AUSTRALIAN RAIL TRACK CORPORATION LTD

PRODUCTIVITY COMMISSION INQUIRY

ROAD AND RAIL FREIGHT INFRASTRUCTURE PRICING

AUSTRALIAN RAIL TRACK CORPORATION SUBMISSION IN RESPONSE TO PRODUCTIVITY COMMISSION DISCUSSION DRAFT

November 2006

Contents

1. Introduction

The Council for Australian Governments ("COAG") is developing a new Competition Policy Reform Agenda ("Agenda"). A number of commitments and studies were initiated at the last COAG meeting in February 2006 to assist with the development of the new reform agenda. These include a review of the economic costs of freight infrastructure and efficient approaches to transport pricing by the Productivity Commission. COAG agreed to a public inquiry into road and rail freight infrastructure pricing and subsequently the Commission invited interested parties to make a submission on any matter they see as relevant to the Terms of Reference.

The Commission has subsequently released its discussion draft and has invited response from interested parties. ARTC has reviewed the discussion draft and there are numerous issues raised in the draft to which ARTC responds to below. Specifically, ARTC has grouped its response into 4 main areas:

- Road Pricing and Competitively Neutral Pricing.
- Social Cost of Infrastructure Usage ("Externalities").
- Rail Regulation and Industry Structure.
- Productivity Commission Specific Requests For Further Information

2. Road Pricing and Competitively Neutral Pricing

2.1 Efficiency and Equity Considerations

ARTC notes that Draft Finding 7.1 of the Commission's Discussion Draft states that there is no compelling case to increase charges for road freight infrastructure users on competitive neutrality grounds and that modelling suggests an increase in road charges is unlikely to have a significant impact on rail's market share. ARTC has undertaken some high level analysis on road / rail price elasticises and we discuss this in section 2.2 below.

In making this finding, the Commission appears to have assumed that heavy vehicles recover their cost based on the attribution and allocation methodology used by the NTC and that this approach does, in fact, result in the 'true' cost incurred by these vehicles. The rail industry has been questioning this approach for many years and was expecting that the inquiry would deliver an independent assessment of the NTC approach based on solid engineering research and analysis. Unfortunately, the Commission has conceded that the same issues such as lack of valid, up-to-date and specific data and engineering research that have thwarted NTC efforts to improve the

methodology remain and once again, lead to an inconclusive outcome in this inquiry.

The Commission has noted that ".a lack of adequate data about corridor costs and traffic flows precludes a definitive conclusion."[1] However, the Commission has foreseen to make draft recommendations based on the inadequate data.

As an outcome, the road industry seems to have taken the Commission's finding as an endorsement of the current NTC approach and previous statements in relation to heavy vehicle cost recovery.

ARTC does not believe that any final recommendation or findings can be made without the appropriate research and analysis being undertaken.

Hence ARTC recommends that the Commission seek the further time it requires to undertake the detailed data collection and analysis, including engineering studies that it has recognised are currently inadequate or deficient in detail. The Commission's final recommendations should deferred until the completion of the analysis of the revised data and studies.

ARTC's position on Pricing and Investment for Road and Rail is:

1. Sustainable, efficient pricing in both modes is a pre-requisite to sustainable, efficient infrastructure investment. Infrastructure investment and planning can then also be based on the same economic criteria (preferable triple bottom line approach). The AusLink approach is an appropriate starting point.
2. ARTC seeks a common framework for cost allocation and recovery initially, and with full economic cost (FEC) as a target in the long run. This can be primarily achieved through growth rather than through price change (see below). Any competitive outcomes desired from a policy perspective should be transparent and competitively subsidised.
3. There is, as recognised by the Commission, a need for more accurate, current data specifically on road corridor usage and heavy vehicle movements. Assumptions are being made and conclusions drawn on data that is widely recognised as out of date.
4. There are certain markets and freight types that are well suited to road and others that are suited to rail - pricing is unlikely to move freight from one mode to the other in those markets (eg. certain coal networks are well suited to Rail, some shorter distance networks will likely be serviced by Road etc).
5. Modal shift is only an outcome of seeking competitive neutrality, not a reason for seeking it. The main focus is to achieve a platform for

[1] pXXXIV of the Productivity Commission Discussion Draft

different modes to compete fairly and efficiently and to deliver investment in either road or rail in the most efficient way. As noted, ARTC seeks sustainable, efficient pricing based on the same economic criteria as this is important for sustainable, efficient infrastructure investment.

ARTC is of the view that achieving consistency in pricing approach and subsidy should be the aim in the short term, whilst minimising the level of subsidy or removing it (full economic cost recovery) should be the long term aim.

Full economic cost could be achieved in the long run through the substantial growth and infrastructure utilisation forecasted without relying on pricing. If left to compete neutrally, the most efficient mode to meet a particular transport task will gain the volume, improve cost recovery and attract investment. The less competitive mode will phase out of the market over time. Where intermodalism delivers the most efficient outcome for transport in a market, the optimal mix of road and rail infrastructure will result and become sustainable.

The important task is to achieve maximum consistency that provides incentives for efficient investment at least in the first instance. Moreover the government should be providing its subsidies in a clear and directed manner in the meantime.

