



Great Southern Railway

Submission to the Productivity Commission

Road and Rail Freight Infrastructure Pricing

May 2006

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1. Executive Summary

Great Southern Railway (GSR) operates three long distance Passenger trains; the Indian Pacific; The Ghan and the Overland. GSR is the only privately owned company in this market and operates the only Passenger rail services that traverse Australia. The rail infrastructure used by our Passenger trains is the same as that used by freight trains. We therefore request that the Productivity Commission consider and address access pricing issues for Passenger rail as part of its review of freight infrastructure pricing.

GSR offers a unique Australian tourism experience that attracts large numbers of tourists to rural, remote and regional communities generating significant economic activity in the regional economies of Australia. One study that focuses on Alice Springs alone estimates that in 2005 GSR delivered sufficient tourist visits to generate tourism expenditure of \$50.8 million and create 190 jobs. Extrapolation suggests that GSR directly and indirectly generates 1,400 jobs and \$1billion of economic activity per annum.

GSR's trains link Australia's capital cities with many rural, remote and regional communities. This also satisfies an important community need, particularly for the many members of the community who have limited access to other forms of transport. The long distance Passenger rail industry is clearly important to; the access and transport needs of the community, particularly those members whose travel options are limited; and the tourism economy of Australia, particularly rural, remote and regional economies.

The present track access pricing regime does not differentiate between freight and Passenger trains despite Passenger trains imposing far less cost on the infrastructure than freight trains. The consequence is a significant distortion in pricing, resulting in a price that bears no relationship to the relative costs imposed on the track owner by the different train types. We ask the Commission to consider redressing this distortion.

In considering relative costs, firstly, Passenger carriages' lower axle loads (an average 13 tonne versus 20 tonne for freight) have proportionately less impact on the infrastructure. This means each tonne of Passenger train imposes less maintenance cost than each tonne of freight train. Secondly, the total mass of Passenger trains is less and therefore imposes less cost. Thirdly, Passenger trains are faster, more reliable, more predictable and more flexible than freight trains, and consequently more efficient in their use of network capacity. Detailed analysis in this submission clearly supports the position that long distance Passenger trains impose significantly less cost on track infrastructure per gross tonne kilometre than freight trains.

A Queensland Competition Authority (QCA) report on user-related infrastructure maintenance costs cites numerous studies which all produce results which consistently show 30% to 60% of track maintenance expenses are variable with gross ton-miles.¹ An Indec Consulting report to the Essential Services Commission (ESC) concludes that the fixed infrastructure costs should be recovered in a manner that is related to the recovery of the incremental infrastructure costs.² This is consistent with railway studies in the

¹ Queensland Competition Authority, Working Paper 2 "Usage-related infrastructure maintenance costs in railways" December 2000, p9.

² Indec Consulting, Connex Submission to the Essential Services Commission, 21 March 2006

USA.³ This suggests that notwithstanding the two-part pricing regime in place in most jurisdictions, the overall GTK rate is the best comparator as a measure of cost drivers.

Despite the importance of long distance Passenger trains to the economy of Australia and the unique characteristics of Passenger trains, track access prices have not been developed specifically for Passenger trains. Instead access prices applicable to freight trains are foisted upon Passenger trains. The variable price per Gross Tonne Kilometre (GTK) is usually the same for both freight and Passenger trains. The fixed flagfall price is usually the same or higher for Passenger than for freight trains.

This creates a situation in which the total price (variable GTK plus fixed flagfall) expressed per GTK is much higher for a Passenger train than a freight train, despite lower axle loads. For example on the ARTC network from Adelaide to Parkeston the total prices expressed per thousand GTK are over 70% higher for Passenger than for freight; (\$5.16/000GTK for the Passenger train; \$2.97/000GTK for the freight train.)

Therefore, although Passenger cost is less per GTK, the price it pays is much higher.

This submission also demonstrates that Passenger has a lower capacity to earn revenue per GTK compared to freight. It therefore appears that the end-market has been ignored in the development of the present Passenger pricing regime. Passenger is also denied the benefit of the risk-reward sharing between freight operators and track owners inherent in two-part pricing. The track owner shares volume variance risk with the freight operator under the present price regime. In contrast the same risk is almost entirely transferred to the Passenger operator. The present pricing regime for access to rail infrastructure clearly creates inequities between freight and Passenger.

As a result of the current level of access charges, the services operated by GSR are marginal and do not produce an adequate return on capital to sustain long-run viability. This submission shows that in the 9 years since GSR acquired the Passenger assets of the former Commonwealth owned Australian National Rail, GSR has been able to significantly lift the productivity and efficiency of long-distance Passenger rail. Notwithstanding the efficiency gains of privatization, the current track access pricing regime (established at approximately the same time) acts as a significant barrier to investment for existing operators and is a deterrent to competition. A change in the pricing practices is required to foster long-run sustainability of the sector and create conditions that will foster competition, both within the mode and with other modes.

This submission puts forward alternatives for access pricing based on recognizing that Passenger and freight have unique characteristics and thus require unique pricing structures. This is consistent with the present practice of track owners of treating bulk commodities as a separate category distinct from general freight and applying different pricing structures for access by operators carrying bulk products (such as coal and grain). On this basis, we assert that because of its distinguishing characteristics, Passenger is also a separate category and should be treated as such in an access pricing regime.

³ Queensland Competition Authority, Working Paper 2 “Usage-related infrastructure maintenance costs in railways” December 2000, p8.

GSR suggests the simplest way to rectify the inequities and anomalies is by recalibration of the Passenger flagfall as a proportion of freight flagfall, plus a discounted GTK rate. Based on the present access pricing, the equitable level of pricing will be achieved where the flagfall for Passenger is 25% of the Premium Freight flagfall and the GTK rate for Passenger is 75% of the GTK rate for freight. This solution produces total access price (i.e. total variable plus fixed expressed per GTK) that are comparable for freight and Passenger, and more aligned to relative cost burdens to the Track Owner

The implementation of an alternate access price regime for Passenger trains will have a limited impact on track access providers, because the vast majority of their revenue is derived from freight trains. The benefits however will be substantial and broadly distributed. Furthermore, the change to the regime will not permanently reduce the track owners' earnings from Passenger. Rather, the alternative regime will be a stimulus to investment in capacity growth and will reduce barriers to potential new entrants, leading to long-term sector sustainability and growth, benefiting all stakeholders.

Passenger is a small proportion of the track owners' business and the Passenger business is incremental to the main business of the track owner, being freight. The fact that Passenger is an incremental part of the track owner's business may have contributed to the current situation in which access pricing for Passenger has been ignored. The incremental nature of the Passenger business suggests that incremental access pricing for Passenger may be another appropriate alternative pricing approach. Pricing at a level to ensure Track Owners recovered their incremental costs would likewise rectify the problems associated with the current pricing structure and would result in access prices that are lower than the alternative pricing proposed above

In summary the implementation of a specific track access pricing regime that is appropriate for Passenger trains will deliver a number of significant benefits, in particular:

- Ensuring operators are charged in proportion to the costs they impose;
- Providing equity between freight and Passenger operators;
- Enabling long distance Passenger rail services to become viable and sustainable over the long-term;
- Creating a more competitive industry environment
- Improving mobility for those members of the community with limited transport options;
- Providing visitors and associated benefits to the rural, remote and regional communities visited by long distance Passenger rail operators.
- Stimulating economic activity for tourism industries in regional Australia; and
- Creating increased employment opportunities in regional Australia

Great Southern Railway will be pleased to provide such further assistance to the Commission as it requires in determining how this issue should be addressed.

2. Introduction

2.1 Great Southern Railway's Submission

GSR is grateful to be able to provide this submission in response to the Productivity Commission's Road and Rail Freight Infrastructure Pricing Issues Paper of March 2006 (Issues Paper). GSR's submission provides the perspective of a Passenger rail operator, and focuses on rail infrastructure pricing for both Passenger and freight rail operators and the competition faced by Passenger rail operators from other modes. This submission presents new issues which have remained dormant since the inception of access pricing and these issues now require urgent attention.

The rail infrastructure used by GSR Passenger trains is the same infrastructure as that used by freight trains. We therefore request that the Productivity Commission consider and address access pricing issues for Passenger rail as part of this review. In the context of this submission, the term "Passenger" means long-distance interstate Passenger rail of the type operated by GSR, and does not include urban or intrastate services. The submission addresses the issues specific to the Passenger segment only.

This submission;

- Provides a brief background of GSR and the trains it operates and discusses the public benefits provided by GSR's trains;
- Discusses the terms of reference of the Issues Paper and their relevance to the long distance Passenger rail industry;
- Examines the costs imposed by both Passenger and freight trains on infrastructure providers;
- Comments on the capacity to pay of the Passenger and freight rail markets;
- Identifies the access pricing inequities and anomalies that exist between Passenger and freight trains;
- Proposes alternate access pricing for Passenger trains;
- Discusses the benefits of the proposed alternate pricing;
- Discusses implementation methods for the proposed alternate pricing; and
- Discusses the Issues Paper and the questions asked in the Issues Paper.

Track owners understandably focus their attention on that part of their business which generates the most revenue, being freight trains. Consequently inequities and anomalies exist as a result of the application, to Passenger trains, of a pricing regime to that was developed for freight trains. These issues are yet to be addressed by track owners or Regulators. GSR aims through this submission to create awareness of these inequities and anomalies, and a realisation that such anomalies must be promptly addressed to;

- Achieve equity between freight and Passenger trains;
- Ensure the future long-term viability of the Passenger rail industry in Australia;
- Establish a fair pricing system that fosters competition; and
- Remove the restrictions on the external benefits provided by the Passenger rail industry, particularly for rural, remote and regional Australia.

