has attached a report from Booz Allen and Hamilton containing a DORC estimate for the ARTC network of $1.407b. This valuation represents a 44% writedown for depreciation on an Optimised Replacement Cost (ORC) value of $2.515b. The ORC value equates to $568,000 per route kilometre of track on average.

In ARTC's published accounts for the year ended June 1999 plant and equipment, of which rail infrastructure is the dominant asset, was valued at $118.411m. In ARTC's June 2000 accounts the same balance sheet item was revalued upward to $193.338m. This revaluation was the result of an accounting exercise conducted for ARTC by Equity & Advisory Pty Ltd. Their methodology was to discount expected future net cashflows by the WACC (presumably the same WACC as submitted in the Draft Undertaking) to arrive at a commercial valuation of the asset base.

A copy of the report by Equity & Advisory Pty Ltd is not readily available from ARTC's web site, and it has not been sighted.

ISSUES of CONCERN

Undertaking will lead to substantial increase in ARTC profitability

It seems likely that ARTC's proposed pricing, when viewed in the context of their own traffic growth expectations, and the price indexation clauses of the Undertaking, will lead to a substantial increase in ARTC's profitability over the term of the Undertaking.

Tables 1 and 2 below contain NECG's analysis of the returns that ARTC can expect to earn if it sets prices in line with the Indicative Access Charges set out in the Draft Undertaking. Note that these tables have been compiled based on the limited information on prices, demand, and costs which were provided in the ARTC Undertaking and associated documents. Where possible, these have been reality-tested against figures published in the ARTC 2000 Annual Report. Necessarily, these figures are approximations.

To apply ARTC's two-part tariff, it has been assumed that the average train mass is 3,500 tonnes on the Adelaide – Kalgoorlie sector and 1,800 tonnes on other parts of the network.

Table 1: ARTC's pre-tax rate of return (2000/01) expressed in $2000-01.

sector	Adelaide to Parkeston	Crystal Brook to Broken Hill	Port Augusta to Whyalla	Dry Creek to Spencer St	Melbourne to Albury	TOTAL
BAH no.	1	2	6	3	5	
'000 gtk	14,761,023	1,698,742	123,836	9,558,945	2,028,821	28,234,643
train mass '000 tonnes	3.5	1.8	1.8	1.8	1.8	
Price ($/'000gtk)	2.06	2.33	3.63	2.37	2.16	
Price ($/km)	2.61	1.64	1.64	2.32	1.53	
REVENUE $m	41.34	5.50	0.56	34.95	6.10	88.44
COSTS $m	33.91	6.33	1.24	14.43	5.23	61.51
DEPREC $m	3.75	0.70	0.14	1.60	0.58	6.80
PROFIT $m	3.68	(1.53)	(0.82)	18.92	0.29	20.13
DORC $m	711.80	185.50	37.30	317.90	140.50	1,407.40
Return on DORC(%)	0.52	(0.83)	(2.19)	5.95	0.21	1.43
2000 Book value $m						193.34
Return on book val (%)						10.41

Table 2: ARTC's pre-tax rate of return (2005/06) expressed in $2005-06, assuming 3% annual inflation between 2001 and 2005. Prices assumed to rise by 2/3 of CPI (which is greater than CPI – 2% when CPI is 3%) as foreshadowed in the Undertaking.

sector	Adelaide to Parkeston	Crystal Brook to Broken Hill	Port Augusta to Whyalla	Dry Creek to Spencer St	Melbourne to Albury	TOTAL
BAH no.	1	2	6	3	5	
1.16	*value of $2000-01 1.00 in 2005-06*					
'000 gtk	16,440,924	1,868,009	134,308	10,825,168	2,219,626	31,554,894
train mass '000 tonnes	3.5	1.8	1.8	1.8	1.8	
Price ($/'000gtk)	2.27	2.56	4.01	2.61	2.38	0.00
Price ($/km)	2.87	1.81	1.81	2.56	1.68	0.00
REVENUE $m	50.76	6.67	0.67	43.63	7.35	109.08
COSTS $m	38.87	7.26	1.42	16.54	5.99	70.51
DEPREC $m	4.35	0.81	0.16	1.85	0.67	7.88
PROFIT $m	7.54	(1.41)	(0.91)	25.24	0.69	30.69
DORC $m	825.17	215.05	43.24	368.53	162.88	1,631.56
Return on DORC(%)	0.91	(0.65)	(2.11)	6.85	0.42	1.88
2000 Book value $m						224.13
Return on book val (%)						13.69

