# Open Access to Rail Infrastructure - The NSW Experience

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Abstract

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Recent changes in the regulatory and commercial environments in NSW have paved the way for consistency with the competition policy agreement by the Council of Australian Governments (COAG).

During 1994, State Rail established RailNet to manage the introduction of competition to the rail network in NSW. Given the environment in NSW, and the objectives of the government, RailNet has had to develop a model of infrastructure access management that differs in a number of respects from the existing models in use internationally.

This paper addresses the issues of asset ownership, independence, operator structure, access pricing, accounting separation, asset valuation and CSO policy. It also examines the experience of RailNet in addressing these issues to date.

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## The Hilmer Report and National Competition Policy

During 1993, the Federal Government commissioned a report on how competition could be introduced into sectors of the Australian economy that are currently served by monopolies. This includes sectors such as rail, electricity and gas transmission.

The resulting report (named after the chairman of the commission, Professor Fred Hilmer), has since been broadly supported by all governments at state and federal level, and the Council of Australian Governments (COAG) is now working towards enshrining the national competition policy in legislation by the introduction of a Competition Policy Reform Bill.

The most significant points which arise under the new competition law regime are:

- the establishment of a new Australian Competition and Consumer Commission to replace the Trade Practices Commission and the Prices Surveillance Authority
- the establishment of a National Competition Council
- competition laws will be amended and will extend to businesses carried on by non-incorporated business organisations, including Governments and the professions, and
- some businesses will be forced to give access to essential facilities

The most significant change initiated by the Competition Policy Reform Bill is the incorporation of the new Competition Code. Under the new code, Australia's public transport authorities will be subject for the first time to the prohibitions on anti-competitive conduct provided for in the Trade Practices Act. It is anticipated that this legislation will take effect from 1 July 1996.

Many of the reforms recommended by the Hilmer Report subjecting Government Trading Enterprises to the new competition regime will be achieved via a Competition Principles Agreement between the Commonwealth and State Governments. The Agreement will set out policies and procedures for:

- the pricing oversight of GTE's
- a competitive neutrality policy
- the structural reform of public monopolies
- the review of legislation that restricts competition, and
- access to essential facilities[1]

Professor Hilmer stated a number of principles in his report. The first of these was that:

> *"Before competition is introduced to a sector traditionally supplied by a public monopoly, any responsibilities for industry regulation should be removed from the incumbent.*
>
> *"The location of regulatory functions should place special weight on the need to avoid conflicts of interest."*

The task of industry regulation was removed from State Rail during 1993 with the introduction of the Rail Safety Act (1993), and this is covered in a later section.

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[1] In Brief - Focus on Law and Competition, Corrs Chambers Westgarth, April 1995

Professor Hilmer's second point was that;

> *"Before competition is introduced to a sector traditionally supplied by a public monopoly, there should be a rigorous, open and independent study of the costs and benefits of separating any natural monopoly elements from potentially competitive activities.*
>
> *"Where the natural monopoly element is vertically integrated with potentially competitive activities, there should be a presumption in favour of separation at the ownership or control level."*

The third point that Professor Hilmer made was that;

> *"Before competition is introduced to a sector traditionally supplied by a public monopoly, there should be a rigorous, open and independent study of the costs and benefits of separating potentially competitive activities of the monopoly enterprise."*

It has been accepted in NSW that there is a need to have in place access arrangements for potential new entrants. RailNet was put in place for this purpose although there is ongoing review as to the best structure. It is not considered that providing access arrangements consistent with the COAG agreement also requires infrastructure to be managed and controlled on a day to day basis by an infrastructure group separate from the major train operators.

We have been established so that we are independent of the existing State Rail business groups and other public and private operators, ensuring that we are in a position to grant access on a fair and equitable basis to all comers.

**The NSW Rail Safety Act 1993**

Under the Rail Safety Act, the regulatory powers were transferred to the NSW Department of Transport, and a Director of Rail Safety within the Department was appointed.

Under the Act, anyone who wants to operate a rail service must first be accredited by the Department of Transport. The flipside of the coin is that anyone who is an accredited operator has the right to operate over any lines in the state.

**The National Rail Corporation**

At the same time, the National Rail Corporation had been formed by the Federal Government and the governments of NSW and Victoria to take over the loss making inter-state freight business from the state based rail systems.

