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“Regulating Rail Access & Competition”

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The rail industry has undergone a period of rapid change over the last twenty years. As the pressures to become more efficient and streamlined have been brought to bear, the industry has gone through a period of expansion and consolidation:

- within the rail industry through a process of integration; and
- between the rail industry and the rest of the logistics chain via the growth in intermodal freight movement.

With these changes, however, have come a number of potential access and competition issues that need to be addressed if the rail industry is to realise its full potential as a valuable component of the Australian logistics chain.

The purpose of this presentation is to give an overview of the regulatory framework that governs the rail industry, some of the competition and access issues the industry faces, and the ACCC’s role in relation to both.

A PICTURE OF TODAY’S REGULATORY REGIME...

Part IIIA

The development of a regime to allow access to facilities that exhibit natural monopoly characteristics, in order to promote competition in other markets, was based on a doctrine of access to essential facilities. The doctrine was first developed in the US in the context of the Sherman Act which prohibited monopolisation. It was derived from a 1912 case – US v. Terminal Railway Association. Under the doctrine the Courts were permitted, in certain circumstances, to order access by competitors to facilities determined to be essential to competition.¹

In this case railway companies had combined to acquire rail terminals at St Louis, the only point at which railways carrying freight from east to west could cross the Mississippi River and then put in place arrangements which effectively denied their competitors access to the terminals. In order to allow railways to compete for east-west freight, the Court ordered access to the terminals on competitive terms.

¹ R. V. Miller, Miller’s Annotated Trade Practices Act, Australian Competition and Consumer Law, 26th Edition, 2005, p 195

The doctrine of access to essential facilities also developed in Europe. An example of its application is a case in 1991 where the Court found the Port of Genoa, Italy to be an essential facility.²

Two key purposes of regulated access regimes are:

- Facilitating and encouraging competition in markets that depend on access to monopoly services; and
- Establishing terms of access terms and conditions that balance the interests of infrastructure owners, users and the general public.

In Australia, access to essential facilities is provided for by Part IIIA of the TPA. The provisions of Part IIIA allow:

- Services provided by nationally significant infrastructure to be open for access by third parties through a declaration process;
- Arbitration of disputes relating to access to these services when the dispute cannot be resolved through negotiation;
- Determination of the terms and conditions of access up front through court enforceable undertakings; and
- Certification of effective state and territory access regimes.

National Access Regime

In the rail industry, the monopoly provider of the interstate rail network is the Australian Rail Track Corporation (ARTC). The national rail network is covered by access arrangements pursuant to Part IIIA.

Being the monopoly provider, the ARTC sets the terms and conditions of access. It has done so in the form of an Undertaking presented to the ACCC.

In 2001, the ARTC submitted an undertaking to the ACCC under Part IIIA of the TPA in relation to access to the Victorian and South Australian sections of the ARTC interstate rail network, and in Western Australia as far as Kalgoorlie. Although not covered by the Undertaking, the ARTC can also facilitate access to part of the Western Australian Network that covers the interstate lines west of Kalgoorlie. This is made possible by a wholesale agreement that gives the ARTC the rights to sell access to interstate services between Kalgoorlie, Perth and the Port of Kwinana.

The undertaking was accepted by the ACCC in 2002 for a period of five years, and is due to expire in 2007.

The ARTC is due to provide the ACCC with access undertakings with respect to the NSW section of the network in September this year. The undertakings will then be assessed, and the ACCC will work closely with the ARTC and all stakeholders to resolve any issues that may arise.

² [Merici Convenzionali Porto di Genova Spa V. Siderurgica Gabriellie SpA ECR I-5889.]

State Access Regimes

Apart from the interstate regime, state based regimes also exist throughout Australia for both intrastate access, and access to interstate tracks not controlled by the ARTC:

State	Access Provider(s)	Regulator
Queensland	Queensland Rail	QCA
New South Wales	RailCorp, ARTC	IPART
Victoria	Pacific National	ESC
South Australia	Australian Southern Railroad	ESCOSA
South Australia / Northern Territory interstate track	Asia Pacific Transport Pty Ltd	ESCOSA
Western Australia – Kalgoorlie to Perth	WestNet	Western Australian Economic Regulatory Authority
Western Australia – Pilbara	Private interests, mostly mining companies	No formal arrangements in place
Tasmania	No formal arrangements in place	No formal arrangements in place

Interstate rail access arrangements in Australia have historically been state based, but there has been a shift away from this model, as arrangements for access to the interstate network are becoming centralised into a single, national regime. The current example of this shift is the change in arrangements in New South Wales. This has coincided with calls for regulatory harmony in rail access, most recently from the Government Export Infrastructure Taskforce. The view of the Taskforce was that the scope for simplifying and streamlining the regulatory process as it applies to export oriented infrastructure, including rail, should be explored.³