2.2 Productivity Commission Terms of Reference

The title of the Productivity Commission's paper and the terms of reference specify "rail freight infrastructure". The Terms of Reference document states that "the purpose of the review is to assist COAG to implement efficient pricing of road and rail freight infrastructure". The fact that it is called "freight infrastructure" in the Terms of Reference should not exclude the pricing of infrastructure for use by Passenger rail operators because the same "freight infrastructure" is used by both freight and Passenger.

As a general observation, the focus of the inquiry on freight infrastructure reflects the historical approach to pricing of rail infrastructure that has focused on freight and not considered Passenger trains as a distinct or separate category. This is understandable given the predominance of freight operators on this infrastructure. However such an approach has resulted in the pricing of rail infrastructure access that is specifically suited to freight trains and is by default applied to Passenger trains. This paper will demonstrate that the rail infrastructure pricing that applies in most jurisdictions in Australia is not suited to, and is prejudicial to a viable, sustainable and competitive Passenger sector. It is critical that the inappropriate pricing of rail infrastructure for Passenger services is recognized and then addressed as a matter of priority.

2.3 Great Southern Railway, Scope and Scale of Operations

GSR operates the following long distance Passenger rail services

- The Indian Pacific (Sydney – Perth and return) Twice weekly
- The Ghan (Adelaide – Darwin and return) Twice weekly
- The Overland (Adelaide – Melbourne and return) Three times weekly

The three train services operated by GSR are both a tourism experience and a form of interstate transport. The trains stop at many rural, remote and regional destinations and provide much needed visitors to these areas.

GSR's fleet of carriages consists of 90 Passenger and service units (power vans, crew cars, luggage vans) that are in service on The Ghan and the Indian Pacific. These are of the same construction and interior layout, having been built in the early 1970's. The Overland operates with 20 units that are of a different construction built earlier in the 1960's. GSR's fleet also includes 15 motorail wagons. A further 25 non-operational carriages are held in storage at the Keswick Terminal rail yards. The total book value of assets utilised is \$61 million and the replacement value is approximately \$400 million.

GSR provides direct employment for 400 people. In addition, it contracts hook and pull services to provide locomotive power, maintenance services to maintain rolling stock, catering services for provisioning, and a number of other sub-contracted services such as cleaning and security. We estimate this generates a further 120 jobs.

GSR is Australia's only national Passenger rail operator and accesses rail infrastructure in Western Australia, South Australia, the Northern Territory, Victoria and New South Wales. The breadth of GSR's operations provides GSR with a unique insight into the effect of rail infrastructure pricing on the long distance Passenger rail business.

2.4 Great Southern Railway, External Benefits

GSR delivers significant external benefits particularly in the areas; of satisfying the travel needs of those with limited access to other modes of transport; and of stimulating growth and activity in the tourism industry.

In relation to the public transport service that GSR provides, GSR's trains are an important link for travel between country towns along the various routes and Australia's capital cities. GSR's rail services guarantee a freely available low-cost mode of public transport. Many of GSR's patrons in Red Kangaroo class have limited options for interstate travel. Research shows that they rely on GSR's services as their predominant and often their only means of long distance transport on GSR routes. The current demographic profile of Red Kangaroo passengers is female (60%); aged over 65 (60%) and with an income of less than \$400 per week (80%). This part of GSR's services therefore meet an important need for members of the community whom have limited means, thus GSR contributes to the Government's social inclusion objectives.

In relation to the contribution to the tourism industry, GSR generates significant numbers of tourist visits to rural, remote and regional Australia and each of these visits generate significant benefits for the local economy.

The value and importance of tourist visits, particularly to rural, remote and regional Australia is recognised by the Commonwealth Government who has funded a number of programmes to generate tourism in these areas. A press release issued by the Parliamentary Secretary for Industry, Tourism and Resources in August 2003 states that "A vibrant tourism industry is a vital element of all regional and rural economies. It provides spin-off opportunities for other businesses in the region and creates employment, particularly for young people."⁴

In 2005 GSR carried approximately 52,000 Passengers on The Overland, 74,000 on The Ghan and 79,000 on the Indian Pacific. Many of these Passengers board or alight or make a stop-over in tourist destinations in rural, remote and regional Australia generating significant benefits for these communities. Alice Springs is used here as a case study to estimate a portion of these benefits.

A report on the Northern Territory economy and tourism prepared by the Northern Territory Government estimates that each tourist visit to the Northern Territory in 1999/00 generated expenditure of \$1,125⁵, or \$1,337 in 2005/06 dollars (escalated at 2.5% per annum.) A report prepared on behalf of NT Airports Pty Ltd estimates that one job is created in the Northern Territory for every 200 visitors⁶.

Approximately half of the Passengers on The Ghan board, leave or make a stop-over at Alice Springs, therefore in 2005 The Ghan generated 38,000 tourist visits to Alice Springs. The above research indicates that the tourists brought to or from Alice Springs by The Ghan generated expenditure of \$50.8 million and created 190 jobs.

⁴ Media Release, The Hon Warren Entsch, MP (Parliamentary Secretary 1998-2006, 4 August 2003

⁵ Northern Territory Government, Northern Territory Economy, www.nt.gov.au,

⁶ NT Airports Pty Ltd, The economic significance of Alice Springs Airport, 1 June 2004, pvii

This is a significant contribution to the economy of Alice Springs and the Northern Territory. It is clear that GSR creates significant external benefits well in excess of the revenues collected by GSR. Importantly these external benefits accrue in rural, remote and regional communities.

There are many other rural, remote and regional communities that are visited by GSR such as Katherine, Broken Hill, Kalgoorlie, Port Augusta, Bordertown, Dimboola, Horsham and Ararat. GSR provides a tourist experience that forms a link between these communities and the cities of Sydney, Melbourne, Adelaide, Darwin and Perth.

The total benefits delivered by GSR to all the rural, remote and regional communities visited by GSR have been estimated below and are substantial. The restriction of such benefits by inappropriate access prices for long distance Passenger trains must not be allowed to continue and is discussed further in this submission.

Internal estimates based on the Alice Springs study cited above suggest that GSR services generate expenditures in the tourist destinations visited by GSR in the region of \$200 – 300 million and create 700 – 1,000 jobs. Taking into account the multiplier effect of this tourism expenditure, the level of additional economic activity could be in the region of \$1 billion.

2.5 A Historical Perspective

The separation of track ownership and above rail operation was established as part of the 1997 micro-economic reform and is largely based on the Hilmer reforms.

GSR was formed to acquire the Passenger assets and operations of the former Commonwealth-owned Australian National Railways when it was privatized in 1997 as part of the Howard government's micro-economic reform agenda.

The ARTC was formed in 1997 when the Commonwealth and State Governments of New South Wales, Victoria, Queensland, Western Australia and South Australia signed the Intergovernmental Agreement. The ARTC is a company whose shares are owned by the Commonwealth. The ARTC commenced operations in July 1998.

Access to the ARTC interstate network is based on the ARTC Undertaking, submitted in February 2001. The ARTC Undertaking was voluntarily lodged by the ARTC under Part IIIA of the Trade Practices Act 1974 (TPA) and approved by the ACCC on 1 May 2002. Part IIIA of the TPA is based on the notion that competition, efficiency and public interest are increased by overriding the exclusive rights of owners of monopoly facilities to determine the terms and conditions on which they will supply their services. Part IIIA focuses on facilities of national significance that it would be uneconomic to duplicate or replicate and that supply a service, access to which would promote competition in another market.⁷

During the development of the ARTC's Undertaking and the access regimes applying in other jurisdictions, access prices were developed on the basis that one price fits all. These prices tended to suit the dominant freight operators. Since this time these prices

⁷ Miller's Annotated Trade Practices Act, 2004, Lawbook Co, p178

have been applied to Passenger trains by default, without due consideration of the different and unique characteristics of Passenger trains and the Passenger rail industry.

With the benefit of hindsight and as this paper will demonstrate, there are significant differences between freight and Passenger. These differences render the application of a “freight” access price to Passenger trains inappropriate and damaging as explained in this submission. This historical oversight needs now to be dealt with to strike the appropriate balance between track owners’ costs and access fees for Passenger (as distinct from freight) and to ensure long-term sustainability of the competitive environment for Passenger.

2.6 Long Term Viability

Access fees are a significant proportion of GSR’s costs, accounting for approximately 15% of ticket revenue. As this submission will demonstrate, the magnitude of access fees, particularly the fixed Flag-fall component, threatens the long-term viability of GSR’s Passenger train services.

Since privatization GSR, has delivered significant improvements in the financial performance of Passenger, by growing revenue and by extracting gains in both productivity and efficiency. This is illustrated in Table 1 below.

Table 1: Comparative Financial Performance of GSR – pre-privatisation to 2005

\$millions	1996	2005
<u>Revenue</u>		
Net Ticket Sales	35.3	67.4
Commonwealth Concessions	5.1	8.3
Other Revenue	2.9	12.5
Total Revenue	43.3	88.2
<u>Expenses</u>		
Operating Expenses	32.8	51.0
Wages & Salaries	18.3	18.0
Overheads	10.6	11.3
Total Expenses	61.7	80.3
EBITDA¹	-18.4	7.9
NPAT²	n/a	0.7
Investment	n/a	61.5
Return on Investment³	n/a	1.1%

¹ Earnings before Interest and Tax and before Depreciation & Amortisation

² Net Profit (after depreciation & amortization of rolling stock & other assets) After Tax

³ Percentage of NPAT to Net Assets.

Table 1 draws data for GSR's financial results from detailed financial data supporting Great Southern Railway Holdings Pty Ltd Special Purpose Accounts that will be lodged with the Australian Securities Commission. The financial data for 1996 performance of the Passenger rail unit of Australian National Railways is from a 2003 Australian National Audit Office (ANAO) Report. It is noted that the ANAO figures are based on direct costs only and do not include any charges for the capital costs of the rolling stock.

