

Productivity Commission

Draft Report on Progress in Rail Reform

Comments from National Rail Corporation Limited

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This document contains comments from the National Rail Corporation Limited on the Commission's *Draft Report on Progress in Rail Reform*, which was issued in March 1999.

These main headings in this document are those used as chapter headings in the Draft Report. For ease of reference, page numbers from the Draft Report are shown to the left of the text in this document. A small number relate to important errors of fact, method or interpretation, while a larger number are on matters of detail only.

Overview

The purpose of comments here is to point out apparent inconsistencies between the 'Overview' and the content of the main body of the Draft Report. There is also a need to revise the conclusions in a number of areas once the main body of the Report is revised in the light of other comments.

- xix In the 'boxed text' entitled 'Key messages' the **content of the main body of the report is not accurately reported. This has led to a number of news media reports which replicate the stereotypes about the 'sick railways'. Perpetuation of this (inaccurate) view of the rail industry is a major factor in slowing the remaining reforms which need to occur.**

It is an unfortunate fact that in the very competitive market for land transport in Australia, it is in the interests of the rail industry's competitors for the stereotypes of 'old rail' to be perpetuated. The business interests of rail operators are affected by these stereotypes, which are used against rail in the marketplace.

Specific content in this 'boxed' section of text which are not accurate or are a misleading articulation of the main contents of the report relate to productivity comparisons (which are repeated on page xxiv), and the concept of 'commercial focus', which is not consistently defined.

- xxiii In the range of ownership and governance arrangements, the **'Corporations Law' model** has been omitted, although it was mentioned as an important recommended reform in the 1991 report, and is mentioned elsewhere in the Draft Report.

- xix **The conclusions regarding comparative productivity in the Overview are inconsistent with those in the body of the Draft Report and the data presented in Appendices.** In particular, contrast the unqualified statement in the second dot-point in *Key messages* box ("*The productivity of Australian railways ... remains well below that of the United States and Canada*") and in the graph on page xxiv, with the statement on page 65 that "*The large difference in the scale of freight rail operations in Australia, the United States and Canada is likely to be a dominant factor explaining the differences in productivity achieved.*"

- D21 Furthermore, Table D.7 (page D21) shows that after removing the effects of 'scale efficiency', the 'technical efficiency' of Australian, US, and Canadian railways are almost identical. This indicates that apart from the unavoidable effects of geography and population, the productivity of Australian and North American railways is virtually identical. This conclusion should be more clearly and explicitly articulated in the Overview.

- xxvi As commented below (reference page 50) the **critique of what is variously referred to as 'commercial discipline', 'commercial focus' and 'customer focus' is inconsistent.** In particular, the conclusions on pages 242-243, which point to changes required in policy affecting the commercial environment and business objectives of rail organisations are in contrast to the unqualified and damaging statement on page xxvi that "the customer focus of government owned railways is poor". The evidence presented in the Draft Report to support this statement is very slight and some of it is inaccurate and tendentious.

Railways in Australia (Chapter 2)

- 7 It is misleading to characterise all of those in Table 2.2 as ‘major service providers’, as many are not ‘major’. It would provide a more useful perspective on the degree of impact made on the industry by entry of the private sector to classify the entities listed by size (NTK and employees) and to distinguish between those which operate largely with leased or hired resources and those which have a major investment in assets and trained people.

This touches on an important issue for the industry, **that is the poor quality of some assets in use above rail**. This reflects the unwillingness of many new entrants to risk investment in new assets. This issue is alluded to in a recent media release by a major rail-based freight forwarder.¹

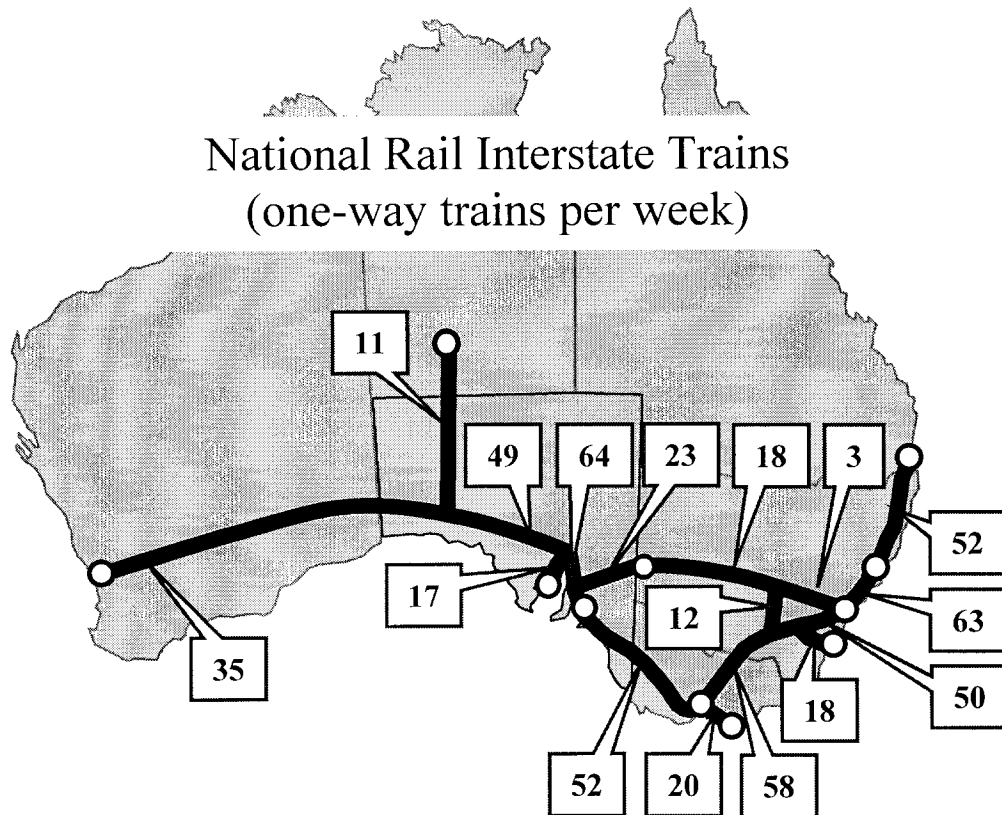
The low rate of above-rail investment by many new entrants reflects the high risk to such investment caused in part by the poor quality or obsolescence of much of the below-rail infrastructure, resulting from the long term low rate of below-rail investment. **A key issue for policy is how to reduce the risk to new private investment both above and below rail resulting from the legacy of historical under-investment by the public sector.** The National Rail policy initiative in 1991 was in part aimed at ‘pump-priming’ by investing in new assets which would break the cycle of “perceived high risk → under-investment → low profit”. The same pump-priming policy has not so far been applied significantly to below-rail infrastructure (it was intended as part of the National Rail initiative, but did not occur with vertical separation from 1995), but is almost certainly necessary to reduce the perception of high risk for the private sector investing in above-rail assets [see below comment at pages 17-18].

