Why Consider Track Access for Long Distance Passenger Rail?

The Background to the Terms of Reference states the purpose of the review is "to assist COAG to implement efficient pricing of road and rail freight infrastructure" (Terms of Reference, Page V). Whilst naturally the principle focus of the Commission's work is on pricing of the infrastructure for freight movement, the Terms of Reference do not restrict consideration of pricing for other uses. We therefore submit that pricing use of the rail infrastructure for Long-distance Passenger Rail (LDPR) should be given consideration.

It is noted the COAG communiqué asks the Productivity Commission to develop proposals for . . . "pricing regimes in a manner that maximises net benefits to the community, *in particular rural, regional and remote Australia.*" (Communiqué, Page VII)

The COAG communiqué further states that the inquiry will "*include an analysis of how particular communities might be impacted"* (ibid). The Commission also notes that it is "asked to assess potential impacts of pricing reform options on rural and remote communities" (About This Enquiry, Page 1.7).

The key points that link LDPR to this framework are:

- Whilst the principle use of the national infrastructure network is for carriage of freight, it is also used for LDPR

- Reforms in the track access regime will have clear implications for all uses, not just freight, particularly as freight pricing is presently applied to usage for LDPR.

- Whilst LDPR use of the infrastructure accounts for only a small portion of total usage, it does make an important contribution to Australia's rural, regional and remote communities. Broadly, these benefits are both economic (from a tourism perspective) and social (through provision of transport, particularly to those sectors of the community of limited means and/or with special transport needs).

- The future pricing regime applied to passenger will have a clear impact on rural, regional and remote Australia. It could either sustain LDPR or bring about its demise. This would have material consequences for the communities the Commission has been asked to consider.

GSR respectfully submits that the Commission needs to take into consideration the implications for LDPR of its findings and recommendations on rail infrastructure and to consider how particular communities may be impacted by the consequences for LDPR of the Productivity Commission's Report.

In the following submission, GSR offers observations, analysis and recommendations on the Draft Report aimed at maximizing the net benefits for rural, regional and remote Australia from LDPR usage of rail infrastructure.

Price Discrimination

The Draft Report notes that "vertical separation and access regulation might constrain scope for efficient price discrimination across users and impede efficient investment" (Overview Page XLV). It goes on to say "nor should efficient price discrimination by below rail operators be discouraged" (ibid.)

GSR accepts that the Draft Report findings support these views. However, we ask for the potential impact on LDPR to be recognized, and for the recommendations to provide for further consideration of the consequences for LDPR as and when government takes action in response to the Productivity Commission's findings.

On price discrimination, draft recommendation 11.3 in part states

> "The objects clause, declaration thresholds and pricing principles (which among other things, allow for multi-part pricing and price discrimination when they aid efficiency) now embodied in the Trade Practices Act should be incorporated into all rail access regimes" (Findings and Recommendations, page LIII).

In relation to this recommendation, GSR offers the following observations:

- GSR operates in multiple jurisdictions, dealing with several track access providers. A uniform regime will be of benefit through reduction of red-tape and simplification of business process by virtue of the consistency it will provide. GSR supports the concept of a uniform national framework.

- The original GSR submission in effect presents arguments for price discrimination for LDPR, on the grounds of the lower unit-cost it imposes, the end-market capacity to pay, and to facilitate the long-term economic sustainability of LDPR. GSR supports the recommendation in principle.

- Access providers to date have dismissed all approaches from GSR to consider a pricing regime that recognizes the specific circumstances of LDPR. They have used their market power to maintain premium rates (in the case of ARTC) and extract substantial price increases (in the case of APT).

- The Draft Report notes elsewhere that "Rail Track Operators [may] have scope to discriminate more finely between types of freight than can road infrastructure providers" (Efficient Pricing of Road and Rail, Page 8.11). Clearly, it is within the capacity of infrastructure providers to establish a separate category of pricing for LDPR. They simply choose to rely on their bargaining position to continue the imposition of a rate regime without adequate justification.

We respectfully submit that the Productivity Commission needs to include within its recommendation that specific consideration be given to providing protection for and/or special consideration for the particular circumstances of LDPR use of rail infrastructure to ensure its economic sustainability. This is further addressed in subsequent sections of our submission.