Table 1 illustrates that GSR has been successful in growing revenue, which has doubled since 1996. At the same time, labour and overheads have been held at substantially the same level, demonstrating that in private sector hands, there have been significant gains in productivity and efficiency.

Analysing GSR Operating Costs, the largest cost increase is in track access charges, which amounted to approximately \$10 million in 2005. The comparative 1996 ANAO figures are based on direct operating costs only and therefore exclude charges for use of track infrastructure. The 2005 GSR Operating Costs also include \$2.5 million for insurance. The Commonwealth effectively self-insured, and therefore it can be inferred that there is no insurance cost in the 1996 ANAO figures. When taking into account these two new costs that are in the 2005 GSR numbers, but not in the 1996 AN numbers, it again demonstrates there has been a significant efficiency gain realised by privatization.

This shows that GSR has delivered on the benefits of micro-economic reform the Howard government had envisaged at the time of privatisation. However, in spite of the fact that the sector is now efficiently operated, the return on investment is inadequate. Based on the current written down value of the rolling stock and notwithstanding the improvements mentioned above, GSR's Return on Investment does not support significant investment in new rolling stock or existing assets in the long term.

The present level of track access fees is a significant impediment to delivering an adequate return on investment for Passenger rail operators. Whilst the sunk cost and the marginal returns will sustain survival of the sector in the near term, the present access pricing regime puts the longer term at risk. Until such time as there is a competitive environment in which an efficient Passenger operator with sufficient scale can generate an adequate return on investment, it will be difficult to support the replacement of existing rolling stock at the end of its useful life.

Track access apart, all other costs are now market based and contested, as a result of previous micro-economic reform. Track access remains a natural monopoly that requires regulation to ensure that an appropriate level of cost is imposed on Passenger rail operators, having regard to the specific nature of Passenger's use of the rail freight infrastructure. As this submission will demonstrate, intervention is needed to deliver a structural adjustment in the pricing regime for Passenger, to create a fair competitive environment for the sector and establish conditions for its sustainability.

3. Costs Imposed by Freight and Passenger Trains on Rail Infrastructure

The following analysis explains why Passenger imposes significantly less cost on track infrastructure per Gross Ton Kilometre (GTK) than freight trains.

Firstly, Passenger trains are much lighter than freight trains. For example the Indian Pacific is approximately 1,130 tonne and The Overland is approximately 595 tonne compared to freight trains on these corridors of approximately 3,400 tonne. Therefore Passenger trains involve far fewer GTKs than freight trains.

More significantly, Passenger trains have much lighter axle loads than freight trains. GSR's carriages have axle loads of approximately 12 tonne, compared to freight wagons using the same track as GSR that have typical axle loads of approximately 20 tonne. The axle load and the total mass of a train have a significant bearing on the maintenance costs caused by the train.

A Queensland Competition Authority (QCA) report provides analysis of the Queensland Rail (QR) network and maintenance costs and states that for a train of the same total mass a 6 tonne reduction in axle load results in a corresponding 8.3% reduction in maintenance cost. The maintenance cost component of the access price can be adjusted from \$0.54 per '000GTK to \$0.495 per '000 GTK.⁸ Applied to Passenger trains this means that not only do Passenger trains cause less maintenance costs because they are lighter trains but each tonne of Passenger train causes less maintenance cost than each tonne of freight train because the axle load of a Passenger train is less.

A study of US railways between 1978 and 1981 showed that "running track maintenance" and "track maintenance – overhead" vary at 50% and 58% respectively with gross ton-miles.⁹ The QCA report on user-related infrastructure maintenance costs cites numerous studies which all produce results which consistently show 30% to 60% of track maintenance expenses are variable with gross ton-miles.¹⁰ This supports the industry practice of using GTK based access prices to recover variable maintenance and operational costs. However, given the relative axle loads, the price per GTK for recovery from Passenger logically ought to be less than that for freight.

An Indec Consulting report to the Essential Services Commission (ESC) also concludes that fixed costs should be recovered in a manner that is related to the recovery of the incremental maintenance costs.¹¹ This is consistent with the US railways study.¹² On

⁸ Queensland Competition Authority, Working Paper 2 "Usage-related infrastructure maintenance costs in railways" December 2000, p23.

⁹ Queensland Competition Authority, Working Paper 2 "Usage-related infrastructure maintenance costs in railways" December 2000, p8.

¹⁰ Queensland Competition Authority, Working Paper 2 "Usage-related infrastructure maintenance costs in railways" December 2000, p9.

¹¹ Indec Consulting, Connex Submission to the Essential Services Commission, 21 March 2006

¹² Queensland Competition Authority, Working Paper 2 "Usage-related infrastructure maintenance costs in railways" December 2000, p8.

this basis the fixed component of the cost of providing access for Passenger trains would also be less than the recovery rate for freight.

It is clear that access prices should be proportional to the costs imposed by the operator. On the basis of the foregoing, a strong argument can be developed for the creation of Passenger specific access prices that have a lower price per GTK than freight due to the lower axle load and thus lower maintenance costs imposed by Passenger trains.

The lower GTK rate must also be accompanied by a lower fixed flagfall price, to reflect the fact that the costs imposed on the track owner are lower and Passenger Trains are much lighter. The reverse is presently the case, with flagfall for Passenger being the same as or higher than freight. The effect of this is to substantially increase the total access charge without any reference or proportionality to the costs imposed.

In general terms it is clear and well accepted that Passenger trains cause lower track maintenance costs than freight trains. They also impose lower overall costs on freight infrastructure. The access prices that currently apply to Passenger trains have not been developed specifically for Passenger trains. This creates the incongruous situation in which Passenger trains pay higher access prices and higher access charges when expressed per GTK than freight trains whilst imposing significantly less cost. This situation also results in a number of other inequities and anomalies regarding access pricing that are further discussed in section 4 of this submission.

4. Existing Access Pricing Anomalies between Passenger and Freight Trains

GSR pays access fees to the Australian Rail Track Corporation (ARTC), Asia Pacific Transport (APT), WestNet, Rail Infrastructure Corporation (RIC) and RailCorp. The ARTC, APT and WestNet all structure their access prices as a fixed flagfall and a usage price based on GTKs. The usage price is generally the same as the usage price applying to freight trains. The flagfall is usually the same or higher than the flagfall applying to freight trains.

The following analysis demonstrates the application of these access prices to freight and Passenger trains using ARTC published rates (included in Appendix 1). The ARTC access prices are typical of the access prices charged by other track owners. ARTC access charges constitute approximately 54% of all access charges paid by GSR.

4.1 Comparative Pricing of Typical Freight and Passenger Trains

Under the ARTC reference pricing each track section has a different price. The Adelaide to Parkeston section has been selected as being representative of the other sections and is the longest section in the ARTC reference prices. This section of track is 1,992.5 km long. The charges that apply are;

Usage	\$2.256/'000GTK;	All Trains
Premium flagfall	\$6,565.57;	Maximum Speed 115km/hr (Passenger and bi-modal trains only)
High flagfall	\$5,688.52;	Maximum Speed 110 km/hr
Standard flagfall	\$4,812.55	Maximum Speed 80 km/hr

These access prices are now applied to typical freight and Passenger trains to demonstrate the anomalies that arise in the application of such pricing structures. A typical freight train travelling on this corridor can be up to 1800m long and is likely to be 1500m long and have a gross mass of 3,380 tonne, a typical Passenger train travelling on this corridor is likely to be 595m long and have a gross mass of 1,134 tonne.

Table 2: Comparative Pricing of Typical Freight and Passenger Trains – Adelaide to Parkeston on ARTC track

	Freight Train	Passenger Train
Length (m)	1,500	595
Mass (tonne)	3,380	1,134
Total '000's GTKs	6,734.6	2,259.5
Flagfall Charge (Fixed)	\$4,813	\$6,566
GTK Charge (Variable)	\$15,193	\$5,097
Total Charge	\$20,026	\$11,663
Ratio of Fixed Flagfall to Total	24%	56%
Total Charge expressed as a price per '000 GTK	\$2.97	\$5.16

Table 2 shows that the total access charge is less for a typical Passenger train than for a typical freight train. This would be expected as the Passenger train is approximately one third of the mass and one third of the length of the freight train. However, despite being 33% of the mass and length, the total charge for the Passenger train almost 60% of that of the freight train. This is unjustifiably high given the relative cost impositions. The cause of this distortion in relativities is the flagfall price.

Table 2 demonstrates that the flagfall is so high in relation to the usage charge that any relationship between the access charge and the relative costs imposed is destroyed. The result is that Passenger pays a much higher total unit price than freight trains when expressed as a total charge per GTK. Given the preceding analysis of cost drivers (see Section 2.3) it is clear these charges are well in excess of the relative costs imposed.

The high flagfall results in an access charge that is; not related to the costs imposed; higher than can be sustained; restricting investment in Passenger rail and diminishing the competitiveness of the Passenger rail market.

Continuance of such a high flagfall charge for Passenger trains cannot be justified. If the charge is an attempt to recover fixed costs there is a strong argument for recovering these fixed costs in proportion to the variable costs imposed by the rail operator. This argument is presented in the Indec Consulting report to the Essential Services Commission Victoria (ESC)¹³ and the US railways study¹⁴. On the basis of these studies, it would be more reasonable to recalibrate flagfall prices for Passenger relative to freight on the basis of typical GTKs, as they are a better indicator of what drives the variable maintenance costs, as well the fixed costs imposed by Passenger.