Access Undertakings as Part of the Mergers Work of the ACCC

In the mergers context, the ACCC assessed Pacific National's (PN) takeover of Freight Australia. This led to the development of court enforceable undertakings related to access to rail terminals. The ACCC was concerned that Pacific National, by virtue of its ownership of a section of track that led to the Somerton terminal, could frustrate access to that terminal by competitors. The ACCC accepted an undertaking offered by Pacific National that Pacific National would ensure it did not control access to the Somerton terminal. The ACCC understands that negotiations between the relevant parties are currently underway in order to finalise a long-term solution that will assist

³ Australian Export Infrastructure Taskforce Report, p.44

access for all parties to the relevant tracks at the entrance to the terminal. The ACCC is monitoring compliance with the undertakings.

RECENT TRENDS IN THE INDUSTRY

At present in Australia there are two significant trends in freight transport: integration and intermodal.

Integration

The rail industry, and indeed the logistics industry as a whole, has undergone a period of consolidation over the past twenty years. In the last five years the pace of this consolidation has accelerated as the demand for more and more efficient logistics solutions has increased.

Prior to the 1987 stockmarket crash, Mayne Nickless, TNT and Brambles dominated the logistics industry, with second tier players concentrating their businesses on niche markets. The 1987 crash primarily affected the larger, listed companies and provided opportunities for smaller players to expand and grow. Companies such as Toll Holdings and Lang Holdings (Patrick Corporation) embarked on programs of integrating their logistics tasks that continues to this day.

Integration, especially vertical integration, can lead to increased efficiencies as companies take advantage of economies of scope. For example, integrating a company's freight forwarding service with its line haul service can lead to increased efficiencies in service levels and communication between segments of the logistics chain. This in turn can increase the efficiency of a company's operations, and improve the competitiveness of the industry as a whole.

Integration has occurred not only in the rail industry, but in the logistics industry as a whole, as companies have attempted to gain a greater degree of control over more aspects of the freight task. P&O and ARG's recent joint venture to run trains between Melbourne and Adelaide six days per week is a good example. In fact, P&O has indicated that it sees its future in intermodal freight transport. Another example is that of Queensland Rail's purchase of the CRT business. It is this increasing significance of the importance of intermodal freight transport industry that is the second trend affecting the rail industry.

Intermodal

The increased emphasis on intermodal capabilities is a function of the desire to transport freight in the most efficient and timely manner. Having the capability to take advantage of a variety of transportation modes has become more attainable, and companies are branching out to incorporate different modes of freight movement, taking advantage of economies of scope.

This 'streamlining' of the freight task is desirable in as much as it reduces transaction costs, improves information flows and improves coordination between different links in the logistics chain.

The increased intermodal nature of the freight task has led to an increase in demand for terminals where freight can be transferred from one mode of transport to another. In the last five years access to intermodal terminals has become an issue of increasing importance in the rail industry.

The amount of activity surrounding these terminals indicates that many companies view access to particular terminals as highly desirable, if not essential.

COMPETITION ISSUES ASSOCIATED WITH THESE TRENDS

Economies of Scale and Scope

While integration and consolidation reduce costs and increases efficiency, they have the potential to pose competition issues. As consolidation progresses, smaller and less efficient players may be bought out or exit the market as larger players grow and take advantage of economies of scale and scope. This is nothing new to the transport industry which, as we have seen, has experienced a period of consolidation in recent times.

Consolidation can promote efficiency within an industry by allowing the achievement of economies of scope and scale. However, as the number of players in the market reduces, so too do the incentives for large firms to fully exploit such efficiencies. Further, the fewer the players there are in a market, the greater is the potential for firms operating in more competitive parts of that industry to be hindered.

To take an example, the ACCC recently published a Statement of Issues regarding the proposed acquisition of FCL by Patrick Corporation, highlighting some of the competition issues that can arise through the process of vertical integration. One point of discussion that the ACCC raised centres around integrating rail haul services (the upstream business) with rail freight forwarding (the downstream business), and the issues that arise where this leads to parties to a joint venture in the upstream market (in this case Toll) being in direct competition in the downstream market.

The ACCC has queried whether the acquisition of FCL by Patrick would align the interests of Pacific National's owners, Patrick and Toll, in the rail freight forwarding industry. The ACCC questions whether this alteration to the market structure would impact on the competitive tension between Patrick and Toll's freight forwarding operations. Basically, Toll and Patrick would have common competitors in the freight forwarding market, and the ACCC is concerned that this may provide the necessary incentive for Patrick and Toll to engage in anticompetitive, exclusionary behaviour.

