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Monitoring Rail Access & Competition Arrangements

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1. Introduction

Over the past five years, there has been significant reform of the rail industry. While the pace of reform has not been as rapid as many would have hoped for, the industry is discernibly different today compared to the mid 1990's.

Now there are some promising signs that competitiveness of the rail sector can be taken to a higher level. The ACCC has a significant role to play in that process. As Commissioner with responsibility for much of the ACCC's role with rail, I welcome the opportunity to speak to you today.

There has been structural change in the rail industry. A wide spectrum of arrangements is now in place across jurisdictions. Nationally, the formation of the Australian Rail Track Corporation (ARTC) has provided some impetus to developing a national rail network. ARTC now owns the interstate track in South Australia (including the track to Kalgoorlie in Western Australia and to Alice Springs in the Northern Territory) and has control over the interstate track in Victoria where it has a lease agreement.

There has also been a number of rail asset privatisations. In recent years, rail assets have been sold in Victoria and Western Australia. Other governments are also moving to privatise their rail businesses.

In line with these structural developments, there have also been changes in rail industry regulatory arrangements. Part IIIA of the *Trade Practices Act 1974* (TPA), which establishes a legal regime to facilitate access to the services of certain facilities of national significance such as rail track, has been introduced.

These changes mean that the Commission is playing a more significant role in the rail industry in coming years.

Today, I will talk about the Commission's role in rail industry access and competition arrangements, focusing on two main areas.

First, I will discuss the Commission's role in administering rail access arrangements under Part IIIA of the TPA. As many of you would be aware, the Commission has recently released its draft decision on ARTC's undertaking. The undertaking is significant for the Commission, because it is the first undertaking submitted to the Commission in respect of rail infrastructure. I will outline the major findings of the draft decision.

Second, I will discuss the Commission's role in assessing the competitive effects of rail industry privatisation under the mergers provisions of the TPA. This role is currently being exercised in the National Rail – FreightCorp parallel sale process.

In carrying out these roles, the Commission will attempt to ensure that the benefits of rail reform are promoted by effective access arrangements and not diminished by anti-competitive merger proposals. In this way, rail reform will result in significant benefits not only to Australian industry, but also to the community more generally.

2. Regulating Rail Access

One of the main areas of ACCC involvement in competition policy reforms for rail infrastructure services is through administration of access arrangements.

This comes from the roles given to the ACCC under Part IIIA of TPA. Part IIIA of the TPA was introduced in 1995 as part of the national competition policy reforms. The purpose of Part IIIA is to provide a statutory basis for access on reasonable terms and conditions to services provided by a limited class of facility. Third party access arrangements are being promoted because access to rail services can encourage upstream and downstream competition.

Facilities covered by Part IIIA exhibit the following features:

- natural monopoly characteristics;
- strategic position in an industry; and
- national significance in facilitating interstate or international trade.

The service defined in Part IIIA is a service provided by means of a facility, not the facility itself. Included in the definition is the use of an infrastructure facility such as a railway line.

Part IIIA defines a role for regulatory agencies only after a process of private negotiations between the parties fails to resolve an access dispute. 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. Once declared, if the facility owner and access seeker can not reach agreement on terms and conditions for access, either directly or through a private arbitrator, then the matter may be referred for arbitration to ACCC or another arbitrator. Arbitration determinations by the ACCC are enforceable through the courts.

- *Undertakings*. The owner of a facility can offer an undertaking to the ACCC stipulating the terms and conditions upon which it is willing to provide access to third parties. Once an undertaking is accepted by the ACCC, the service in question cannot be declared and the undertakings are enforceable through the courts. The purpose of the undertakings provisions of Part IIIA is to give the facility owner the opportunity to remove the uncertainty inherent in a declaration/arbitration process as to what access conditions may apply.