We note the Draft Report acknowledges there is "some evidence that price discrimination already exists in rail, with commercial track operators allocating the largest share of common costs to particular types of freight such as coal" (Road Infrastructure Costs Page 4.24). We support this finding. However, it is suggested that price discrimination for bulk freight such as coal is based not so much on the principle of efficiency, but rather on capacity to pay, in combination with the high cost of switching to alternative modes. This concentrates market power in the hands of the rail infrastructure owner giving them a strong bargaining position. It is suggested that oversight is required, even when dealing with large customers.

The Commission already recommends for price discrimination at Draft Recommendation 11.3, previously cited. We ask the Commission to consider recommending further that there be explicit price discrimination for LDPR that considers amongst other things its capacity to pay, the costs it imposes, and its economic sustainability, as well as ensuring there is effective oversight to guard against misuse of market power.

Government Policy Settings for LDPR

The Draft Report asserts the need for a case by case approach to vertical separation thus:

> "For vertical separation to increase above-rail competition there needs to be the prospect of profitable entry into above-rail markets. However most rail networks typically face strong intermodal competition and struggle for commercial sustainability, particularly where there are low volumes of freight . . . " (Addressing Non-Price Impediments, page 10.13).

The same analysis holds true for LDPR i.e. LDPR faces strong competition from private vehicles, buses and air transport modes resulting in low passenger volumes and a struggle for commercial sustainability. The unintended consequence of vertical separation in 1997 and the track access pricing regime that was subsequently established has been to compromise LDPR's long-run commercial sustainability. This is detailed further the original GSR submission (Section 2.6, pages 10 and 11).

The Draft Report also observes that:

> "If infrastructure providers are not covering their full economic costs – even though they may be profitable based on the book value of their assets – they may not be viable in the long-run. In other words, infrastructure would not be able to be replaced at the end of its useful life if the decision were based purely on commercial considerations" (Rail Infrastructure Costs, 5.9).

As the original GSR submission also demonstrates, this is precisely the situation for GSR, as the only privately-owned commercially-run LDPR Company in Australia. We respectfully request the Commission therefore modify or comment on Draft Finding 5.1 that follows the above-quoted analysis to recognize that Finding 5.1 also applies to certain rail infrastructure users, particularly commercial LDPR operations. i.e. that they struggle for commercial sustainability and may not be viable in the long-run within certain policy settings for track access pricing

This outcome is contrary to the Australian government's intent in privatising the passenger rail operations, which was to ensure its on-going commercial viability. Consequently, further consideration of the policy settings for LDPR track access is warranted. GSR suggests the Commission recommend that "consideration of specific government policy for LDPR to promote its commercial viability should be subject to detailed independent examination".

In considering this proposition in the context of the Commission's work-brief, the Commission may find it useful to refer back to our original submission, which illustrated the benefits of LDPR to rural, regional and remote communities. The Commission might also like to consider the dis-benefit to such communities in the event that changes to the pricing regime that arise out of its recommendations have as a consequence the discontinuance of privately-owned and commercially-operated LDPR services.

Additionally, we observe that Draft Recommendation 11.5 recommends that "whether allowing vertical re-integration of particular rail lines or networks would promote their commercial viability should be subject to detailed independent examination" (Findings and Recommendations. Page LIV). In the same vein, we submit that the Commission also recommend "consideration of specific government policy for LDPR to promote its commercial viability should be subject to detailed independent examination".

Vertical Separation

As noted in the previous section, the Draft Report asserts the need for a case by case approach to vertical separation thus:

> "For vertical separation to increase above-rail competition there needs to be the prospect of profitable entry into above-rail markets. However most rail networks typically face strong intermodal competition and struggle for commercial sustainability, particularly where there are low volumes of freight . . . . " (Addressing Non-Price Impediments, page 10.13).

The same section of the report goes on to say " . . . Vertical separation is likely to compromise the commercial sustainability of these networks" (ibid). Whilst GSR does not object in principle to the concept of re-integration, we hold grave concerns for the future viability of LDPR in such circumstances without adequate checks and balances. We foresee a risk of that vertically-integrated track owners may subsequently implement cost allocation and pricing practices that discourage access by third parties and inhibit use by LDPR (whether intentionally or otherwise).