ARTC believes that adoption of the Swedish model where governments fund both road and rail, and users only pay marginal cost will further entrench existing problems and ensure government, rather than industry or market driven, outcomes.

The Commission's should examine carefully the implications of the current road pricing model for incentives for efficiency for road infrastructure provision and operator efficiency. ARTC supports incentives for delivery of efficient road maintenance and investment, as currently exist in rail through market forces and, where appropriate, regulation.

The goal, however, should be to deliver a simple, consistent pricing approach that finally resolves the competitive neutrality issue.

2.2 Road-Rail Price Elasticity

ARTC is well aware that the impact of factors other than price, for example transit time and reliability, have a significant impact in current modal choice decisions. ARTC has developed an elasticity model, which is a refinement of

work undertaken by Booz Allan and Hamilton in the late 1990's and early 2000's. The graph below (Figure 1) is a graphical representation of the elasticity model, where the curves in varying shades of grey are illustrative of different levels of service quality performance and the x axis represents road/rail price relativity. The black curve represents the point at which road and rail service quality is equal, and hence at price equality both modes would get 50% market share.

Figure 1 below highlights the following:

- On the Melbourne-Sydney and Sydney-Brisbane sections, rail has poor service levels, a low market share and is operating on a point of the curve that has a low sensitivity to price relativities (in layman's terms, the curve at this point is relatively flat). Thus any relative changes in road pricing currently do not have a significant affect on road market share.
- Rail is much more competitive on the Melbourne-Brisbane corridor and the relative market share reflects this. Modal choice is much more price sensitive. The relative gradient ("steepness") of the curve at this point reflects a much higher price sensitivity.
- Not shown on the attached graph but also supporting the Commissions findings, rail market share on the East-West corridor is approximated at 80-85%. At this point, rail's market position is operating on the "flatter" part of the curve (but at the high market share end of the curve). Again, at this level, relative increases or decreases in road pricing are not going to impact modal choice by substantive degrees. Further, the road / rail price differential is already significant on this corridor.

Hence, in today's environment, ARTC's approximation of elasticity generally supports the PC conclusion that an increase in road price is not likely to significantly increase rail freight volumes on the Melbourne-Sydney and Sydney-Brisbane rail corridors (evidence would also support this for Sydney-Perth and Melbourne-Perth freight where rail has a significantly large market share already). The Melbourne-Brisbane rail corridor is currently more price sensitive.

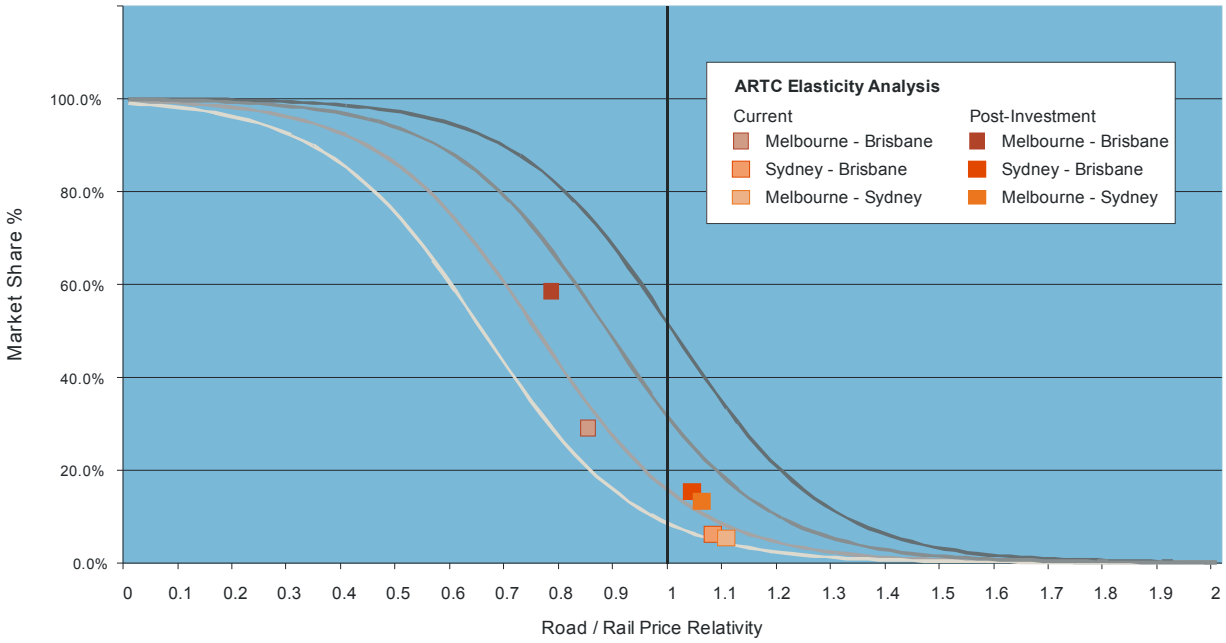
However, the environment after completion of ARTC's investment program is different – the competitive market dynamics will change as service performance is expected to improve significantly and will shift rail into a position of being substantially more competitive against road.

