



31 January 2007

Statement of Issues – Transurban Group’s proposed acquisition of Sydney Roads Group

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of Sydney Roads Group (SRG) by Transurban Group (**Transurban**) (**the proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC’s preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC’s *Merger Review Process Guidelines* (available on the ACCC’s website at www.accc.gov.au), the ACCC has established and will maintain an indicative timeline for its assessment of the proposed acquisition. The indicative timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find any relevant documents, market participants should visit the Mergers Register on the ACCC’s website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. The proposed acquisition was publicly announced by Transurban on 14 December 2006. In December 2006, Transurban provided its submission seeking the ACCC’s view on an informal basis.

The parties

Transurban

6. Transurban is an international tollroad developer and investor with assets in Australia and an asset in the U.S. (Pocahontas Parkway). The company focuses

on the long-term ownership and management of tollroads and in particular, electronic tollroads.

7. Transurban has ownership interests in three of Australia's tollroads; Citylink Melbourne (**Citylink**) (100%), Westlink M7 (**M7**) (47.5%) in Sydney and the M2 Motorway (**M2**) (100% ownership after an acquisition from the Hills Road Group in 2005) in Sydney.
8. Transurban, or its related entities, are the electronic tolling services provider (**tag issuer**) to the tollroad owners of Citylink, the M7 and the M2 employing the following brands: *Roam* (M7), *Roam Express* (M2) and *Citylink* (Citylink). In addition, Transurban has entered into a long term contract to supply tolling product services (excluding 'back office' facilities) to the owner and operator of the Lane Cove Tunnel.

SRG

9. SRG was established through the demerger of Macquarie Infrastructure Group and was listed on the Australian Stock Exchange in July 2006. SRG is a holding entity with ownership interests in three established Sydney tollroads namely the M1 Eastern Distributor (**M1**) (71.35%), M5 Motorway (**M5**) (50%) and M4 Motorway (**M4**) (50.61%).¹
10. The entity that operates the M5, Interlink Roads Pty Ltd (**Interlink**), currently provides electronic tolling services to the three tollroads in which SRG holds an interest (namely the M1, M4 and M5). As a result, SRG has a 50% interest in the Interlink tag issuing business.

The Transaction

Commercial rationale

11. Transurban has stated that the proposed acquisition will allow it to add value to SRG by utilising Transurban's tollroad management expertise to improve customer service, increase traffic volumes and lower operating costs. Transurban submits that it will work with SRG's partners in tollroad concessions to investigate consolidated tolling operations amongst other things.² However, the time frame and details as to how these measures may be implemented is not clear.

¹ According to information obtained by Transurban from ASIC registries and SRG's public prospectus, the minority shareholders in each of the tollroads that SRG holds an interest in are:

- **M1:** National Nominees Ltd (10%), J.P. Morgan Nominees Ltd (7.5%), National Asset Management Ltd (6.15%) and Motor Trades Association of Australia Ltd (5%).
- **M4:** Utilities of Australia Ltd (10.27%), National Nominees Ltd (9.81%), Karatal Holdings Pty Ltd (9.51%), J.P. Morgan Nominees Ltd (8.6%), Australia Infrastructure Fund Limited (6.25%) and Hastings Fund Management Ltd (4.95%).
- **M5:** J.P. Morgan Nominees Ltd (19.8%), Utilities of Australia Pty Ltd (19.2%), Cogent Nominees Pty Ltd (8.2%) and National Nominees Ltd (2.8%).

² SRG and Transurban Joint ASX Release dated 14 December 2006.

Industry background

Tollroad construction and ownership

12. When the Federal or State government decides to build a new road under a Public Private Partnership³ (PPP) model, an open tender process is run. The successful bidder enters into a formal agreement (**Project Deed**) with the government to build, own, operate and, usually, transfer the ownership of the road back to the government at the end of a defined period.⁴ All operating costs are met by the tollroad owner over this period.
13. In the case of a PPP tollroad, the tollroad will need to provide a financial return to repay costs incurred through the project. This typically comes from an entitlement in the concession granted by the government for the private owner to charge motorists a toll for use of the tollroad. The owner of the road is responsible for collecting the tolls and operating and maintaining the tollroad as well as for the electronic tolling systems which are used to track use of the road by motorists.
14. Bidding for tenders is typically done by way of consortia that cover all aspects of the project including construction, financial advice, debt provision, road maintenance/operations, tolling operations and tag issuing. Transurban submits that a tendering consortium will bid a price that enables it to offer the lowest toll which will need to be charged in order to repay money borrowed and provide a suitable return on equity contributed. In some circumstances the government may establish the toll price and ask tendering consortia to bid against it.