- 7 In **Table 2.2**, BHP is shown to have its principal area of operation in WA. In fact it also operates on a substantial scale in South Australia and on a smaller scale in New South Wales.
- 11 In **Table 2.3**, **the data used are too old**. In particular, it would be useful for assessing the impact of new entrants to present data for years since 1994/95, since new entries have occurred largely since mid-1995. Accurate statistics for later years are available from National Rail for all years up to and including 1998/99, and could be disaggregated into bulk, non-bulk and intercapital.
- 17 It is confirmed here that little is known about the extent of private sector investment in rail, other than anecdotal and unquantified evidence in a few submissions (could a quantitative survey be carried out?). However, the conclusion drawn on page 18 that there appears to have been little private investment in new assets is correct from our observation.
- 18

Railway characteristics (Sub-chapter 2.2)

- 20 The **composition of the interstate network** tentatively proposed should include the lines linking Sydney, Broken Hill and Crystal Brook, and linking to Whyalla, Western Port and Port Kembla. All links shown in the map below perform significant roles in the interstate network. The map below illustrates the density of trains on every principal link in the interstate system. The links joining Whyalla, Western Port and Port Kembla to the remainder of the national system are vital to the movement of large quantities of steel to and/or from these locations.

¹ “Major rail customer slams rolling stock”, FCL Interstate Transport Services Pty Ltd, 14 May 1999.



20 The four categories of rail operations must be considered very informal, and characteristics described on page 20-21 and in Table 2.6 are at best very approximate.

25 The Report states that “*The four networks and their economic characteristics provide a framework for discussion of issues in this report relating to performance, industry structure, public and private participation, and regulatory reform.*” The analysis is faulty in a number of areas.” The main issues relate to ‘low volume regional networks’ and the ‘interstate network’.

Low volume regional networks

23 **It not correct that “There is little or no competition either for the market or between train operators on low volume regional railways.”** Instances of competition on low-volume lines are very few as the possibility of competition on regional lines is very recent; the NSW Rail Access Corporation has provided successfully for genuine competition, and in NSW there are several examples where real competition has occurred. Our experience indicates that competition is looked for by shippers in all states using regional railways, and there are significant instances of real potential competition. This includes lines carrying agricultural commodities and minerals (eg coal, copper and other non-ferrous metals and non-metallic minerals).² See page reference 99 below for more detailed comment on this area.

Where CSO support is paid to one rail operator, the probability of competition is greatly reduced. Some rail operators on low volume rail networks are subsidised by CSOs; this occurs even in NSW where the incumbent operator is vertically separate from the track owner. In effect, the incumbent rail operator has a ‘fighting fund’ which is not available to potential

² In NSW these include significant haulage of non-metallic minerals from the NSW south coast to Sydney, movement of bulk commodities from within Sydney to Port Botany, and rail transport to service the reopened CSA copper mine at Cobar, NSW. Further examples could be provided subject to strict confidentiality.

competitors. The main requirement for government financial support is below-rail not above-rail. The major costs requiring subsidy on low volume networks are those for sustaining track and related infrastructure. Above-rail assets are very mobile and relatively low volumes can be carried efficiently.

Where CSO financial support is paid to the track infrastructure owner, competitive neutrality between potential above-rail train operators is preserved. To enable communities and industry served by low volume regional networks to benefit from competition between rail operators, governments should pay CSO subsidies to infrastructure owners, and not to train operators.

The interstate network

- 24 The major points at issue in relation to the interstate network are whether there is scope for growth of the market (or rail's market share), and whether profitability is likely. In relation to both issues, the evidence reported is sketchy and/or out of date.
- 24 It is **incorrect to infer from the evidence of National Rail that "rail is losing market share to road in non-bulk freight"**. The data used for Figure 2.5 (1971-1995) is now out of date. There has been a significant change in the competitive position of interstate rail freight since 1997, when the quality of assets and cost structure of rail began to improve – largely resulting from the commissioning of National Rail's new fleet of 120 NR Class locomotives and low-tare high-capacity wagons, and the ensuing changes in train economics. The effect has been especially marked on the East Coast.

National Rail's two-day transit Melbourne-Brisbane intermodal trains have achieved growth of almost 40% since mid-1997, with the pace accelerating since mid-1998. The economics of train operations have been improved by longer trains and reduced fuel consumption, and the market acceptance of rail services has increased by a substantial increase in service reliability. National Rail has also added services targeted at previously poorly-served market segments, eg high-cube, over-height, refrigerated and specialised freight (eg cars in dedicated wagons).

The commercial viability of these services has improved very substantially, and with further growth in volume is expected to become profitable in the near future.

- 25 **The inferred contrast between National Rail and two private firms which "would only remain in the market if they earn or expect to earn a commercial return" is puzzling [emphasis added]**. There is in fact no contrast, other than the fact National Rail's accounts are a matter of public record, and those of the other rail operators mentioned are not. As a corporation under the Corporations Law, National Rail can trade only while it remains solvent. Since it ceased to receive any financial support from its shareholders some 15 months ago, its Directors must have an expectation of commercial returns, backed by shareholder-approved strategic plans.

Rail reform in Australia (Chapter 3)

- 34 In **Tables 3.1 to 3.5** it should be made clear that it was not only AN which transferred its interstate freight business to National Rail, but also the State-owned railways in New South Wales, Victoria, Queensland and Western Australia.

It might also be useful in Tables 3.1 to 3.3 to state that the **shareholders of National Rail have announced their intention to sell their shares in the company** – Commonwealth (in 1996-97), Victoria (in 1996-97) and NSW (in 1997/98). The similar intention of Westrail in respect of Westrail is noted in Table 3.5.

