



AUSTRALIAN RAIL TRACK CORPORATION LTD

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House of Representative
Standing Committee on Transport and Regional Services
Parliament House
Canberra ACT 2600

INQUIRY INTO THE INTEGRATION OF REGIONAL RAIL AND ROAD FREIGHT TRANSPORT AND THEIR INTERFACE WITH PORTS ARTC COMMENTS

Thank you for the opportunity to comment with regard to the above inquiry.

ARTC was created after the Australian and State Governments agreed, in an Inter-Governmental Agreement ("IGA"), in 1997 to the formation of a 'one stop' shop for all train operators seeking access to the national interstate rail network. The IGA had a term of 5 years, which expired in 2003. ARTC is a company, under Corporation Laws, in which shares are owned by the Australian Government through the Ministers for the Departments of Transport and Regional Services and Finance and Administration.

Under the IGA, ARTC would be responsible for negotiating access to the national interstate rail network between Brisbane and Perth by virtue of direct ownership or lease of certain parts of the network, or under wholesale arrangements to be negotiated with State Government owners of other parts of the network as applicable.

ARTC initially had responsibility for the management of 4430 route kilometres of standard gauge track, mainly in South Australia, Victoria and Western Australia. ARTC owns the following rail corridors:

- ❖ Wolseley - Kalgoorlie
- ❖ Pt Augusta - Whyalla
- ❖ Broken Hill - Crystal Brook
- ❖ Tarcoola - Alice Springs (long term lease to Asia Pacific Transport, operators of the Alice Springs - Darwin Railway)
- ❖ Parts of the Adelaide metropolitan track between Dry Creek and Outer Harbour.

In Victoria, ARTC leases the two mainline interstate standard gauge corridors from the Victorian Government, being:

- ❖ Melbourne – Wolseley
- ❖ Melbourne – Albury

ARTC also manages access to the connection from the interstate mainline network to the Appleton and Swanson Dock precincts in Melbourne.

ARTC also has a 60 year lease on the interstate mainlines in NSW from Albury to Macarthur (around 60kms south of Sydney), Cootamundra west to Broken Hill, the Hunter Valley network and from the north of the Sydney urban area to the Queensland border. The lease provides for ARTC to construct a rail freight corridor from Macarthur to Chullora (the main intermodal freight terminal in Sydney) and following completion of that corridor, for ARTC to assume control of all freight only lines in the Sydney area, including access lines to Port Botany.

Over these corridors, ARTC is responsible for:

- ❖ Selling access to train operators
- ❖ Pricing access to train operators
- ❖ Development of new business
- ❖ Capital investment
- ❖ Operational management
- ❖ Management of infrastructure maintenance

In NSW, ARTC also manages, on behalf of the NSW Government, the regional branchline network in NSW consisting of around 40 track segments and being around 3350 km in length. ARTC carries out the maintenance and train control on the network under contract to the NSW Government, which is responsible for ongoing funding on investment in the branchline network.

The IGA provided for ARTC to negotiate wholesale access arrangements with each of the track managers in NSW, Queensland and WA, which would give ARTC exclusive rights to sell access for interstate operations to those parts of the interstate network within these jurisdictions.

ARTC has negotiated an agreement with the West Australian Government (assigned to WestNet Rail) that gives ARTC such exclusive rights with respect to new agreements or the novation of existing agreements. WestNet Rail still effectively controls the maintenance, investment and operations between Kalgoorlie and Perth.

ARTC's Corporate Vision and Mission Statement are to:

'Ensure rail is an integral, sustainable element of the nation's transport logistics network.'

'Through innovation and creative strategies, satisfy our customers, expand the industry; provide efficient access, across modes, to the interstate network; and assist in development of an integrated national transport logistics network.'

ARTC's objectives largely focus around increasing the role of interstate rail freight in national and regional transport supply chains through:

- ❑ Providing efficient access to users of the interstate rail network
- ❑ Pursuing a growth strategy for interstate rail through improved efficiency and competitiveness
- ❑ Improving interstate rail infrastructure through better asset management and coordination of capital investment, and,
- ❑ Promoting uniformity in access, technical, operating and safeworking procedures.