Upon completion of ARTC's rail upgrade investment program, rail's market share for each of the 3 corridors, including the shorter Melbourne-Sydney and Brisbane-Sydney sections, become more sensitive to price, that is, the curve is 'steeper' at the point of the forecast post investment market shares. Hence any variation in relative prices between road and rail will then have a greater

impact on rail market share. The movement in market share for the Melbourne-Brisbane section highlights how significant the investment program outcomes are and how important relative modal pricing will be at that point in time.

ARTC recommends that the Commission review it assumptions on price based modal shift outcomes based on the expected outcomes of ARTC's North-South corridor investment program.

Figure 1: Graphical Representation of Elasticity Model



ARTC has also become aware of work performed in relation to elasticity models with respect to north-south transport markets as part of the North-South Corridor Study undertaken on behalf of the Australian Government. ARTC would recommend the Commission seek out this additional work.

2.3 Mass Distance Charging (MDC)

ARTC welcomes the recognition in the draft Commission's report that MDC is inevitable in Road. ARTC supports the finding that location based charging on major freight corridors has the potential to bring significant additional efficiency benefits.

The Commission recognises that the effect of "averaging" within the current NTC approach has a significant effect on the outcomes within and across

vehicle classes. Within vehicles classes it is evident that "…vehicles travelling longer than average distances and/or carrying heavier than average loads are cross subsidised by other vehicles within the class".[2]

ARTC views that MDC is a means of overcoming many of the issues in relation to the effect of heavy vehicle road use cost averaging.

The Commissions draft finding 8.12 states that "mass-distance location based charges have the potential to bring substantial efficiency benefits. But they also could entail substantial costs and pose some formidable implementation challenges"[3] Given that there is no draft recommendation in the Commission's discussion draft in relation to the introduction of MDC on road, it is apparent that the Commission has concluded that the costs of MDC outweigh the benefits.

In its previous submissions, ARTC has noted certain parts of the existing road fleet have already invested in GPS tracking technology for fleet and supply chain management. ARTC maintains its view that the benefits of GPS tracking and vehicle weighing technology extend beyond the improvement of pricing and investment signals, and assisting in the delivery of competitive neutrality between modes. For example, 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.

ARTC remains of the belief that there is significant potential for the application of technology to deliver mass distance charging in the first instance in relation to the contestable component (eg interstate markets) of the road freight market. ARTC believes that limiting MDC use, in the first instance, to the contestable land freight market (estimated to incorporate between 4-8% of the heavy vehicle fleet) will ensure there is minimal impact on regional or remote areas. The majority of regional and remote areas that would be affected do not have a contestable freight transport supplier market.

A distance only measure is useful starting point but only marginally better than current pricing measure (being diesel fuel excise). Location based charging should be the priority.

ARTC recognises that implementation issues need further detailed investigation however ARTC continues to recommend a pilot of MDC on road in the more contestable (eg. interstate) markets

[2] pXXXIII of the Productivity Commission Discussion Draft
[3] P8.34 of the Productivity Commission Discussion Draft

2.4 Road Cost attribution and Allocation

The Commission determines that, under the framework of the PAYGO system and given the conservative approach taken by the NTC, heavy vehicles "…as a group currently more than cover their assessed attributable costs"[4]

The PC has made assertions on the extent of heavy vehicle cost recovery (in total and by class) based on the NTC approach despite acknowledged weaknesses in the cost allocation process (such as national averaging and averaging within vehicle class) and the PC's inability to assess the validity of historic engineering paradigms. The Commission further acknowledges that the NTC currently ".excludes a significant proportion of road expenditure from the cost base"[5]

ARTC finds it difficult to comprehend how the Commission is able to conclude that heavy vehicles are paying their way when:

- The Commission has based it findings on road data that it recognises is inadequate or out of date.
- There continues to be a significant proportion of expenditure excluded from roads cost base.
- It is acknowledged that no-one knows the economic costs of road and rail infrastructure provision.

Recent published analysis from Associate Professor Kim Hassall of the Freight & Logistics Group at the University of Melbourne concluded the following:

> "…there is a pretty big free kick afforded to the "For Hire Sector". Even though the old surveys do need recalibrating, an ancillary road train pays 10 to 14 times more per kilometre than its hire and reward counterpart"[6]

In the context of this analysis, ancillary road operators are "…certainly not in competition to rail transport"[7] whereas the 'for hire sector' competes directly with rail. The conclusion of this analysis further highlights deficiencies in the NTC averaging methodology (and also supports the need for a distance based approach as discussed above).

ARTC recommends more further detailed data investigation and analysis, including

- Undertake detailed data collection and analysis on road corridor usage and;

[4] pXXXII of the Productivity Commission Discussion Draft
[5] pXXXIII of the Productivity Commission Discussion Draft
[6] p31, Australian Transport News, October 2006
[7] p30, Australian Transport News, October 2006

- An independent engineering assessment of the NTC cost allocation criteria for heavy vehicles;
- An estimation of network valuation based on DORC principles and full economic cost of the rail and road network, with the interstate rail/road network (or AusLink network) being a minimum. This analysis leads to an assessment of full economic cost and a more detailed "apples with apples" comparison of relative road/rail cost recovery.