In **Table 3.1**, line 1, National Rail should be shown as “**National Rail Corporation Ltd**”, and it would be useful to mention that it was “**incorporated**” [on 19 September 1991, under the Corporations Law, registered in ACT], not simply established. This is important, as **National Rail and the ARTC are the only instances of implementation of the first recommendation of the Industry Commission in 1991 that full commercialisation be effected by means of incorporation under the Corporations Law** (see Report p 31, Box 3.1, line 1).

- 39 **In Tables 3.1 to 3.6, the only state in which information is presented with respect to development of rail access regimes is NSW; information on other states should also be included.** Table 3.4 should note that Queensland Rail issued a draft rail access undertaking to the Queensland Competition Authority in 1998/99. Table 3.5 should note that WA issued a draft rail access regime to the NCC in 1998/99. Table 3.6 should note that South Australia legislated a Rail Access code (but did not request its certification by the NCC) in 1996/97), and that the Northern Territory and South Australia legislated for a Rail Access Regime to apply to the railway line from Tarcoola to Alice and Darwin, and jointly applied for its certification by the NCC in 1998/99. Victoria has no Rail Access Code at this time, as far as we are aware.
- 42 It would be useful in Table 3.7 to mention the details of the **Australian Standard** referred to, that is “AS 4292”.

Problems identified in 1999 (Sub-chapter 3.7)

- 50 **The critique of commercial and customer focus here and elsewhere in the Draft Report requires further inquiry in our view, as the evidence is sketchy and anecdotal.** Some allegations mentioned in the paragraphs below are in any case not accurate. As indicated below, the most useful comments on this issue are in the Draft Report’s conclusions, on pages 242-243.
- 242 In most of the Draft Report, comments made on this issue infer that the problem is primarily one of management behaviour. However, pages 242-243 state clearly that it relates to the policy and institutional environment in which many rail entities operate: “ownership arrangements”, “competitive neutrality”, “complex and inconsistent regulatory regimes”, “competition”. Under the heading *Increasing commercial focus* on page 243, the key impediments to achieving a more commercial focus are accurately listed.

The discussion of this issue throughout the report should be clarified to make clear that the issue is as described on pp 242-3, and not simply one of inappropriate management attitudes and behaviour. This is important so that the focus of the Report will be clearly on the policy issues.

- 51 **The comment of the Australia Southern Railroad (ASR), referring to National Rail, that “... at the rates bid for the Great Southern Railway business we doubt if there is a profit motive in the organisation”, should be deleted from the report, as it is unsupported by evidence and is not factual.**³
- 191 The same comment by ASR is repeated on page 191, and should also be deleted there. The comment by Austrac at page 191 is also unsupported by evidence, and also should be deleted.

In fact, National Rail has been informed by the Great Southern Railway Ltd (GSR) that it won the ‘hook and pull’ contract from GSR in November 1997 with a quoted price *higher* than that offered by one or more other tenderers, on the basis of superior service quality, and the business earns a profit for National Rail. It is unlikely that ASR had knowledge of the rates quoted by other bidders, including National Rail, when this comment was made to the Commission.

³ A significant amount of other material in the ASR submission to the Inquiry is also factually inaccurate.

It is clearly too easy for participants in the inquiry to make allegations of anti-competitive behaviour against their competitors in the industry unsupported by evidence. These allegations are matters potentially referable to the ACCC under the *Trade Practices Act 1974*, and should not be repeated in this Report without significant evidence to support them. Also as previously stated, the National Rail Corporation Ltd is bound by the Corporations Law, and it is also inappropriate for the Report to give credence to suggestions by competitors that the company's directors are neglecting their fiduciary duties.

Performance of Rail (Chapter 4)

This chapter requires substantial revision in respect of the following issues:

- The **end-point of the data series** used in the analysis of productivity is now close to 2 years out of date; for the Final Report, data up to and including 1998/99 should be used.
- The characterisation of National Rail for the purpose of productivity analysis as “**AN-NRC**” is **inappropriate**, as it assumes that the post-1993 operations of National Rail were predominantly those formerly under AN control.⁴ In fact they were substantially broader, encompassing the interstate freight operations of the State Rail Authority of NSW, the Public Transport Corporation of Victoria, Queensland Rail and Westrail, as well as AN. AN's operations were a minority of the total.
- **The conclusions drawn from the assessment of productivity change since 1989/90 do not properly reflect the data or methodology, in particular the distinction between ‘technical’ and ‘scale’ efficiency.** This is a key issues, as the most newsworthy findings in the Draft Report were those on the comparative productivity of Australian railways, which are based on the 30 times larger US Class 1 railroads.
- The appropriateness of comparing Australian railways, small and large (in the Australian context) with US Class 1 railroads, when the physical and commercial circumstances of the latter are very different from those in Australia. The fact that data are not available for a more appropriate comparison does not excuse the use the Class 1's as the sole benchmark.
- The opportunity may exist in the current inquiry to make some findings about the **‘limits of productivity’ for Australian railways.**
- The assessment of price and quality performance and of stakeholder impacts are also flawed in a number of ways, which are detailed below.

Data collection and selection of comparators

58 The Australian data series used for assessment of productivity can be improved in two ways, alluded to above: extension to 1998/99, and reconstruction of the National Rail series to include the full range of pre-1993 antecedents of National Rail's operations.

It would be worthwhile to attempt to extend the data series beyond 1996/97, as there are several events which have occurred in the following two years:

- Transfer in 1997/98 of the former AN business to new private sector owners, the first significant privatisation in the Australian rail industry.
- Continued expansion of private sector operations in the east-west corridor.
- Changes in train operations, including increased permissible train lengths, made possible by infrastructure investment funded by the One Nation program, completed in 1995, notably on the east coast.
- Transfer of control of 57 ‘good old’ locomotives to National Rail in 1997/98.

⁴ The limited nature of the ‘AN-NRC’ entity is confirmed on page D8: “... the models analyse the productivity change of the combined AN and NRC entity.”

- Commissioning of National Rail's 120 NR-Class locomotives in 1997/98, which brought about substantial reductions in train operating costs.
- Completion of intermodal terminal upgrades in interstate rail freight, except Sydney.

59 **The 'AN-NRC' entity used to analyse the productivity of interstate freight before and after transfer of the business to National Rail** would not matter if there were not specific comparisons made between National Rail and other rail systems, on pages 61-63. These comments about the problems with the 'AN-NRC' entity do not affect the analysis of the rail sector in aggregate. However, it is likely the growth of productivity in the interstate freight sector is greater than shown in the Draft Report.