The ARTC states in a submission to the Essential Services Commission that “ARTC’s approach to structuring rail access charges has been to keep the flagfall component of charges relatively small (approximately 30% of the average total charge) so as to promote intra-modal competition.”¹⁵ The ARTC clearly recognises the benefit of a lower fixed charge and has established a principle for the application of fixed charges to the

¹³ Indec Consulting, Connex Submission to the Essential Services Commission, 21 March 2006

¹⁴ Queensland Competition Authority, Working Paper 2 “Usage-related infrastructure maintenance costs in railways” December 2000, p8.

¹⁵ ARTC, Submission on the ESC’s Draft Decision, www.esc.vic.gov.au, April 2006.

trains on its network. However, it has not applied its stated approach to Passenger trains.

We therefore submit that the Commission recognise the differences in the operating characteristics of freight and Passenger trains, and consider recommending to government mechanisms that will recalibrate the flagfall to a more justifiable level in line with the relative costs imposed.

4.2 No Rational Justification for Disproportionate Flag-fall Prices

There does not appear to be any logically sustainable rationale for the level of the present flagfall charges that are imposed on Passenger rail operators by track owners.

On the ARTC web site (under the heading “About ARTC”) they state that the flagfall is “a charge for occupying capacity on the network, regardless of the size of the train”. On their Price Schedule (see Appendix 1) the ARTC sets the criteria for different flagfall prices for trains by reference to different maximum speeds and axle loads. However axle load has no affect on capacity consumption. The only differentiating characteristic of the train type which may affect capacity is the maximum train speed. The ARTC set the maximum speed for the Premium flagfall at 115kph. The maximum train speed for the High flagfall category is 110kph (and for Standard it is 80kph.)

It is highly unlikely that a train with a maximum train speed of 115kph would occupy more capacity than a train with a maximum train speed of 110kph. In fact it is not the actual train speed alone that determines capacity consumption it is the difference between the speeds of the trains on the track. Trains travelling in the same direction at different speeds require a greater separation on the track than trains travelling in the same direction at the same speed. Furthermore, if trains are travelling at the same speed the faster they all travel the more trains that can be operated and the less capacity each train consumes. This demonstrates the logical flaw in the differential rates for Premium (115kph max) and High (110kph max) in ARTC’s flagfall structure.

The maximum train speed is often not closely related to the average train speed. For example, The Overland, which travels between Adelaide and Melbourne on the ARTC network, has a maximum train speed of 115kph however the average train speed is much less at 81.3kph or 84.8 kph when adjusted for scheduled station stops (assuming 4 minutes per stop). The average train speed of the train incurring the Standard flagfall is 80kph, which is very similar to the average train speed of The Overland. Yet The Overland is charged the higher Premium flagfall.

Average train speed is affected by topographical, timetabling and infrastructure issues, all issues outside of the operator’s control. Where the train is travelling at an average speed of 84.8kph the maximum speed of 115kph available to The Overland will actually give the ARTC more flexibility to operate the train. The Overland can be accelerated to meet crossings and The Overland will therefore in practice consume less track capacity than a freight train which has a lower maximum speed and slower acceleration capabilities. This characteristic of greater flexibility to manoeuvre holds true for all Passenger services that use rail freight infrastructure.

The reliability of a train also impacts on the track capacity consumed. Every time a train is late it effectively occupies another train path. If the original train path cannot be allocated to another train the late train has consumed 2 train paths. This is relevant as Passenger trains tend to have much better reliability than freight trains. For example, the Overland's on time departure for 2005 was approximately 80% which compares favourably with freight trains which average less than 50% on time departure across the ARTC network, according to the ARTC's Annual Report. (Departures are used as they are less affected than arrivals by factors outside the operator's control, including infrastructure factors.)

Related to the capacity consumed and the operational cost incurred by the track owner are the frequency and degree of amendments to the operation of the train. Every time a train is rescheduled, timetable planning and train control resources are consumed. All of GSR's train services are timetabled and operate strictly in accordance with the timetable. Freight trains however are subject to much greater variation in their operating times thus imposing more management cost on the track owner.

To summarise, maximum train speed is not a useful indicator of track capacity consumed. In fact faster trains can consume less capacity, however the ARTC's flagfall pricing structure applies in the reverse and results in higher flagfall charges for trains which consume less capacity. Passenger trains occupy less capacity than freight trains due to their higher speed, more flexible operating characteristics and relatively more routine and reliable operation. Consequently there is no justification for the relatively higher flagfall prices imposed on Passenger trains on the basis of track capacity occupied or maximum train speed.

4.3 Current Total Charges Expressed as a Price per GTK

Based on the Indec Consulting report,¹⁶ the US railway study¹⁷ and the rationale presented in Section 2.3 that variable costs provide a form of indicator of fixed costs; the flagfall price needs to be examined in the context of the GTKs. When the total access charges currently applying to freight and Passenger trains are converted to a price per GTK the anomaly between the flagfall that applies to Passenger and freight trains is revealed and it is clear that Passenger is being forced to pay a much higher rate.

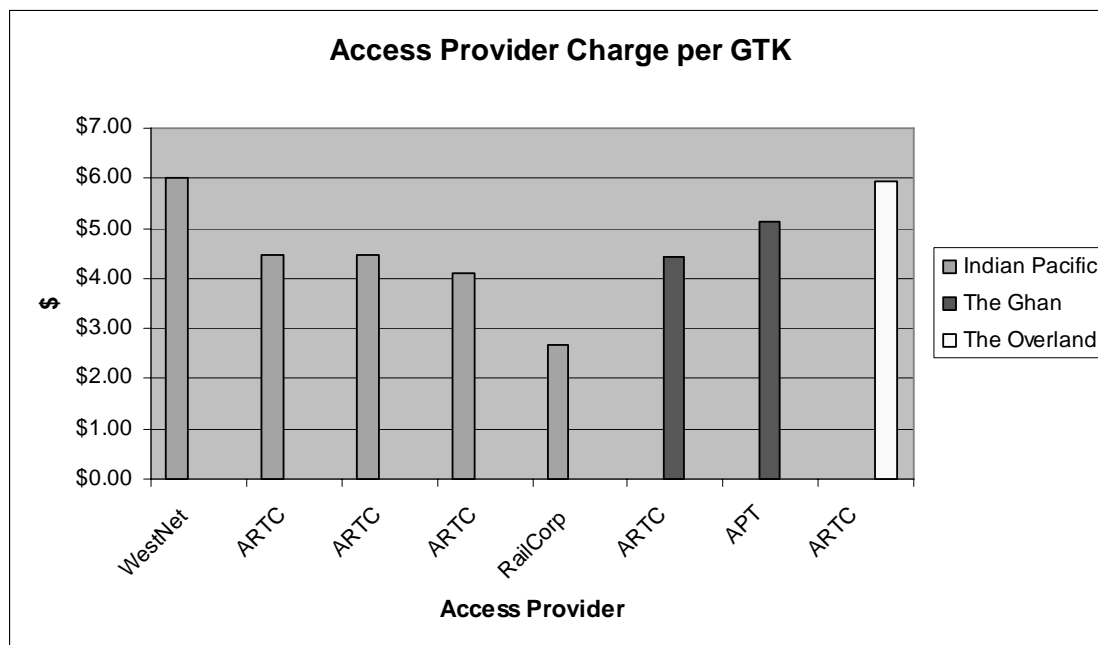
The charges calculated in Section 4.1 for the Adelaide to Parkeston corridor show relative total price per GTK as \$2.93/'000GTK for a freight train; and \$5.16/'000GTK for a Passenger train. The price per GTK paid by the Passenger train is almost double the price paid by the freight train. These charges are inversely related to the costs imposed by the Passenger and freight trains as discussed in section 3.

The graph on the following page provides an indication of the access prices, expressed as a price per thousand GTKs that GSR pays in the various jurisdictions in Australia.

¹⁶ Indec Consulting, Connex Submission to the Essential Services Commission, 21 March 2006

¹⁷ Queensland Competition Authority, Working Paper 2 "Usage-related infrastructure maintenance costs in railways" December 2000, p8.

Graph 1: Total Fixed (Flagfall) and Variable (GTK) Track Access Charges Expressed as a rate per Thousand GTK's



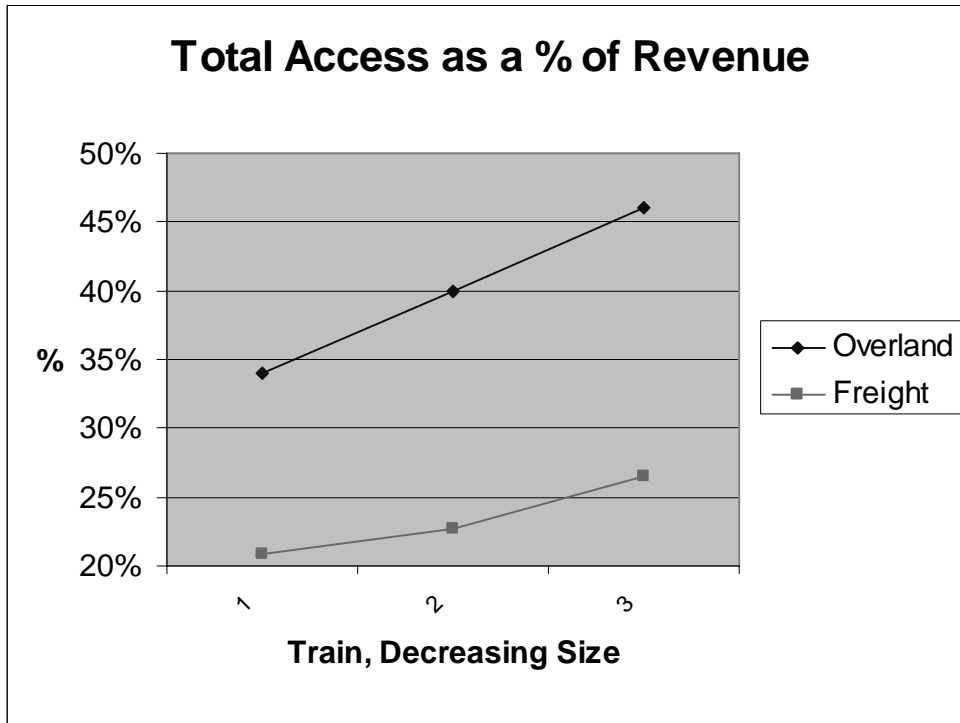
These prices indicate that the Adelaide to Parkeston example is representative (Mark, does this follow when table 5 shows \$5.16??) of the access prices GSR pays in the various Australian jurisdictions. They show that uniformly across all networks with the exception of RailCorp, track owners are imposing significantly higher unit rates of charge on Passenger compared to freight. This is not justifiable and is not sustainable in the long-run.