3. Social Cost of Infrastructure Usage ("Externalities")

ARTC notes that the Commission's discussion draft suggests externality charging will have minimal impact. The Commission's discussion draft suggests that it is essentially in urban areas where most externalities are evident (refer draft finding 6.3) and in urban areas rail is heavily reliant on road for final destination delivery – hence the assumption is that any externality charge will increase PUD for freight on both modes.

ARTC notes that the Commission draft finding 6.10 suggests that further research is required on transport externalities and that the BTRE is best placed to undertake this research. There is no draft recommendation in relation to this finding.

ARTC continues to be of the view that inclusion of at least a nominal charge (recognising already internalised costs and the complex nature of determining exact externality costs) on both modes is required to create greater awareness and impetus for future decision making and research.

Further, ARTC noted in its previous submissions to the commission that there is a disparity between external amenity costs included in Rail's cost base but not generally included in Road costs. For example, Rail has to provide pedestrian crossings (including footbridges or tunnels) when these are amenities in the road definition. Rail pays for the costs of rail safety regulation which provides public amenity but road users do not etc). The inclusion of these items in rail's cost base demonstrates another degree of variability in the current competitive position between rail and road. The Commission's draft findings do not seem to recognise this variance in allocation of amenity costs between the two modes.

ARTC believes that for both modes the cost base should include all costs that would otherwise not have been incurred but for the existence and use of the transport infrastructure (the road or rail). As per the recommendations in section 2.4 above, ARTC suggest more accurate data investigation and analysis is required on issues such as these. Hence this should be included in the final recommendation that follows the Commissions draft finding 6.10.

4. Rail Regulation and Industry Structure

4.1 Access Regulation

The Commission's draft recommends that there is "scope to moderate or even revoke access regulation where pricing by vertically separated below rail operators is significantly constrained by competition from road and sea"[8]

ARTC is supportive of reducing the level and complexity of regulation where it is appropriate and specifically in areas, such as the interstate rail network, where there is effective market competition. ARTC has an Undertaking on its interstate network and this was largely borne from a requirement to submit one as part of ARTC's original charter. ARTC believes there is sufficient competition between road and rail on the interstate network to restrain pricing and other non-competitive behaviour by below rail operators / infrastructure owners.

ARTC notes that in submissions to the Commission it has been said that without regulation a vertically separated infrastructure owner can expropriate normal above rail rents, even in the presence of strong intermodal competition. It could do this in the short term, ignoring the long term impacts on network utilisation of unviable above rail operations. ARTC does not believe this has been the case in relation to vertically separated infrastructure owners to date, particular where government retain involvement.

The interstate network stands out as one where most intermodal competition exists. Access to this network has been priced at well below full economic cost in order to promote rail growth. This occurred before access regimes were in place. In the period prior to 2002 (when ARTC's Access Undertaking was accepted by the ACCC), access pricing to ARTC's network reduced in both nominal and real terms over a five year period. In this unregulated environment, this would not appear to be behaviour of an infrastructure owner taking a short term view or seeking to expropriate above rail rents. In fact ARTC is currently undertaking a substantial investment program in order to deliver long-term market benefits to the freight industry.

Coverage and intensity of regulation should depend on existence of substantial market power and incentives arising from vertical integration. Regulation should only be imposed where there is substantial market power (focussed around price regulation) and/or vertical integration (ring-fencing, constraint of anti-competitive behaviour).

[8] Refer draft recommendation 11.4 of Productivity Commission Discussion Draft

ARTC supports a review of the current framework for delivering access regulation in Australia with a view to reducing the regulatory costs associated with its duplication and implementation and creating stronger incentives for efficient investment. Under current regulatory structures there has been an imbalance where regulatory practice has focused more-so on efficient service provision than on investment for longer-term sustainability and capacity. A re-balancing is required in this regard.

This need for flexibility in different markets in a national approach leaves the door open to significant interpretation by jurisdictional regulators. As such, ARTC considers that it is unlikely that a national approach to access can be delivered effectively without a national regulator.

Economic regulators need to operate independently from government decision making. ARTC would strongly support a recommendation by the Commission to adopt the ACCC as the single economic regulator for the national rail network. This would deliver the required consistency and independence in access regulation and pricing.

4.2 Vertical separation / Re-integration in Rail

The Commission's draft recommendation in relation to rail industry structural issues is that "…allowing vertical reintegration of particular rail lines or networks would promote their commercial viability and should be subject to detailed independent examination".[9]

In submissions provided to the Commission as part of this inquiry, it has been asserted that vertical separation brings about significant loss of efficiency, coordination and transaction costs. Further, some have said that there is a lack of coordination in many aspects (such as infrastructure investment) that needs to be minimised, possibly through regulation.

It is ARTC's experience that real above rail competition (or a credible threat) is far less likely in a vertically integrated environment. On the other hand, varying degrees of competition (that show strong evidence of market benefits) have arisen on most vertically separated networks in Australia.

ARTC is not convinced that separation has resulted in substantial transaction costs and/or loss of efficiency. ARTC is aware that there has been preliminary research undertaken by the Planning and Transport Research Centre (PATREC) at Curtin University that suggests that the separation in rail that occurred in the mid 1990's has not resulted in loss of efficiency.