Since it commenced operations in 1998, ARTC has been actively pursuing these objectives, and whilst it has been generally accepted that the efficiency and competitiveness of interstate rail has improved significantly on east west corridors through improvement in these areas, there are still many impediments to the efficiency of intermodal transport, particularly between capital cities on the eastern seaboard.

There is also a significant volume of bulk export commodities moved on the ARTC network. This primarily includes coal and grain. Around 80-85 million tonnes of export coal is carried on the Hunter Valley rail network leased by ARTC to Newcastle. Other coal is also carried on the ARTC network from the Blue Mountains and Southern Highlands fields to Pt Kembla.

A significant quantity of export grain is also carried on the ARTC network in three states. This includes grain from the Murray mallee and mid north in South Australia to ports in Adelaide and Pt Pirie; the western grain belt in Victoria to ports in Melbourne, Geelong and Portland; Grain from southern, central and northern NSW regions to ports at Newcastle and Pt Kembla. In most cases the grain is carried from farm or silos on branchlines, by road or rail, to larger centralised receival ports sometimes on the ARTC network, for transport on the ARTC network to port. It is therefore important to the industry that road/rail and rail/port interfaces operate efficiently and enable the economics of linehaul transport of product to be maximised. Also in many cases, where grain is hauled over a longer distance, rail is generally more competitive and has larger market share. Road is more competitive over shorter haul journeys direct to port or centralised receival point.

As such, whilst volume on the ARTC network is predominantly interstate intermodal freight, significant parts of the network around Adelaide, Melbourne, Sydney and Newcastle carry large volumes of bulk export commodities from regional areas to port.

ARTC recognises that the service it provides, and influence it has, covers only part of a number of broader transport supply and distribution networks, both domestic and international. Overall improvement of the efficiency of these networks is the responsibility of many of the industry participants involved as well as regulators and governments. This will involve greater cooperation between players and a more holistic view of the service provided by rail and transport generally, as well as the necessary investment to improve infrastructure capacity (track, rollingstock, terminal and port) and performance.

Whilst both the grain and coal industries are major contributors to Australia's economic activity and prosperity, the economics of the two industries are significantly different. This largely arises from differences in the level and volatility of global pricing and volume flow of the two commodities, geographical and logistical differences, and the type and quality of infrastructure supporting the respective supply chains. Each industry has its own distinct economic issues to deal with in regard to investment and efficiency.

EXPORT GRAIN

Regional rail systems play an integral part in the delivery of regional grain volumes to ports. Over the past 10-15 years, major reform of the rail industry has resulted in a significant improvement in rail efficiency, service levels and lower freight rates. Reforms during this period have resulted in:

- Vertical integration and privatisation of rail operations and the regional grain infrastructure in SA, Victoria and WA. The introduction of third party access regimes to encourage above rail competition for grain haulage
- Vertical separation of the rail operations from the regional grain infrastructure in NSW, with privatisation of the contestable rail operations, and corporatisation of the monopoly infrastructure element. The introduction of an open access regime to encourage competition.

Previously, grain networks had largely been state government owned vertically integrated railways.

In most states the condition of the branchline infrastructure is poor and deteriorating further. The quality and capability of the infrastructure is a major impediment to the efficiency of rail operations. The current poor standard of branchline infrastructure results from a number of historic and economic realities such as:

- many years of under-investment in the network

- low and seasonal volume on many lines is insufficient to sustain economic return for the owner
- a lack of road and rail infrastructure pricing transparency and equity
- historic balance of economic regulation is towards efficiency rather than sustainability

Inherited maintenance deficit

The present maintenance deficit is significant on many of the lines producing a 'catch 22' situation where the cost to improve the lines back to a reasonable service level is well over that which could achieve a viable economic return; a situation that has resulted from past deterioration in infrastructure condition and service level. This situation cannot be addressed from current privatised owners requiring a return. There is a need for governments to intervene to assist in correcting the acquired deficit or recognising a transfer to road. It may be necessary, following thorough and holistic economic assessment, to recognise that some low volume, old lines to support farm to silo transfer need to be rationalised, and grained trucked to more efficient silo capacity near more economic lines.