4.4 Flag-fall and Demand Risk

As shown in Table 2, the fixed flagfall component paid by Passenger is a much greater part of the total access fees than for freight (58% for Passenger versus 24% for freight, in the case of Adelaide to Parkeston, which is a representative sample.) This exposes Passenger rail operators to greater demand risk than freight rail operators.

As a result of the access price structure, on any given Passenger train, if Passenger numbers and thus revenue decreases the access charge will remain relatively fixed. Comparably, on any given freight train, as freight volume and thus revenue decreases, access charges also decrease. This is illustrated in Graph 2 below. Consequently, track owners effectively share in the inherent demand risk of the freight operator and conversely the reward as volume grows. Comparatively, the demand risk for Passenger operators is almost entirely transferred to the operator by virtue of the application of the two-part access price structure and the relatively higher flagfall.

Graph 2: The effect of Volume Variance on Freight Versus Passenger. (See appendix 2 for detail of supporting calculation)



Graph 2 shows that as train size decreases, the proportion of revenue consumed by access charges for a freight operator rises only marginally, limiting the financial impact of falling volumes. By comparison, there is a much steeper rise in the proportion of revenue consumed by access charges for the Passenger operator.

Passenger is consequently denied the benefit of the risk-reward sharing that occurs between freight operators and track owners inherent in two-part pricing. The track owner shares volume variance risk and upside with the freight operator under the present price regime. In contrast, the same risk is almost entirely transferred to the Passenger operator. The present track access pricing regime is clearly inequitable between freight rail and Passenger rail.

5. Capacity to Pay

5.1 Why Consider Capacity to Pay

Pricing based on the end market's capacity to pay is consistent with section 44ZZA of the Trade Practices Act 1974, subsection 3) which states,

"The Commission may accept the undertaking, if it thinks it appropriate to do so having regard to the following matters:

- b) the public interest including the public interest in having competition in markets (whether or not in Australia);
- c) the interests of persons who might want access to the service;
- e) any other matters that the Commission thinks are relevant."

To answer the question as to why capacity to pay should be considered, let us first examine what might occur if public interests were ignored. Setting access prices without considering the market's capacity to pay has the potential to diminish the external benefits of Passenger rail particularly in rural, remote and regional Australia by pricing it out of its competitive market (compared to alternative modes). Ignoring capacity to pay may also discourage fair competition through prohibitive pricing, which is not in the interests of the public or of persons who might want access to the use of freight infrastructure. It may also distort the competitive landscape within the market for use of rail freight infrastructure by favouring one category of user over another (for example, freight over Passenger) by creating a pricing regime that favours one category of operator. Setting access prices that reflect the market's capacity to pay is therefore clearly in the public interest

In fact, track owners already consider the end markets' capacity in setting access prices for particular broad categories of freight traffic. In particular, a different access price structure has been specifically developed for coal, wheat and other bulk products such as cement. This applies in Queensland, New South Wales and Western Australia. The pricing structure that applies is generally accepted to be a result of the capacity to pay of the particular category of traffic using the rail freight infrastructure.

The published ARTC reference prices do not include commodity specific pricing as historically ARTC has only taken inter-modal freight on its network. However, with the recently acquired New South Wales network, they have also inherited a commodity specific pricing arrangement that is different from (and higher than) the pricing applied to inter-modal freight trains. Consequently, the principle of category specific pricing in accordance with capacity to pay is well established in most jurisdictions and is being considered in others. In Victoria the Essential Services Commission's Draft Decision requires some access providers to implement access prices differentiated on the basis of freight type, grain and non-grain.¹⁸

Unfortunately, no Passenger specific access prices have been developed. Rather the access pricing regime for inter-modal freight trains has been applied by default to Passenger trains. The principle of category specific pricing developed on the basis of

¹⁸ Essential Services Commission, Draft Decision April 2006, www.esc.vic.gov.au

capacity to pay is well established and should now to be extended to Passenger, in accordance with the capacity to pay of the Passenger market.

5.2 Long Distance Passenger Rail has a Lower Capacity to Pay

Table 3 below illustrates why Passenger trains have a lower capacity to pay access charges than freight trains. Due to the nature of the respective end markets, Passenger earns less revenue per train service, per train km and per GTK compared to freight. Notwithstanding this, at present, Passenger pays higher access prices than freight when the total of fixed and variable charges is expressed as a price per GTK. The higher total access price per GTK stems from the fact that both Passenger and freight incur the same variable GTK usage price, whilst Passenger incurs the same or a higher flagfall price. As this flagfall is spread over less GTK's the total access charge expressed as a price per GTK is significantly higher in the case of Passenger.

The table below is based on a sample of GSR Passenger trains compared to typical freight trains travelling through the ARTC network. In the case of Sydney to Perth, the rates from the ARTC network are extrapolated to other jurisdictions.

Table 3: Comparison of Revenue and Access Costs per GTK for freight and Passenger on key Interstate Corridors.

Route	Perth – Sydney		Adelaide – Melbourne	
	Freight	Passenger	Freight	Passenger
Length (metres)	1500	595	1500	331
Mass (tonne)	3380	1134	3378	595
Total Revenue	\$230,000	\$139,000*	\$43,000	\$11,000*
Revenue/km	\$54	\$32	\$51	\$13
Revenue/'000GTK	\$16	\$28	\$15	\$22
Total Access Charges	\$33,000	\$24,000	\$9,000,	\$3,000
Access/'000GTK	\$2.26	\$5.16	\$3.15	\$6.54
\$Revenue/\$Access	\$6.99	\$5.67	\$4.85	\$3.51

*Ticket revenue

From the analysis in Table 3, it can be seen on the revenue side that freight trains earn significantly more revenue per train km. On the cost side, Table 3 demonstrates that the total access charge expressed as a price per 1000 GTK is significantly higher for Passenger trains than for freight trains (despite the fact that they impose lower costs per GTK). As a consequence, Passenger generates less revenue than a freight operator for each dollar paid in access charges. This is clearly inequitable.

From Table 3, it is clear that Passenger's capacity to pay is lower than the freight market's capacity to pay, whilst the current access pricing regime extracts significantly more total dollars per GTK from Passenger trains than from freight trains. Track owners are over-recovering from Passenger rail operators relative to freight rail operators. This amounts to a form of cross-subsidy in which Passenger rail operators are paying access charges well in excess of; their capacity to pay; and the costs they impose; compared to freight rail operators. We request that the Commission recommend the identification and implementation of measures to redress this distortion, suggested measures are provided in sections 6 and 7 of this submission.

6. Proposed Access Price Structures

6.1 Summary of Current Situation

The foregoing analysis has identified a number of anomalies and inconsistencies with the current framework of access pricing for the freight rail network in the case of the long-distance Passenger operator. To recap on the key points so far:

- Total (fixed and variable) costs per GTK that are imposed by Passenger trains on the rail infrastructure are less than the total costs imposed by freight trains;
- Total (fixed and variable) price per GTK charged to Passenger for use of rail freight infrastructure is much higher than the price per GTK charged to freight;
- fixed flagfall prices that are charged to Passenger trains are disproportionately high and there is no rational basis for the level of the price;
- Variable GTK rail maintenance costs that arise from running Passenger carriages are lower (and lower per GTK) than for freight wagons because Passenger carriage axle loads are one-third less;
- Access prices for Passenger do not take into account the market's capacity to pay, which is lower than the freight market's capacity to pay; and
- Effectively the distortion in pricing creates an inequity between freight and Passenger that results in over-recovery of costs from Passenger relative to freight rail operators.

Passenger rail operators cannot reasonably be required to continue paying inflated access charges in the face of the evidence and analysis in the preceding sections of this submission. The matter must be addressed to; restore the competitive market for the use of rail freight infrastructure by the distinct categories of operator; and create a sustainable long-term competitive environment for Passenger rail.

The current situation has arisen because the access prices applying to Passenger trains have not been specifically developed for Passenger trains but are simply freight train (inter-modal) access prices which are applied by default to Passenger trains. The solution is therefore to develop access prices specifically for Passenger trains. The development of Passenger specific access prices is a very reasonable step that will simply bring Passenger rail into line with the other freight traffics which already have traffic specific access prices.

6.2 The Long-Run Cost of the Status Quo

As illustrated in section 2.6 Passenger rail operators currently recover sufficient funds to cover short run costs but do not derive sufficient earnings to reinvest in the business. Passenger rail is an asset intensive industry and without sufficient funds to reinvest in the business the standard of service will decline. In the long term a lack of investment will result the Passenger rail industry not being able to offer a viable service. Logically this would require the Federal government to consider intervention and financial assistance, or accept the loss of the Passenger sector, with consequent reduction in public transport competition.