The effect of the complex functional and financial arrangements during National Rail's transition to full control of the interstate freight business from 1993/94 to 1996/97 is that estimates of productivity in this sector of the industry in these four years are meaningless.⁵

The best option would be a 'before-and-after' comparison based on the aggregated interstate freight business of AN, SRA, PTC, Westrail and QR in 1989/90, 1990/91, 1997/98 and 1998/99. 1997/98 was the first year in which all of the extraneous factors distorting National Rail's real costs from start-up were absent.

Data for reconstruction of data points for freight task, employees, wagons and locomotives in FY1990/91 have been provided to the Commission in separate correspondence, and additional information is currently being supplied with respect to 1997/98 resources and freight task. Expenditure in each major functional area in 1990/91 and 1997/98 are shown in the table below.

Expense (\$ million)	Rail Authorities (Interstate Freight) 1990/91⁶	National Rail 1997/98
Fuel	130	79
Crew	90	58
Locomotive maintenance	70	33
Wagon maintenance	70	23
Terminal costs / Off Network	123	51
Track access	150	105
Overheads	100	81
Depreciation	50	34

We will try to provide further information for 1989/90 and 1990/91 and if requested.

⁵ National Rail began commercial operations by a progressive take-up of control of functions and assets from Australian National, the NSW SRA, the PTC of Victoria, Queensland Rail and Westrail. The process had a number of distinct phases, in which groups of functions were transferred (marketing, revenue administration, and operation of intermodal terminals in 1993; wagon deployment and maintenance in 1994; train crewing in 1993-94 and 1994/95; deployment and maintenance of locomotives in 1997/98). Pursuant to the Shareholders' Agreement of 1991, the financial arrangements underpinning this process had the (deliberate) effect of 'quarantining' costs within the State-based rail authorities, making some of the costs incurred for operation of interstate freight services invisible, as they were not reported in National Rail's financial statements; the proportion of 'quarantined' costs gradually diminished to zero in 1996/97; shareholder support in the form of payments under clause 5(4)(b) of the Shareholders' Agreement ceased on 31 January 1998. These complex arrangements are described in National Rail's *Annual Reports*.

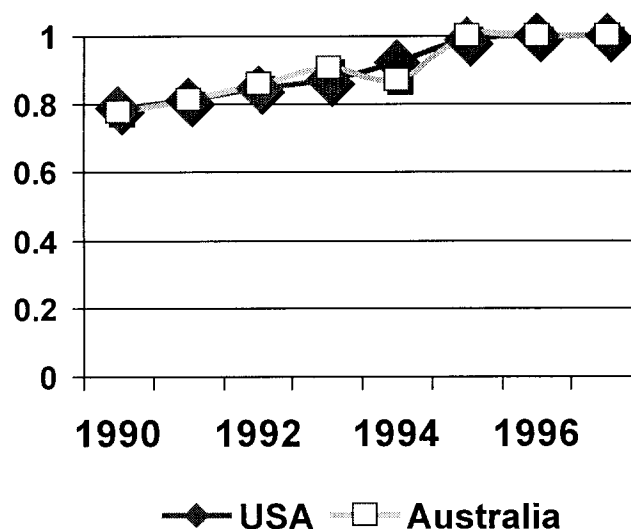
⁶ From Ernst and Young Business Consulting Services, *Benchmarking Review of Operating Costs*, September 1998, Final Report, page 5. From the Ernst and Young report: "NB: The breakup of the 1990/91 figures are estimates only. They are made up of the Rail Authority interstate freight results prior to the formation of National Rail. No adjustment has been made to the 1990/91 figures for inflation."

65 **The findings relating to ‘technical efficiency’ on page 65 do not recognise the significance of this partial measure of productivity; it should be the major basis for the findings in the Draft Report.** The relationship between ‘technical efficiency’, ‘scale efficiency’ and ‘productive efficiency’ is not adequately explained on pages 64-65. The main adviser to the Commission on the DEA methodology, R.C. Morey, stated at the Commission’s 13 April 1999 workshop that the focus for assessing the performance of Australian railways should be entirely on ‘technical efficiency’, not ‘scale efficiency’ or overall ‘productive efficiency’; this is consistent with the explanation given in Box D.2.

The explanation contained in Appendix D indicates that the ‘technical efficiency’ of Australian Railways in aggregate is equal to that of US Class 1 railroads, as shown in the graph below.

Figure: Relative Technical Efficiency of US and Australian railways.

(Source: VRS scores in *Draft Report*, Table D7, page D21)



The opportunity might exist in this Inquiry to assess the ‘limits of productivity’ in Australia’s railways. In other words, to find an answer to the question what is the realistic highest attainable productive efficiency of Australia’s railways compared with US Class 1 railroads.

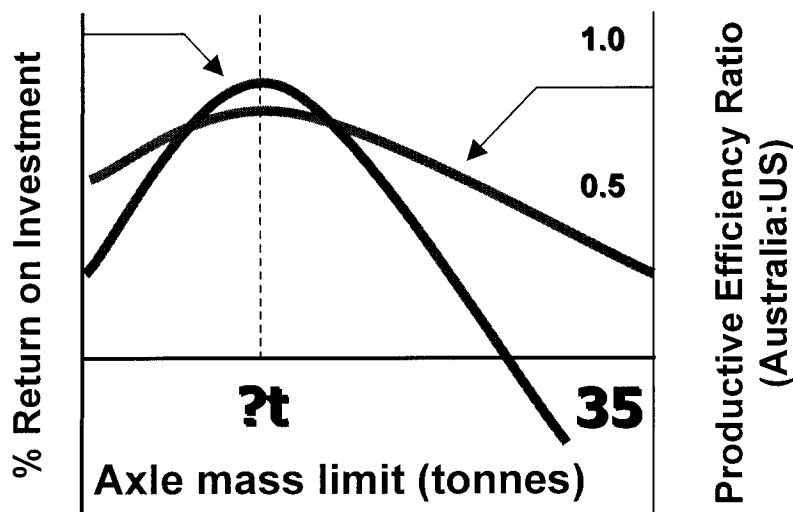
A number of environmental and technical factors determine that the unit costs of carrying some types of freight by rail in Australia are higher than in the US and Canada. For example in North America there are:

- Heavier maximum axle loads (up to 35 tonnes on mainlines carrying non-bulk freight); 60% more payload is possible with 35 t compared with the Australian norm of 21 t.
- Double stacking of containers in all major trans-continental corridors
- Double track on all major trans-continental corridors, permitting train crossings without the delays inherent with single track operation.