Unsustainable economic returns

The volume and variability, and pricing that can be achieved, on many lines is insufficient under any rational economic model to sustain the rail operations and infrastructure, given the cost of appropriate sustainable service provision. It is not surprising that under-investment has continued since branchlines networks have been privatised, given the under-investment that occurred under government ownership.

Lack of infrastructure pricing transparency and equity

Contributing to the above, is the failure to properly price road transport placing rail pricing at market disadvantage. This is exacerbated by the cost of road and grain transfer to road being masked in this false economic effect.

Historic balance of economic regulation is towards efficiency rather than sustainability

The fear of competition and the sometimes constrained return to the asset owner inhibits asset renewal to an extent that could produce market failure. Regulatory practice to date has focused more-so on delivering efficient service provision (and lower end user cost) than on investment for sustainability and capacity. Significant gains have been achieved for the industry and now the focus needs to be re-balanced towards the need and incentives for infrastructure owners to renew assets and invest for capacity enhancement. This needs to be recognised in the regulatory framework.

Some parts of the industry have suggested that the application of National Competition Policy (NCP) to regional rail networks largely servicing the export grain industry has not delivered the positive outcomes seen on other rail networks such as coal networks and the interstate networks. It has been said that NCP is a significant contributor to market failure in this regard.

ARTC does not subscribe to this theory and believes that there are many factors that need to be considered, including underlying economics, market and industry structure, historic under-investment, competitive neutrality. There has not been a serious threat of competition on the WA or SA grain lines, nor effectively on the grain lines in Victoria. In southern NSW, a small degree of rail on rail competition was quickly eliminated by the acquisitions in 2004 of Freight Australia and Australian Transport Network by Pacific National. It is difficult to conclude that the current market predicament has been brought about by rail on rail competition.

ARTC would support the Federal Government undertaking a review of the role of rail in the national export grain industry, to assist with future road/rail investment decision-making. In the end, market forces will dictate the most appropriate transport mechanism for the industry. It is up to Government to provide a policy, regulatory and investment framework in place that supports this.

ARTC would support a re-balancing of regulatory emphasis towards providing greater encouragement for investment in infrastructure sustainability and capacity. The short term trade-off of possible efficiency loss is likely to be outweighed in long term growth benefits. ARTC would not support exempting rail networks servicing the export grain industry from the provisions of National Competition Policy.

ARTC would support improved transparency and equity of modal infrastructure pricing in a manner that produces fair and efficient outcomes for the transport industry as a whole.

ARTC is not opposed to the vertical integration of low volume regional branchline networks, a position taken by the Productivity Commission in 2000.

The NSW regional branchline network

As stated earlier, ARTC manages the maintenance and network control of the regional branchline network in NSW. This network supports a significant export grain haulage task, as well as haulage of other minor commodities and regional passenger services. Most of the network is in poor condition, resulting in low permitted train speeds and locomotive restrictions, which contribute to extended cycle times and low above rail productivity. Current access revenue derived from the network only recovers a small fraction of the cost of maintaining the network in a useable condition, and historically the lines have been financially supported to remain open through annual NSW Government CSO payments. Under ARTC's management, the NSW Government would still have responsibility for the level and funding of future track maintenance. The predominant train operator on the NSW regional branchline network is Pacific

National, which is bound to continue to provide train operations on the network until 2007, which are likely to be marginal.

There are currently 15 lines in the network that are classified as 'restricted', which are relatively lightly used, in poor condition, and are maintained only to provide safe operations. These lines have been at the centre of significant debate and review by the industry and government. The most recent review¹ undertaken by the Grain Industry Advisory Council, established by the NSW Government, considered the optimum road/rail transport option for each of these lines, and allocated priority to each line in terms of continued funding or closure.

In the future, it is not certain that the grain entry to rail will be at all the branchlines currently equipped with grain loading facilities. Considerations which give rise to some doubt are, from the viewpoint of:

- the NSW Government, the public liability having regard to high maintenance costs and low volumes at current access pricing;
- the customer, the Australian Wheat Board (AWB), the economic viability having regard to:
 - related supply chain arrangements²; and
 - alternative road/rail logistics options; and
- the rail operators' costs in relation to freight rates, particularly having regard to:
 - A commercial imperative to decommission light axle load, but obsolete, locomotives³ with a consequential inability of most of the restricted lines to accept less ancient, but heavier, locomotives⁴;
 - Obligations, arising from the purchase of FreightCorp⁵ to provide services irrespective of commercial merit until 2007; and
 - The degree to which access charges will continue to subsidise the rail operator by failing to recover the full costs of providing access.