[9] Refer draft recommendation 11.5 of Productivity Commission Discussion Draft

Preliminary analysis and anecdotal evidence suggests that this result is possibly because coordination was not that strong even within the previously vertically integrated rail environment.

Third party access regulation of vertically integrated networks has not been effective in bringing about competition, and may introduce transaction costs and loss of coordination through ring-fencing.

In any event, loss of efficiency (if any) needs to be weighed up against the benefits of competition.

ARTC takes the view that integration should be considered where there is unlikely to be competition in the above rail market. In this regard there are differences in evidence in relation to above rail market competition when the Interstate network is compared to regional networks.

4.2.1 Interstate Network

ARTC is convinced that a vertically separated environment can and will deliver effective competition and resulting economic benefits on the interstate network. The interstate network is commonly broken into 2 corridors North-South (which is broadly Melbourne-Sydney-Brisbane) or East-West (which is broadly Melbourne-Adelaide-Perth and also Sydney-Perth). Under the current largely vertically separated system on these corridors the following is evident:

- Above rail competition and rail market share is strong on the East-West corridor.
- Above rail competition has arisen on the North-South corridor in recent years (eg. QR and other above rail operators have entered the market). However rail market share is low on this corridor due to a number of factors.
- The Rail industry has undergone substantial change over last 10 years (eg ownership, amalgamation, take-overs etc) and change is likely to continue.
- It has been argued by some that separation has been an impediment to rail infrastructure investment. This largely arises from assertions that there is a lack of coordination and consultation on investment between above and below rail elements. Whilst it is accepted that a vertically separated environment is unlikely to give rise to the same degree of above and below rail coordination as might occur in an integrated environment, this is normally accepted as a necessary trade-off to achieving competition. Even in a vertically integrated environment where third party access is mandated, regulation actually works to reduce the ‘close proximity’ of the related above and below rail elements to the extent that this may result in anti-competitive

behaviour. A substantial degree of consultation with users was undertaken by ARTC in developing its investment programs for the East-West network in the past, and now the North-South corridor investment strategy. ARTC is undertaking a significant investment program of over $1.6-billion on the North-South Corridor. The investment program was designed and scoped with significant industry consultation and alignment.

- Whilst it is acknowledged that there is always room for improvement, market forces have necessitated that any investment undertaken on the interstate rail network must be designed to deliver desirable market outcomes in terms of transit time, reliability, capacity and yield. On the interstate network, it is the below rail element that takes on market risk in relation to investment and therefore is commercially motivated to mitigate this risk. ARTC has only been able to establish market requirement through a process of consultation with users and in surveys of freight forwarders and end users. ARTC has then sought to deliver these outcomes in the most cost effective manner.
- ARTC believes that factors such as a lack of capacity and access to integrated assets such as intermodal terminals are more likely to have been an impediment to competition and expansion in North-South rail markets. Intermodal terminal access (vertically integrated) could be impediment.

The current investment program being undertaken by ARTC on the existing North-South rail corridor is aimed at significantly improving reliability, transit time and yield. ARTC's customers have indicated to it that these are the most important market drivers of competitiveness. At the completion of the investment program, transit time is planned to decrease to 11.5 hours Melbourne-Sydney, 15.5 hours Sydney-Brisbane and 27.0 hours Melbourne-Brisbane. These transit times will hence meet the threshold requirements for rail competitiveness (as specified in the recent the North-South Rail Corridor study conducted by Ernst & Young) and a planned outcome of this is a significant increase in intermodal traffic to and from Melbourne-Sydney, Melbourne-Brisbane and Sydney-Brisbane.

The completion of the North-South investment will change rail's competitive position in markets and create a different environment for new investment, entry and competition, as discussed above in relation to price elasticises (refer above section 2.2 Road-Rail Price Elasticity).

4.2.2 Regional Networks

ARTC believes that there is more likely a case for investigation of re-integration on certain regional networks. As stated above, integration may be

appropriate where there is unlikely to be competition in the above rail market and intermodal competition places a sufficient constraint on rail. The position in relation to the two main regional rail freight network types – Grain and Coal – need to be considered separately.

Grain Networks

There are different industry structures that apply to different regional grain networks across Australia:

- Vertically integrated and privatised in SA and Victoria (note, the Victorian Government and Pacific National announced on November 1st that, after the next election, the Victorian Government would buy back the lease of the Victorian regional rail network thus creating a vertically separated environment).
- Vertical separation and privatised in WA
- Vertically integrated Government ownership in Qld.
- Vertical separation of regional grain infrastructure and privatisation of contestable rail operations in NSW.

In some states, branchline infrastructure is in poor condition and deteriorating further, vertical separation alone is neither a fix nor the cause of the problem as vertically integrated networks are in same predicament. Separation is unlikely to improve above rail competition on these networks due to a number of historic and economic realities including:

- Historical under-investment in the network
- Low and seasonal volumes on many lines is insufficient to sustain economic return
- Historic balance of economic regulation is towards efficiency rather than sustainability

The announcement on November 1st by the Victorian Government that it would buy back from Pacific National the lease of the Victorian regional rail network currently highlights that industry structure is not the cause of the problem experienced by regional networks. The fact that the operator (Pacific National) has made a commercial decision to separate the above and below rail infrastructure highlights that the issues discussed above are significant.

