



Australian  
Competition &  
Consumer  
Commission

**Australian Rail Track Corporation**

**Access Undertaking – Interstate Network**

**Issues Paper**

**14 January 2008**



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## List of Abbreviations and Terms

2002 Undertaking	The access undertaking submitted by ARTC and accepted by the ACCC in 2002
Act	Trade Practices Act 1974
ACCC	Australian Competition and Consumer Commission
ACT	Australian Competition Tribunal
ARTC	Australian Rail Track Corporation
COAG	Council of Australian Governments
CPI	Consumer Price Index
December Undertaking	The access undertaking submitted by ARTC to the ACCC on 20 December 2007
DORC	Depreciated Optimised Replacement Cost
ENOC	Excess Network Occupancy Charge
IAA	Indicative Access Agreement
June Undertaking	The access undertaking submitted by ARTC to the ACCC on 8 June 2007 and withdrawn by ARTC on 15 October 2007
Kph	Kilometers per hour
MRP	Market Risk Premium
NCC	National Competition Council
RAB	Regulatory Asset Base
SSFL	Southern Sydney Freight Line
TPA	Trade Practices Act 1974
WACC	Weighted Average Cost of Capital

# 1. Introduction

Under Part IIIA of the *Trade Practices Act 1974* (TPA) the Australian Competition and Consumer Commission (ACCC) is required to assess Access Undertaking applications. On 20 December 2007, the Australian Rail Track Corporation (ARTC) lodged an application for the ACCC to assess its Access Undertaking for the Interstate Rail Network (December Undertaking). The purpose of this Issues Paper is to assist interested parties prepare submissions to the ACCC on Australian Rail Track Corporation's (ARTC) December Undertaking. It provides information on the December Undertaking, the ACCC's assessment processes and issues that are likely to be relevant to the ACCC's decision to accept or not accept the December Undertaking.

## 1.1 ARTC Undertakings for Interstate Rail Network Background

In May 2002, the ACCC accepted an Access Undertaking (2002 Undertaking) from ARTC in respect of open access to tracks on the interstate network managed by ARTC in Victoria and South Australia, extending to Broken Hill in New South Wales and to Kalgoorlie in Western Australia. The 2002 Undertaking expired on 1 June 2007.

On 8 June 2007, ARTC lodged an Access Undertaking application with the ACCC for tracks covered by the 2002 Undertaking and also for tracks in New South Wales (June Undertaking).<sup>1</sup> The June Undertaking sets out the terms and conditions upon which ARTC will negotiate access to interstate rail tracks in South Australia, Victoria, New South Wales and Western Australia.

On 22 June 2007, the ACCC released an Issues Paper seeking views on the June Undertaking. Seven submissions were received from stakeholders in response to that Issues Paper.

Drawing on submissions received from stakeholders, the ACCC sought further information and clarification from ARTC on its June Undertaking. On 15 October 2007, ARTC withdrew the June Undertaking.

The December Undertaking contains a number of changes to the June Undertaking. ARTC provided more information and further clarification on its approach in some areas and proposed some changes to that approach. It has also made changes to improve the clarity of the drafting in the Undertaking. A marked up version of the December Undertaking and the Indicative Access Agreement (IAA), which identifies all changes made since the June Undertaking was withdrawn, are available on the ACCC webpage at: <http://www.accc.gov.au/content/index.phtml?itemId=789738>.

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<sup>1</sup> In September 2004, ARTC commenced a 60 year lease of certain parts of the New South Wales rail network, including the interstate rail network outside of the Sydney metropolitan commuter network from Macarthur to Newcastle, the Hunter Valley coal network, and some parts of the regional rail network. The New South Wales interstate rail lines are incorporated into ARTC's most recent Access Undertaking application to the ACCC.

## **1.2 The Issues Paper**

Section 44ZZBD of the TPA provides that the ACCC may undertake a public consultation process to assist it to assess an access undertaking. Given that the ACCC has already sought detailed submissions on ARTC's June Undertaking, this Issues Paper focuses on the changes ARTC made in the December Undertaking and provides interested parties an opportunity to comment particularly on those changes. It also seeks further views and evidence from interested parties on IAA issues that were raised in previous submissions.

Following the receipt and consideration of submissions to this Issues Paper, the ACCC will release a Draft Report that assesses the December Undertaking, including those elements that are unchanged from the June Undertaking. The ACCC will then seek submissions on the conclusions reached in the Draft Report.

While this Issues Paper mainly covers areas where ARTC proposed changing its Undertaking, it does not necessarily follow that the ACCC has concluded that it will accept the rest of the Undertaking. Any ACCC concerns about unchanged parts of the Undertaking will be outlined in full in the Draft Report.

## **1.3 Stakeholder Submissions to this Issues Paper**

In assessing the December Undertaking, the ACCC will have regard to submissions made on the June Undertaking. It is suggested, therefore, that interested parties focus their submissions on the changes made by ARTC to its Undertaking and parties need not make a further submission on issues raised in relation to the June Undertaking.

The body of the Issues Paper identifies areas where the changes proposed affect the substance of the provisions in the Undertaking or the IAA, rather than clarifying drafting. The issues for comment in the Issues Paper are provided for guidance only. Interested parties making submissions to the ACCC need not limit their comments to the issues for comment in the Issues Paper and are welcome to raise other relevant issues.

In responding to this Issues Paper, the ACCC encourages interested parties to support their views by providing as much evidence as possible.

Unless a submission is marked confidential, it will be made available to any person or organisation on the ACCC's webpage ([www.accc.gov.au](http://www.accc.gov.au)). The sections of submissions for which confidentiality is being claimed should be clearly identified.

Under section 44ZZBC of the TPA, the ACCC is required to use its best endeavours to make a final decision within six months of receiving the Access Undertaking application, that is, by 20 June 2008. Although, as noted in the timetable on page 8, it is anticipated that this process may be completed in less than six months.

The rest of the Issues Paper is structured as follows. Background information on access undertakings and an overview of the ACCC's assessment framework are presented in section 2. Section 3 describes the assessment process the ACCC will adopt for the

ARTC Undertaking. Details of the ACCC's mailing and electronic mail addresses for lodging submissions are in section 4. Finally, section 5 summarises the changes to the Undertaking and identifies issues for comment about which interested parties may wish to express views to the ACCC.

## 2. Part IIIA of the Trade Practices Act and Access Undertakings

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

- natural monopoly characteristics;
- a strategic position in an industry with the potential to affect competition in upstream or downstream markets; and
- national significance.<sup>2</sup>

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

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

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

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<sup>2</sup> Under s.44G in Part IIIA, the concept of national significance encompasses matters such as size, and importance to trade, commerce and the national economy.

governments to ask the NCC to recommend to the Federal Treasurer that their regimes be certified effective.

Access undertakings provide an alternative mechanism to declaration of a service under Part IIIA. Undertakings have the advantage that they ‘provide a means by which the owner or operator of a facility can obtain certainty about access arrangements, before a third party seeks access.’<sup>3</sup> Once accepted, the services covered by the undertaking cannot be declared. Undertakings thus avoid the possibility of time consuming and expensive processes about whether to declare a service and then establishing the terms and conditions of access through arbitration.

## **2.1 Assessment of Access Undertakings**

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

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

- the objects of Part IIIA (box 1);
- the pricing principles specified in s.44ZZCA (box 1);
- the legitimate business interests of the service provider;
- the public interest, including the public interest in having competition in markets (whether or not in Australia);
- the interests of the persons who might want access to the service;
- whether the undertaking is in accordance with an access code that applies to the service;
- whether access to the service is already the subject of an access regime that the Commonwealth Minister has decided is an effective regime under section 44N; and
- any other matters that the ACCC thinks relevant.

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

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3 Second Reading Speech accompanying the Competition Policy Reform Bill 1995.