AWB has constructed 10 high capacity terminals located on, or near, the regional branchline network in NSW and, for the most part, at the downstream end of the branchlines. The apparent purpose is diversion of ex farm grain from the traditional local receival silos (local bins) to the new AWB terminals (super sites). AWB seems to be enticing growers to the super sites by offering a grain price at super sites which is higher than offered at the local bins. The strategic objectives might be:

¹ GIAC Report on Rail/Road Options for Grain Logistics Final Draft (January 2004)

² Particularly a joint venture with GrainCorp, provider of most country grain storage and the controller of grain ports in NSW

³ 44 class – 19 tonne axle load and built c1955, 48 class – 13 tonne axle load and built c1959

⁴ 81 class – 22.5 tonne axle load and built c1982

⁵ A rail operator previously owned by the NSW Government

- Reduction of rail transport costs by bypassing low capacity rail lines and receival facilities
- Possible elimination of a competitor from the farm to customer supply line, and
- Better control of inland storage and related port and shipping logistics.

ARTC estimates that the impact of this strategy will be a reduction in the number of local bins on the regional branchline network of around 55%. A number of 'grain only' lines and associated locals bins may become uneconomic, and the reality may be that the track downstream of the super sites should become the infrastructure priority.

Analysis by ARTC suggests that the current level of funding support may not be sufficient to maintain even the status quo on restricted lines.

ARTC considers that the best future strategy for the network is to identify those lines that have no operational future for closure, not consume further funding on these lines and focus on funding those lines most likely to survive for market and rational logistic reasons.

EXPORT COAL

The export coal industry has a significantly different economic framework to that which applies with regard to export grain and rail branchlines. Key differences are:

- The ability of the industry to be able to pay for sustainable high quality infrastructure
- The more integrated nature of the coal supply chain, involving the mine, rail network, above rail operations, and the port. This necessitates a highly coordinated approach to the utilisation of the infrastructure where maximum capacity is not necessarily achieved by optimising utilisation of discrete components of the supply chain, but by optimising utilisation of the supply chain itself. This is more difficult for the export grain industry.
- The more regular nature of volume throughput.
- The lack of a highly competitive transport alternative, where infrastructure pricing is governed by regulation rather than competition.

It is now well documented that the current high international demand, and pricing, for coal has resulted in coal supply chains in NSW and Queensland reaching, and exceeding, exist levels of capacity, resulting in bottleneck, usually manifested at the port. The bottleneck may have resulted from insufficient infrastructure capacity

being available in one part of the supply chain, or may have resulted from less than optimum coordination of the supply chain as a whole.

ARTC's main experience in this regard is with the Hunter Valley coal supply chain. Over the past 3-5 years, supply chain throughput has increased from around 60mtpa to around 80-85mtpa. This has been achieved through a combination of:

- Limited infrastructure investment in rail and port infrastructure
- The identification, and reduction, of inefficient operating practices
- A more coordinated approach to coal supply chain management.

Most improvement in capacity has resulted from 'soft' investment in management practices and support systems, rather than investment in 'hard' assets. From the rail perspective, ARTC understands that infrastructure investment by the previous network manager was largely constrained by the long term nature of the investment vis-à-vis the economic life of the business funding that investment, and the regulated return from that investment vis-à-vis the perceived risks associated with that investment. Such risks included stranding risk, market risk and regulatory risk.

In the end, the perceived constraint on infrastructure investment in the industry is likely to have forced participants to look at alternative means of increasing chain throughput such as improving coordination, management practices and information usage. It could be argued that this resulted in a more efficient outcome for the industry than equivalent investment in hard assets.

Given that efficiencies with regard to chain management practice have now largely been achieved, the industry must now take the next step of developing a quantum increase in chain capacity from existing levels to meet forecasted demand for coal throughput over the next 5 years.