- *Effective regimes*. Part IIIA allows for States and Territories to have their own access regimes recognised as "effective" and thus exempted from the further provisions of Part IIIA. To clarify whether the National regime or a State regime governs access to a particular service, the TPA permits State and Territory governments to ask the NCC to recommend to the Federal Treasurer that their regimes are certified effective. If the Treasurer decides that a particular access regime is effective, the terms of access will be governed by that regime rather than a national access regime.

In this presentation I will focus on access undertakings, because the Commission currently is considering an access undertaking in rail.

3. Undertaking - Assessment Criteria

In deciding whether to accept or reject any proposed rail access undertaking the Commission is required to take into account, amongst other things, the legitimate business interests of the service provider and also the interests of potential third party users.

These criteria are quite broad, focusing on the interests of the various parties as well as the public interest. The Commission must give appropriate weighting to the various concerns raised by interested parties and achieve a workable balance between the diverse interests represented by the criteria. In balancing these criteria the Commission will consider its overriding objective that an access undertaking should promote competition and economic efficiency.

The ACCC's approach to the assessment of access undertakings is set out in its publication 'Access Undertakings'. This publication sets out the matters that an undertaking should cover in order to provide an effective third party right of access.

In particular, the Access Guide notes that:

> *The ACCC needs to be satisfied that the undertaking is sufficiently detailed to be court enforceable. Thus the boundaries to negotiations specified in an undertaking must be clearly defined.*
>
> *As a starting point for negotiations undertakings should:*
>
> - *clearly specify what services are subject to the undertaking;*
> - *specify what terms and conditions are open to 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.*

Negotiations could cover a range of issues, which might include:

- *access prices;*
- *service standards;*
- *connection and disconnection arrangements;*
- *capacity constraints and extension of capacity;*
- *trading and queuing policies; and*
- *review and expiry.*

4. ARTC Access Undertaking

On 22 February 2001, ARTC lodged an access undertaking with the Commission. The undertaking sets out the terms and conditions of providing 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.

The undertaking covers issues such as –

- the scope and administration of the undertaking;
- access negotiations;
- pricing principles sets out the principles used by ARTC to derive access charges;
- management of capacity;
- network connections and additions to capacity;
- network transit management; and
- performance indicators.

5. Draft Decision on ARTC undertaking

Last month, the Commission released its draft decision on the ARTC undertaking. This followed an extensive public consultation process, which assisted the Commission in assessing the undertaking against these legislative criteria.

The Commission released an Issues Paper on the draft undertaking in March and submissions were due in June 2001. Issues surrounding the undertaking were discussed at a public discussion forum held in Melbourne on 16 August 2001.

The Commission also sought consultancy advice from Resolve Advisors on dispute resolution processes and from Currie & Brown on the asset valuation methodology used by ARTC.

Submissions received from interested parties, consultants' reports, as well as the discussion at the public forum, have all assisted the Commission to assess ARTC's undertaking.

So what decision is reached in the draft decision?

In a nutshell, the Commission proposes to accept ARTC's undertaking, subject to ARTC addressing a number of recommendations. Most of these recommendations relate to the undertaking's negotiation provisions and dispute resolution processes. The purpose of the recommendations is to achieve a rebalancing of interests where the Commission considered that the undertaking may have provided ARTC with considerable scope for discretion in the way it sought to negotiate with operators. Other recommendations relate to drafting points and the need for greater clarity or the removal of ambiguity. The Commission's view is generally that ARTC's undertaking is a sound proposal within which the Commission's concerns could readily be accommodated.

I now highlight some of the major issues of the Commission's draft decision.

Dispute resolution

The draft decision states that the Commission is prepared to adopt the role of arbitrator under the undertaking. As such, a number of recommendations are made in relation to the proposed dispute resolution process. These include allowing the publication of arbitration decisions (subject to some consideration of commercial confidentiality), allowing joinder of arbitrations, and the appointment of a conflict manager (as recommended by Resolve Advisors).

The role of the conflict manager is specified in the Resolve report and the draft decision. The Resolve report recommends that the first step in the dispute resolution be a meeting with the conflict manager. The conflict manager's role is to establish the most appropriate processes for consensual resolution in light of the particular circumstances of each dispute. These processes can be run concurrently with arbitration, if either party considers arbitration appropriate.