**Box 1 – Amendments to Part IIIA**

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

The objects of this Part are to:

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

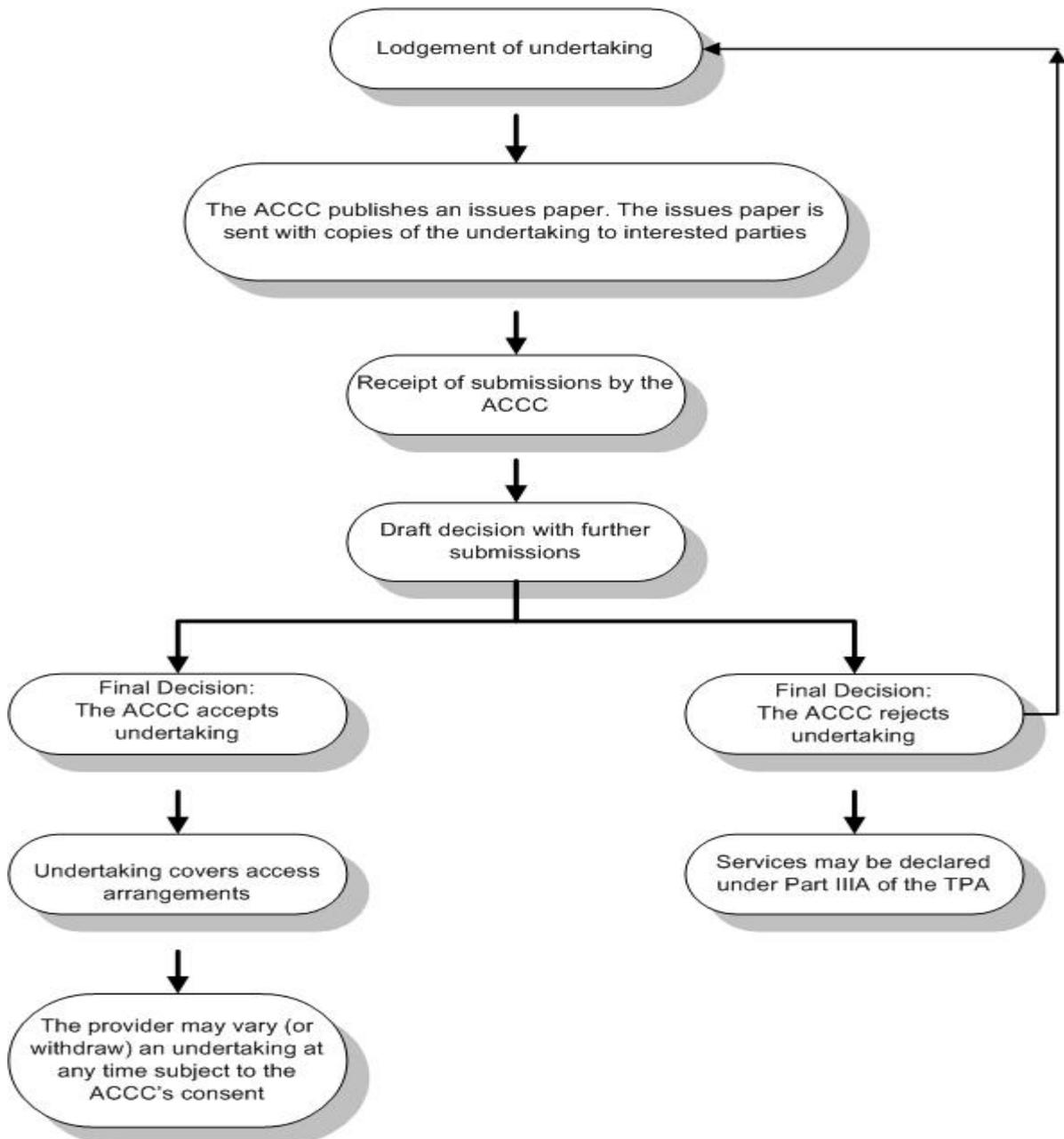
**Section 44ZZCA - Pricing principles for access disputes and access undertakings or codes**

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

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

### 3. Assessment Process for ARTC Undertaking

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



### **3.1 ACCC Time Lines**

The legislative regime provides for the ACCC to use its best endeavours to complete the assessment of an undertaking within six months of receipt of the application. The ACCC received the ARTC Access Undertaking on 20 December 2007. For the purposes of the ARTC Undertaking, the ACCC has developed the following indicative timetable:

- publication of the Issues Paper on 14 January 2008;
- receipt of submissions by 8 February 2008
- ACCC draft decision by early March; and
- ACCC final decision by April/May 2008.

### **3.2 Interested Parties**

At the commencement of its consideration of the June Undertaking, the ACCC compiled a list of parties who may have an interest in the Undertaking. Copies of this Issues Paper have been sent to those parties to assist them to prepare submissions. The Issues Paper, the December Undertaking, an explanatory guide submitted with the June Undertaking, a supplementary explanatory guide on the December Undertaking and other documents relevant to ARTC's Interstate Rail Access Undertaking are available on the ACCC's web site at [www.accc.gov.au](http://www.accc.gov.au). The ACCC can provide hard copies of the other documents on request.

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

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

## 4. Submissions

Submissions should be forwarded by AEST5:00pm on **Friday 8 February** 2008 to:

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

(03) 9290-1862

Electronic versions should be emailed to:

**[transport.prices-oversight@acc.gov.au](mailto:transport.prices-oversight@acc.gov.au)**

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

Further inquiries:

Telephone: Deborah Cope on (03) 9290-1867 or

Dominic L'Huillier – Director, Transport Regulatory  
(03) 9290-1807

Fax: (03) 9663-3699

## 5. Issues

This section describes the key features of ARTC's December Undertaking and identifies issues that may assist interested parties in presenting their views about the December Undertaking.

The objective is to highlight for comment and discussion areas in which the Undertaking changed significantly or the ACCC believes it needs more feedback from stakeholders. These changes include, for example, ARTC moving from regulation based on the RAB capitalisation loss model to a standard building block approach, increasing the term of the Undertaking to ten years, changing the value of the Weighted Average Cost of Capital (WACC) used to calculate the ceiling test, and clarifying the operation of the excess network occupancy charge and the capacity reservation fee.

It is not intended, however, for the issues raised to limit feedback. Comments on other matters relevant to the amendments to ARTC's Undertaking are welcome. To assist parties to identify the issues they wish to raise, the following sections:

- outline the original provision in the June Undertaking;
- summarise the key issues already raised by interested parties and questions of clarification raised by the ACCC;
- notes ARTC's changes to the Undertaking and ARTC's comments on the issues raised; and
- identify issues for comment, which interested parties may wish to consider in developing their submissions.

### 5.1 Scope and Administration of the Undertaking

#### 5.1.1 Term of the Undertaking

##### *The June Undertaking*

The June Undertaking proposed, in conjunction with a capitalisation loss model, a regulatory term of five years.

##### *Issues Raised*

In the ACCC June Issue Paper, stakeholders were asked for feedback on whether the proposed term for the Undertaking was appropriate given the nature of the rail industry and the services covered by the Undertaking.

Submissions to the ACCC made a number of comments on the term of the Undertaking. These included:

- A five-year term was acceptable, although a ten-year term would be more appropriate because rail investments are capital intensive and a ten-year term is more in line with the length of contracts between access seekers and customers;

- A five-year term was too short given that the investment time for an above rail operator investing in terminals, locomotives and rolling stock is ten to twenty years; and
- A five-year term was appropriate given the relative immaturity of rail access regimes in Australia.

### *The December Undertaking*

ARTC is now seeking a ten-year Undertaking term. Its views on the benefits and costs of extending the Undertaking term are in box 2.

#### **Box 2 – ARTC’s Views on the benefits and costs of a ten-year Undertaking**

##### Benefits

- ARTC believes that this longer term commitment by ARTC will increase certainty going forward in the industry and will promote greater commitment and investment by users of the network. This is important to ARTC as the achievement of the modal shift from road that underpins ARTC investment in north-south corridors depends very much on complementary investment in above rail assets (locomotives, rollingstock and terminals).
- To date, evidence points toward a general reluctance by operators to commit to this investment in north-south markets. One of the reasons cited for this is a lack of longer term certainty in the market resulting from the relatively short term of access regimes.
- Some stakeholders have suggested this, and expressed concern with the five-year term of the undertaking, in submissions to ARTC and the ACCC. Particularly, PN [Pacific National] in its submissions has indicated that whilst a five-year term is not unreasonable, a ten-year term is more appropriate for the following reasons:
  - ‘since the inception of that document [2002 ARTC Access Undertaking], all parties have had the opportunity to understand the workings of undertakings and it is now appropriate to put in place a longer term arrangement.’
  - ‘...a 10-year term is...consistent with other capital intensive infrastructure such as gas pipeline access undertakings.’
  - ‘Pacific National’s preferred outcome would be: A longer term, more in tune with likely contract lengths (ie 10 years), ...’