For its part, ARTC is currently refining, with the industry, a Hunter Valley corridor capacity improvement strategy that is intended to increase capacity from current levels to nearly 140mtpa by 2009, requiring infrastructure investment of around \$270m. The coal industry has indicated support, and willingness to pay for, this investment, which ARTC considers to be a prerequisite to making the investment.

One risk perceived by ARTC to this investment is the need for other parts of the coal supply chain to invest in complementary infrastructure such as above rail assets, and port capacity in order to increase overall chain capacity. In the Hunter Valley, ARTC notes that the owner of the port has announced investment to increase port capacity from 89mtpa to around 102mtpa at a cost of \$170m.

ARTC considers that one of the key impediments to further improving the efficiency, capacity and sustainability in coal supply chains is the impact of regulation. Once again, ARTC supports the application of NCP to coal supply chains, and notes that this has resulted in substantial efficiencies being made and reductions in infrastructure pricing for coal users. There is however, strong evidence that the regulatory balance applied to coal supply chains in NSW and Queensland may have constrained sufficient investment in recent times in order to grow and sustain these industries in an internationally competitive environment in the medium to long term.

This seems to have been the case with respect to the under-investment in the past, and delay to future investment, in the coal terminal at Dalrymple Bay in Queensland. Previous and current regulatory practice in this coal supply chain appears to have focus on achieving efficiency gains and improving chain competitiveness in the shorter term, rather than on sustainability and growth of the chain in the longer term. ARTC notes that the regulatory authority in Queensland has recently allowed for higher returns on terminal capacity expansion investment to be made by the owner, and investment has proceeded.

In the Hunter Valley, uncertainty about the nature and impact of the regulatory framework in the past appears to have, and has the potential to, constrain infrastructure investment. ARTC considers that there are a number of elements of the existing rail access regime in NSW⁶ that have the potential to constrain growth and sustainability investment, to promote efficiency and reduced pricing. Examples of these include:

- The stand-alone nature of the revenue ceiling test. Infrastructure investment can only be included in the regulatory asset base (from which a return may be made) to the extent that that investment is necessary and efficient for a rail network required to support coal only. This is a theoretical scenario that does not reflect the reality of use of the network. Perhaps unlike some other similar network, export coal users share the Hunter Valley coal network with other users such as domestic coal, grain and passenger. As these other users take up capacity (and passenger has legislated priority), Hunter Valley network capacity is consumed (and investment is required) well before the level of throughput that might be achieved by coal, if it were the only user. As such, investment is required, and coal does not need it on a stand-alone basis, but does in reality and is prepared to pay for it. Even so, the regulatory regime does not provide for the owner to recover a return. Other network users, due to intermodal competition cannot afford to pay for a share of the investment. An inability to earn an appropriate return on the investment acts as a constraint to infrastructure investment by the owner.

On the other hand, the application of a stand-alone ceiling test is argued to be economically efficient in that it prevents export coal users from paying for any more than the efficient cost of infrastructure needed.

⁶ NSW Rail Access Undertaking pursuant to Schedule 6AA of the Transport Administration Act 1988 (NSW)

- The regulatory regime only provides for a return to be made on the regulatory asset base associated with a defined network deemed to be required for regulated coal use. It ignores the fact that the Hunter Valley coal network does not exist in isolation and is connected to a wider network. It may be that infrastructure investment outside of the regulated coal network may represent the most efficient means to provide capacity improvement within the regulated coal network, with benefits accruing to regulated coal usage. The regulatory regime does not provide for a return to be made by the infrastructure owner where the users of the network outside of the regulated coal network are unable to pay for the investment. The coal user effectively does not pay for investment from which a benefit is derived. This provides an incentive for the infrastructure owner to only invest in capacity within the regulated coal network, even where it is not the most efficient investment. On the other hand, the regime only allows efficient investment to be included in the regulatory asset base. The overall outcome is a disincentive to invest.
- The regulatory rate of return allowed by the regulator is designed to reflect the average weighted average capital cost (WACC) of the company, as assessed by the regulator. Where the infrastructure owner or, more importantly, its debt and equity investors, take a different view as to the risks faced by the infrastructure owner, the investment may not recover the company's WACC, let alone achieve the company's investment hurdle rate, which may be set higher. Regulation does not provide for any further upside to act as an incentive to invest. Where the infrastructure owner has other assets, which may or may not have a higher risk profile, and may offer potential upside in excess of cost of capital, the likelihood is that scarce capital resources may be channelled into other areas of the business outside of the regulated asset.