Notes: We have assumed that the DORC remains constant in real terms and that prices decline by 1% in real terms (nominal prices rise by 2/3 CPI = 1% real price decline if CPI = 3%).

While the real prices are declining by 1% per annum, the expected increase in traffic volume, combined with downward pressure on real maintenance costs, is expected to lead to a real increase in ARTC profitability over the 5 year period considered in the undertaking. This increase is reflected by the improvement in return from 1.43% of DORC to 1.88% of DORC.

This small change relative to a DORC valuation equates to a 55% increase in nominal profit over the five years (from $20m in 2000-01 to $31m in 2005-06). It represents an increase on the book value of ARTC assets (assumed to be constant in real terms) from 10.4% to 13.4%. It is this significant increase in nominal profitability, driven by CPI-related nominal price increases, which is the largest single cause for concern with ARTC's proposed pricing.

ARTC's customers are likely to be poorly placed to pass on CPI-linked price increases to their customers, given the competitive dynamics of road and rail freight. Thus CPI-driven price increases may serve no other purpose than to displace more rail freight to road and other transport modes.

Doubtful relevance of CPI increases to ARTC's cost base

Provisions which permit automatic CPI price increases, or CPI-linked increases, are commonplace in contracts of many types. So common, in fact, that it is tempting to accept them without further scrutiny. In the particular circumstances of interstate freight, however, this common assumption must be challenged.

Effective prices in this market have not kept pace with inflation due to continuing productivity improvements, driven by innovations in road vehicular technology, increasing mass limits, and the improving quality of interstate highway infrastructure. Interstate road freight is a highly competitive industry which effectively determines the prices achievable for interstate rail freight.

On the other side, there is no clear CPI relationship to ARTC's costs which, according to ARTC's own predictions, are likely to continue to decrease. It is difficult to see how consumer price changes would bear on ARTC's input costs. Even if there were such a relationship, CPI indexation would pay little regard to the impressive productivity gains ARTC has reported in the past few years.

To have a significant supplier of a key input (rail access) to the interstate rail freight business impose CPI-indexed price increases without regard to rail's competitive position threatens the viability of the rail operators who depend on that input. It must be recognised that these operators have significant sunk investments themselves in rolling stock and other rail-related facilities, and are to that extent captive to the rail infrastructure provider.

ARTC seeking profit on grant-funded assets

While it is understandable that ARTC is running its enterprise in accordance with sound business practices, and that they have continued to offer real price reductions over the past several years, the macroeconomic consequences of a profit maximising rail track owner must be carefully considered. In the particular context of non-bulk freight, where road transport competes vigorously with rail (thanks in part to significant infrastructure cross-subsidies from private cars) the rail owner's profit comes at the expense of greater market share for rail.

There is no question that new rail infrastructure investments, to the extent that they are funded from the track owner's retained earnings, must be able to earn a rate of return which reflects the cost of capital. However in ARTC's case, the majority of infrastructure investment was and continues to be funded by Commonwealth grants.[44]

In this situation it is arguable that the asset writedown accepted by the Commonwealth in transferring the infrastructure assets of the Australian National Railways Commission to ARTC was a type of capitalised 'Community Service Obligation' payment intended to restore some balance to road and rail infrastructure funding—at least as far as non-bulk freight is concerned.