##### Costs

- ARTC considers that the greater risk to providing a longer term certainty to access terms and conditions lies with ARTC. ARTC would be committing to a longer term in an industry environment that is yet to stabilise. On the other hand, ARTC has indicated to the market that it is willing to enter into access agreements for longer terms than five years, so such a risk is present in part anyway. In relation to the Undertaking, ARTC can mitigate the risk to some extent by seeking to amend the Undertaking as provided for.
- An additional administrative cost associated with a Term of ten years, may be a need to:
  - Provide an extended financial model demonstrating compliance with the ceiling test; and
  - Incorporate longer term estimates of Capital Expenditure.

To reduce this cost, ARTC is proposing that it would not provide detailed revenue and expenditure forecasts to the ACCC, but instead merely extrapolate, at a high level, ceiling and floor limits and revenue out to ten years. ARTC considers this reasonable in the circumstances given the uncertainty involved and the existing revenue/ceiling relativities.

- In relation to capital expenditure estimates, ARTC proposes to make provision in the Undertaking for subsequent estimates of five year expenditure and associated pricing adjustments if necessary to be submitted to the ACCC for endorsement during the fifth year of the Undertaking term.

ARTC has a commercial incentive to continue to grow the interstate rail market in a long term sustainable manner. As such, ARTC believes that the benefits in terms of industry investment, growth and sustainability of making a longer term commitment outweigh the risks to the company as described above.

As noted above, in forecasting revenue and cost figures for the ten years for the December Undertaking, ARTC did not actually estimate in detail years 2012-13 to 2016-17. Instead, it extrapolated the estimates for years 2007-08 to 2011-12 out to 2016-17 based on segment specific assumptions about traffic growth, pricing, above rail productivity, below rail cost variability and productivity, and investment. ARTC said that this approach (rather than detailed estimation and modelling) is reasonable given the difficulty estimating rail demand and costs more than five years into the future and the current low level of economic recovery on ARTC's Interstate Rail Network segments.

***Issues for Comment:***

*ARTC's ten year Undertaking term*

*ARTC's approach of extrapolating out segment revenue and costs from years 6 of the Undertaking*

## **5.1.2 Southern Sydney Freight Line**

### ***The June Undertaking***

ARTC proposed that the June Undertaking would extend to include the Southern Sydney Freight Line (SSFL) when completed and commissioned for rail operations (clause 2.1(c) of the June Undertaking).

### ***Issues Raised***

In the June Issues Paper, the ACCC asked whether there was sufficient clarity about the extension of the June Undertaking to the SSFL and whether the arrangements in the June Undertaking relating to the SSFL were appropriate.

Submissions to the ACCC on the June Undertaking raised concerns about the process by which ARTC would extend the Undertaking to the SSFL. Operators expressed concern about the lack of clarity in the Undertaking, particularly whether ARTC intended to seek ACCC approval to extend the Undertaking to the SSFL. It was also unclear to operators why ARTC sought to include the SSFL extension in the Undertaking but to exclude other extensions to the network.

The ACCC sought further information and clarification from ARTC on how it intended to extend the June Undertaking to include the SSFL and whether the Undertaking obliged ARTC to provide the ACCC with an indicative price for that line.

### ***The December Undertaking***

ARTC includes provisions in the December Undertaking that make it clear that it intends to develop and submit for ACCC approval the indicative charges to apply to the SSFL (clause 2.4(b) of the December Undertaking). ARTC intends to submit these indicative access charges at least six months prior to the SSFL being commissioned for service. The Undertaking would not cover the SSFL until the applicable indicative access charge has been accepted by the ACCC.

#### ***Issues for Comment:***

*ARTC's amendments regarding the Southern Sydney Freight Line*

## **5.1.3 Review of Schedule H – Capital Expenditure**

### ***The June Undertaking***

In the June Undertaking ARTC outlined its proposed capital expenditure for network segments, including the SSFL. Consistent with the five year period of the June Undertaking, the proposed capital expenditure covered the financial years 2007-08 to 2011-12.

Capital expenditure for network segments was disaggregated in the June Undertaking to provide expenditure forecasts for improvement project works (for example, track works), train control and corridor infrastructure investment. Network allocation was also disaggregated to indicate capital expenditure on track investment, signalling and communications investment.

### ***Issues Raised***

In the June Issues Paper, the ACCC sought stakeholders' views on the detail ARTC had provided on the nature and extent of its proposed capital expenditure and whether this expenditure was likely to be efficient.

Operators raised a number of issues on ARTC's proposed capital expenditure. They were concerned that Schedule H, while informative, did not commit ARTC to making any capital investment. Further, it was unclear to operators what criteria would be used to determine the capital expenditure required. Operators argued that these concerns were important because they depend on continuing and efficient capital expenditure to maintain and improve rail capacity to compete with road and sea transport.

Operators were also of the view that the June Undertaking should include provisions that allowed for greater industry consultation on proposed capital expenditure and, in instances where existing assets are expected to earn the maximum rate of return permitted by the regulator, an obligation on ARTC to invest in asset replacement and new capacity.

The ACCC sought clarification from ARTC as to whether extending the June Undertaking term to ten years would affect the proposed capital expenditure. The ACCC also engaged a consultant to assist it assess the reasonableness of ARTC's proposed capital expenditure.

### ***The December Undertaking***

The December Undertaking proposes a ten-year term. However, given the difficulty in forecasting (with certainty) ten-year capital expenditure programs, ARTC proposes to include only a five year capital expenditure schedule (2007-08 to 2011-12) in the December Undertaking and to resubmit a further five year program for years 2012-13 to 2016-17 by 31 December 2011 (clause 2.4(c)). Clause 2.4(c) of the December Undertaking states that ARTC will submit for the approval of the ACCC its proposed capital expenditure for the financial years 2012-13 to 2017-18 by 31 December 2011.

ARTC notes that it engaged extensively with industry participants and other stakeholders in developing its proposed capital expenditure.

#### ***Issues for Comment:***

*ARTC's proposal to submit a subsequent five-year capital programme by 31 December 2011*

## **5.2 Negotiating for Access**

### **5.2.1 Prudential criteria**

In the June Undertaking, ARTC set out the prudential requirements that an access seeker must meet to negotiate with ARTC for an access agreement. These requirements were outlined in clause 3.4(d), and required an applicant to demonstrate to the reasonable satisfaction of ARTC that it has, or has access to, sufficient resources to meet the actual or potential liabilities of an access agreement. This requirement was in addition to the standard solvency and material default provisions that require the access seeker to demonstrate financial adequacy to the reasonable satisfaction of ARTC.

#### ***Issues Raised***

The ACCC sought further information from ARTC on its June Undertaking to clarify that the prudential requirements were not unduly onerous and would not discourage applicant from seeking to negotiate access or act as a barrier to entry. Also, that the expected standards were clear and protected the legitimate interests of access seekers. The balance of commercial interests in the prudential criteria clauses was raised in industry submissions.

In responding to this issue parties should note that the commercial balance in the prudential criteria is not only affected by the provisions in the clause but also by what is standard industry practice. Parties with concerns about the prudential criteria should provide evidence on why these clauses are inconsistent with what applies under other rail access agreements.

### ***The December Undertaking***

ARTC comments that it is not seeking to ‘raise the bar’ on the requirements in the 2002 Undertaking but merely seeks to constrain the ability of an applicant to have legal and structural arrangements that increase ARTC’s risk of the applicant not meeting its contractual obligations. ARTC states that it is not in favour of prescribing a test for this criterion, as greater prescription may reduce the effectiveness of the provision. In the December Undertaking ARTC has, however, amended clause 3.4(d) to remove references to “reasonable satisfaction” and provide greater clarity around what aspects of the Applicants business are considered.

#### ***Issues for Comment:***

*ARTC’s revised prudential criteria in clause 3.4(d)*

## **5.2.2 Requirement to offer the IAA and Access Agreements**

### ***The June Undertaking***

The June Undertaking, in particular clause 3.11(b), referred to the execution of Access Agreements stating 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.

### ***Issues Raised***

Stakeholders indicated that there was some confusion about the obligation to offer the IAA.

The ACCC sought clarification from ARTC on whether it was intended that the June Undertaking should:

- explicitly oblige ARTC to offer the IAA to an access seeker wishing to adopt it;
- expressly set out “principles” in the IAA, as referred to in clause 3.11 (b) of the Undertaking; and
- provide that the IAA may be used as a starting point for access negotiations where an access seeker is seeking to negotiate access to the network to run a non-indicative service.