All of these superior technical characteristics, which provide greater productive efficiency, come at a cost in greater capital investment, in a heavier track structure, double track and a more generous outline gauge. In North America, the larger capital investment can be defrayed by the very much greater traffic density than exists in Australia.

This suggests that the limits of productivity in Australia are determined ultimately by traffic density (ie scale), which in turn determines the level of investment in productivity enhancing

capital improvements which could earn a viable return. The question is: what is the optimal level of investment, and what is the comparative level of productive efficiency which is attainable with that level of investment. The graph below attempts to illustrate the concept with reference to one of the explanatory variables, ie axle mass limits:



Clearly a significant effort would be required to calculate the optimum axle mass (which will differ by corridor), similar values for other such limits, and the peak attainable productive efficiency. However, for the road transport industry, there has been a conceptually similar assessment of axle mass and dimension limits carried out on three occasions since the mid-1970s. A similar investigation for rail would go a long way to resolving the issue of the limits of productivity and the limits of viable investment in this industry.

A recommendation that the recently established National Office of Rail Safety Administration (NORSA) should arrange to conduct a rail version of ERVLS and RORVLS, should be made by the Commission in its final report.

- 67 The inference drawn on page 67 that “To compete with road AN-NRC and other carriers of bulk {sic – should be “non-bulk”] freight are often forced to set freight rates below cost recovery....” is not correct.
- 67 The **average freight rate across the whole rail sector**, reported on page 67, is meaningless as it applies to a very wide spectrum of business conducted by railways, with a very wide range of rates charged for greatly differing tasks, commodities and distances, with a variety of value added services.

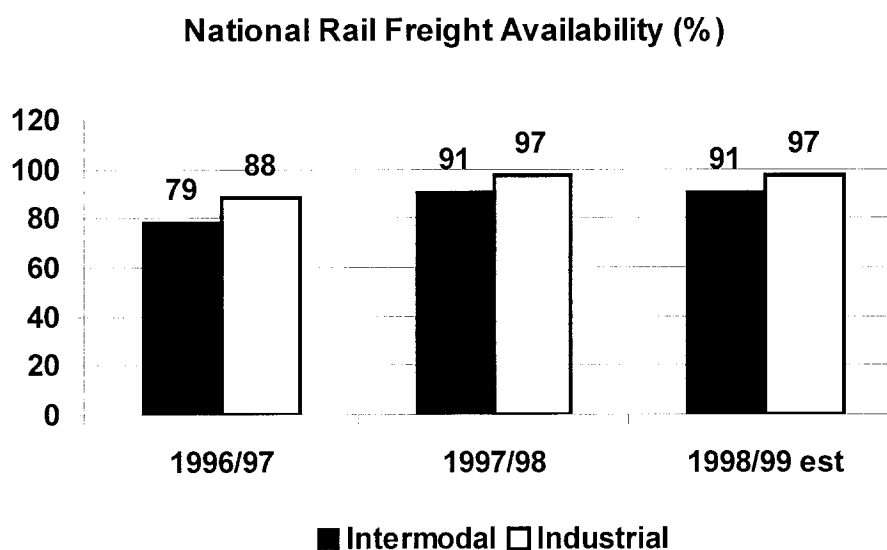
Quality

- 71 The comments on this section are aimed at improving two aspects of the analysis:
- The **use a more appropriate measure of freight output quality** (the timely delivery of freight).
 - Improving the usefulness of findings by providing more up-to-date data..

The appropriate performance measure for timely delivery of freight is “freight availability”. This measure calculates the percentage of occasions when the time at which customers are promised they will receive delivery of their freight is the same as the actual time at which freight is made available by the rail operator.

On-time train running is not an appropriate measure, other than for internal management control. The arrival times of trains can vary substantially from these times, eg when freight is promised to be available at 6 am, and owing to timepath allocations a train is due to arrive in the terminal at 3 am. If the train arrives late at, say, 4.30 am, this will not normally affect on-time availability of the freight on the train.

Freight availability is routinely measured by some railways in Australia. The chart below shows National Rail performance for the three most recent full years:



These figures are very different from those reported on page 71 of the Draft Report. There was a decline in reliability between 1993/94, when business functions began to be transferred to National Rail, and 1995/96, the last year before delivery of the first NR Class locomotives. This has since been rapidly corrected, as shown above. More detailed performance data are available and should be used in the Final Report.

- 79 In paragraph 8, the comment mentioning “redundancy payments” is not appropriate to National Rail, which has not made any redundancy payments until 1998/99.

The preferred structure (Sub-chapter 5.4)

- 99 It is suggested in the Draft Report that low volume regional railways should be exempted from the National Competition Policy, but **the ‘special case’ for vertical integration of low volume regional railways has not been made convincingly**. It is interesting to note that the case for special consideration for ‘low volume regional railways’ is being made by a number of incumbent rail operators on such networks. The argument is effectively one in favour of eliminating rail competition on all intrastate rail corridors except very high volume single-purpose coal and iron ore lines.

All of the arguments used to justify vertical integration of ‘low volume regional networks’, however, defined, apply equally to interstate rail corridors, where the Draft Report argues the opposite case:

- There is strong competition from road transport; in the case of interstate freight there is also strong competition from coastal shipping

- The low density of traffic means that division of the market between two or more rail carriers deprives any of them of the train operation economies of scale.
- The advantages of single control of above and below rail factors of production.

These arguments cannot be indiscriminately applied to any network without testing the circumstances of individual cases. The definition of low volume regional railways is too simplistic and general to warrant the conclusion drawn. No threshold volume test has been proposed by the Commission, and the definition refers to some relatively high volume minerals corridors, which for many years have been subject to virtual monopoly by intrastate carriers.

There is a need to test the economics of each line, and the potential benefits of competition, using the processes available in Access Codes. Three non-regulatory barriers to entry on these lines are minimal, as the cost of operating stand-alone unit trains for bulk commodities is low, and significant price reductions have been delivered to commodity shippers on minor regional lines, without compromising profitable operation by National Rail.