Indicative access charge

A number of submissions argue that the indicative charges are unacceptable as they bear no relation to cost. The draft decision expresses the view that, given the degree of competition to which ARTC is subject, these charges are essentially market-based prices. The draft decision argues that there are limited grounds on which the indicative charge should be rejected.

In developing the floor and ceiling limits, ARTC has used a cost-based analysis that for the most part is consistent with the Commission's "building block" approach as described in the Draft Statement of Regulatory Principles.[1] ARTC has adopted an acceptable approach to estimating weighted average cost of capital. Cost consultants Currie & Brown were contracted to form a view on the reasonableness of ARTC's asset and operating costs. They concluded that ARTC's DORC asset valuation was

[1] ACCC, "Draft Statement of Principles for the Regulation of Transmission Revenues" 27 May 1999.

reasonable and operating costs were low when compared with other Australian rail track operators.

'Non-standard' services

The undertaking includes indicative access charges for an indicative service type. For other service types, the undertaking states that ARTC will 'have regard to' the indicative access charges. The indicative access charge, and the indicative service, represent a subset of ARTC's current schedule of prices.

The draft decision interprets these provisions as implying that, for the other types of services currently provided by ARTC, the broader schedule would be considered the starting point for negotiations. This may effectively price-cap the charges for those services as well as for the indicative service explicitly included in the undertaking.

'Like services' provisions

The undertaking makes a commitment to not differentiate charges between users of like services who are operating in the same end markets. The draft decision expresses some concerns with this provision in relation to the extent to which it limits ARTC's ability to recover its economic costs, but accepts it as a voluntary undertaking.

Performance Indicators

The undertaking imposes an obligation on ARTC to maintain the network in a "fit for purpose" condition and to publishing a set of specified performance indicators on its website. As currently drafted, the "fit for purpose condition" clause is quite vague, and therefore would be difficult to enforce. For example, it is not clear what is the purpose that the network is to be fit for. Accordingly, the draft decision considers that what constitutes "fit for purpose" needs to be appropriately defined.

Interface issues

The draft decision represents an important step in the process of rail reform in Australia, as it reinforces ARTC's role as a one-stop shop for rail operators whose activities traverse state boundaries. The undertaking should encourage use of Australia's interstate network.

In coming to a view on the matter of interface issues, the Commission recognises that the ARTC rail network is itself part of a larger rail network and as such, it is important that in the interests of facilitating the movement of rail traffic across state borders, it interfaces well with other access regimes. Optimal interface can only be achieved if the owners of the connecting tracks cooperate to bring about a complete integration of the management of the entire interstate network. The Commission is aware of efforts towards this end.

Nevertheless, the Commission is required to assess ARTC's undertaking pursuant to the criteria in section 44ZZA(3) of the TPA. While the Commission notes the constraints on ARTC to achieve an ideal level of interface with other tracks, it considers that the proposed processes for managing interjurisdictional traffic movements in the undertaking achieve an adequate level of interoperability with adjoining tracks.

The Commission considers that the undertaking itself represents a significant step towards improving interstate rail access for train operators. Other jurisdictions may be expected to follow with access undertakings covering other parts of the interstate rail network. ARTC's undertaking, and the Commission's assessment of it, can be used as a guide for this process.

Next steps

The Commission encourages comment on its draft decision. The Commission will be hosting a forum on 17 December to discuss the issues that the draft decision raises. We would also welcome any submissions that you may wish to make on the draft decision.

These submissions are due by 31 January 2002.

The Commission will consider the issues raised at the public forum and in submissions and aims to release its final decision in March next year.

6. Privatisation and Merger Issues

The Commission also plays a role in the rail industry in assessing privatisation proposals under section 50 of the TPA.

Section 50 of the TPA prohibits mergers or acquisitions which result, or are likely to result, in a substantial lessening of competition in a market. The Commission assesses merger proposals to determine whether such proposals are likely to breach this test. Section 50 sets out a number of criteria that the Commission must take into account in assessing the potential competitive impact of a proposed merger.