As such, any review of industry structure on grain branchlines needs to also focus on addressing a range of other issues. State Governments and the industry need to set out what the optimal long term plan is for dealing with regional grain transport (road and rail). State Government should put in place a policy and regulatory framework that will allow market forces to deliver the most efficient long term outcome in each particular circumstance, whether that be road, road or a combination of both servicing the export grain supply chain.

Coal Networks

The impact of industry structure on Coal rail networks is another example that demonstrates that industry structure is not the driving factor for efficient and competition market outcomes. In Coal rail networks in Australia there is no evidence that vertically separation has not delivered appropriate outcomes (certainly not any more than a vertically integrated structure would have done). An example of this is the efficiency of the Hunter Valley network, where, in a vertically separated structure, above rail competition has been delivered in the Hunter Valley. The Coal industry welcomes competition for the market in Hunter Valley, and as discussed below, efficiency and volume improvements have been improved by means of co-ordination between all the logistics providers. There is clearly a competitive environment in which the vertically separated access provider operates. Supply chain competition and international competition leads to more efficient market practices in any event. Hence there is no prima facie case for re-integration in networks such as the Hunter Valley coal rail network.

On these coal networks, which operate under both vertically integrated and separate structures in each state, there is not strong evidence of differentials in investment.

ARTC's analysis highlights that the scope for any re-integration is likely to be limited to regional rail networks, dominated by the transportation of bulk grain. There is strong evidence to suggest that vertically separation has had significant positive benefits to competition and investment on the interstate and coal rail networks. Re-integration on those networks is likely to unwind those benefits and discourage further growth in above rail competition.

4.2.3 The Case for Logistics Co-Ordination regardless of Structure

A key element, regardless of vertical structure is the need for co-ordination between all parties. ARTC has significant experience in this regard in relation to the Interstate and Hunter Valley network.

On the interstate network, ARTC undertakes a substantial degree of consultation with users undertaken by ARTC in developing its investment programs for the East-West network in the past, and the very significant North-South corridor investment strategy. ARTC bears substantial market risk from investment in its network and market forces have necessitated that any investment undertaken on the interstate rail network must be designed to deliver desirable market outcomes in terms of transit time, reliability, capacity and yield. On the interstate network there are regular forums (monthly) at

which users of the network are able to articulate their needs and proposals to ARTC for consideration. .

ARTC (and others) bear market risk on below rail investment in the interstate network, and is commercially compelled to consult with customers in order to establish market need to mitigate this risk. ARTC has then sought to deliver the market driven outcomes in the most cost effective manner.

In the Hunter Valley, the coal supply chain participants have focussed more-so on improving productivity of the transport chain by improving the efficiency and coordination between various elements of the chain to deliver increased throughput of around 80-85mTpa tonnes from around 65mTpa 3 or 4 years ago. However, substantial investment in transport infrastructure (rail, rollingstock and ports) is now needed to deliver the step change capacity improvements to meet forecasted growth in coal demand in the Hunter Valley. To date, the development of investment programs has been undertaken on a consultative basis involving all elements of the transport chain.

ARTC believes that commercial necessity and market forces will continue to provide impetus for continued consultation and coordination on ARTC's network (ie. the interstate and Hunter Valley networks). In this regard, ARTC does not believe that there is a need for 'entrenching' formal consultation through regulation, There is a risk that formal consultation processes may add cost and even delay investment.

4.3 Nature and Term of Access Agreements

The Commission highlights that an issue relevant in a vertically separated rail environment is the duration of access agreements. Above-rail operators have stated to the Commission that it is difficult to obtain access agreements longer than five or ten years. While relatively short-term access agreements may be designed to promote above-rail competition, they are likely to also reduce certainty and, therefore, potentially reduce investment incentives. On the other hand, a requirement for lengthy access agreements could become a significant barrier to entry for start-up operators with small volumes and uncertain futures.

ARTC's current Access Undertaking is for a period of 5 years and is due for renewal in 2007. It is noted by ARTC that the Commission has highlighted a perceived lack of certainty for investment in interstate rail due to rail operators not being able to obtain access certainty beyond the term of ARTC's Access Undertaking (ie. 5 years maximum).

ARTC advised in an earlier submission to the Commission in this inquiry that it is able and willing to negotiate longer-term (more than 5-year) contractual agreements with rail operators[10]. 'Certainty' can be obtained via commercial contracts negotiated between the parties. The terms and conditions of contractual agreements preside over and above the terms and conditions that may arise from any new access undertakings that may apply during the term of a contract between ARTC and an operator.

5. Productivity Commission Specific Requests For Further Information

The Commission has sought comment and feedback from interested parties on specific elements of its observations and findings. ARTC comments are in the following table.