### ***The December Undertaking***

ARTC indicates that the Undertaking is a public document and includes an IAA, which remains constant and is available to any access seeker who meets the prudential criteria and wants to operate an indicative service during the term of the Undertaking. ARTC also indicates that, from time to time, it may negotiate terms and conditions with access seekers that are different to those in the IAA, thus creating a set of current available market terms and conditions. ARTC states that it publishes these market terms and conditions on its web site and would make these terms and conditions available to any other access seeker wishing to operate on a like for like basis.

ARTC amended the Undertaking to clarify its intentions and changed the following clauses:

- clause 3.11 to include:
  - a clause that states that where an Applicant accepts the terms and conditions in an Access Agreement then both ARTC and the Applicant will execute the Access agreement.
  - clarification that the access agreement may be either:
    - i) the indicative access agreement;
    - ii) the current available market terms and conditions as published on ARTC’s website; or
    - iii) a negotiated access agreement which must, unless otherwise agreed between ARTC and the Applicant, address the essential elements set out in Schedule C. ARTC has removed the word “principles” from clause 3.11(b)
- clause 3.8 which now requires ARTC to make reference to the IAA and the current available market terms and conditions as published on ARTC’s website when providing an Indicative Access Proposal to an applicant.

***Issues for Comment:***

*The addition of clause 3.11(b), which obliges ARTC and an Applicant to exercise an Access Agreement if the Applicant accepts the terms and conditions in that agreement*

*ARTC’s clarification that it will negotiate an access agreement on any terms and conditions outside the IAA providing both ARTC and the Applicant agree*

### **5.2.3 Arbitration provisions**

#### ***The June Undertaking***

The June Undertaking provided for the arbitration procedures to be determined by Division 3 Subdivision D of Part IIIA (clause 3.12.4(b)(iii)). The June Undertaking, in clause 3.12.4, also contained provisions specifying that the Applicant must pay any costs incurred by the ACCC as a consequence of conducting arbitration as prescribed by the ACCC in clause 3.12.4(xiv).

#### ***Issues Raised***

In seeking further clarification and information from ARTC on its June Undertaking, the ACCC noted that the arbitration procedures in Part IIIA of the TPA only apply to declared services and not to voluntary undertakings. In relation to the provisions for the ACCC to charge costs for conducting an arbitration, the ACCC informed ARTC that

under the existing provisions of the TPA, it cannot oblige an applicant to pay any costs incurred in conducting an arbitration, without the applicant agreeing to such charges.

### ***The December Undertaking***

ARTC altered the wording of clause 3.12.4(b)(iii) in its Undertaking to specify that ARTC and the access seeker agree to adopt the arbitration procedures in Division 3 Subdivision D of Part IIIA. The ACCC considers that this alternative drafting makes the procedures binding in event of arbitration.

ARTC also amended the clauses that relate to recovering the costs of arbitration. The provisions in clause 3.12.4 now require an Applicant seeking to resolve a dispute through arbitration to agree to pay relevant costs, as determined by the arbitrator. The changes to clauses 3.12.4(a)(i), 3.12.4(b)(ii) and 3.12.4(b)(xiii) give the ACCC the legal authority to charge costs.

#### ***Issues for Comment:***

*ARTC's amendments to the Undertaking's arbitration provisions*

*ARTC's amendments to clause 3.12.4 on how the costs of arbitration would be met should a dispute arise*

## **5.2.4 References to Arbitration Outside the Dispute Resolution Clause**

### ***The June Undertaking***

Several clauses in Part 3 of the June Undertaking, outside of the dispute resolution provisions in clause 3.12, discussed referring a dispute to an arbitrator.

#### ***Issues Raised***

In seeking further information and clarification on ARTC's June Undertaking, the ACCC identified that clauses 3.4(f) and 3.8(e) were ambiguous, as it was not clear whether a dispute must go through the whole dispute resolution procedure in clause 3.12, or whether these clauses were intended to by-pass negotiation and meditation and move straight to arbitration.

### ***The December Undertaking***

ARTC amended clauses 3.4(f) and 3.8(e) in the December Undertaking to state that in the event of a dispute, parties would proceed straight to arbitration.

#### ***Issue for Comment:***

*ARTC's amendments to the dispute resolution procedures outlined in 3.4(f) and 3.8(e)*

## 5.2.5 Appeal Rights

### *The June 2007 Undertaking*

In specifying the details of the arbitration process, the June Undertaking stated that “the determination by the arbitrator shall be final and binding on the parties subject to any rights of appeal.” Clauses 3.12.4(b)(xv) and (xvi) of the Undertaking also referred to situations in which the arbitrator’s determination or decision had been appealed.

### *Issues Raised*

In their submissions, a number of parties suggested that the basis on which a determination made by the ACCC could be appealed was unclear.

In seeking further information and clarification on ARTC’s June Undertaking, the ACCC noted that the Undertaking did not specify an appeal procedure. Any rights of appeal against an arbitrator’s determination would appear to be confined to judicial review. Subdivision E of Part IIIA provides for a party to apply to the Australian Competition Tribunal (ACT) for a review of arbitration only for *declared* services. Hence, in the case of voluntary access undertakings, it appears that these provisions do not apply.

### *ARTC’s proposed changes in the December Undertaking*

ARTC altered the December Undertaking to clarify the nature of appeal rights. Instead of referring to situations in which decisions have been appealed, clauses 3.12.4(b)(xv) and (xvi) now make it clear that access seekers’ appeal rights are restricted to judicial review.

### *Issues for Comment:*

*ARTC’s amendments regarding appeal rights for arbitration*

## 5.3 Pricing Principles

### 5.3.1 RAB loss capitalisation model

#### *The June Undertaking*

The June Undertaking proposed a regulatory roll forward model that allowed ARTC, over time, to capitalise a segment’s economic losses into the regulatory asset base (RAB). That is, the size of the asset base would be adjusted each year to reflect whether the infrastructure is operating at an economic profit or an economic loss.

The RAB capitalisation model allowed a long run view of profitability so that expenditure that was not recovered in the early years of an investment was built into the regulated asset base and may be recovered in the future. If the firm has earned insufficient revenue to cover its operating costs plus a return on capital, the RAB would increase over time to reflect the need to recover larger amounts in the future. If the firm has earned more than sufficient revenue to cover its operating costs plus a return on

capital then the RAB would decrease to reflect the need to recover smaller amounts of revenue in the future.

### ***Issues Raised***

In the Issue Papers on the June Undertaking, the ACCC asked for stakeholder feedback on whether the proposed RAB capitalisation model was an appropriate basis for regulating ARTC's network. Submissions to the ACCC claimed that the model:

- had advantages where significant capital expenditure is required and that expenditure cannot be supported by revenue in the short to medium term;
- (as proposed) effectively removed the ceiling limit on ARTC for the foreseeable future, and allows ARTC to escape future regulation;
- may cause futures prices to have no relationship to replacement cost due to the capitalisation of losses through time;
- may distort pricing signals between segments in the future, due to different changes in the RAB on segments that have greater or lesser recovery; and
- sought to allow a commercial return on assets that are non-commercial government subsidy investments.

Following the submissions, the ACCC sought further information and clarification from ARTC on the effect of the proposed model on future regulation and prices, given ARTC's proposed starting DORC values and WACC.

### ***The December Undertaking***

ARTC accepts that, on many parts of the Interstate Network, it was unlikely the RAB would approach the RAB floor under the RAB loss capitalisation model. It nonetheless argues that the use of the RAB loss capitalisation model would have resulted in a better long term balance between asset sustainability and market growth than a building block approach because the model allowed short term revenue shortfalls (that is, recovery below full economic cost, which could result from ARTC setting prices to grow volumes and improve its long term sustainability) to be recovered in the long run.

ARTC also suggests that if such shortfalls arise from a lack of market power, it could be argued that the access provider would be price constrained irrespective of whether the building block ceiling had been reached. In this situation, the RAB loss capitalisation model would allow recovery of initial shortfalls from future market growth, rather than price increases, and this would benefit network users.

Despite ARTC's preference for the RAB loss capitalisation model, the December Undertaking adopted a standard building block methodology in relation to the network covered by this Undertaking.