Toll pricing and electronic tolling

15. All NSW tollroad owners are subject to regulation in relation to the toll prices motorists pay to use the tollroads. The Project Deed that each road owner has with the Roads and Traffic Authority (RTA) or the NSW Government sets the level of tolls. Transurban submits that these agreements limit the ability of tollroad owners to increase tolls or offer differential pricing except with the consent of the RTA and/or Government.
16. Traditionally, tolls in NSW have been collected in cash at toll booths. However, the last five years has seen the introduction of non-cash collection of tolls using electronic tags and more recently electronic passes. In NSW, with the exception

³ According to Transurban, in making decisions regarding construction of a new road the relevant government can choose that the road:

- be publicly owned and funded (eg. Pacific Highway and M5 East);
- be publicly owned with a toll (eg. Sydney Harbour Bridge); or
- involve private ownership, construction and operation (at least for a time) under some kind of Public Private Partnership (eg. Cross City Tunnel and Lane Cove Tunnel).

Transurban suggests that the following new roads may be built in the future:

- F3/M2
- M4 East
- Brisbane Airport Link

⁴ Such projects are generally referred to as BOOT Schemes.

of the Lane Cove Tunnel, all tollroad operators also supply (through related companies) electronic tags to tollroad users.

17. Transurban submits that in NSW the RTA⁵ and Interlink⁶ each have an approximately 40% share of the total electronic tags issued to motorists, Transurban⁷ has an approximate 20% share and the Cross City Tunnel has a very small share.⁸
18. While the tollroad operators are not permitted to charge any more than the mandated toll when collecting by cash or by tag, in the case of electronic toll collection:
 - a tag issuer may charge administration fees to the users of its tags (subject to RTA approval); and
 - in the case of non-tag electronic toll collection, tollroad owners are permitted to charge an administration fee on top of the toll to recover the costs of collecting the toll. These non-tag electronic tolling products are known as 'passes'.

Interoperability, Roaming Agreements and Roaming Fees

19. The RTA is responsible for, amongst other things, managing the NSW road network. The RTA has established technical standards for tollroads to ensure that road users can use the electronic tag of their choice on any Australian tollroad. This means that all tollroads and tag products are 'interoperable', such that a road owner is unable to force road users to use a particular tag on their road. There are currently tollroads operating in Victoria, NSW and Queensland, all of which comply with the requirements of interoperability.
20. Interoperability is governed by a Memorandum of Understanding (**MOU**) between all tollroad owners nationally, including the RTA, under which tollroad owners are required to enter into 'roaming agreements'. Roaming agreements are bilateral agreements between each tollroad owner and each tag issuer which provide for the interoperability of tags on all tollroads.
21. Pursuant to the MOU, tollroad owners and tag issuers negotiate 'roaming fees' that are the subject of roaming agreements. Every time a motorist uses a tag to pay the toll on a tollroad the motorist's tag issuer collects the toll and pays this to the tollroad owner, less the negotiated 'roaming fee'.
22. Where the tollroad owner and the tag issuer are part of the same group of companies, then the roaming fee for toll collection is simply an internal transfer cost. However, where the tollroad owner and the tag issuer are from separate unrelated companies then the roaming fee is charged to the tollroad owner by the tag issuer.

⁵ The RTA is the tag issuer for the Sydney Harbour Bridge and Sydney Harbour Tunnel (E-toll).

⁶ As set out above, Interlink is the tag issuer for the M1, M4 and M5 (E-way).

⁷ As set out above, Transurban is the tag issuer for the M2 and M7 (Roam, Roam Express).

⁸ The Cross City Tunnel is the tag issuer for the Cross City Tunnel (Beep).

23. There is no regulation of the amount of the roaming fees for tollroads in NSW, Victoria or Queensland.¹⁰ The roaming fee which is charged cannot be passed onto the motorist and is therefore a cost to the tollroad owner.

Market inquiries

24. On 14 December 2006 the ACCC commenced market inquiries regarding the proposed acquisition with a range of interested parties including other tag issuers, providers of tolling services, tollroad owners, construction companies, financial advisers, debt-providers, road maintenance and operations providers and industry associations.

