

11 February 2008

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By email:- transport.prices-oversight@acc.gov.au

Dear Margaret,

**Re:- Australian Rail Track Corporation (ARTC)
Rail Access Undertaking – Interstate Network**

Thank you for the opportunity to comment on the above draft Undertaking.

We would first record that this latest iteration of the Undertaking has not addressed nor substantively modified the earlier version's stance on any of the issues and concerns raised by SCT Logistics in its earlier letters to the ACCC of 20th July 2007 and 14th September 2007 and to the ARTC of 25th January 2007.

We therefore ask that you include these three letters as part of this submission. We can provide further copies should you wish.

Overall Assessment

Firstly, two overarching comments.

The stated objects of Part IIIA, ms.44ZZA include "... promote economically efficient ... use of ... the infrastructure." The draft ARTC Undertaking does not promote the economically efficient use of the infrastructure and on this basis alone, the Undertaking should be rejected by the ACCC. This Undertaking is a backward step from the previously-approved one. It now seeks to gouge as much short-term revenue from operators as is possible without regard for the long-term effect on the road, rail and sea freight markets.

We invite the ACCC to formally consider the likely impact of this draft Undertaking on the modal share of East-West rail and its impact on road infrastructure spending, energy usage, greenhouse gas emissions and road trauma before reaching a final decision. A good reference as an alternative would be the previously-accepted Undertaking but no doubt research would identify even better alternatives.

The same analysis would allow assessment of the degree to which the draft Undertaking met the public interest test, including particularly congestion and spending on the roads and at least maintaining competition between road and rail.

Further, the Pricing Principles refer to a return compared to the commercial risks involved.

We submit that the ARTC is integral to and an arm of the Federal Government – somewhat akin to the subsidiary of a publicly-listed company. Accordingly, any analysis of the business activities of the ARTC is, in reality, an assessment of the Federal Government's investment in

and operation of the national rail infrastructure. The creation of the ARTC is merely an organisational issue. There is no commercial risk involved. The returns on investment should have the same criteria as the returns on investment achieved for the other (differently-organised) road infrastructure.

Latest uplift

We would advise the ACCC that in the absence of an Undertaking, the ARTC has recently increased its access charges to SCT by in excess of 7.5%. This is only some six months after its access charges were increased by the maximum amount allowed under the previous Undertaking. 7.5% in six months is akin to an annual rate of increase of some 16%pa.

The formal advice of the increase notified SCT that if it did not accept the increase then its trains would be prevented from running after 1st February this year. The extension of operations was only offered for six months. Will there be another similar increase then????

Issue raised by the ACCC in its paper of 14 January 2008

The following addresses (issue by issue), those points raised by the ACCC in its Issues Paper of 14 January 2008.

1. 5.1.1 Term of the Undertaking

- a. In general, longer is better as it gives greater certainty and provides a continuous framework for investment and pricing decisions.
- b. However, a bad undertaking (as is this draft) should have a shorter time frame to allow the pitfalls to be corrected. Much of the undertaking is predicated on an incorrect view of the future by ARTC. The proposed undertaking will damage rail transport (vis a vis road transport). If the ACCC is inclined to approve the draft undertaking as presented, then a shorter timeframe is to be preferred.
- c. The ARTC claim of additional administrative costs is nonsense. It is a trivial cost in the ARTC scale of things, should be a normal part of infrastructure planning and would be orders of magnitude less than the effort to detail, draft and have approved a new five-year undertaking in five year's time.
- d. The ARTC view (as detailed in Box 2) on reasons for lack of commitment by operators to NS again shows how out of touch ARTC is. The reason for a declining market share of rail is its lack of cost competitiveness. If rail were preferable economically, then operators would follow. SCT's concern is that the ARTC is endeavouring to push E/W rail into an equally-uncompetitive position.

2. 5.1.2 Southern Sydney Freight Line

It is not sensible to use a cost-of-capital pricing approach for the SSFL. Both the resultant price and the model are inappropriate. Other (competing) Government-supplied road infrastructure does not have segment pricing and individual investments to improve the infrastructure do not result in increases in usage charges.

3. 5.1.3 Review of Capital Expenditure

- (a) It is accepted that detailed capex forecasting past 5 years is difficult and we accept that the proposed approach is reasonable, subject to validity and reasonableness checks.
- (b) However, it should be noted that a studied analysis of capex forecasts will generally show a small underspend in the early part of the period (due generally to spending being slower than commitment) whereas longer term forecasts tend to underestimate the amount as new and/or unforeseen projects arise.