[10] ARTC June 2006 Supplementary Submission to the Productivity Commission Inquiry into Road And Rail Freight Infrastructure Pricing,

Commission's question / feedback request	Relevant Finding or Commentary in the Commission's Discussion Draft	ARTC View
1. *The Commission seeks comments from participants on approaches to achieving an efficient allocation of the common costs of providing rail infrastructure.*	*DRAFT FINDING 5.3* *While access regimes do not explicitly preclude rail infrastructure providers from allocating proportionately more common costs to less price-sensitive users, it is not clear that the benefits of such pricing are adequately reflected in the approach of regulators.*	• ARTC undertaking and other regimes do not preclude price discrimination (or Ramsay pricing) where it is appropriate, but constrains differential pricing that may distort downstream markets.
2. *The Commission seeks further evidence from participants regarding the impacts of vertical separation or integration on the interstate track and on the major regional coal lines.*	*Draft Finding 10.2* *There appear to be no benefits, and some costs, in maintaining or implementing vertical separation on regional rail networks where infrastructure providers are unable to exert market power.*	• Refer above Section 4.2 'Vertical separation / integration in Rail'.
3. *The Commission seeks comments from participants on the desirability of moving to a single national regulator or regulatory regime for rail infrastructure.*	*DRAFT FINDING 10.6* *There are significant potential economic benefits from achieving a nationally consistent approach to access regulation of the rail sector. The reform measures agreed by COAG in February 2006 represent a way forward to achieving such consistency. Progress of the current agreed COAG reforms should be monitored to determine whether there are likely to be additional net benefits from moving to a single national regulator or regulatory regime* *.*	• Refer to above Section 4.1 – Access Regulation. • Economic regulators need to operate independently from government decision making. ARTC would strongly support a recommendation by the Commission to adopt the ACCC as the single economic regulator for the national rail network. This would deliver the required consistency and independence in access regulation and pricing. • Different markets need to be recognised in a national approach. For example, the identification and allocation of capacity is different on the interstate network to that on coal networks. This need for

Commission's question / feedback request	Relevant Finding or Commentary in the Commission's Discussion Draft	ARTC View
		flexibility in different markets in a national approach leaves the door open to significant interpretation by jurisdictional regulators. As such, ARTC considers that it is unlikely that a national approach to access can be delivered effectively without a national regulator. • The intensity of regulation should reflect the existence of substantial market power (where price control is needed), and any incentives to prevent or constrain access, such as may exist in a vertically integrated structure (where mechanisms to prevent preferential self dealing are needed).
4. *The Commission seeks comments from participants regarding the appropriateness of the current coverage of access regimes for rail infrastructure. What might be the effects of removing access regulation on the vertically separated elements of the interstate track?*	*DRAFT FINDING 10.7* *In view of the lack of market power of vertically separated below-rail operators competing with road freight, there is likely to be a strong case for price regulation only for coal lines in New South Wales and Queensland and for those parts of the network where below-rail operators also run above-rail services.*	• ARTC agrees in principle with the Commission's draft finding 10.7. • For discussion refer detail above in Section 4 'Rail Regulation and Industry Structure' • ARTC believes there is sufficient competition on the interstate network between road and rail to restrain pricing and other non-competitive behaviour by below rail operators / infrastructure owners. ARTC does not consider that it has substantial market power in its markets, which is a view that the ACCC seemed to share in its deliberations over ARTC access undertaking. • It has been suggested that there is a need for Access regimes and undertakings to provide "certainty" to operators. "Certainty" can be obtained

Commission's question / feedback request	Relevant Finding or Commentary in the Commission's Discussion Draft	ARTC View
		via commercial contracts negotiated between the parties. These contracts could be negotiated for periods longer than the standard practice of 5 years for access undertakings. • It has also been suggested that there is a need for regulatory oversight in a vertically separated environment so as to deliver as close as possible to vertically integrated outcomes in relation to investment and other matters (minimise economic losses associated with vertical separation). • There may be a case for some regulation in this regard where the access provider has substantial market power, as is evidenced by the regulation of formal consultation practices in the Hunter Valley, where it is the industry that is fully funding investment and substantially bearing market risk. Here, incentives for the access provider to maximise throughput are possibly constrained by regulation. • On the interstate network, where the access provider does not have substantial market power, it is the access provider that is required to fund the investment and more importantly take market risk on that investment. There are commercial incentives for the access provider to seek to mitigate that risk through establishing regulator consultation and coordination with the market. ARTC does not see a need to regulate this activity. • On the interstate network there are regular forums

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		(monthly) at which users of the network are able to articulate their needs and proposals to ARTC for consideration. In the end however, where ARTC bears the market risk, it must be free to choose to undertake that investment if it is in its own commercial interest.
5. *The Commission seeks participants' views on the performance of government-owned rail providers.*	*Discussion Draft p10.27-10.28* *Lack of commercial focus of government operations* *Despite corporatisation, concerns remain that government-owned rail operators are insufficiently commercially focussed. Governments, as shareholders, appear to have neither demanded nor enforced the same degree of commercial discipline as is placed on private sector operators (see for example Commission's 1999c). There are a number of possible reasons for this, including:* • *while most government railways are corporatised, the remaining problems may reflect difficulties in the implementation of the corporatisation model;* • *governments still subject their rail operators to multiple, and often conflicting, objectives, including some relating to social welfare, without guidance on prioritisation;* • *governments as shareholders facing budget constraints (and observing poor returns in rail) are often reluctant to provide adequate equity funding or allow railways to borrow on their own behalf, even when justified commercially; and* • *governments often have difficulties in maintaining an arm's length relationship with their railway boards due to community pressures.*	• ARTC supports continued improvement in commercial focus of industry participants. • Substantial gains in the last 10 years have been achieved through privatisation and corporatisation. • There are still limited opportunities for further improvement. Benefits would result from creating a level playing field between participants.