### ***Issues for Comment:***

*Any issues that may arise from ARTC's use of a building block methodology for the Interstate Network*

### 5.3.2 Variation to capital expenditure

#### *The June Undertaking*

In the June Undertaking ARTC outlined the limitations to capital variation in the Definition and Interpretation section of the Undertaking. ARTC proposed that any variation to capital expenditure would be limited to that which may result from:

- the removal or addition of a capital or renewal project by ARTC needed to meet market demand for capacity or the need to extend the economic life of the network;
- whether expenditure is incurred efficiently in implementing the capital or renewals project in the context of prevailing access, operating requirements, and input costs;
- adjustments in relation to the timing of commencement or commissioning or projects; and
- industry support.

#### *Issues Raised*

Operators suggested that the limits to capital expenditure variation should impose an obligation on ARTC to only include efficient costs in the RAB, though they claimed that the extent to which the provisions in the June Undertaking achieved this was unclear. Operators also noted that the limitations to capital variation outlined in the Definition and Interpretation section of the June Undertaking were an operative clause and should be contained in the body of the Undertaking.

The ACCC sought further information from ARTC on the conditions under which the Undertaking would require ARTC to seek the ACCC's approval for changes to the proposed capital expenditure program.

#### *ARTC Views and Proposed Changes in the December Undertaking*

ARTC has deleted the variation to capital expenditure provisions from the Definition and Interpretation section and inserted this material into the body the December Undertaking (clause 4.4(e)). ARTC has also added additional provisions at clause 4.4(e) which stipulate that any increase to capital expenditure would be limited to that which may result from "an increase in the scope of works identified in the applicable ARTC Corridor Strategy current as at the Commencement Date or as varied from time to time" (clause 4.4(e)(ii)) and "a change in what is consistent with existing standard and configuration of adjacent and/or existing infrastructure with similar utilisation and market requirements, or its modern engineering equivalent" (clause 4.4(e)(iv)).

Clause 4.4(e) of the December Undertaking provides that ARTC will obtain the ACCC's approval for any increase to capital expenditure exceeding 20 per cent of capital expenditure on the network for any one year.

#### ***Issues for Comment:***

*ARTC's changes to the capital expenditure provisions*

### 5.3.3 WACC

#### *The June Undertaking*

The June Undertaking proposed a WACC for ARTC with adjustments for the systematic risk, capital structure and commercial risk appropriate for ARTC's Network. The overall pre-tax nominal WACC proposed by ARTC was approximately 13.9 per cent.

ARTC provided an experts report by Synergies, which justified the proposed WACC based on input parameters that included:

- a market risk premium, the premium to be allowed over the risk free rate to compensate investors for investing in the market portfolio, of 6.5 per cent;
- a gamma value, the market value to investors of one dollar of imputation tax credits, of zero; and
- a tax rate to be used to calculate WACC parameters, and most importantly to gross up the post-tax WACC to a pre-tax WACC, equal to the statutory corporate tax rate of 30 per cent.

In addition, ARTC proposed to convert the yields to maturity on the risk free proxy and debt proxy to effective annual rates. This was in contrast to the quoted rates in the market which are semi-annually compounded annual rates.

#### *Issues Raised*

In the Issues Paper on the June Undertaking, the ACCC sought comments on whether the WACC parameters and assumptions were appropriate, and whether the capital asset pricing model had been applied properly. Submissions raised concerns about whether the overall value of the WACC was reasonable, even if each parameter individually was considered by interested parties to within a reasonable range.

In seeking further information and clarification of the ARTC's WACC parameters, the ACCC raised whether:

- the use of historical market risk premium (MRP) studies was relevant to justify the forward looking MRP, particularly if no adjustment was made for unexpected returns over the data period;
- ARTC's adoption of a zero gamma in combination with a tax rate of 30 per cent may result in an excessive tax allowance, that is above ARTC's real tax cost;
- a post-tax framework would be more applicable if ARTC reverted back to a building block based model; and
- it was appropriate to calculate effective annual rates for the risk free rate and debt proxies when ARTC's cash flows actually occur throughout the year rather than at the end of the year.

### ***The December Undertaking***

In the December Undertaking, ARTC adjusts a number of inputs to their WACC calculation and moves to a post-tax revenue model. As a result, the following WACC parameters are adopted in the December Undertaking:

- an MRP of 6 per cent (6.5 per cent in the June Undertaking);
- a gamma of 0.3 (0 in the June Undertaking); and
- no longer converting the yields on the risk free rate proxy and debt proxy to effective annual rates (converted to effective annual rates in the June Undertaking).

In addition, ARTC continues to use a 30 per cent statutory tax rate. However, it moves to a post-tax revenue model where forecast tax costs are allowed for separately as a revenue allowance.

These changes result in a nominal post-tax WACC for ARTC estimated at 10.93 per cent on 20 November 2007.

#### ***Issues for Comment:***

*ARTC's revised WACC parameter values*

*ARTC's use of a post tax revenue model*

### **5.3.4 Publication of prices for indicative services**

#### ***The June Undertaking***

The June Undertaking did not set out access prices for services other than the indicative service (non-indicative services). Rather, the undertaking committed ARTC to negotiate on access charges for non-indicative services, having regard to:

- indicative access charges for indicative services;
- the characteristics of individual services;
- the particular segments of the network to which access is sought;
- the commercial impact on ARTC;
- the impact on other traffic on the network (including system capacity and flexibility); and
- the market value of the particular time path being sought.

Information provided by ARTC indicated that non-indicative services accounted for about 40 per cent of total revenues. Of this 40 per cent, revenue for the next two biggest market segments utilising non-indicative services represented about 30 per cent and 20

per cent respectively (or about 12 per cent and 9 per cent of overall revenue respectively).

While the variable access charge for non-indicative services was the same as for indicative services, the flag-fall charge varied between indicative and non-indicative services and varied among non-indicative services (subject to the 'like for like' provisions).

Historically, ARTC has published on its web site prices for non-indicative services in the following categories:

- Low Flag-fall: off peak train paths;
- Standard Flag-fall: maximum train speed 80kph, maximum axle load 23 tonnes, length up to corridor standard maximum;
- Premium Flag-fall: maximum train speed 110kph, maximum axle load up to 21 tonnes; and
- Super Premium Flag-fall: maximum train speed 130kph, maximum axle load up to 20 tonnes.

Access prices for non-indicative services were not subject to the consumer price index (CPI) price cap that applied to indicative services.

### ***Issues Raised***

In the Issues Paper on the June Undertaking, the ACCC asked whether the method for establishing prices for non-indicative services was clear in the Undertaking and whether there was an appropriate level of certainty about prices of non-indicative services.

Submissions indicated that the absence in the Undertaking of prices for non-indicative services was a concern for all operators. Operators generally claimed that there was insufficient information in the Undertaking on how non-indicative services would be treated. Operators were also concerned that they had no certainty about the cost of access to non-indicative services and that ARTC's prices had not been subject to scrutiny by the ACCC.

In seeking further information and clarification from ARTC on the June Undertaking the ACCC noted that while ARTC has been voluntarily publishing prices for non-indicative services on its web site, this was not required in the June Undertaking.

### ***The December Undertaking***

ARTC amends clause 2.6(b) of the December Undertaking to explicitly recognise its intention to continue to publish prices for non-indicative services on its web site.

ARTC indicates that rail access pricing has historically been negotiated and included in access agreements subject to confidentiality provisions. It cites its 2002 Access Undertaking as an example of the first time (outside of cost based reference pricing such as in coal networks) that indicative access pricing was incorporated in an

undertaking and a commitment made to publish all other access prices. ARTC considers that by committing to prices for indicative services it is already providing more transparency than has been available under the NSW rail access regime where access prices are confidential to access contracts.

***Issues for Comment:***

*ARTC's commitment in the Undertaking to publish charges for non-indicative services*

### **5.3.5 Excess Network Occupancy charge**

#### ***The June Undertaking***

The June Undertaking provided for an Excess Network Occupancy Charge (ENOC). The charge was defined as a function of time in excess of reasonable allowances for Section run times and for other network utilisation needs (dwells for crossings and other operational activities) for the applicable train service type. ARTC intended to add the charge to the flag-fall component of access prices and levy the charge irrespective of whether the path was used.

ARTC stated in the Explanatory Guide to the June Undertaking that through the charge it was “seeking to identify relative consumption of capacity by usage outside of standard path prescription, and to better match this with relativity in pricing. ARTC’s objective is to encourage efficient utilisation and rationing of Network capacity, so as to provide better signals for future investment in Network capacity.”<sup>4</sup>

Effectively, ARTC determined that the ‘base transit time’ (to which the flag-fall charge applies) was equal to:

- section run times for the applicable flag-fall category **plus**
- dwells for crossing/passing other trains **plus**
- a specified corridor allowance for above reasonable above-rail activities.