Some examples of relevant lines include:

- Cobar to Parkes, Cobar to Muswellbrook, and Blayney to Muswellbrook/Sydney (mineral concentrate corridors); intense rail competition in these corridors is currently reducing rates to local mineral producers.
- Moree to Newcastle (cotton and seed traffics in bulk trainloads).
- In the NSW Riverina (where competition from Austrac and National Rail has seen rates significantly reduced)
- In Western Australia, the corridors serving the Eastern Goldfields minerals province (Murrin Murrin, Malcolm, Kambalda, etc) and iron ore ex Koolyanobbing to Esperance.
- In Western Australia, the lines providing rail access for transport of bauxite.
- In South Australia, the isolated non-metallic mineral hauls from the Barossa Valley and the upper Eyre Peninsula could also be subjected to tender-based competition, as in the case of Leigh Creek-Port Augusta coal. The fact that infrastructure in the latter corridor is owned by the freight customer is not different in principle from the other lines mentioned provided there is a strong Access Regime to protect the interests of rail customers.
- Grain lines in any state can be subject to tender-based competition

An appropriate test in all the above instances would be whether integration would have the effect of creating (or re creating) a rail monopoly. The result of such a test on any regional line with more than minimal volume, particularly involving one or more bulk commodities, is likely to be yes. In many such cases, the road-based option is not a practical alternative owing to the volume of bulk freight to be carried. Even 2-3 modest trains per week can be a superior alternative to the economics of road transport, as has been demonstrated by Austrac in the NSW Riverina. As on the interstate network, there is a place for efficient “niche” operators on regional networks (see page 104).

Vertical separation of ‘low volume’ regional lines in New South Wales is allowing rail competition with the result of improving service and reducing prices to consumers, but at rates which are profitable to National Rail. Business being won by National has been subject to formal or informal tender, often in areas where there is no effective competition from road. Communities and industries (manufacturing, agricultural and extractive) in regional Australia will not benefit from potential competition if vertical integration on these rail lines is sheltered from competition.

High volume regional railways

- 103 **Vertical separation of high volume regional railways is essential to achieving the benefits of competition for customers using these railways.** This has been demonstrated in NSW, which is the only State in which there is vertical separation, and also the only State in which rival rail operations have been established on the intrastate network. This competition has resulted in substantial reductions in freight costs for customers, and also the introduction of new service types adapted to individual customers' circumstances.

Public and private participation (Chapter 6)

- 111 There can be no doubt that the most effective form of commercialization for government-owned trading entities including railways is incorporation under the Corporations Law. The standards of commercial behavior required of such entities is more strictly sanctioned than in any special legislation. It is also aligned with the mainstream commercial culture of the business community in which it operates in competition with other privately owned firms.

The National Rail Corporation Limited and the Australian Rail Track Corporation Limited are the only rail entities in government ownership which are constituted under the Corporations Law, as recommended by the Industry Commission in 1991. The Commission should recommend wider application of the Corporations Law model, as it would eliminate a number of the shortcomings of corporatisation as it has been implemented in most entities.

- 117 Table 6.2 should contain reference to the substantial tendering and contracting (outsourcing) by National Rail between 1993 and the present. This includes locomotive maintenance, wagon design and construction, some wagon maintenance and component interchange, terminal equipment maintenance, all provision of all information technology development and operations and a number of corporate functions, including internal audit, treasury, recruitment, and staff training.

Privatisation

- 127 There are undoubted/undisputed benefits from privatisation, and National Rail's board has given strong support to the announced intention by its shareholders to sell their shares in the company. However, the contrast sometimes drawn (eg on page 127 of the Draft Report) between the commercial behavior of private and publicly owned companies is exaggerated.

In the case of National Rail, an incorporated company, its government shareholders have not given it any directives beyond those implied by the requirement that they approve annual corporate plans. To go beyond this would be in breach of the Corporations Law. The main impediment to a more complete replication of 'commercial' practice are constraints on changes to balance sheet structures, eg debt raising, issue of further equity, takeovers, mergers and establishment of subsidiaries.⁷

- 130 Mention is made of **alleged "hoarding of assets" by National Rail**, but without evidence. The assets of National Rail include spare capacity to cater for growth anticipated in the next 1-3 years. The recent growth of 40% in 20 months in the east coast corridor and recently won business in intrastate markets (especially NSW) is an indication of the potential to make effective use of all present assets.

⁷ Some of the allegations of non-commercial behaviour by National Rail by respondents to the Inquiry have their origins in the need for rapid change during formation of National Rail's business. Eg, long-standing services which were heavily loss-making could not be sustained and had to be quickly modified or terminated. Intermodal freight rates were very disorganised and strongly discriminated against some customers; this was also changed, to the disadvantage of some who were benefiting from the former situation.

Regulating access to rail markets (Sub-chapter 7.2)

Ensuring genuine competitive access to the rail network is central to the efficient functioning of the rail system as a whole. Customers using portions of the rail network which are not subject to real contestability will obtain no benefit from competition policy reforms. Well designed and effectively administered access regimes are a critical factor in ensuring on-going improvements in rail productivity and service quality. Their influence in this regard has been very significant.

Access regimes must be designed with two background facts in mind:

- Rail access providers are monopolists, exhibiting varying degrees of monopoly behaviour
- Where there is vertical integration between an access provider and a rail operator, the probability of monopoly behaviour is increased.

The goals of regulating access to rail markets should therefore be:

- To promote genuine contestability cross the total rail network.
- Within this framework to preserve economies of scale and scope.

It is not appropriate to give either of these goals primacy over the other. It is a fact that economies of scale and scope can be negated by monopolistic pricing and neglect of service quality by protected access providers and rail operators.

Characteristics of a well designed access regime

145 The characteristics enumerated on page 145 are very broad in nature. **In practical terms, the required features of a well designed access regime are:**

- A process to administer requests for negotiation of access in good faith, fairly and without undue delay.
 - This must include a requirement for adequate information on the infrastructure service available, cost structures and quality performance measures/targets.
- Pricing guidelines which contain clear criteria for floor and ceiling prices, allow for minimal price discrimination, take account of all government subsidies in the revenue base of the access provider, and provide for periodic independent review of key price variables (eg rates of return).
- Transparent prices once agreed, or alternatively an obligation on an independent regulator to ensure that all price agreements conform with non-discrimination rules
- Vertical separation of ownership and/or control of infrastructure and above-rail operations
- In the absence of vertical separation, effective ‘ring-fencing’ of the access provider from its associated above-rail operator, to ensure a probity in all aspects of its relationships with access seekers, including:
 - Processing and storage of confidential information
 - Negotiation of terms and conditions which do not unfairly discriminate in favour of the incumbent.
- Balance in the scope of contract terms, to ensure the access provider cannot exert monopoly power over access seekers, including appropriate two-way indemnities and warranties, and two-way commitments to performance measures and objectives.
- Contracts for track access should give sufficient security of tenure of train time-paths to enable rail operators and their customers to enter into binding transport contracts, with terms commensurate with commitments to capital investment and commodity sale contracts. This means a minimum of 15 years, with options for renewal.