Accordingly, we respectfully submit that recommendations for consideration of vertical integration incorporate explicit recommendations for robust oversight mechanisms that guard against the misuse of market power and/or discriminatory pricing practices that results in the exclusion of LDPR (whether intended or not).

Effects of Removing Regulatory Controls

The Commission seeks comment from participants on the potential effects of removing access regulation. In considering this issue, the Commission notes from comments from ARTC and the ACCC that “concerns about market power and the ability of access seekers to obtain competitive prices seems misplaced” (Addressing Non Price Impediments, page 10.23). This is not GSR’s experience. To the contrary, ARTC has consistently dismissed all attempts by GSR to negotiate, rejecting written submissions out of hand and verbally indicating that charges should be substantially increased. The effect of removing regulatory control is likely to lead to the imposition of increased charges which would in turn make commercially operated LDPR completely unviable.

Again, we respectfully submit that recommendations include explicit recommendations for robust oversight mechanisms that prevent the misuse of market power.

Treatment of Common Costs and Pricing Methodology

The Draft Report discusses Ramsey Pricing, concluding that whilst it is “at best likely to be applied in rough and ready manner . . . . even this is likely to be superior to other allocation methods” (Efficient Pricing of Road and Rail, page 8.11). We suggest noting in this section that the consequences of allocating more common cost to LDPR and escalating access fees further will put further pressure on a sector that is already struggling for commercial sustainability, and could precipitate its demise.

It is suggested that the Commission identify potential measures to mitigate the risk of failure of commercially-operated LDPR for consideration by Government policy-makers. One such measure would be to establish a discriminatory pricing regime for LDPR that provides for a certain proportion of total capacity (e.g. 5%) to be made available to LDPR at strictly its incremental cost. Should arrangements be needed to enable infrastructure owners to recover common costs; this could be facilitated by CSO payments. In considering this proposition, we refer to the following parts of the Draft Report:

- Draft Finding 8.8 “Prices charged to users of freight transport network services should at least cover the directly attributable or incremental costs of providing the services they consume” (Efficient Pricing of Road and Rail, page 8.19)

- “CSO payments made to publicly-owned providers could be ‘passed on’ to private above-rail operators through lower access fees or where private providers own below-rail infrastructure by covering ‘commercial’ access fees” (Rail Infrastructure Costs, Page 5.22)

- “Strictly speaking a government subsidy to meet the common or fixed costs of providing infrastructure need not result in inefficient outcomes, provided the investment is efficient . . . . and that the subsidy does not distort choices between modes” (Efficient Pricing of Road and Rail, page 8.18).

Consequently a discriminatory pricing regime for LDPR that provides for a certain proportion of available capacity (e.g. 5%) to be made available to LDPR at strictly its incremental cost is consistent with the findings in the Draft Report.

Price Sensitivity

In analysing the allocation of common costs, the Draft Report suggests that "given that freight's usage of rail is widely viewed as more price sensitive than passenger use, it might be expected that infrastructure operators would allocate common costs more heavily to passenger trains" (Rail Infrastructure Costs, Page 5.11)

The Draft Report also notes that "DOTARS (Submission 69) suggested that both passenger and freight demand is inelastic with respect to price, albeit with freight demand somewhat less price sensitive" (Efficient Pricing of Road and Rail, page 8.10)

These two points seem to be contradictory. We submit that passenger is price sensitive.

In general, it is suggested that any assertion on this subject by a government owned enterprise, particularly one that is vertically integrated, should be treated with caution. The reason is that in the public sector, an increased cost allocation to LDPR for track access can be offset by either ticket price increases, service reductions or increased CSO funding from government. Since price increases and service curtailment are politically unpalatable, recourse to increased government funding invariably occurs.

In particular, on the matter of price sensitivity, we present evidence of a recent change in Great Southern Railway's pricing practice that demonstrates the price sensitivity of LDPR. The context of this is as follows:

- When setting prices for the new service on The Ghan between Alice Springs (ASP) and Darwin (DRW) GSR set concessions for Pensioners and Veterans in line with those available on the rest of the network, pending resolution of the Government funding for them. In 2004 and 2005, prices offered were at a discount of between 32% (Gold) and 55% (Red) compared to the full adult fare.