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	Stricter application of the corporatisation model to government owned railways may produce further gains and resolve some of the above issues. Others consider that inherent limitations of the corporatisation model will always lead to suboptimal economic and financial performance, and that private sector alternatives to government provision should play more of a role — such as competitive franchising and/or contracting out and full privatisation. *While there may be merit in suggesting a larger role for the private sector, it seems reasonable to conclude that, for the reasons outlined above, the corporatisation model is yet to be fully implemented or tested. Opportunities almost certainly exist for improving the performance of government-owned rail operators by more strictly applying the corporatisation model.*	
6. *The Commission seeks information from participants identifying any remaining regulatory restrictions on freight movement. In particular, are there any remaining regulations that effectively restrict particular commodities to rail or to road?*	*Discussion Draft p10.31* *Remaining regulatory restrictions on freight movement? Historically, regulations restricted the movement of certain commodities to rail. While these measures have been almost entirely removed, there may be merit in a suitable body, such as the NTC, undertaking a stocktake of current regulatory restrictions on freight movement (ideally across all modes). The stocktake could identify any remaining anticompetitive regulation and, where desirable, make recommendations for reform.*	• The main restriction to road and rail competition on the ARTC network occurs in the Hunter Valley through legislative restriction on the use of roads by trucks. • There are more significant regulatory constraints (rather than restrictions) on rail competitiveness arising from the multiplicity of jurisdictional regulation in the areas of access regulation (described earlier), rail safety, and different operating and engineering standards.

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7. *The Commission seeks further input from participants on intermodal issues affecting the efficient transport of freight and appropriate strategies.*	*Discussion Draft p10.31-10.34*
	10.4 Enhancing intermodal connections
	Intermodal connections provide the means of transferring freight from one mode of transport to another at key points along the logistics chain. The seamless transfer of freight across modes is important to the efficiency of the national freight system as a whole, and in promoting efficient investment to cater for particular transport tasks. It is important to identify and address any bottlenecks that may diminish otherwise desirable transfers of freight across transport modes.
		• Significant impediments to rail efficiencies include:
		  • Terminal bottlenecks – there is a need for more investment & development of rail terminals & associated infrastructure
		  • Rolling-stock inadequacies – there is a need for further investment in rail rolling stock to cater for any substantive increase in rail volumes.
		• ARTC has noted a range of impediments in its previous submissions (refer p47 and Attachment 2 of ARTC's initial submission to the Commission).

8. *The Commission seeks the views of participants about the potential costs and benefits of reintegration on specific rail networks.*	*DRAFT RECOMMENDATION 11.5* *Given the mixed success of vertical separation in encouraging above-rail competition, whether allowing vertical reintegration of particular rail lines or networks would promote their commercial viability should be subject to detailed independent examination.*	• Refer detail above in section 4.2 'Vertical separation / integration in Rail'.
9. *The Commission seeks participants' views about the feasibility of establishing a national road fund, particularly how inter-jurisdictional issues might be resolved.*	*DRAFT FINDING 11.1* *A national road fund has the potential to improve the efficiency of road spending decisions, but, to achieve this, it would need to operate with a high degree of autonomy reinforced by appropriate governance arrangements and transparent processes, and also would require inter-jurisdictional agreement about processes and criteria for setting heavy vehicle charges and allocating funds. These are complex issues on which further input is sought.*	• The process or system by which funds from road pricing is collected is not as important as the structure of pricing and the criteria in relation to investment & infrastructure decisions. • Sustainable, efficient pricing in both modes is a pre-requisite to sustainable, efficient infrastructure investment. Infrastructure investment and planning can then also be based on the same economic criteria (preferable triple bottom line approach). • ARTC seeks a common framework for cost allocation with full economic cost as a target.

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		• ARTC finds it disappointing that Commission's views that there is no compelling case to increase road charges as an increase in road charges is unlikely to have a significant impact on rail's market share - modal shift is only an outcome of seeking competitive neutrality, not a reason for seeking it. The main focus is to achieve a platform for different modes to compete fairly and efficiently and to deliver investment in either road or rail in the most efficient way. • Getting the economic cost methodology correct and utilising a national investment evaluation framework through institutionalised reform through a body similar to an NTAC that provides overall policy directives through an AusLink program would be a suitable policy outcome.
10. The Commission seeks participants' views about the feasibility of introducing more commercially-oriented management for the major freight routes, the potential benefits and costs, and how pricing, network 'boundary' and other implementation issues could be resolved.	*DRAFT FINDING 11.2* *Location-based charging on major freight routes has the potential to bring significant additional efficiency benefits, especially if accompanied by more commercially-oriented road infrastructure provision. But the formidable implementation issues, including how to resolve 'boundary' issues and how to charge for non-freight road use, as well as the potential distributional implications flowing from a breaking down of network averaging and cross-subsidisation within current charging arrangements, require detailed investigation.*	• Refer detail above in section 2.2 'Mass Distance Charging (MDC)'.