ARTC also stated in the Explanatory Guide to the June Undertaking that the charge would not apply if schedules with excessive transit times must be used because a better path is not available. The charge would only apply where the Applicant sought additional time in section run times or dwells for above rail activities in the train path sought.

#### ***Issues Raised***

Submissions to the ACCC on the June Undertaking argued that the ENOC provisions provided insufficient detail about the quantum and timing of the charge. Operators were concerned that the lack of transparency about the charge meant that the ACCC was not able to assess the reasonableness of the charge under Part IIIA of the TPA. More generally, operators noted that capacity and incremental capacity consumption in a rail

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<sup>4</sup> ARTC, Explanatory Guide, June Undertaking, p. 54.

network are complex concepts and are not amenable to simple measures, complicating the task of establishing the parameters for the charge.

Further, operators questioned how the charge would provide signals and incentives for investment in capacity, as the Undertaking did not commit ARTC to linking new investment with revenues from the charge. They said that uncertainty about the charge would affect their decisions on network utilisation and investment in above-rail assets and would affect demand for access by new access seekers, raising barriers to entry into rail freight.

Submissions also noted that the Undertaking did not preclude ARTC from applying the ENOC (and the flagfall component of the access charge) even if it was not able to provide the contracted train path.

The ACCC sought further information and clarification from ARTC as to how the excess network occupancy charge would operate in practice.

### ***The December Undertaking***

ARTC notes that the objective of the charge is not to reflect the opportunity cost of reduced occupancy but to “encourage efficient utilisation and rationalisation of capacity...”. The charge is based on flagfall pro-rated on the additional time sought by the Applicant against the total of Section run times for a Segment. The charge arises where section run times that are longer than the standard allowances determined by ARTC are sought by the Applicant, or where additional time for above rail activities on the Network are sought by the Applicant. ARTC asserts that “corridor allowances for reasonable above-rail activities have been determined following review of existing allowances in schedules for normal activities such as crew changing, locomotive fuelling, etc.” In the Explanatory Guide to the December Undertaking, ARTC further clarified that “the ENOC only applies to the excess time in the contracted Train Path requested by access seekers and not the excess time path that might arise in actual running.”

In the December Undertaking ARTC introduces new provisions describing in greater detail how the excess network occupancy charge would be determined. Clause 4.5 states that:

- (a) Access charges will comprise:
  - (iii) an excess network occupancy component, which is a function of time (\$/hr or part thereof) sought by an Applicant for a Train Path on the Network, which is in excess of:
    - a) a reasonable allowance for Section run times for the applicable Train service type as determined by ARTC;
    - b) dwells for crossing and passing other Trains as determined and made available by ARTC for the Train Path; and
    - c) an allowance for the reasonable requirements for operational activities whilst the Train occupies the Network as specified at 4.6(c).
- b) Subject to clause 4.5(c), the application of the excess network occupancy component relates only to the contracted Train path, and not the utilisation of the Train Path.

- c) In determining the excess network occupancy component, ARTC will pro-rata the flag-fall component back to an amount per hour by reference to the total of Section run times applicable to the relevant Segment to which the flag-fall component applies.

While, as noted above, ARTC says it does not intend to require the access price to include the ENOC if the contract must include a schedule with excessive transit times because a better path is not available, it does not make an explicit commitment in the December Undertaking to this effect. Clause 4.5(a)(iii)(b) above excludes dwells for crossing and passing other Trains as ‘determined and made available’ by ARTC. This is irrespective of the quality (transit time) of the path. ARTC has amended the Indicative Access Agreement to provide that once a path has been contracted the ENOC (and the flagfall charge) will not be applied if the contracted train path is not available and the reason for its unavailability is ARTC’s fault. Similar amendments are not incorporated in the December Undertaking.

ARTC provides an example of how the excess network occupancy charge is intended to work in practice. The example shows how the charge would be calculated for the Adelaide – Parkeston segment using running times for December 2006.

SECTION run times	Indicative Service	
	Down	Up
KALGOORLIE	15	
PARKESTON (1850)	17	16
GOLDEN RIDGE	25	17
CURTIN	24	24
BLAMEY	17	24
KARONIE	22	16
CHIFLEY	23	18
COONANA	29	23
ZANTHUS	49	25
KITCHENER	18	40
BOONDEROO	24	19
NARETHA	31	23
RAWLINNA	23	31
WILBAN	24	22
HAIG	29	24
NURINA	31	28
LOONGANA	29	31
MUNDRABILLA	33	31
FORREST	20	32
REID	33	21
DEAKIN	30	31
HUGHES	29	30
DENMAN	28	27
COOK	36	30
FISHER	15	36
OMALLEY	18	15
WATSON	21	19
OOLDEA	47	20
BATES	28	48
BARTON	26	28
MUNGALA	25	26
MT CHRISTIE	28	27
WYNBRING	32	26
LYONS	21	31
MALBOOMA	28	20
TARCOOLA	32	29
FERGUSON	33	30
KINGOONYA	24	32
KULTANABY	40	27
WIRRAMINNA	23	39
BURANDO	33	23
PIMBA	30	35
WIRRAPPA	27	24
MCLEAY	24	27
BOOKALOO	26	25
HESSO	17	24
TENT HILL	26	16
SPENCER JCT	9	25
PT AUGUSTA	16	8
STIRLING NORTH	12	13
WINNINOWIE	19	14
MAMBRAV CREEK	14	20
PORT GERMEIN	15	13
PT PIRIE	6	12
COONAMIA	19	10
CRYSTAL BROOK	5	25
ROCKY RIVER	15	5
REDHILL	20	16
SNOWTOWN	18	19
NANTAWARRA	15	16
BOWMANS	15	14
LONG PLAINS	12	16
MALLALA	11	13
TWO WELLS	11	10
BOLIVAR	14	10
DRY CREEK YARD		12
<b>TOTAL SECTION RUN TIME</b>	<b>1509</b>	<b>1481</b>

#### Determination of the ENOC

Segment Run Time (Ave. Down/Up)	1495	Published Indicative Section run times Clause 4.6(b) of the undertaking Published ARTC Pricing Schedule
Indicative Flagfall Component (\$/km)	3.263	
Segment Length (km)	1992.5	
Indicative Segment Flagfall (\$)	6501.53	
Flagfall per minute offered	4.349	
Flagfall per hour offered	260.9	
ENOC for each additional hour sought by Access Seeker	261	

#### *Issues for Comment:*

*ARTC's methodology for calculating the ENOC*

*ARTC's intention to apply the excess network occupancy charge only when a better path is not available*

*The incorporation in the Indicative Access Agreement of a commitment to not applying the ENOC if ARTC is not able to provide the contracted train path*

### 5.3.6 Price Escalation Formula

#### *The June Undertaking*

In the June Undertaking ARTC proposed to adopt a “cumulative” CPI-based formula for setting the maximum annual variation of the Indicative Access Charge instead of the “greater of CPI – 2% or 2/3rds of CPI” approach used in the 2002 Undertaking. The formula did not include an annual real price reduction and allowed “accumulation” of rises not applied in any one year for the five-year term of the Undertaking.

ARTC stated in the Explanatory Guide to the June Undertaking that the aim of the proposed escalation formula was:

... to increase flexibility in indicative access price variability to better reflect market conditions. The existing mechanism means that any opportunity to increase pricing that is forgone (for any reason) cannot be recovered' impacting longer term sustainability.

Under the proposed price escalation formula, ARTC would have the discretion to increase prices more than once in any one year or not at all, subject to the limitation that over the term of the Undertaking price increases do not exceed accumulated changes in the CPI.

#### *Issues Raised*

In the June Issues Paper the ACCC requested views on whether there was sufficient clarity about how the proposed access prices escalation approach would work and whether the ability to maintain the real level of access prices and to accumulate increases over time represented an acceptable balance between ARTC's and access seekers interests.

In submissions to the ACCC, above-rail operators expressed concerns that the cumulative CPI-based approach to price increases made the future cost of access less certain and discouraged investment and innovation above rail. The absence of an efficiency discount factor in the price escalation formula also raised concerns among operators who argued that without an “X” in the price cap, ARTC had few incentives to pursue efficiency gains.