Statement of issues

25. For the purpose of this Statement of Issues, the issues in this matter are divided into three categories: 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to pose concerns'. The ACCC is seeking comments from market participants including the RTA in relation to all issues.

Issues of concern

Likely effect on competition for tollroad construction and ownership

26. The requirement of interoperability compels tollroad owners to negotiate bilateral agreements with each tag issuer so tollroads do not reject otherwise valid electronic tags. To date these negotiations amongst industry participants in NSW have been reasonably balanced by the fact that almost all tollroad owners had tag issuing businesses and tags were spread relatively evenly between providers.
27. However, a new tollroad owner (that does not have an established tag base) may be at a disadvantage due to the existing high level of electronic tag penetration among motorists in the Sydney metropolitan area. It is unlikely that a new tollroad owner would be able to issue tags to the large number of motorists that already have an electronic tag. Consequently, it is likely that a new tollroad owner would need to pay roaming fees to other tag issuers in order to collect toll revenue. The extent to which a new tollroad owner would have to rely on roaming fee arrangements would depend upon the location to the new tollroad and the extent of existing tag penetration in that area.
28. To the extent that a major tag issuer has the ability to increase roaming fees disproportionately to costs, this could impact upon competition with respect to tollroad construction and ownership. Roaming fees are likely to represent a

¹⁰ However, the Mitcham-Frankston Freeway Concession Deed between the Victorian Government and this tollroad owner provides that roaming fees reflect the net incremental marginal cost of providing the roaming service (section 33.9). However, Transurban is not presently bound by this as the Melbourne CityLink Project Deed was effected prior to this contractual regulation.

small but material cost to a consortium bidding for a tollroad project. The inclusion of a major tag issuer in a bidding consortium could affect the competitive bidding process for new tollroads in at least two ways.

29. Firstly, a bidding consortium which did not include the major tag issuer would have to build a premium into any future bids for tollroads to cover the cost of high roaming fees. This could increase their bid above competitive levels whilst a major tag issuer could align itself with a particular consortium and provide it with reduced exposure to the cost of roaming arrangements.
30. Secondly, the inclusion of a major tag issuer in a bidding consortium could create such uncertainty as to overall costs that potential competing bidding consortia, which did not include the major tag issuer, could be significantly deterred or foreclosed from participating in the tender process for new tollroads.
31. Higher roaming fees would have effects on the development of future tollroads by raising costs to government (when awarding new tenders) and possibly road users (through higher tolls on future tollroads).
32. Transurban submits that operational costs such as roaming fees are not a significant factor in determining toll prices or bids by consortia for new tollroad projects. It submits that the major considerations in determining toll prices are traffic forecasts, construction costs, length of concession and cost of capital.
33. More generally, Transurban submits that given that SRG only has a 50% interest in Interlink and due to the control structure of Interlink (under which a Board resolution would require the consent of 85% of shareholders), the proposed acquisition would not give Transurban effective control of the Board of Interlink and in turn the tag accounts issued by Interlink.

Invitation for further information –tollroad construction and ownership

34. The ACCC invites information and views from the RTA and other interested parties on:
 - whether and how the merged entity's 50% share in Interlink would enable the merged entity to exercise control over tag issuing by Interlink and potentially increase roaming fees above competitive levels;
 - whether and how any ability of the merged entity and Interlink to significantly control roaming fees could create such uncertainty as to overall costs that potential competing bidding consortia, which did not include the major tag issuer, would be significantly foreclosed from participating in the tender process for new tollroads;
 - whether and how any ability of the merged entity and Interlink to significantly control roaming fees could cause a bidding consortium, which did not include the major tag issuer, to build a premium into any bids for new tollroad projects to cover the cost of high roaming fees, and thereby increase their bid above competitive levels; and

- whether Transurban might be a party to multiple consortia bidding for a particular new tollroad project and, if so, whether and how this would maintain credible independent competition in new tollroad bidding processes.