Intermodal Terminals

Intermodal terminals are another current example of the competition issues that can arise. Rail operators that own terminals in strategically important places may have:

1. the ability to block access to them; and

2. the incentive to block access to them.

In general, where access to terminal facilities is denied or is made more costly for competitors, then the actions of a terminal owner can produce inefficient outcomes.

So while competition in the rail industry has led to a period of integration and consolidation, with companies attempting to gain competitive advantages through economies of scale and scope, it does not necessarily lead to industry structures that themselves are conducive to competition. Where competition within an industry is not workable, an effective access regime is necessary.

REGULATION OF THE INDUSTRY

Vertically Separated Structure

The ACCC's role in regulating rail infrastructure has been with the ARTC, which operates as a vertically separated business; the ARTC does not run trains.

Obviously, the incentives and interests of above and below rail operators are different.

Above rail operators have an interest in getting access to rail paths at desirable times for the lowest possible price, and therefore have an interest in track paths being available whenever they require them.

Below rail operators on the other hand, have an interest in encouraging as much use of their tracks as possible and charging the highest price they can. Consequently, these operators may have only a limited interest in new investments until the existing infrastructure reaches capacity.

Hence, regulation of Australian rail access in a vertically separated environment is tailored to balance the interests of below and above rail operators, and address the potential access issues that can arise as a result of the competing interests of access seekers and providers.

Another characteristic of regulating a vertically-separated business is that the track provider does not have an incentive to discriminate between train operators in a way that is anti-competitive. This means that regulation is somewhat simplified by not needing to deal with – for example – provisions regarding accounting separation, ring-fencing or favouring a related train operator.

ARTC Undertaking

As mentioned earlier, access to much of Australia's interstate rail network is facilitated by the ARTC, and regulated pursuant to Part IIIA of the TPA.

Prior to the ARTC becoming the single point of contact for rail operators seeking access to the national network, a piecemeal approach existed that

required rail operators to deal with the states individually. The current system allows for consistency in the approach taken to track access. A dispute resolution mechanism is in place, with the ACCC as the arbitrator, but to date, no disputes have arisen that have required the ACCC's attention.

The impending ARTC undertakings for the NSW section of the interstate track will provide increased certainty for rail operators, bringing the NSW section of the track within the ARTC regime for the interstate track.

In its assessment of an undertaking for the NSW network the ACCC will apply the criteria set out in Part IIIA. In essence, the ACCC will seek to strike a balance between the interests of the ARTC and access seekers. The ACCC is interested in seeing that it is efficient use of rail that is encouraged, that efficient new entrants are provided with the incentive to enter the market, and that there are correct signals for new investment.

The ACCC looks forward to receiving the undertaking later this year, and working with the industry and with the ARTC to ensure above and below rail and the interests of consumers are adequately protected.

Intermodal Terminals

While the ARTC access regime appears to have been a successful approach to regulating track, intermodal terminals, which are not included in the regime, can also be considered to be bottleneck facilities.

Most intermodal terminals are privately owned or leased and have not been subject to mandated access pursuant to Part IIIA of the TPA.

In order for a service to become 'declared' by the NCC, a person or company must approach the NCC with an application for declaration. In 1997 Specialized Container Transport (SCT) applied to the NCC for a declaration of an intermodal terminal in Perth.⁴

The NCC found that the terminal in question did not meet the criteria outlined in Part IIIA because it found such a terminal was economic to duplicate and not of national significance.

With the exception of Victoria's Dynon Terminal, State Governments have declined to make intermodal terminals the subject of access regimes.

Recently, the Victorian Department of Infrastructure published a proposed revised legislative framework⁵ for its intrastate network, but again declined to declare mandated access for any intermodal terminal except for Dynon. Therefore access to all intermodal terminals except Dynon is not governed by a process based on Part IIIA of the TPA.

Any proposal for mandated access would need to meet the criteria set out in Part IIIA, meaning that a terminal would be of national significance and would

⁴ SCT Application to NCC, 21 November 1997

⁵ *Victorian Department of Infrastructure*, "Reform of the Victorian Rail Access Regime", December 2004

not be economic to develop another facility. Of course the option is also open for owners of terminals to develop their own access arrangements and submit them in the form of an access undertaking to the ACCC. Once the ACCC accepts such an undertaking, the terminal would no longer be at risk of being declared.

Notwithstanding the existence of formal access arrangements, the owners of terminals or controllers of access to terminals remain subject to the general competition provisions of the TPA.

Authorisation of Anti-Competitive Conduct – Dalrymple Bay & Port Waratah

The ACCC has assisted industries to deal with bottlenecks in other logistics industries.