4. 5.2.1 Prudential

- (a) As the ACCC would be aware, there are relatively few formal rail access undertakings in Australia. Rather, several states have or have had access regimes that have been approved as effective by the ACCC. These include Queensland, NSW and Victoria. None of these have such extreme credit requirements as 3.4(d) (iii) in the draft ARTC Undertaking. Accordingly, the proposed ARTC approach is out of step with what all others have seen as reasonable.
- (b) Further, the ARTC does not allow any remedy for an applicant not meeting the 3.4 (d) (iii) requirements.
- (c) It is often practice that early trading (not negotiating) may require some form of demonstrating creditworthiness or committing to a deposit, bond, guarantee or similar. However, it is general practice that a history of smooth trading then allows for the removal of such bonds etc. The ARTC has not provided for this.

5. 5.2.2 Requirement to offer the IAA and Access Agreements

- (a) Revised clause 3.11 (b) No comment
- (b) The standard practice in the competing road industry is that there are standard terms and conditions for access to the infrastructure. They are not negotiable. They are legislated. SCT believes that such a standard, non-negotiable access terms approach is also sound for the rail industry and ensures a level playing field for competition and competitors. If there is a formal ability to alter the terms and conditions of access (as proposed by the ARTC), then the level playing field is open to being tilted by the interpretation and judgement of individual officers. For example, would it be acceptable for the undertaking to say that a certain operator would be entitled to the reference pricing but that another operator would get a cheaper pricing. No!! It would be seen as discriminatory. However, if the ACCC accepts the ARTC proposal, then this will leave the ARTC free to put in place such an arrangement at a later time and (as operators would not be aware of other operators access agreements) without any reference to an arbitrator.
- (c) The requirement in the undertaking should be for all operators to have **identical** access terms and conditions – after all it is for access to essential Australia infrastructure.

6. 5.2.3 Arbitration

No comment.

7. **5.2.4 References to Arbitration Outside the Dispute Resolution Clause**

No comment

8. **5.2.5 Appeal Rights**

No comment.

9. **5.3.1 RAB loss capitalisation model**

Refer to FROG response

10. **5.3.2 Variations to Capital Expenditure**

Refer to FROG response

11. **5.3.3 WACC**

(a) The ARTC proposes to use a cost of capital that is not appropriate for it. The COC varies between industries and each industry needs to have a separate assessment and determination. In the case of the ARTC, its industry is the supply of transport infrastructure by a Government or Government-owned entity. Accordingly, the appropriate COC for the ARTC is that which is earned by (particularly) Government-owned roads.

(b) In addition to ensuring a level playing field for all transport by using the same cost of capital for all supply of transport infrastructure by the Government, recognition that the capital source is the same as for (eg) roads will also allow the issue of Government gifts, low interest and non-interest loans and Government-funded assets to be sensibly addressed. All ARTC assets and its business are funded from the same source – Government expenditure.

(c) Further, the use of the WACC on the DORC value does not address the past (free) funding of these assets by the Government without expectation of a commercial return to them.

(d) Further, it should be noted that the COC is proposed to be applied to a revalued DORC. Thus, the operator (ARTC) is implicitly able over time to earn its Cost of Capital return on what it has and does spend plus the revaluation arising from undertaking the DORC exercise. It achieves the DORC “profit” by the ceiling each year being higher than it would have been had it merely earned a COC return on its actual investment.

12. **5.3.4 Publication of Prices for Indicative Services**

(a) SCT reiterates its strong position made in its submission on the earlier draft that all services (not just indicatives services) should be the subject of the undertaking. This can easily be accomplished by requiring all access prices to reflect only the differences in costs to the ARTC of the non-indicative services. Any anomalies that might exist in the past published prices for certain non-indicative services could be “chiselled in granite” now to preserve them. The fact that the ARTC has not accepted such an approach is prima face evidence that it intends to lift access prices for non-indicative services.

- (b) Please note that SCT's concern relates primarily to future services rather than the four or so present non-indicative services for which the ARTC has published access prices in the past.
- (c) Further, publishing prices does not imply any restriction or control. With the present wording, the ARTC could double non-indicative access prices and then merely publish them.

13. 5.3.5 Excess Network Occupancy charge.

SCT reiterates its position that adding an ENO charge is a defacto real increase in access prices and such an increase is not in the public interest. The ENO charge is acceptable to SCT as a sensible way to go provided that any expected revenue results in an equivalent decrease in basic access charges. If the ENO charge is to be effective then the real benefit to the industry is in better utilisation of the network – and the real argument should be how to share this benefit between the ARTC and operators.