Factors to be taken into account include:

- the level of market concentration;
- barriers to entry;
- countervailing power;
- dynamic characteristics of the market;
- availability of substitutes; and
- the level of vertical integration.

The Commission's Merger Guidelines outline the approach adopted in assessing each of these factors.

To date the Commission's assessment of acquisitions involving Australian railways has largely been limited to the sales of a number of state-based railways to parties that, in general, have been new entrants to the Australian transport industry.

For example, in late 1998 – early 1999 the Commission considered the privatisation of V/Line Freight. The Commission did not oppose the purchase of V/Line Freight by any of the shortlisted bidders, including Rail America which was ultimately successful in acquiring the business.

However, recently the Commission has been considering the upcoming joint sale of National Rail and FreightCorp. Listeners may be aware that there are three consortia who are bidding for the stapled National Rail and FreightCorp businesses. These are:

- A consortium comprising elements of LangCorp and Toll Group
- Another comprising the Australian Rail Road Group
- And the third consortium is headed by Freight Australia.

I am not in a position to comment on the sale process itself, since that is being conducted by the vendors. The Commission's role in this process is to assess each bidding party to see if they present any competition concerns, or whether in fact a substantial lessening of competition would be likely to result if any of these parties were to acquire the stapled National Rail and FreightCorp companies. The Commission is working to complete these inquiries early in the new year.

By way of background I may explain that FreightCorp is currently owned by the NSW Government, and that its business is mainly centred on the NSW carriage of bulk freight, predominantly coal and grain but it also carries minerals and cement among other things.

National Rail is jointly owned by the Commonwealth Government, the NSW Government and the Victorian Government, which is a relatively minor shareholder. National Rail's principal business is the interstate carriage of general freight and it also has the movement of BHP's steel products as a large part of its business.

In August the three governments concerned put out a joint press release in which they stated that they had agreed to a number of sale objectives, including

- Seeking the development of a commercially sustainable and competitive freight business, able to contribute to a competitive and viable domestic freight transport industry; and
- Ensuring quality freight services to customers in regional and rural Australia.

7. Examination of the National Rail / FreightCorp Joint Sale

The Commission had been examining the joint sale of National Rail and FreightCorp for many months and communicating to the governments concerned the need to privatise the companies in a manner that was consistent with a competitive rail industry. The Commission also flagged several specific competition issues that would likely need addressing in the context of any joint sale.

So the Commission was heartened to hear that the Commonwealth and NSW Governments had agreed to a comprehensive examination of the access and track management arrangements for interstate track access in NSW, with a view to reaching an agreement to transfer management responsibility for this track to ARTC. This agreement provides a timetable for the resolution of a number of access matters. The ARTC arrangements will be subject to approval by the NSW and Commonwealth governments, and are expected to be finalised by the middle of next year.

Subject to the transport policy objectives and assurances given by the vendors, the Commission decided not to oppose the joint sale of National Rail and FreightCorp. However the vendors were told that each and every bidding party would be subject to scrutiny as to whether a substantial lessening of competition would arise should any party become the owner of the stapled rail businesses.

The Commission is currently assessing possible competition effects posed by the various bidders for National Rail and FreightCorp. Because the Commission has not reached a view on each bidding consortia, I will not pre-empt any decisions here. However any competition issues that may be said to exist – such as vertical integration issues across freight forwarding and rail asset ownership; or any concentrations of rolling stock, are all being considered by the Commission in its market analysis.

8. Conclusion

I have spoken today about the access and mergers roles performed by the Commission. It can be expected the Commission will play a more significant role as reform of the industry advances.

In carrying out its functions, the Commission will attempt to ensure that the benefits of rail reform are promoted by effective access arrangements and not diminished by anti-competitive merger proposals. In this way, reductions in freight costs and improved service quality will result in a more competitive rail sector with significant benefits for the productivity of Australian industry and the well being of the wider community.