The TPA recognises that there are circumstances where conduct that may be anti-competitive may nevertheless be associated with a benefit to the public. The authorisation process allows businesses to obtain protection from legal action under the TPA where they can demonstrate that their proposal – which might otherwise breach the TPA – results in sufficient public benefits to outweigh any anti-competitive detriments. The authorisation process is open and transparent involving public consultation, draft decisions and appeal processes. The ACCC has considered two applications in recent times dealing with logistics chains and queue management.

- ***Port Waratah Coal Services Ltd***

On 1 October 2004 Port Waratah Coal Services (PWCS) sought authorisation of the proposed medium term capacity distribution system (CDS) to reduce the imbalance between the demand for coal loading services at the Port of Newcastle and the capacity of the Hunter Valley coal chain. The ACCC's previous authorisation of the short term CDS expired on 31 December 2004.

Broadly, under the medium term CDS coal producers are provided with the option to accept a pro-rata reduction in coal demand nominations (as per the previous CDS), or participate in a demand auction, in the event that demand for coal shipping services on the Hunter Valley coal chain exceeds available capacity by 3 million tonnes.

Public detriment concerns raised by interested parties focused on whether the CDS would result in reduced coal exports through the port, remove pressure for and defer necessary investment to expand the capacity of the coal chain and result in other efficiency losses.

The ACCC was satisfied any public detriment arising from a reduction of the volume of coal moved through the coal chain is likely to be negligible and was satisfied that the Medium Term CDS would not remove the pressure to invest in expanding the capacity of the Hunter Valley coal chain, including at the port.

To help safeguard against under-investment, the ACCC has only granted authorisation until the end of 2007, and PWCS is required to report annually on the progress of the capacity expansion program.

The ACCC concluded that the CDS would likely result in significant public benefits particularly in reducing demurrage costs and improving economic efficiency.

- ***Dalrymple Bay Coal Terminal***

On 5 April 2005, the ACCC received applications for authorisation from the Dalrymple Bay Coal Terminal (DBCT) in relation to a proposed Queue Management System to address the imbalance between demand for coal loading services and the capacity of the Goonyella coal chain.

On 29 April 2005, the ACCC decided to grant interim authorisation to the operator of DBCT to implement the queue management system.

The queue management scheme essentially rations the amount of coal each producer can export through the Terminal on a pro rata basis so that the overall capacity of ships arriving better matches the amount that can be delivered by the congested coal chain.

The ACCC is continuing to consult with interested parties to inform its consideration of the application and has been investigating the potential impact of the queue management system on new entrants.

Like the PWCS matter, the ACCC has moved quickly under the authorisation process to consult and make preliminary assessments and under the interim process given protection for early operation of arrangements.

THE ROAD AHEAD – INFRASTRUCTURE TASKFORCE REPORT

It is concerns with regulatory and infrastructure bottlenecks as they relate to the export industry that the Recent Government Export Infrastructure Taskforce Recommendations attempt to identify.

The Report focuses on relieving regulatory and infrastructure bottlenecks in Australia's export industry.

The Report made some key recommendations, including the streamlining and harmonising of regulation of export related infrastructure, and introduction of time limits for dispute resolution processes.

COAG agreed in-principle to a number of specific reforms, such as:

- hastening the long-term planning being undertaken under Auslink;
- extending Auslink planning and coordination to ports and associated shipping channels;
- each jurisdiction providing a report to COAG every five years on infrastructure;
- the Commonwealth facilitating the establishment of groups to coordinate logistics chains of national importance;

- reinvigorating the agenda for harmonising road and rail regulations; and
- establishing “one-stop shops” in each jurisdiction for project facilitation and approvals.⁶

There have been significant changes in the rail industry over the past few years, the most significant of which has been the consolidation of the industry through vertical integration. As this process advances it is important to strike a balance between the efficiencies associated with integration, and the need to ensure the industry remains competitive. To this end, it is also important, as far as possible; to foster and maintain a harmonised approach to regulation to ensure issues are tackled in a uniform way.

For its part, the ACCC will continue to promote, and where it has the power, foster, fair and efficient outcomes in the rail industry. Through its functions under the access provisions of Part IIIA, the ACCC will take into account the interests of the key stakeholders in deciding the appropriateness of terms of access to Australian rail infrastructure.

Similarly, where the circumstances require, the ACCC will continue to work closely with the rail industry to ensure competition is not substantially lessened through its mergers and adjudication powers.

Rail transport is vital to a country as large as Australia. It is therefore vital that the industry stays competitive, and the ACCC looks forward to working with the rail industry to this end.

⁶ COAG Communiqué from 3 June 2005 meeting