- Independent, transparent and expeditious arbitration and appeal processes.
- An independent and transparent periodic review process, to occur at intervals of no greater than five years.

Four access regimes are currently being considered by national or state competition authorities with a view to becoming 'effective'.⁸ Two others have not been formally presented to these authorities.⁹

For major rail customers and for above-rail operators, the practical effectiveness of access regimes is a matter of daily commercial concern and is material to their business success and failure. For National Rail, rail access fees are approximately one-quarter of total costs, and the quality of access provided is a very large factor in determining the quality of service which can be provided to customers. The strength and unanimity of comments made in first-round submissions to the Commission, many of them reproduced in the Draft Report, indicates a high level of concern in this area.

The experience of National Rail in negotiating access with six access providers over five years is that the practical areas in which national and state-based access regimes are deficient (in varying degrees) are:

- Lack of price transparency, which belies a desire by some access providers to exploit the potential to price discriminate. Without posted prices, there is potential for unfair (or economically inefficient¹⁰) price discrimination. This is significantly aggravated where (as in most cases in Australia) the access provider is vertically integrated with a competing rail operator. Such integrated operators not unnaturally expect to receive favorable treatment from their colleagues, and there is a natural suspicion by access seekers that they sometimes receive it (with no way of verifying the contrary).
- Few if any incentives in pricing arrangements for productivity improvement by access providers, which have been the laggards in lifting productivity during the 1990s.
- In some cases, weak arrangements for review of pricing variables (rates of return, etc); NSW is a notable exception in this regard, and may in the event provide the benchmark for the remainder of the country.
- Weak 'ring fencing' arrangements which provide too few safeguards against leakage of commercial information within vertically integrated rail entities, and too few sanctions against breaches of probity standards. For example, few existing regimes provide a right to recover civil damages from vertically integrated access providers in the event of losses suffered from breaches of 'ring-fencing' standards.
- The time required to negotiate access is seriously out of step with the 'rhythm' of commercial demands by rail customers, giving competitors (incumbent rail operators and road transport) an inherent advantage over a rail competitor requiring track access. Posted prices are a partial remedy for this.
- Lack of balance in the rights and obligations of access contracting parties. In particular, there few if any provisions for financial rewards and penalties in the event of deviation from agreed quality performance standards.

⁸ Regimes (legislation and attached Access Codes) have been presented to the NCC for certification as effective by New South Wales, Western Australia and jointly by South Australia and the Northern Territory; Queensland has formally presented an access 'undertaking' to the Queensland Competition Authority. It is understood an undertaking for the national railway infrastructure is being developed by the Australian Rail Track Corporation.

⁹ An access regime for intrastate rail infrastructure has been developed in South Australia but there has been no application for certification to the NCC; similarly there has been no application from Victoria for an access regime for intrastate infrastructure.

¹⁰ The comment of Mr Ernie Easton quoted on page 153 of the Draft Report is relevant in this regard.

- Performance standards should apply reciprocally. The recent plea for higher standards of operational performance by train operators in a media release by a large freight forwarder indicates the need for performance obligations to be accepted by both parties.¹¹ Reciprocal performance obligations are an increasingly common feature of contracts between rail operators and their customers. For National Rail, the majority of contracted revenue is subject to these terms.

155 The Draft Report contains a number of comments concerning the allocation of train timepaths. The comments here relate to proposals for **auctioning train time-paths**.

‘Grandfathering’ of existing train timepaths is said to give advantages to existing rail operators. In theory, auctioning of time-paths would provide signals about the value placed on paths by actual and potential users. However, the practical difficulties, some of which are mentioned in the Draft Report, are a powerful argument against the auctioning approach:

- Where there is a need for a new train path to serve a new customer or new market, it will be rare that any more than one operator is in a position to bid for it. In the Australian context where customers are few in number, and opportunities for new business are infrequent, it is likely that only one operator will have the prospect of secure new revenue requiring a new time-path.
- For existing time-paths, there are long-term business relationships and contracts which rely on continuing access to the path at a stable price. To place this on sale by auction would disrupt these relationships, and it is likely that most operators displaced from a path by an auction process would be forced out of business.
- There are strong inter-actions between time-paths on the network, both ‘vertically’ (between time-paths on the same track), and ‘horizontally’ (between time-paths on adjacent sections of track, which are administered by different access providers). The practical difficulties of coordinating auction of a continuous path across a whole corridor (eg Sydney-Perth) would make an auction impossible.
- Rail cannot compete with road and coastal shipping if it must secure access to infrastructure under such tenuous conditions.

So what is the solution to this? Is there a need for one? Rail’s competitors on the road network pay a standard posted price for infrastructure access regardless of time of day, day of week, location of corridor or type of commodity. Why should rail operators be required to do businesses in a much more complex and uncertain environment? Rail reform will be permanently handicapped if regulation of rail becomes continually more complex.

The opportunity for price discrimination arises only because rail access providers are monopoly providers of infrastructure, unlike the providers of competing road infrastructure.

158 The rates of return on infrastructure investment proposed in a number of access regimes are generally too high. The rigorous analysis contained in the recent NSW IPART report should be replicated by any jurisdiction fixing a rate of return and in periodic reviews.

158 **Outcomes likely to be produced by the concept of the ‘one-stop shop’ for rail access are not well understood.** As currently formulated, they would create a new role as ‘middleman’ for the ARTC for access to infrastructure used for interstate rail operations in New South Wales and/or Western Australia. Interstate rail operators in these states would purchase through the middleman, but all functions involved in providing the access would continue to be performed by the state-based authorities. This recipe comes from a misconception of the issue, and would create more problems than it would solve, for example:

¹¹ “Major rail customer slams rolling stock”, FCL Interstate Transport Services Pty Ltd, 14 May 1999.