Issues that may pose concerns

Likely effect on competition for supply of electronic toll services to motorists

Possible effect of higher roaming fees on competition between tag issuers

35. Market inquiries also indicated concerns that the merged entity and Interlink may use its position to increase roaming fees to tollroad owners both in NSW and interstate.
36. An advantage in winning new tollroad projects could result in an increase in Transurban's tag base through the issuing of additional tags to motorists seeking to use the new tollroad. This could further boost Transurban's position as a tag issuer and potentially provide a further ability in increasing roaming fees. Over time, this increase to the cost base of other tollroad owners and decreasing tag penetration relative to Transurban may weaken the tag issuing businesses of Transurban's competitors, potentially limiting their ability to compete in terms of prices and marketing in the issuing of tags to motorists or causing a move away from providing in-house tag issuing services.
37. Transurban's submissions in this regard include that roaming fees are governed by bilateral roaming agreements and it could not change the fee unilaterally under the terms of these existing agreements.

Invitation for further information

38. The ACCC is seeking views and information from the RTA and other interested parties on:
 - the extent to which there is contestability in relation to the services that are the subject of bilateral roaming agreements given that interoperability must be achieved through bilateral roaming agreements between specific tag issuers and tollroad owners;
 - the extent to which, under the terms of existing bilateral roaming agreements, existing roaming fees would prevail in the event of a fee dispute and whether this would act as a constraint on pricing of roaming fees by the merged entity;
 - whether the RTA provides a benchmark for roaming fees and how this is achieved;
 - whether the RTA's regulatory role would act as an indirect competitive constraint on the merged entity's ability to increase roaming fees above competitive levels and how this would be achieved, for example, due to:

- the RTA's involvement in authorising decisions relating to all NSW tollroads (including for example road widening, signage and marketing material); and
 - the RTA's involvement in awarding new tollroad concessions.
- the extent that the merged entity could increase roaming fees and the likely effect on tag issuing services to motorists as a result of the increased costs incurred by the tollroad owner (for example, a move away from providing in-house tag issuing services or limiting their ability to compete in terms of prices and marketing in the issuing of tags to motorists); and
 - whether there is the potential for new entry to the provision of electronic tag services to motorists by entities that do not have tollroad operation.

Possible effect on administration fees to motorists

39. Given the merged entity and Interlink's shares of electronic tags post acquisition, the ACCC may be concerned if the merged entity and Interlink had the ability and incentive to exercise market power by either raising administration fees charged to its tag holders above competitive levels or by lowering the level of services provided to motorists.
40. Transurban submits that:
- the RTA requires a 'fee-free' tag account to be provided, being a prepaid account with automatic top-up linked to a bank account and having no administration fees;
 - only additional services requested by a tag account holder may be charged for and that the charges must be cost recovery only in nature and be determined in consultation with the RTA; and
 - the merged entity and Interlink will continue to face strong competition from the RTA and other tag issuers so that any unreasonable fee increase would result in motorists switching to a competitor.

Invitation for further information

41. The ACCC is seeking views and information from the RTA and other interested parties on:
- the extent to which the RTA imposes a compulsory requirement for tag issuers to provide motorists with a fee-free account and whether this regulation would constrain the merged entity from increasing administration and account fees to motorists;
 - the extent to which charges for additional services to motorists are regulated by the RTA and could not be increased by the merged entity; and
 - the ability and incentive for motorists to switch to alternative tag issuers including the RTA, and whether this would provide an effective competitive constraint on administration and account fees charged to motorists by the merged entity.

Issues unlikely to pose concerns

Likely effect on competition for tolling services to tollroads

42. The ACCC has considered whether the proposed acquisition could impact upon the provision of tolling services to tollroads (comprising physical and electronic toll collection and customer service and complaint handling functions). Transurban and SRG currently provide these functions for the tollroads that they have interests in and Transurban has agreed to provide these functions on a third party basis to the Lane Cove Tunnel.
43. It appears that while there are third party providers with respect to these functions, the functions are primarily provided by tollroad owners on an in-house basis. Further, it does not appear the proposed acquisition would reduce competition or increase barriers to entry in the provision of tollroad services to tollroads.
44. As a result, it appears unlikely that the proposed acquisition would adversely impact on competition for tolling services to tollroads.

ACCC's future steps

45. The ACCC will finalise and publicly announce its view on this matter after it considers market responses invited by this Statement of Issues.
46. The ACCC now seeks submissions from the RTA and industry participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
47. Submissions are to be received by the ACCC no later than **Monday 12 February 2007**. The ACCC will consider the submissions received from the market and the merger parties in light of the issues that are identified above and will, in conjunction with information and submissions already provided by the merger parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
48. A Public Competition Assessment for the purpose of explaining the ACCC's final view on the proposed acquisition may be published following the ACCC's public announcement of its view.