



## Department of Infrastructure

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Dear Mr Banks

### REVIEW OF THE NATIONAL ACCESS REGIME

The Office of the Director of Public Transport in the Department of Infrastructure appreciates the opportunity to put some comments to the Commission regarding its Inquiry into the National Access Regime in relation to the regulation of access in the rail industry.

The rail freight industry in Australia is undergoing substantial restructuring, moving from a set of State based monopolies to a competitive industry which readily crosses State boundaries.

This development is being fostered by third party access regimes but is also being encouraged by a commitment amongst rail operators to progress the efficiency and competitiveness of the rail industry, and overcome historical operational differences that impede the efficient operation of the rail network. For example, an Industry Reference Group has prepared a draft set of uniform codes for a range of operational systems including safe working, communication requirements, train operations, axle loads, braking standards and rolling stock specifications.

#### *Victoria's Initiatives*

The Victorian Government recognises the significant safety, environmental and social advantages that rail freight has over road. It seeks to foster an increased rail share of the overall freight task, including an increase in rail's modal share of freight entering and leaving the ports from 10% to 30%.

Improved regional freight links, coupled with the development of a nationally competitive and vibrant rail freight industry are crucial to achieving these goals. Victoria's initiatives to promote the development of a competitive rail freight industry include:

- Leasing, for a period of fifteen years from 1 July 1999, the Victorian interstate track from Serviceton on the South Australian border to Albury on the New South Wales border to the Australian Rail Track Corporation to be managed as part of a "one stop shop" for trans-national rail movements.
- Giving the ARTC management responsibility for infrastructure maintenance and train control of the Victorian interstate rail network in addition to access management as part of the 15 year lease.
- The commitment in the recent State budget of \$96m to standardisation of much of the Victorian country network to eliminate historical gauge barriers to interstate rail traffic movements.

- The implementation from 1 July 2001 of a Victorian rail access regime covering the freight network ensuring that access seekers can access Victoria's intrastate freight lines and the key Dynon intermodal terminals on reasonable terms and conditions.
- The standardisation of the Geelong grain loop to facilitate the transport of grain and other freight from standard gauge tracks to the Port of Geelong.
- Extension of Dock Link Road to improve links between the Dynon and South Dynon rail freight terminals and the Port of Melbourne.
- Development of long term strategic plans for the industry, including a Freight and Logistics Strategy for Victoria, a range of studies into the feasibility of re-introducing rail into the Port of Melbourne, the Dynon Hub Master Plan and the Inner Western Rail Corridor Master Plan.

The Government is also committed to substantial works to upgrade several regional rail tracks to improve or extend passenger services. Infrastructure to Geelong, Ballarat, Bendigo and the LaTrobe Valley will be upgraded to provide for regional fast trains. Services will be extended to Ararat from Ballarat, Bairnsdale from Sale and South Gippsland from Cranbourne. The Mildura line will be upgraded for the reintroduction of passenger services. The substantial track upgrades associated with these projects will also be of benefit to the rail freight industry.

#### *A National Rail Access Regime – Dual Use of Tracks*

Rail access policy is usually discussed in terms of its impact on the rail freight industry where benefits are generated for rail operators and their customers. However, many parts of Australia's rail network are also used by passenger services. These services are generally subsidised by State Governments. Where the needs of freight and passenger services compete, decisions about the allocation of capacity and priorities are required to be made.

Rail operators depend heavily on Government subsidies even in a privatised passenger rail environment such as Victoria's. Major investments in extending or improving services require Government funding, whether directly, or indirectly through higher ongoing subsidies to private sector operators to enable them to fund investment. States also invest heavily in rail infrastructure for freight, although the Commonwealth has committed some funding to the 'national' rail track. It is therefore preferable that where State Governments have primary responsibility for rail asset management, they retain the ability to regulate the asset, including access arrangements.

The public holds State Governments responsible for the operation of the rail network in a way which meets social as well as industry needs. States necessarily need to retain control over their rail networks in the interests of managing these competing interests. Typically this has been achieved through State based regimes provided that they are consistent with the Competition Principles Agreement in order to promote the development of a nationally competitive rail freight market.