6.3 Restoring Equity with a Flagfall and GTK Price Recalibration

GSR asserts that the simplest way to rectify the existing access pricing inequities is to apply a one off recalibration of the flagfall and GTK rates payable by Passenger.

Recalibration of the fixed flagfall component of Passenger trains' access prices by this methodology would address the problems of;

- The unsustainably high total access charge;
- The restriction of community benefits provided by Passenger rail;
- The transfer of demand risk imposed by the high fixed cost; and
- The inequity of the access charges applying to Passenger and freight trains.

Recalibration of the variable GTK rate by this methodology would establish an equitable pricing structure that reflects the lower maintenance costs imposed by Passenger trains when compared to freight trains by reason of the lower axle-loads.

The following two options are proposed for consideration by the Commission. Worked examples are provided in tables 4 and 5 showing the results and comparing them with the present situation for freight and Passenger trains. The comparisons demonstrate that the alternative pricing would establish an equitable balance between freight and Passenger, as well as achieving the other benefits put forward in this submission.

Table 4: Proposed Alternatives for Passenger Access Pricing, expressed as a percentage of the Scheduled Freight Access Prices

Passenger	Flagfall	Variable GTK
Option 1	Premium less 75%	Less 20%
Option 2	Standard less 50%	Less 33%

The ARTC prices are used as a representative example. In the first option, it is proposed that Passenger pays 25% of the Premium Flagfall and 80% of the GTK price. In the second option, it is proposed that Passenger pays half the Standard Flagfall rate, and 75% of the GTK price. The following tables apply these pricing options to the previously presented worked examples, using ARTC reference rates.

Table 5: Comparative Pricing of Typical Freight and Passenger Trains – Adelaide to Parkeston on ARTC Track – Current and Alternatives

	Freight	Passenger Current	Passenger Option 1	Passenger Option 2
Length (m)	1,500	595	595	595
Mass (tonne)	3,380	1,134	1,134	1,134
Total '000's GTKs	6,734.6	2,259.5	2,259.5	2,259.5
Flagfall Charge (Fixed)	\$4,813	\$6,566	\$1,642	\$2,407
GTK Charge (Variable)	\$15,193	\$5,097	\$4,077	\$3,823
Total Charge	\$20,026	\$11,663	\$5,719	\$6,230
Flagfall to Total	24%	56%	29%	39%
Total Charge expressed as a price per '000 GTK	\$2.97	\$5.16	\$2.53	\$2.76

Table 6: Comparative Pricing of Typical Freight and Passenger Trains – Adelaide to Melbourne on ARTC Track – Current and Alternatives

	Freight	Passenger Current	Passenger Option 1	Passenger Option 2
Length (m)	1,500	331	331	331
Mass (tonne)	3,378	595	595	595
Total '000's GTKs	2,810	496	496	496
Flagfall Charge (Fixed)	1,575	1,741	435	788
GTK Charge (Variable)	7,290	1,286	1,029	965
Total Charge	8,865	3,027	1,464	1,753
Flagfall to Total	18%	58%	30%	45%
Total Charge expressed as a price per '000 GTK	\$3.15	\$6.10	\$2.95	\$3.53

Tables 5 and 6 demonstrate that the price recalibrations proposed in options 1 and 2 result in total charges expressed per GTK that are similar to the charges applying to freight trains and more reflective of the relative costs. In Option 1, the flagfall charge is reduced to a level which is consistent with the ARTC's stated pricing principle of 30%¹⁹ of total charge. In Option 2, the flagfall is also significantly reduced, although it remains above the 30% level preferred by the ARTC. Such a reduction in the flagfall will diminish the burden of the relatively higher demand risk and thereby improve investment prospects in the Passenger rail industry.

The total access charge is also reduced to a level that will remove the current lack of affordability of investment and renewal in the Passenger rail industry. Importantly such a pricing structure will restore equity between Passenger and freight rail operators and remove the over recovery that access providers currently impose on Passenger rail operators.

While the alternative pricing approaches produce significant reductions in access charges, they can be justified on the basis that they are all; within the range of equivalent total prices per GTK for freight trains; more reasonably reflect the costs resulting from the use of freight rail infrastructure; remove the over recovery currently imposed on Passenger rail operators in comparison to freight rail operators; take account of the end market's capacity to pay.; will create a framework for fair competition for use of the rail freight infrastructure by Passenger; and will create a framework for increased competitiveness of Passenger rail and its long-term sustainability.

¹⁹ ARTC, Submission on the ESC's Draft Decision, www.esc.vic.gov.au, April 2006.

6.4 Impact on GSR, Track Owners and Public Benefit

The proposed pricing approaches for Passenger would have significant positive impacts on the Passenger sector, competition and externalities. However, the impact on track owners would be minimal.

The forecast annual access charges to be paid by GSR on its present timetable and at current access rates are set out in the table below.

Table 7: GSR Annual Access Charges (2006 forecast) by Train and by Provider (current timetable)

Access Charges	Amount
Indian Pacific	\$5,528,914
The Ghan	\$4,319,745
Overland	\$1,041,317
Total	\$10,889,976
ARTC	\$6,380,186
RailCorp	\$151,572
WestNet	\$1,014,426
APT	\$3,343,792
Total	\$10,889,976

The ARTC annual report 2004/05²⁰ indicates that the ARTC received revenue of \$273.5 million from customers. The ARTC's 2004/05 revenue has increased significantly due to the inclusion of the New South Wales track access revenue from September 2005. The ARTC collected access fees of \$107.74 million in the 2003/04 financial year.²¹ In the first full year of operation with the New South Wales track it is estimated that the ARTC will collect access revenue of approximately \$300 million per annum. The total access fees paid by GSR to the ARTC are approximately \$6.4 million. If the amount of access fees paid to the ARTC by GSR was halved, the impact on ARTC's total revenue would be approximately 1%.

Each of the other access providers used by GSR collect a small proportion of their total revenue from Passenger. A reduction of Passenger access fees by 40% to 50% will also have a minimal effect on those access providers. The benefits; to the public; to the rural, remote and regional communities; to the tourism industry; and to the Passenger rail industry, will far out weigh any loss of revenue to access providers.

As observed earlier in this section, if fees paid to the ARTC by GSR were halved, the impact on ARTC's total revenue would be less than 1%. This illustrates the incremental and incidental nature of Passenger operations on the overall functioning of the non-urban freight rail infrastructure. A further alternative approach to addressing the access pricing issue may therefore be to mandate that track owners price Passenger at strictly incremental costs, applying the principle of floor pricing as established by some regulatory regimes. This would further improve the competitiveness of the sector, by reducing the rates even further than those recommended in Section 6.3.

²⁰ ARTC, ARTC Annual Report 2004/05, www.artc.com.au

²¹ ARTC, ARTC Annual Report 2003/04, www.artc.com.au

The key outcomes are that application of one of the proposed alternative pricing regimes would:

- Enable GSR to reduce fares in the range of 8% to 12% for the standard economy adult fare (Red Kangaroo Seats) making the pricing of its services immediately more competitive with other modes of point to point transport. (Premium fares would reduce by the same dollar amounts). This would deliver an immediate external benefit.
- Lift rates of return on investment to a level that would create the conditions to support further investment in rolling-stock refurbishment by GSR, leading to volume growth over the medium term
- As volume grows, enable GSR to offer more frequent services, enhancing the external benefits to regional and remote communities and providing further economic stimulus
- Create an environment more conducive to the entrance of new competition

7. Implementation Mechanisms

Various mechanisms may be used to introduce the proposed amendments to the structure of access prices applying to Passenger trains accessing rail freight infrastructure. Some suggestions are provided below.

7.1 The ARTC Access Undertaking

In relation to the ARTC this body is a company owned by the Commonwealth Government and the anomalies created by the ARTC's current pricing practices can be rectified by a change in Government policy. The proposed amendments to Passenger rail access prices are entirely consistent with the principles of the ARTC's current Access Undertaking.

The ARTC Undertaking (1 May 2002) was voluntarily lodged by the ARTC under Part IIIA of the Trade Practices Act 1974 and approved by the Australian Competition and Consumer Commission (ACCC). The Undertaking includes Indicative Access Charges. Interestingly, the undertaking does not include a Premium Flagfall and indeed there is only one flagfall per track segment (excerpt provided at appendix 2). Schedule 3 of the Indicative Access Agreement (Schedule D of the Undertaking) does not provide any prices, but simply provides 3 categories for access prices which depend on the term of the access agreement and duration of the train path. A Premium Flagfall and the method of its application to Passenger trains were not included in the Undertaking and have not been specifically approved by the ACCC.

There are also sections of the Undertaking which appear to be somewhat inconsistent with the ARTC's flagfall prices. The Preamble, clause 1.1 (f) states that the "ARTC has adopted the concepts of equity and transparency as key elements of its pricing policies." The flagfall arrangement is not equitable as it has been shown in this submission that it penalises Passenger trains and is not transparent because no explanation is provided for this inequitable application.

The Objectives, clause 1.2 state that "the Undertaking is to: ... (b) use transparent and detailed methodologies, principles and processes for determining access price limits, terms and conditions;" In the case of the Premium Flagfall there is no detailed methodology provided. It appears from the ACCC's "Issues Paper" of March 2001 discussing the ARTC's Undertaking that little consideration was given to the application of access prices to Passenger trains.

GSR suggests that the Productivity Commission include in its report a recommendation that the Commonwealth Government introduce a policy requiring the ARTC to reduce flagfall prices applying to long distance Passenger trains to 25% of existing flagfall prices and GTK prices to 80% of existing GTK prices, in line with option 1 in section 6.3. The Productivity Commission may wish to recommend that this arrangement be formalised by the ARTC lodging an amended Undertaking.