- Following protracted discussions with both the Northern Territory and Commonwealth Governments, both declined to extend funding for concessions to this sector. Concession fares were then reset. For all travel between ASP and DRW from 1st January 2006 the prices offered were at a discount of only 20% to the full Adult Fare (both Gold and Red).

Table 1 appended to this report shows changes in concession-fare passenger numbers and average spend, comparing January to October 2006 results to the same period in the two prior years. The results of the price reset is that whilst the average yield (revenue per ticket) rose by 23.4%, passenger volume fell by 33.6% and total revenue fell by 18%. This demonstrates that the LDPR end-market is price sensitive and exhibits price elasticity. In the intermediate market of LDPR, on a strictly commercial basis there is little ability to absorb track access price increases. In the absence of any external distorting factor (e.g. CSO's) there is likely to be reduction or cessation in services, with equivalent reduction track capacity consumption. Therefore both intermediate and markets are therefore also price sensitive.

On the basis of the foregoing evidence and analysis, we ask the Commission to reconsider its analysis and find that there is evidence and rationale to support the view that passenger is price sensitive and demand is elastic.

Is Passenger Priority Factored into Access Charges?

The Draft Report notes that “passenger priority is rarely factored into access charges” (Addressing Non-Price Impediments, page 10.15). This is incorrect. ARTC schedule of rates applies a Premium Flag-fall to passenger which is higher than the standard Flag-fall for Freight. ARTC justifies this on the basis of the priority given to passenger.

The Draft Report supports the above observation by referring to an assertion by PN that “the average speed of passenger trains is higher than for freight trains . . . . the outcome is that freight trains are often “run down” and then have to wait to allow passenger trains to pass before they can proceed. The cost of passenger priority is borne by freight trains, but this is not internalised into any access pricing” (ibid).

Firstly, there are a number of classes of freight trains that operate at varying speeds, some slower than passenger, and some at the same speed. As a general principle, if all freight trains were to operate at the same higher speed, there would be more network capacity and greater efficiency in the overall network. At present, passenger trains are frequently slowed from their normal operating speed and there are delays are built into their timetables to fit with the overall schedule for the corridor. This is to accommodate slower-running freight trains on the network. Contrary to the PN assertion, this means that passenger bears the cost of the inefficiency of the slower freight trains.

We ask the commission to consider a scenario in which all trains can operate at the maximum speed for which the track is engineered. Logically, there would be an increase in the capacity available over the present limits. This would in turn reduce the unit cost of capacity consumption. It therefore follows that in the present system the slower trains ought to bear the cost of their own inefficiency. This could be achieved by inverting the Flag-Fall scale of charge, so that Flag-fall for trains that can operate more efficiently is proportionately lower than the Flag-fall for slower trains.

Consequently, we request that the Commission incorporate into the Draft Report consideration of this alternative view.

And Exactly What is Passenger Priority?

The Draft Report notes that “the financial viability of rail freight infrastructure may be impeded by factors such as access regulation . . . . or preference being given to passenger trains when allocating access paths” (Rail Infrastructure Costs, page 5.3).

The premise on which this observation is based is not strictly correct. LDPR trains are not given preference when allocating train paths. Historically, when GSR has sought timetable changes, or sought to secure new train paths, it is constrained by pre-existing allocations and timetables. GSR does not receive any preferential treatment by virtue of its status as a passenger operator. Any change is granted only to the extent that the needs of other network users can be accommodated. If not, then GSR trains are forced to adopt a sub-optimal timetable. For example, the Overland is presently required to “burn time” on the Melbourne-Geelong sector to accommodate the requirements of freight operators. This results in an actual transit time of more than 2 hours as against a possible transit time at normal track speeds of about 1 hour.

Network rules for Passenger Priority are established to provide a decision-making framework in the event that trains on the network are not running to schedule. This is in effect where the application of Passenger Priority could impact on freight. Simplistically, network rules state that when two trains are running behind schedule, Passenger gets the priority. To understand the practical effect of this, it is suggested the Commission consider the on-time running performance of trains using the network.