#### *Victoria's arrangements*

Victoria's access regime is provided for in Part 2A of the *Rail Corporations Act 1996 (Vic)*. The regime is a negotiate-arbitrate regime with the Office of the Regulator-General (ORG) acting as the independent arbitrator of disputes. The legislation provides for passenger priority and for Orders-in-Council to be made that are binding on the ORG in determining disputes. Provisions in the *Transport Act 1983 (Vic)* also provide for passenger priority (with provision for exceptions).

Orders-in-Council declaring the Freight Network, the Bayside Network and the Dynon Terminals, and setting out pricing principles have been issued. Under the orders for the Freight Network (leased to Freight Australia) passenger and freight services share the 'base' costs of a line and freight users are not required to contribute to costs which are only incurred to meet the needs of passenger trains. Access seekers pay a share of the relevant forward looking costs. On the Bayside Network, which is primarily a passenger facility, freight is charged incremental costs to travel during off-peak hours, but a full share of network costs to travel at the peak (subject to the availability of paths). There is also a Pricing Order for the Dynon Terminals.

These principles were considered more appropriate for Victoria than floor-ceiling price arrangements, as Victoria lacks the high return mining business which are conducive to those pricing arrangements in some jurisdictions.

### *Freight Australia Issues*

In May 1999 Freight Australia (then known as Freight Victoria) purchased the V/Line Freight business and entered into a 45 (3 x 15) year lease of the Victorian country passenger and freight intra-state track. Prior to the transaction bidders were advised of the Government's intention to implement a third party rail access regime, which would be subject to pricing principles which did not allow lease (or sunk) costs to be recovered in access prices, but allowed for cost recovery on operations and maintenance, together with a margin, and new capital expenditure costs, together with a commercial return. The regime is a negotiate-arbitrate one, under which parties are free to agree on any terms and conditions they wish and the pricing orders are only applied by ORG in the event of a dispute.

Freight Australia's December 2000 submission refers to the treatment of sunk costs (see page 5). The discussion appears to be based on the premise that new investment undertaken during the term of the lease is also treated as being sunk. However, it is only the case that investment prior to the date of the infrastructure lease being entered into, 30 April 1999, is treated as 'sunk'. This investment was undertaken by previous Governments. Had the access regime allowed a return on sunk costs it is likely that V/Line Freight would have attracted a higher price. The cost of this policy decision was therefore borne by the Government through a lower sale price and not by the purchaser of the business. Bidders would not have been willing to pay for a revenue stream which would subsequently be unavailable to them. Any change in the treatment of sunk costs at this point would confer a windfall gain on the successful bidder, Freight Australia, which would be likely to translate into higher access charges for potential rail competitors.

Prior to the introduction of the Victorian Regime new capital expenditure undertaken since the lease was entered into is eligible to receive a return of at least 4% above the Commonwealth 10 year bond rate in any pricing determination made by ORG. The pricing principles which apply to the freight network thus allow Freight Australia to recover its own new investment in the track. Under the pricing principles this return is also recoverable if the facility is sub-leased.

Freight Australia's concerns on this point were also discussed at the public hearing in Melbourne (*Transcript 28 May 2001, page 12*) where reference was made to the \$163m total purchase price for the business, including the freight carriage (above rail) business. In particular, Freight Australia asserted that \$90 million of its total purchase price was allocated to the acquisition of the lease. On this point, it should be noted that bidders for V/Line Freight were advised that they could structure their bid in whatever manner they chose. Thus a bid could have been successful, whilst offering \$0 for the lease, or allocating the whole purchase price to it. Any amount allocated to the pre-paid lease was at the option of the

bidder and was likely to have been influenced by financial engineering issues, not an economic assessment of the value of the lease.

I trust these comments will be helpful to you in considering issues raised in the Inquiry. If you require further information on Victoria's access arrangements, please contact Mary Potter on 03-9655-6418.

Yours sincerely



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