14. 5.3.6 Price escalation Formula

- (a) SCT has strong objections to the proposed changes to the 2002 Undertaking. To reiterate our previous argument:-

It is generally-accepted practice that in an efficient world and particularly one where best-practice is a requirement that prices should decrease in real terms. In other words, escalation should occur at a lower rate than inflation.

This was embodied in the present Undertaking by limiting escalation to 2/3 of CPI or CPI-2%, whichever gave the better return to the ARTC.

However, the less-than-inflation cap has been dropped from the revised undertaking.

The new Undertaking should include the capping provisions that are in the present Undertaking.

- (b) Further, the sixth-year reset of the cumulation achieves little. It merely means that the ARTC is likely to ensure that it has lifted rates at that date by full CPI.
- (c) As previously noted, publishing details of price rises is not a management or control of prices mechanism.

15. 5.3.7 Building Block Ceiling Test

Refer to FROG comment.

16. 5.4.1 Capacity Reservation Fee

- (a) Please refer to the comments in our submission on the previous draft.
- (b) The combination of the ability of the ARTC to agree alternative access terms and conditions and the stated intention of the ARTC to select the "highest present value of future returns" means that a scarce path would move out from under the

limitations/control of the undertaking. The highest bidder to the ARTC would get the path. This is not consistent with offering equitable access by a monopoly supplier.

- (c) SCT does not agree that there is any significant “opportunity cost” in reserving paths provided that such reservation period is limited to the time to acquire above-rail assets (i.e. to move to an operational service). An opportunity cost would only arise if the reservation causes the freight to move to road – otherwise it would be carried by another rail operator. SCT is not aware of any such cases. The gaming of paths by operators to exclude competitors is the real issue with the reservation of paths and this is adequately addressed with “use it or lose it” provisions.
- (d) Any revenue from the CRF should be substitute revenue otherwise the introduction of the fee is effectively a real price increase.

17. 5.4.2 Renegotiation of existing access rights

No comment

18. 5.5.1 Additional capacity sought by ARTC

- (a) Refer to FROG submission.
- (b) As noted above, this section should not lead to different access rates for different operators nor give preference to certain operators. As with road access, the rate mechanism must be identical for all for there to be equitable competition.

19. 5.6.1 Definition of associated facilities

SCT accepts that it is reasonable **in concept** to exclude sidings and yards from the definition of associated facilities. However, there may be some which fall into the category of essential facilities to run train services and/or where it is impractical for an operator to construct alternative facilities. Thus the ARTC would be in a position of a monopoly supplier and effectively control access to the mainline track. Accordingly, SCT would appose such exclusion on a general basis according to clause 44ZZA of the Trade Practices Act. If certain ARTC yards and sidings are to be excluded then these should be identified and nominated separately.

20. 5.6.2 Definition of prudent capital expenditure

As noted above, this section should not lead to different access rates for different operators nor give preference to certain operators. As with road access, the rate mechanism must be identical for all for there to be equitable competition.

21. 5.7 Indicative Access Agreement

- (a) Clause 9.5(b) There should be an exception for circumstances where Paths are not operated due to the actions or inaction of ARTC or third parties over whom SCT has no control.
- (b) Clause 15.7(b) The sub-clause should be deleted. It has already been the subject of an objection by SCT as outlined to the ACCC in our earlier letter of 14 September. It negates the common law principle that an “injured party” is entitled to be compensated only for the value of the relevant asset at the time of its destruction. A party should not

have to replace old with new, particularly having regard to the potential (extended) life span of most rail assets.

(c) Clause 15.8 The clause is unreasonable and should be deleted or redrawn.

- Responsibility for the “incident” should be established before liability for payment arises.
- There is no requirement for the claimant to have to justify the quantum of the claim and no right to object to the claim itself or the quantum
- There should be provision for repayment, with interest, if it is subsequently established that the claim was without merit in whole or in part.

As you would be aware, analysis of the draft Undertaking and preparation of the above, involved some considerable coming to grips with the detail. We believe that we have captured the essence of and most of the detail with respect to what concerns we may have with the draft Undertaking. However, it is possible that we may become aware of other issues as we continue to study the draft and its implications. In such a case, we would advise the Commission at that time and would trust that this would receive a sympathetic hearing.

Yours truly,



Peter Mason
Director