7.2 Other Jurisdictions

In relation to other access providers which are not owned by the government, legislative amendments will be required to introduce the necessary recalibration of flagfall prices. GSR suggests that the Productivity Commission include the following recommendations in its report:

- That the South Australian and Northern Territory Governments, pursuant to clause 50 of the Code, the Schedule to the AustralAsia Railway (Third Party Access) Act 1999 (South Australia), review the Code to provide for Passenger specific access prices that remove the existing inequities imposed on Passenger rail operators; and
- That the Western Australian Government, pursuant to clause 12 of the Railways (Access) Act 1998 (Western Australia), review the Code to provide for Passenger specific access prices that remove the existing inequities imposed on Passenger rail operators.

8. Benefits of the Proposed Access Price Structures

The access prices proposed in section 6.2 have been developed specifically for Passenger trains and more appropriately respond to; the costs imposed by Passenger trains; the Passenger rail market; and the contributions to infrastructure from both Passenger and freight trains.

The benefits of introducing access prices appropriate to Passenger trains include:

- The future viability of long distance Passenger trains;
- The removal of the inequity in the access charges applying to Passenger and freight trains.
- Improved competition in the Passenger rail market;
- Increased benefits to those members of the community with limited travel options;
- Increased benefits to the tourism industry; and
- Increased benefits to the rural, remote and regional communities visited by GSR.

These benefits are now discussed.

GSR is operating a number of services that are viable in the short-run but not sustainable in the long-term. If this situation is allowed to continue the Passenger rail industry will deteriorate and eventually diminish to the point of extinction or rely increasingly on direct government funding. This is in large part due to the magnitude and structure of the access prices and the proportion of ticket revenue that the access charges consume. Implementation of Passenger appropriate access pricing will ensure that these services are not reduced or eliminated due to unsustainable access charges.

The reduction of access charges and in particular the reduction of high fixed flagfall rates with the attendant reduction in demand risk to Passenger rail operators will:

- Provide incentives for Passenger rail operators to manage train lengths in an economically efficient manner both on a daily and a seasonal basis;
- Remove the existing limitations on investment opportunities; and
- Enable Passenger rail operators to develop expansion plans without the burden of artificially high fixed costs.

Establishing Passenger specific access prices will ensure that all rail operators are treated equitably in terms of access pricing and the anomalies that exist today will be removed. Access providers will recover network costs from operators in proportion to the costs imposed by those operators. This will encourage all operators to behave in a manner that minimises the costs imposed on access providers. Access pricing that is equitable and responds to the costs imposed by operators will drive a more efficient rail market.

One important corollary of an increase in the long distance Passenger rail business is an increase in benefits to rural, remote and regional communities. These benefits are significant, one job created for every 200 additional visitors²² and expenditure of \$1,337 per visitor²³. GSR already contributes significantly to these communities and GSR will be in a position to deliver much greater benefits to these communities in the event that access pricing for long distance Passenger trains is rectified.

In summary the introduction of access prices developed specifically for Passenger rail operators will:

- Ensure operators are charged in proportion to the costs they impose;
- Provide equity between freight and Passenger operators;
- Enable long distance Passenger rail services to become viable in the long term;
- Provide benefits to the public;
- Provide benefits to the Passenger rail and tourism industries; and
- Provide significant benefits to the rural, remote and regional communities visited by GSR.

This is an equitable approach that is long overdue. This approach is based on the reasonable proposition that Passenger rail should not be denied an access price structure specifically developed for Passenger rail. Access pricing specifically developed for the market is currently enjoyed by the various freight markets, such as intermodal, grain, coal and other bulk products. Such an approach will provide significant benefits to; members of the community with limited transport options; rural, remote and regional communities; and the industries of long distance Passenger rail and tourism.

²² NT Airports Pty Ltd, The economic significance of Alice Springs Airport, 1 June 2004, pvii

²³ Northern Territory Government, Northern Territory Economy, www.nt.gov.au,

9. Productivity Commission Questions

The Productivity Commission's Issues Paper poses a number of questions grouped into topics. Each of the topics is addressed below and the questions relevant to GSR's submission have been specifically answered. A sample of the questions in each topic has been addressed sufficient to raise the points relevant to GSR's submission. Further detail on the issues raised appears in the earlier sections of GSR's submission.

Topic 1. Do participants agree that the Commission should focus on economic costs as the relevant measure of the costs of providing transport infrastructure?

Transport has broad community and social impacts, both costs and benefits, and an economic approach captures more of these externalities associated with transport. GSR agrees that the Productivity Commission should focus on economic costs as the relevant measure of the costs of providing transport infrastructure for freight.

However, Passenger rail creates many external benefits which often cannot be captured by strict financial analysis, such as benefits to the tourism industry, rural, remote and regional communities and the environment. Specifically, in the case of Passenger rail, there are also social benefits. For example, many of GSR's patrons in Red Kangaroo class have limited options for interstate travel. Research shows they rely on GSR's services as their predominant and often their only means of long distance transport on GSR routes. Of note, the current demographic profile of Red Kangaroo is female (60%); aged over 65 (60%) and with an income of less than \$400 per week (80%). This part of GSR's services therefore meet an important need for members of the community whom have limited means, thus GSR contributes to the Government's social inclusion objectives. These benefits are considered in more detail in section 2.4 of this submission.

Topic 2. Various questions related to the methodology for valuing assets.

This submission focuses on the valuation of rail infrastructure assets.

Jurisdictions in Australia use different asset valuation methods such as Depreciated Optimised Replacement Cost (DORC) and Gross Replacement Value (GRV). Some jurisdictions treat assets in existence at the time the business was acquired differently to assets subsequently procured by the asset owner. Notwithstanding these differences in approach, all jurisdictions use asset valuations to set regulated ceiling access prices. However, these ceiling prices are well in excess of what the Passenger market could bear. This reduces the effectiveness of the regulation of monopoly rail infrastructure owners as it does not provide any control of the infrastructure owners pricing behaviour. Furthermore such excessive ceiling prices expose the Passenger rail operator to the risk of being priced out of business.

For example the track from Tarcoola to Darwin, owned by Asia Pacific Transport (APT), has a ceiling price (\$33.23 per thousand GTK) which is 19.5 times greater than the floor price (\$1.70 per thousand GTK). This gives the asset owner excessive latitude in access negotiations, with little if any other effective regulatory check or balance. The

ceiling price is also 5.4 times greater than the current access price. The current price itself is now at a level that is unlikely to lead to a sustainable Passenger rail sector operating on this route in the long term. Some alternative method of setting ceiling prices or additional regulatory controls are warranted

The asset values that are allowed for the determination of ceiling prices under the regulated regimes in many jurisdictions are well in excess of the market price that would be paid for the same assets. Thus an asset owner can comply with the access regime by pricing below the ceiling price but earn extraordinary returns on the price paid for the asset. For example the track under the Western Australia's Rail Access Regime is valued, using GRV, at approximately \$1million per track km.²⁴ However when Babcock and Brown and Queensland Rail purchased the Australian Railroad Group (ARG), Babcock and Brown paid \$853.5 million for the below rail assets which included "in excess of 5,000km of track"²⁵, this values the track at less than \$170,000 per track km. Effectively, the acquirer has the potential to leverage enormous returns on their actual investment whilst remaining well within the ceiling. Consequently, the results of the excessively high ceiling prices is an effectively unregulated price damaging to the viability of access seekers and that enables access providers to price within the ceiling and receive windfall returns on the market and book value of their infrastructure.

One possible solution is to establish an NPV based approach with legislated standards for discount rates and asset life.

Another possible solution to this is to value the assets on the basis of the market value of the assets rather than the cost of providing the assets. Market prices have been brought to bear on the access prices applying to freight trains on the APT network. Access to the APT network is governed by the Australasia Railway (Third Party Access) Act 1999. The Schedule to the Act contains the Australasia Railway (Third Party) Access Code which sets out the key features of access under the Code, such as the pricing principles.

The methods of calculating freight access prices provided in the Code use floor and ceiling prices but also a competitive price to provide a reference point within the range of the floor and ceiling price. This competitive price avoids the problems described above by providing a market driven and relevant guide to the appropriate access price. Unfortunately the Code does not use a competitive price in relation to Passenger trains. The Commission may wish to examine the viability of expanding the use of reference prices from other modes of transport for standard economy fares.

Topic 3. Various questions about the allocation of common costs.

This submission focuses on the question, "How should common costs be allocated across freight and Passenger users?"

²⁴ Office of the WA Rail Access Regulator, Floor and Ceiling Costs to Apply to WestNet Rail, September 2003, Appendix 2

²⁵ Babcock and Brown, ASX Release, 22 February 2006

There is considerable evidence that heavier trains cause greater infrastructure maintenance costs. This has been confirmed in the QCA working paper²⁶ and is discussed in section 3 of this submission. Passenger carriages have axle loads of approximately 12 tonne, and freight wagons have axle loads of approximately 20 tonne. Passenger trains cause less maintenance costs than freight trains, and cause less maintenance cost per tonne than freight trains due to the lower axle load of Passenger trains.

Indec Consulting has stated that the higher maintenance costs are associated with higher indirect and overhead costs²⁷. The Indec Consulting paper argues that allocating common costs on the basis of GTKs will capture the additional common costs imposed by heavier trains, which are generally freight trains. GSR agrees with the Indec Consulting proposal to allocate common costs between Passenger and freight trains on the basis of GTKs and believes this approach is appropriate for the rail infrastructure used by GSR.

The Connex Cost Allocation Policy submitted to the Essential Services Commission Victoria²⁸ proposes a more complex cost allocation method. For example, track maintenance costs are allocated on the basis of GTKs whereas signal maintenance costs are allocated on the basis of trips. This approach is likely to provide a slightly more accurate cost allocation but is quite complex. It is suggested the additional complexities are not warranted and GSR prefers the simplicity of a single factor on which to allocate cost, as proposed by Indec Consulting.