ARTC's 2005 Annual Report (page 62) shows 68.35% of all trains on their network were "unhealthy" (i.e. running more than 15 minutes late) and only 31% of trains were "healthy" (on-time). With the exception of GSR and Countrylink, whose on-time performance is closer to 90%, the trains on the ARTC network are freight. As LDPR accounts for only a small portion of total network capacity utilization (less than 10%), it is difficult for freight to argue that LDPR or passenger priority is a practical impediment to more efficient operation. It would a lot more productive for freight to analyse and deal with the root causes of "unhealthy trains". It would be only when their performance levels approached those of LDPR that the Passenger Priority rule may be some practical impediment to greater efficiency.

Summary of Recommendations

In summary, GSR recommends the Draft Report be varied in the following areas:

- include within its recommendations that specific consideration be given to providing protection for and/or special consideration for the particular circumstances of LDPR use of rail infrastructure to ensure its economic sustainability (possibly at Draft Recommendation 11.3)

- recommend that there be explicit price discrimination for LDPR that considers amongst other things its capacity to pay, the costs it imposes and its economic sustainability as well as ensuring there is effective oversight to guard against misuse of market power (supplementary to Draft Recommendation 11.3)

- modify or further comment on Draft Finding 5.1 to recognize the finding also applies to certain categories of service providers using rail infrastructure, particularly commercial LDPR operations i.e. that they struggle for commercial sustainability and may not be viable in the long-run within certain government policy settings and/or track access pricing regimes

- recommend "consideration of specific government policy for LDPR to promote its commercial viability should be subject to detailed independent examination"

- incorporate in recommendations for consideration of vertical integration further explicit recommendations for robust oversight mechanisms that guard against the misuse of market power and/or discriminatory pricing practices, particularly those that might result in the exclusion of LDPR (whether intended or not).

- note in section 8.11 in the discussion on Ramsey Pricing that the consequences of allocating more common cost to LDPR and escalating access fees further will put further pressure on a sector that is already struggling for commercial sustainability, and could precipitate the demise of commercially-operated LDPR

- identify for potential measures to mitigate the risk of failure of commercially-operated LDPR for consideration by government policy makers. Note that one such solution would be to establish a discriminatory pricing regime for LDPR that provides for a certain proportion of available capacity (e.g. 5%) to be made available to LDPR at strictly its incremental cost, with CSO payments to infrastructure owners to cover common costs, if needed.

- reconsider its analysis and commentary on Price Sensitivity in Section 5 of the Report and find that there is evidence and rationale to support the view that passenger is price sensitive

- incorporate an alternative view of the arguments about passenger priority, speed and efficiency that contemplates all trains operating at the maximum speed for which the track is engineered; note that in this case there would be an increase in total capacity and a reduction in the unit cost of capacity consumption. Present the alternative view on the basis of the foregoing that there is also a case for slower trains bearing the cost of their own inefficiency.

- amend observations on Passenger Priority presented in Section 5.13 and 10.3

Why Should the Commonwealth Have an Interest in these Recommendations?

On 6 March 1997, the Australian Government announced its intention to sell the assets and businesses of Australian National Rail. An extract from the ANAO Audit Report (No 28 of 1998, page 11) on the sale process notes that in its announcement and in the Tender Documents subsequently issued the Government's sale objectives were to:

> " . . . enter into an agreement with the successful purchasers by 30 June 1997 or as soon as possible thereafter; provide efficient, competitive, dynamic and reliable transport services; *contribute to the establishment of a viable and competitive rail system*; promote private sector investment in the rail industry; contribute to regional development; obtain a financial return to the Commonwealth that represents fair and reasonable value; and *divest the Commonwealth from ongoing responsibility for the operation of rail in Australia, except for its involvement in track access*" (italics added)

These objectives make it clear that in selling its LDPR business and thus establishing the only commercially operated LDPR in Australia, the government's intent was to continue involvement in track access and to ensure viability and competitiveness. As this enquiry is about ensuring competitiveness of the rail system, we respectfully request the Productivity Commission consider inclusion of matters relevant to it inquiry that has potential to impact on LDPR.

Tony Braxton-Smith
Chief Executive Officer