The ACCC sought information and clarification from ARTC on whether the ability to “bank” access price rises increased operators’ uncertainty about future access charges, and whether such uncertainty could unduly complicate operators bids for new freight business and plans for future investment, particularly long-term investment. The ACCC noted that the purpose of an “X” is to impose strong incentives for efficiency improvements and to allow operators to share the benefits of those improvements.

### ***The December Undertaking***

From ARTC’s perspective, the price escalation formula provides it with the flexibility to take market conditions into account when it considers access price rises. ARTC submits in the Explanatory Guide to the December Undertaking that the advantage of the proposed price escalation methodology is “to increase ARTC’s flexibility to better match pricing variation to prevailing circumstances by allowing ARTC to recover a shortfall between the actual variation and a maximum allowable variation in a subsequent year.” ARTC could decide, for example, to forego a rise in access charges when demand for access was weak and operators could not easily absorb additional access costs, and apply it in later years when conditions are more buoyant. This is not be possible with a more rigid approach in which forgone price increases could not be recovered in later years.

ARTC states that with a flexible approach to price escalation it could take into account the effects of its NSW investment program when setting access prices, by foregoing price increases in NSW when the investment programs may impact on service levels and implementing those increases once the investments are completed and service levels returned to normal, and improved as a result of the investment.

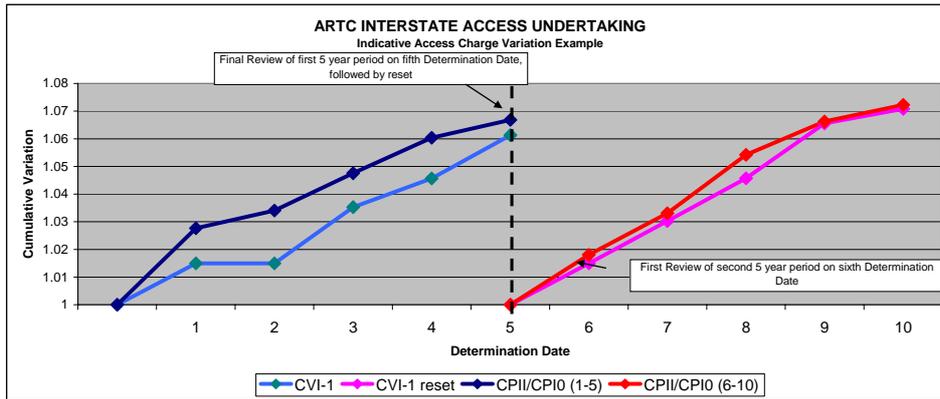
ARTC also says, in the context of the five-year term of the June Undertaking, that a cumulative cap should not unduly affect operators’ investment decisions, as most investments are evaluated over more than five years.

The December Undertaking has a ten-year term. It allows for price increases to accumulate over five years, such that price increases in the first five years of the Undertaking are capped by the cumulative CPI increase over that time. Price increases not instituted in the first five years of the Undertaking can not be carried over into the second five years.

To increase certainty about future price movements, the December Undertaking commits to publishing regularly a “state of play” with information on the permitted variation based on “transparently assumed inflation forecasts for the remainder of the term and cumulated variation to date.” ARTC also provides the following example of how the price escalation formula is intended to be applied.

**ARTC ACCESS UNDERTAKING - INDICATIVE ACCESS CHARGE VARIATION - EXAMPLE APPLICATION**

Determination Date		1	2	3	4	5	6	7	8	9	10
CPI <sub>t</sub>	0	1	2	3	4	5	6	7	8	9	10
	155.6	159.9	160.9	163	165	166	169	171.5	175	177	178
CPI/CPI <sub>0</sub> (1-5)		1	2	3	4	5					
CV <sub>t,1</sub>	1.000	1.028	1.034	1.048	1.060	1.067					
	1	1.015	1.015	1.0353	1.045653	1.0613378					
CPI <sub>0</sub> reset						166	6	7	8	9	10
CPI/CPI <sub>0</sub> (6-10)						1	1.018	1.033	1.054	1.066	1.072
CV <sub>t,1</sub> reset						1	1.015	1.030	1.046	1.066	1.071
TV <sub>t</sub>		1	2	3	4	5	6	7	8	9	10
	2.763	1.878	3.208	2.426	2.026	1.807	1.786	2.329	1.969	0.633	
V <sub>t</sub>		1	2	3	4	5	6	7	8	9	10
	1.5	0	2	1	1.5	1.5	1.5	1.5	1.9	0.5	



On the issue of efficiency discount, ARTC considers that its record of always striving to become more efficient shows that it does not need to be incentivised to pursue efficiency gains. ARTC considers that normal commercial profit maximisation incentives apply where revenue falls short of ceiling levels and, therefore, the CPI-X approach may be more effective under cost based pricing regimes. As such, it considers that there is no need for an efficiency discount factor in the price escalation formula. In the Explanatory Guide to the December Undertaking ARTC states that the CPI-X cap in the 2002 Undertaking “was not intended to be a mechanism to drive some level of productivity improvement.”<sup>5</sup> Rather, the commitment to real price reductions was intended to encourage growth in the utilisation of its network. Furthermore ARTC considers that it cannot continue to offer real price decreases because they affect its ability to recover costs.

ARTC’s explanatory guide notes that maintaining real prices in effect pass on productivity improvements to customers to the extent that network rail costs increase by more than CPI.

**Issues for Comment:**

*ARTC’s proposal to provide for accumulation of price increases over a period not exceeding five years*

<sup>5</sup> ARTC, Explanatory Guide December Undertaking, p. 16.

*The absence of an efficiency discount factor or an alternative mechanism to an efficiency discount factor*

*ARTC's proposal to regularly publish details of price rises applied and price rises that could be applied under the price escalation formula*

### **5.3.7 Building block ceiling test**

#### ***The June Undertaking***

As noted above, the regulatory framework used in the June Undertaking was based on a RAB loss capitalisation model. Under a RAB loss capitalisation regime, revenues would be unconstrained until the RAB is equal to the RAB floor, at which point the conventional building block regulatory model with floor/ceiling bands would apply.

#### ***Issues Raised***

As also noted above, ARTC's December Undertaking replaces the RAB loss capitalisation model with a building block regulatory model with a revenue floor based on incremental cost and a revenue ceiling based on stand alone economic cost.

In clarifying the application of the building block model, the ACCC sought more information on the ceiling test proposed in the December Undertaking and how that test would constrain ARTC from earning revenue above the ceiling. In particular, the ACCC drew attention to clause 4.4(b)(ii) which provided for revenues earned on a segment to exceed the ceiling with agreement of the access seeker.

#### ***The December Undertaking***

ARTC amends the definition of the revenue ceiling test in clause 4.4(b)(ii) of the December Undertaking and deletes reference to the possibility of revenues exceeding the ceiling by agreement with the access seeker.

#### ***Issues for comment:***

*The proposed changes to the ceiling test*

## **5.4 Management of Capacity**

### **5.4.1 Capacity Reservation Fee**

#### ***The June Undertaking***

In the June Undertaking ARTC proposed a new capacity reservation fee (clause 5.2). The capacity reservation fee relates to the ability for an Access Agreement to be executed more than six months prior to the commencement of the actual Services, subject to there being sufficient available capacity to accommodate the Services. The capacity reservation fee would be calculated by ARTC with regard to the opportunity cost of reserving that capacity and it would reduce the reservation fee to the extent that the path is used by other operators during the reservation period. ARTC did not propose to limit price differentiation for reserved capacity as it did for indicative services.

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

### ***Issues Raised***

In the June Issues Paper, the ACCC asked whether the provisions dealing with the capacity reservation fee were sufficiently clear about how the opportunity cost of reserved capacity would be estimated and what the likely effects were on operators.

A key issue in submissions on the June Undertaking was that the provisions dealing with the capacity reservation fee did not provide sufficient transparency as to how ARTC intended to determine the fee. Operators argued that, while they needed to secure train paths in advance to plan business growth and investment, this did not necessarily mean that ARTC should charge a reservation fee, and that charging such a fee may not reflect ARTC’s actual opportunity cost or encourage infrastructure investment.

The ACCC sought more information and clarification from ARTC as to how the fee would be set and applied and also its justification for the fee.

### ***The December Undertaking***

ARTC states that the capacity reservation fee is justified to recover the opportunity cost of reserving capacity (including operational inflexibility resulting from reserved paths), prevent capacity hoarding, and to provide ARTC some return for reducing the risk faced by new entrants arising from their ability to reserve capacity in advance. ARTC has also states that the fee cannot be prescribed ex-ante because the costs of securing capacity rights before the service is actually provided depended on the circumstances at the time contracts are executed. ARTC states that it internally balanced in pricing such a fee between the need to increase asset utilisation, and risk of foregoing a future revenue opportunity.