Topic 4. Various questions related to the studies cited.

No comment.

Topic 5. Do participants agree with the costing methodologies employed and estimates made by rail regulators?

GSR does not agree with the costing methodologies employed by rail regulators. As discussed under question 2 the general principle used to cost infrastructure is based on the estimate of the cost of fully replacing the infrastructure which may have no relationship to the market value paid for the infrastructure or the investment program of the asset owner.

The market value of the infrastructure should always have a role in determining prices for access to the infrastructure depending on the degree to which the rail infrastructure is profitable. In the circumstance that the rail infrastructure is not profitable regulated ceiling access prices based on the cost of providing the infrastructure will be too high. In some jurisdictions, as discussed in topic 2 above, the ceiling access price based on the cost of providing the infrastructure is so high as to be irrelevant. At the point that the rail infrastructure is profitable the market value of the infrastructure will be greater than or equal to the cost of providing the infrastructure. It is only at the point that the rail

²⁶ Queensland Competition Authority, Working Paper on Usage-related Infrastructure Maintenance Costs in Railways, December 2000

²⁷ Indec Consulting, Submission to the Essential Services Commission, 21 March 2006

²⁸ Connex, Cost Allocation Policy March 2006, Essential Services Commission Victoria web site www.reggen.vic.gov.au

infrastructure becomes profitable is it necessary to regulate access pricing using the cost of providing the infrastructure.

Topic 6. What are the major externalities associated with road and rail freight infrastructure use?

This is addressed in the body of our submission. We have no further comments.

Topic 7. Do participants agree with this interpretation? If not, how should “consistency” be interpreted?

GSR agrees with this interpretation of consistency, that is, that the same pricing principles be applied to, and within, both principal modes of freight transport. In relation to Passenger rail operators the access prices paid are often the same, if not more, in terms of the actual price per GTK than is paid by freight trains. Furthermore, the principle that access charges should reflect the costs imposed is not applied equally to Passenger and freight trains, this must be rectified. The current pricing is not equitable nor in the interests of the Passenger rail operator or the public.

The current pricing structure actually penalizes those operators that are imposing less cost on the infrastructure and does not encourage efficient behaviour from rail operators. This point is further explained in section 4 of this submission.

Topic 8. Do participants agree with this interpretation? If not how should competitively neutral pricing regimes be interpreted?

GSR agrees that competitively neutral pricing implies an absence of differential subsidies. This is on the basis that externalities have been accounted for in the pricing of access to transport infrastructure.

Topic 9. How efficient are current charging arrangements for the use of rail infrastructure? What criteria are used to allocate fixed costs of infrastructure across rail users? Are these appropriate criteria? Would alternate allocations be more appropriate?

GSR makes no comment in relation to the current charging arrangement for freight trains. The charging arrangements in most rail jurisdictions in Australia appear to have been developed for freight trains. However when these charging arrangements are applied to Passenger trains a number of problems and anomalies arise. In most jurisdictions Passenger trains pay the same usage rate per GTK and the same or a higher flagfall than freight trains. The result of this arrangement is that the flagfall is a much larger proportion of the total charge for Passenger trains and related to the issue of capacity to pay, the total charge is a much larger proportion of total revenue for Passenger trains. The issue of capacity to pay is significant. GSR's business is limited by access fees to the extent that the future of some services is in jeopardy. These issues are further discussed in section 4 of this submission.

Topic 10. Various questions relating to charging of road vehicles.

No comment.

Topic 11. Various questions relating to the incorporation of externalities into charges for the use of transport infrastructure.

No comment.

Topic 12. What are the likely resource impacts of a shift to pricing regimes that better reflect marginal costs of using road and rail infrastructure?

This submission focuses on the impact on Passenger rail operators of a shift to pricing which reflects marginal costs.

Presently Passenger rail operators pay a high proportion of their access fees as a flagfall. 50% of The Overland's access fee is a fixed flagfall. The absolute value of the flagfall is higher than for 1500m long freight trains and constitutes a much greater proportion of the total access charge than for freight trains.

The flagfall is generally justified on the basis of being a charge for fixed costs and a reservation of access to the track. However, the fixed costs and variable costs imposed by Passenger trains are less than for freight trains and this should be reflected in the structure of the access price. The fixed costs imposed by Passenger trains are less than for freight trains on the basis that fixed costs are related in the long run to variable costs as stated in the Indec Consulting report²⁹. The capacity reservation and operational costs are also lower for Passenger trains. Passenger trains operate to a regular timetable and thus involve less operational planning, tend to operate more reliably and thus involve less train control and operate more flexibly due to greater flexibility in terms of acceleration and running speed thus consuming less track capacity.

Removing the large fixed flagfall charge and moving to a price that reflects the marginal cost imposed by Passenger trains would better reflect the lower costs imposed by Passenger trains. The current arrangements of charging higher fixed costs for Passenger trains which impose lower costs on the network is not equitable or in the interests of the public or the Passenger rail operators. A reduction in the fixed costs imposed on Passenger trains would also result in lower Passenger fares and thus increased volumes of Passengers with the associated benefits for the tourism industry and the economies of many rural, remote and regional communities.

Topic 13. Various questions on road pricing technologies.

No comment.

Topic 14. Implementation Issues.

This submission focuses on the implementation of access charging for Passenger rail operators. The access price amendments that are discussed in this submission can be implemented expediently. The approach to access pricing recommended in this submission will remove the inequity that currently exists and will provide significant benefits to rural, remote and regional communities.

²⁹ Indec Consulting, Submission to the Essential Services Commission, 21 March 2006

Implementation can be achieved in the case of the Australian Rail Track Corporation (ARTC) a company owned by the Commonwealth Government by simply a change in Government policy regarding rectification of the current anomalies. Legislation can also be used to ensure infrastructure providers in all states implement access charging that is developed specifically for Passenger rail operators and thus removes the anomalies discussed in this submission.

The financial impact on the infrastructure owners will be minimal because the majority of their revenue is derived from freight trains. It is anticipated that the benefits; to rural, remote and regional communities; the tourism industry; the public; and the long distance Passenger rail industry will far out weigh any loss of access revenue and in some instances may result in additional Passenger train services or longer Passenger trains and thus additional access revenue. These issues are further discussed in section 7.

Topic 15. Impediments to efficient pricing.

No comment.

10. Conclusion

The train services operated by GSR provide a link between the cities and other areas of Australia providing transport services and a tourism experience that spans coastal, inland, remote, urban and rural destinations. These trains provide significant benefits to the broader community, the tourism industry and the many rural, remote and regional economies that GSR's trains and Passengers visit.

It is clear that the costs these Passenger trains impose on access providers are significantly less than the much heavier and longer freight trains. However, the access prices that apply to Passenger trains do not specifically accommodate the characteristics of Passenger trains, therefore the access prices result in significant over recovery of access providers' costs from Passenger trains relative to freight trains. In particular the flagfall prices which apply to Passenger trains are excessive and impose significant demand risk on Passenger operators that does not apply to freight operators and the GTK prices do not reflect the lower axle loads of Passenger trains.

The flagfall contributes to a total access charge that when expressed as a price per GTK is almost double that of the price applying to freight trains, \$2.97/'000GTK for a freight train compared to \$5.16 for a Passenger train. Passenger trains incur flagfall charges that as a proportion of the total access charge are well in excess of ARTC's own suggested proportion of 30%³⁰. Some long distance Passenger services incur total access charges that constitute as much as 50% of a Passenger train's ticket revenue as opposed to 25% for a freight train. The fixed component of the access charge can be as much as 25% of a Passenger train's revenue as opposed to 5% for a freight train. This issue is significant and seriously threatens the future of the Passenger rail industry and many of GSR's train services.

This submission provides alternate methods of calculating flagfall and usage prices for Passenger trains which demonstrably remove the inequities that currently apply. This submission proposes two options to rectify access prices applying to Passenger trains. Option 1 reduces the flagfall by to 25% and the usage charge to 80% of existing levels and option 2 reduces the flagfall to 50% and the usage charge to 75% of existing levels. The option of pricing Passenger trains at the incremental cost to track owners has also been considered. This approach is logical and would produce significantly lower access prices for Passenger rail. However, options 1 and 2 were considered to be simpler for the purposes of estimation and implementation.

Such a reduction produces prices that when expressed on a per GTK basis are equivalent to the prices applying to freight trains and remove the existing inequities between freight and Passenger trains. These options also produce prices that are in excess of any prices based on the incremental cost that Passenger trains impose on track owners.

³⁰ ARTC, Submission on the ESC's Draft Decision, www.esc.vic.gov.au, April 2006.

The reduced prices will provide significant benefits to the Passenger rail market, the economy, the broader community, the tourism industry and the many rural, remote and regional communities. However the impact on access providers is limited due to the fact that they collect most of their revenue from freight operators. In fact applying pricing that is appropriate for Passenger trains is likely to result in increased competition in the Passenger market and in the medium term increased Passengers, increased train lengths and services, and thus increased access fees.

This submission has provided some suggested implementation mechanisms which for the ARTC may be as straight forward as a change in Government policy to ensure access providers develop access prices specifically for Passenger trains and thus remove the existing inequities.

It is clear that the current access prices applying to Passenger trains are significantly damaging to the Passenger rail market and restrict the associated benefits to the community, the tourism industry and the economies of many rural, remote and regional communities. Passenger specific access prices must be developed and implemented as a matter of priority. This submission has; demonstrated the existing inequities and resulting damage; developed access prices that rectify the existing anomalies; described some of the benefits of implementing the proposed access price structures; and suggested some pricing options and implementation mechanisms.