Given these facts, the need for ARTC to earn its WACC on those assets which have been given to it by the Commonwealth is far from clear. Intermodal competition in non-bulk freight would be better served if ARTC's profit were restricted to those assets which were bought on commercial terms—in other words if no return were sought on grant-funded assets, including the foundation assets transferred to ARTC from ANR.

---

[44] This fact is clearly evident from the ARTC's last two annual reports, which highlight the significant grant funding of infrastructure upgrades by the Commonwealth.

Different treatment required for bulk vs road-competing freight

It might be argued that this position is inconsistent with current practice in the NSW and Queensland coal networks. Both of these networks are in government ownership, and the regulated asset base does not distinguish between inherited and new assets in either case.

The differences between the regulated pricing of East Coast coal networks and the posted pricing of the South Australian interstate non-bulk freight corridor are significant. Coal's ability to pay is determined by the international export market in which Australian coal enjoys cost advantages due to the favourable coastal location of the coalfields. Interstate non-bulk freight's ability to pay is determined by intermodal competition, in which rail is not favourably positioned.

Absence of quality specification to accompany undertakings on price

ARTC has published with its Undertaking a set of Indicative Access Charges, but they have not published a corresponding indicative service quality specification. Clause 4.6 sets out that indicative charges apply to a train meeting certain specified maximum limits. However these touch only peripherally on the key question of service quality. A key quality indicator, for example, is a guarantee of sectional running times. Another is a specified maximum level of temporary speed restrictions.

The concerning point about the absence of a standard service quality specification to accompany the standard price is that the customer does not know what level of product quality is being offered. Given the incentives faced by price-regulated firms to maximise profitability by sacrificing service quality, the absence of a quality standard in this undertaking is definitely problematic. It is well recognised that market power can be exercised even by price regulated firms if they are free to modify the service quality variables.

CONCLUSIONS

While the revenue limits proposed by ARTC in its Draft Access Undertaking, and the asset valuation work which underpins them, appear rational within the State-owned Corporation framework, the proposed pricing may nevertheless serve to exacerbate existing long-recognised problems in achieving modal balance between road and rail.

In light of the difficulties faced by rail-based non-bulk freight, and recognising the near universality of Commonwealth grant funding for infrastructure upgrades, ARTC's apparent aspiration eventually to achieve its cost of capital on a DORC valuation of these gifted assets may be misguided from a policy perspective.

That observation does not imply that bulk freight rail networks should be prevented from earning their WACC on a DORC valuation. Where infrastructure investments are commercially driven and funded from retained access earnings, it is essential that investors are not prevented from earning a capital market return.

It is submitted that the most reasonable tradeoff between an investment-friendly pricing approach and one that gives due weight to social objectives, such as maintaining a reasonable balance between road and rail freight, is likely to be achieved by abandoning the CPI-linked price escalation formulae proposed by ARTC.

On the face of it, there is no reason to suppose that CPI movements necessarily reflect price movements in the interstate general freight market. Instead of a CPI escalator, it may better serve ARTC's social objectives to impose either constant nominal prices, or prices escalated by some indicator relevant to interstate freight pricing, if such an indicator can be found.

Imposing this alternative to price escalation poses no obvious problems to ARTC's ability to earn fair returns on its commercial assets. The commercially funded assets of ARTC represent only a small portion of its asset base, given the large historic and ongoing Commonwealth gift funding of their infrastructure.

RECOMMENDATIONS

Consequently, it is recommended that indicative charges remain fixed in nominal terms, and that automatic CPI-linke price increases be removed from the Undertaking.

In addition, it is recommended that the ARTC publish key service quality indicators which an operator can expect in return for the indicative access charge. These should include, as a minimum, some guaranteed sectional running times and maximum level of temporary speed restrictions. Without a commitment to quality levels, indicative prices are relatively meaningless, and fail to constrain the exercise of market power by ARTC through service quality reductions at a capped price.

Annexure 2 - Annotated copy of the Indicative Access Agreement

[**TO FOLLOW**]

Annexure 3 - Potential Timetable