- Pricing would be shrouded in two layers of secrecy and confidentiality instead of the current single layer. Opportunities for unfair price discrimination would double.
- Negotiation of train time-path details would be conducted through intermediaries, leading to many delays, and the probability of an unsatisfactory outcome.
- Provisions for indemnities and warranties would be made more complex; in particular, the ability of the middleman ARTC to enforce performance warranties on behalf of the access user is questionable.
- The inclusion of performance measures for quality service delivery by the ARTC, when acting as the middleman, would become doubly difficult, as they would have at best a limited ability to affect the quality of service provided by the actual access providers.
- Day to day management of train paths (a large and complex task involving very frequent communication between the contracting parties at present) would be complicated by interposing the middleman; it would be too easy for the ultimate access provider to ‘pass the buck’ to the ARTC, which in spite of its best intentions would be unable to address the detailed operational issues which arise every day.

For all of the above difficulties and others, National Rail and other rail operators have a strong preference to continue to deal directly with the real access providers, both when negotiating contracts for access and when managing the on-going use of access. The problems in dealing with several entities to obtain access are minor compared with those listed above.

- 159 It is stated that the ARTC is developing an industry code for access to the interstate network. If that is so, rail train operators currently using the interstate system (or who are potential future users) have no knowledge of this, and have not so far been consulted about its contents.

Safety regulation and operating standards (Chapter 8)

This chapter is generally good.

The major issue is how to ensure effective formulation and implementation of harmonised regulations, when all the regulations are in state jurisdictions.

The Commonwealth needs to take a strong leadership role in this matter, as it has in the formation and on-going support for the National Road Transport Commission (NRTC), which has an analogous role for the competing mode.

The recent agreement of the Commonwealth, States and the Northern Territory to form a new non-statutory body within the Department of Transport (the **National Office of Rail Standards Administration – NORSA**) is a useful first step. It is imperative there be full consultation with the rail industry as well as regulatory bodies in the states on the objectives, staffing and work program of this new entity. There needs also to be strong representation of the industry on a steering committee to oversight and direct the work of this body.

It is anti-competitive that during policy deliberations of the ministerial Australian Transport Council, the reform agenda of the road transport industry is always strongly and effectively represented at the table by members of the statutory NRTC, while the reform agenda of the rail industry is consistently unrepresented, and goes largely unheeded.

Competitive neutrality across road and rail transport (Sub-chapter 9.2)

Lack of competitive neutrality stems largely from the policy framework and processes. Table 9.1 provides a useful overview of the main areas where there is an absence of competitive neutrality. Taken in total, the effect over several decades has been to create a land transport

system which is powerfully biased towards successful outcomes for the road transport industry and towards failure for the rail industry. It is remarkable that in spite of all the factors listed in Table 9.1 that the rail industry has developed in the largely positive manner seen in the 1990s.

The main outlines of the issue and much of its detail have been stated many times (eg by the National Transport Planning Taskforce and by the Neville Committee), and the Draft Report restates these.

The **most important issue for the long term is that of infrastructure investment**, and the recent federal budget has again confirmed the immense imbalance between the provision of public funding for road and infrastructure, especially on the ‘national rail highway’. The scale of the imbalance is such that the prescription of more private sector funding for investment in rail infrastructure could not provide a full solution.

- 207 The **analysis of taxes and charges on land transport in the Draft Report is disappointingly general**, and the recommendations avoid the central issue of competitive neutrality in taxation.

The discussion in the Draft Report makes little use of data supplied to the Commission at its request concerning whether some part of the Diesel Fuel Excise is to be treated as a ‘road use charge’, or whether the excise is simply a tax.

The **proposals contained in the ANTS package** will erase more than a decade of slow progress towards a rational and economically efficient infrastructure charging system.

Development of such a system was substantially progressed early in this decade by establishment of the NRTC, and the processes created by the *National Road Transport Commission Act 1991* for declaring an appropriate level of ‘road use charge’ (combining a portion of the fuel excise and vehicle registration fees). National Competition Policy reform provided the framework for mechanisms to set parallel charges for rail access.

The ANTS policy will destroy this system by removing the fuel excise from the realm of infrastructure charging, converting it to a new tax on freight and passenger transport, effectively abolishing road use charges for heavy vehicles (all except the small component of vehicle registration charges), but leaving rail to pay the new tax (18 cents/litre) as well as rail access charges (which are equivalent to 73 cents/litre of diesel fuel consumed).

The Commission should make an unequivocal recommendation to begin restoring balance to the system of infrastructure charging for land transport.

Infrastructure charges

- 212 The Draft Report refers to the diesel fuel excise and comments that it “... is regarded by the NRTC as a road use charge....” **The status of the fuel excise as (in part) a road use charge has stronger origins that are implied by this statement.**

The *Heavy Vehicles Agreement* of July 1991 (an inter-governmental agreement of the Commonwealth, States and Territories) provided that the charge nominated by the National Road Transport Commission and not disapproved by a majority of Ministers of Transport (sitting as the Ministerial Council for Road Transport) was to be treated as a charge for the use of roads. The Agreement, which is Schedule 1 to the *National Road Transport Commission Act 1991* (Cwth) defines the ‘road use charge’ as:

a charge equal to the part of the diesel fuel tax levied by the Commonwealth for the use of a Vehicle on a road being the part fixed by the National Commission from time to time, in accordance with this agreement.

Clause 9 of the Agreement (the Schedule to the Act) requires:

The Commonwealth shall take all reasonable steps to ensure that there is levied and collected a tax on diesel fuel, being a tax at no less a rate than that of the Road Use Charge recommended by the National Commission and not disapproved by a simple majority of all the members of the Ministerial Council within two months after that recommendation.

All governments subsequently agreed to declaration of 18 cents per litre of excise as the road use charge referred to in the Agreement. This appears to put beyond doubt that the intention of governments was to create a road use charge from a portion of the fuel excise.

Competitive neutrality requires that only road transport pay this charge, and that competing rail transport be exempted from it.

- 216 National Rail endorses the finding of the Commission on page 216 concerning under-recovery of road costs from heavy road vehicles, and Draft Recommendation 9.3 that “the Commonwealth Government should establish an inquiry into the provision funding and pricing of roads in Australia”.

The way ahead (Chapter 11)

This chapter will clearly require revision to take account of comments received by the Commission on the Draft Report, including those by National Rail in areas such as the application of competition policy to ‘low volume regional networks’.

However, the main outlines of this chapter are sound, and are a better overview of the findings of the Commission than the “Overview” chapter at the beginning of the Draft Report. The “Overview” should be completely re-written.