ARTC includes more guidance in the December Undertaking on how the charge would be calculated and set a ceiling on the charge. Clause 5.2 of the December Undertaking states that the “reservation fee will be no greater than the flagfall component associated with the reserved Access Rights, plus a variable component that would arise if the Access Rights were 50% utilised, where full utilisation is determined by applying the average train length and average axle load for an Indicative Service.” The reservation fee would be reduced if another operator uses the path during the period of reservation.

ARTC also removes the exemption from the charge differentiation obligations (clause 5.2(b) of the June Undertaking).

### ***Issues for Comment:***

*ARTC’s amendments to the capacity reservation fee*

*The appropriateness of the capacity reservation fee including a flagfall and variable components*

## **5.4.2 Renegotiation of existing access rights**

### ***The June Undertaking***

The IAA accompanying the June Undertaking included a provision that would disallow grandfathering of access rights to train paths beyond the term of an access agreement. The IAA gave the existing operator the right to renegotiate an existing access agreement 120 days before the expiry of the agreement. Once the agreement had expired the paths were open to other access seekers.

### ***Issues Raised***

The ACCC considered that the provisions for renegotiating existing access rights provided well defined rules, which assisted operators interested in such paths to clearly understand their entitlements. However, the ACCC sought further information from ARTC about whether the inclusion of these provisions in the IAA, and not the Undertaking, created a risk that the provisions in the IAA could be renegotiated as part of a contract and that the rights of operators that are not privy to those contract negotiations could change without their knowledge.

### ***The December Undertaking***

In the December Undertaking, ARTC amends Schedule C to say that an access agreement must include provisions that are consistent with clause 2.9 of the IAA.

### ***Issues for Comment:***

*The inclusion in Schedule C of a requirement that access agreement should have provisions consistent with clause 2.9 of the Indicative Access Agreement*

## **5.5 Network Connections and Additions**

### **5.5.1 Additional Capacity sought by ARTC**

#### ***The June Undertaking***

In the June Undertaking ARTC proposed that it would consider investing in additional network capacity provided such investment was in its interests, bearing in mind its overall business interests and the economic and technical feasibility of creating extra capacity (clause 6.2). Alternatively, ARTC would consent to the provision of the extra capacity by an applicant if it was consistent with ARTC's operational, engineering, and safety requirements and its overall business interests. The June Undertaking provided for an applicant to meet the costs of the additional capacity by reimbursing ARTC as and when it met the necessary costs, or through increased access charges or other periodic payments. The addition to capacity was ultimately owned and managed by ARTC.

The June Undertaking also provided for owners of other tracks to connect to ARTC's network, subject to conditions, including that:

- the connections did not reduce network capacity;

- there was satisfactory operational and procedural interface with ARTC’s overall network requirements;
- track owners can ensure that users of the connection comply with ARTC’s train control protocols; and
- the costs of building and maintaining the connections were borne by the other track owners.

***The December Undertaking***

In the December Undertaking, ARTC adds provisions that enable it to augment capacity and charge for that additional capacity if the ACCC has approved an application by ARTC demonstrating that the augmentation is worthwhile and beneficial to the industry, even where that augmentation does not have the full support of the industry. ARTC argues that this would inhibit larger and incumbent operators from constraining additional capacity to constrain competition.

Clause 6.3 of the December Undertaking provides that additional capacity sought by ARTC may be approved by the ACCC, having regard to market demand, the efficiency of the proposed means of adding capacity, and the principles in s.44ZZA(3) of the TPA.

***Issues for Comment:***  
*ARTC’s amendments to capacity additions*

**5.6 Definitions and Interpretations**

**5.6.1 Definition of associated facilities**

***The June Undertaking***

The June Undertaking defined associated facilities broadly as equipment associated with the use of the network.

***Issues Raised***

The ACCC asked ARTC to clarify the scope of facilities that were covered by the definition of associated facilities.

***The December Undertaking***

The December Undertaking defines associated facilities slightly differently to the June Undertaking and clarifies that sidings and yards are not included in the definition of associated facilities. ARTC informs the ACCC that the definitional change to associated facilities simply reflected their original intention.

***Issues for Comment:***

*The exclusion of sidings and yards from the definition of associated facilities*<sup>6</sup>

## **5.6.2 Definition of prudent capital expenditure**

### ***The June Undertaking***

The June Undertaking defined prudent “in relation to Capital Expenditure, capital and renewals projects identified, and expenditure incurred, having regard to the meaning of Capital Expenditure.” Capital expenditure was defined to mean “annual expenditure as incurred by ARTC incorporated in annual revaluation of the Network and Associated Facilities.”

### ***Issues Raised***

In response to the June Issues Paper, operators raised concerns that the definition of prudent, in the context of capital expenditure, should also be applied to other terms relating to economic costs, such as “economic costs of a segment,” “segment specific costs,” and “non-segment specific costs.” In addition, operators were of the view that the definition of “prudent” should have regard to paragraphs (a) to (e) noted in the definition of “capital expenditure.”

In seeking further information and clarification on ARTC’s June Undertaking, the ACCC noted that the definition of prudence should be as objective as possible given the context of the ARTC network.

### ***The December Undertaking***

In its December Undertaking, ARTC amends the definition of “prudent” to include specific considerations that the ARTC would have regard to when identifying and incurring capital expenditure. These considerations are:

- (a) the need to meet market demand for capacity and performance of the Network, or the need to extend the economic life of the Network;
- (b) whether the scope of works is consistent with that identified in the applicable ARTC Corridor Strategy current as at the Commencement Date or as varied from time to time;
- (c) what is considered to represent an efficient means to achieve that demand or extend that economic life;
- (d) what is consistent with existing standard and configuration of adjacent and/or existing infrastructure with similar utilisation and market requirements, or its modern engineering equivalent;

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<sup>6</sup> In responding to this issue stakeholders should note that this is a voluntary undertaking. ARTC is not obliged to include any particular facilities in the Undertaking unless it can be demonstrated that its exclusion would undermine the effectiveness of the regime such that it is no longer appropriate for the ACCC to accept the Undertaking, having regard to clause 44ZZA of the TPA.

- (e) expenditure incurred efficiently in implementing the project, in the context of prevailing access and operating requirements, and input costs;
- (f) adjustments in relation to the timing of commencement and/or commissioning of projects; and
- (g) support by the industry.

These considerations are based on the definition of capital expenditure in the June Undertaking with the addition of clauses (b) and (d). ARTC removes these considerations from the definition of “capital expenditure” in the June Undertaking as they related to variations to Capital Expenditure which are now incorporated in the body of the December Undertaking.

***Issues for Comment:***

*ARTC’s proposal for changing the definition of prudent*

*ARTC’s proposal for changing the definition of capital expenditure*

## **5.7 Indicative Access Agreement**

### ***The June Undertaking***

The IAA set out the clauses that would typically be found in an access agreement for indicative services. While the IAA was open to negotiation, ARTC noted that it would make this agreement available to any access seeker wanting access to provide services that meets the prudential criteria and wants to sign the IAA.

### ***Issues Raised***

In response to the June Issues Paper, operators questioned whether there are provisions in the IAA that do not represent an appropriate balance between the interests of access seekers and ARTC.

The ACCC noted that what is commercially balanced was not only affected by the provisions in the clause but also what is standard industry practice. The ACCC, reviewed the issues raised in submissions and identified some of clauses where it does not have enough information about what is standard practice in the rail industry to reach a view on whether the IAA provides an appropriate balance between the interests of operators and ARTC.

### ***The December 2007 Undertaking***

ARTC includes a number of changes in the IAA attached to the December Undertaking, which address some of the commercial balance issues raised in submissions.

***Issues for comment***

*After considering the issues raised in submissions and the changes made by ARTC, the ACCC is interested in any evidence interested parties can provide on whether the*

*issues raised on the following clauses are consistent or inconsistent with standard industry practice.*

*Clause 9.5(b) — whether this clause would be harsh if the operator could not operate because of an action by ARTC, taking into account that a party to a contract cannot act in a way that would frustrate that contract.*

*Clause 15.8 — whether there should be a process for the responsible party to object to the claim, or is this unnecessary given that the clause applies mutually and assumes that the party has already accepted responsibility for the claim.*