ARTC is sure that many other infrastructure owners face similar issues in deciding whether to invest in a regulated network or not.

As stated earlier, one could argue that there is now a need to re-balance the regulatory emphasis towards providing greater encouragement for investment in infrastructure sustainability and capacity for the long term, rather than continuing to focus on even greater short to medium term efficiency gains.

OTHER ISSUES

With regard to some of the other issues raised by the Inquiry Terms of Reference, ARTC makes the following comments:

- ARTC recognises that access to intermodal terminals (capital city and regional) and ports represents an essential component of entry to the interstate and

regional rail network. ARTC shares the concerns of many industry participants that where such a facility is owned or controlled by a vertically integrated service provider that does or would compete with other service providers, it is likely that effective competition will be constrained. Duplication of such facilities, particularly in and around capital cities, whilst technically feasible in some circumstances, often represents an insurmountable barrier in normal circumstances due to insufficient scale of operations.

ARTC is not convinced that access regulation alone is a sufficient remedy in these circumstances. ARTC believes that structural separation represents a better means to limit anti-competitive behaviour, and so encourage market entry and competition in many circumstances including interstate transport. The operation of multi-user terminals with competing users is likely to yield greater benefit to the intermodal interface than the possible efficiency improvement through integration in many cases. Privatisations of state based railways on a vertically integrated basis (with an accompanying access regime) have been far from convincing to date in the context of investment and competition.

- Land use planning practices have been somewhat disjointed, indiscriminate and politically driven. This creates uncertainty for investment in efficient transport infrastructure. ARTC welcomes recent initiatives in some capital cities to develop longer-term transport plans. These will at least provide a better framework for the recognition of strategic freight transport needs in capital cities. ARTC welcomes the AusLink initiative to further focus State and local governments on the long-term needs of the national and key regional transport networks.

ARTC considers that new transport infrastructure should be paid for by the beneficiaries (direct and indirect) of that infrastructure, including developers of residential areas benefiting from the transfer of transport facilities and congestion to other areas.

- ARTC agrees that multiple regulators in each state in the areas of safety and OH&S add significant cost and complexity (through inconsistent treatment) to all parts of the national transport logistics network. ARTC supports the National Transport Commission in its efforts to create a national approach to rail safety and address overlaps between rail safety, OH&S and other forms of regulation in Australia.
- ARTC would welcome initiatives promoting the use of intelligent tracking technology in Australia. ARTC sees a range of benefits arising from the electronic/satellite tracking of heavy road vehicles in Australia, including:
 - The facilitation of 'mass-distance' charging for infrastructure use across both road and rail. Access to rail infrastructure in Australia is, by and

large, based on individual pricing of movements on a mass and distance basis. On the other hand road infrastructure is charged to rail's competitor, long-distance heavy road transport using blunter mechanisms such as fuel consumption and annual registration fees. The use of technology to individually charge road users (even only those operating in direct competition with rail, which represents a fairly small portion of the road fleet and routes) would bring about greater equity and transparency in infrastructure pricing, as proposed earlier. There is increasing interest in the potential for electronic/satellite vehicle tracking technology internationally. This would suggest that such technology is available and feasible. Whilst the Australian environment may be different to that of other countries, this should not represent a barrier to the use of available technology.

- The use of vehicle tracking technology will offer advantages in areas such as safety and supply chain management. With regard to safety, authorities would be far better placed to ensure vehicle maintenance and operating standards are maintained if vehicle travel patterns could be monitored. Electronic tracking of transport inventory in supply chain management would also offer the opportunity for more efficient utilisation of assets, improve industry responsiveness, and provide for more timely consignment tracking.

Australia's regional arterial road and rail networks play a significant role in the national freight transport task. The rail industry is a key contributor to the movement of bulk export commodities. There are significant differences in the relative efficiencies and investment environment surrounding supply chains for different export commodities. Longer term solutions for improving the sustainability and effectiveness of these supply chains call for different government and private sector responses depending on the commodity, as suggested in this submission.

Regards

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