National Rail operates in a competitive environment and is subject to the Trade Practices Act.

As the NRC has not yet taken ownership of any track, it requires access to track owned by State Rail. One of RailNet's main tasks has been the development of an access charging agreement with the NRC.

## The New South Wales Response

RailNet is essentially in the job of negotiating access and dealing with major network development initiatives. The major business groups of the SRA (CityRail and Freight Rail) control the asset on a day to day basis including signalling systems and track maintenance.

Network development initiatives include the construction of new infrastructure, such as the New Southern Railway link to the airport at Mascot, and facilities at Homebush Bay for the Olympics in the year 2000.

### *The Re-structuring of Public Transport Operators*

At the time of writing, the new State Government in NSW is examining options for the restructuring of the State Rail Authority. The aim of this restructuring is to increase the intermodal integration of the public transport network and to improve the customer focus of the existing public transport organisations. The structural responses to competition policy have not yet been finalised, but whatever structure is adopted, our aims will be to win back traffic from road to rail by:

- facilitating a focus by operators on their end customers, and
- encouraging rail expansion into new markets currently dominated by road transport.

### *RailNet's Operations*

RailNet has also been tasked with developing and negotiating the framework for operator access to the network, and ensuring that access charges are levied in a consistent and transparent basis for all operators.

Operators wil include prime users, who are groups such as Freight Rail, CityRail and National Rail, who are the dominant users of certain sections of the main line infrastructure. They would also include heritage or short line operators who would be the dominant users of the branch lines that they operate over.

An unusual example of such an agreement will have to be developed if the western extension to the Pyrmont Light Rail system is given the green light. The extension would be constructed over a set of existing tracks, much of which will soon be abandoned by Freight Rail when their last customer on that line relocates to new premises.

However, there will be a short section of the line at the western end where Freight Rail will need to maintain operations for access to the Rozelle goods yards and the docks at White Bay. This would see the first joint operations in Australia between light rail and heavy rail.

Although joint light/heavy rail operations have been recently introduced in Germany, this was only for passenger services. On this section of track, we will be looking at mixing freight and light rail operations, which as far as we are aware, has not been tried elsewhere.

Although Freight Rail is now the prime user of the line, when it scales down its operations at Rozelle in late 1995 and the light rail moves in, the light rail operator will clearly become the prime user as it will be operating services every 10 minutes or less, as opposed to a maximum of a train a day each way for Freight Rail.

We will therefor be negotiating a contract with the Pyrmont Light Rail Company as prime user. The PLRC will pay us an access charge that will provide us with a return on that asset, while Freight Rail will pay an access charge that will cover the additional maintenance and other costs of allowing freight movements over their track.

### *RailNet's experience to date*

At issue is how prices for access to the network will be set. Prices must be set in such a way that sufficient funding is generated for the long term maintenance and replacement of the rail infrastructure, whilst at the same time ensuring that operators are granted access on a "level playing field". Overall, RailNet will seek to maximise the return on the infrastructure assets under its control.

### The different international access models

When RailNet was first formed, we were by no means the first group to be established that would manage access to the network. In addition to the Swedish and UK models, there are other access models in place around the world that enable operators access to rail infrastructure.

### *USA Model*

In the USA, where the rail operators are predominantly privately owned, access to an operator's infrastructure is generally granted through direct negotiation with the owner with the agreements being overseen by the Interstate Commerce Commission.

Whilst the USA provides an attractive model for us to follow in that it appears to work and work well, there are some aspects such as those of interline arrangements that are not directly transferable to NSW.

Track access arrangements have developed more through the necessity of the operators to have access to the tracks of other operators. There is relatively little involvement by the Interstate Commerce Commission.

The US operators appear mainly of the opinion that free competition over the tracks simply entails a loss of the advantages of the economies of scale that operators now enjoy, so it is therefore avoided. US operators instead rely on collaboration where markets are jointly served. A third party traffic and infrastructure manager along the lines of Railtrack is viewed with some scepticism due to the divorce of such a body from the market.

*Swedish Model*

Sweden became the first country in the world to split operations from infrastructure when it created a new infrastructure authority called Banverket in 1988. The purpose of this split was not to introduce competition or privatisation, but was instead driven by a national transport policy introduced in 1987 that in many ways favours rail over road and air.

Banverket was set up as a vehicle to take on the task of rebuilding and improving Sweden's neglected rail infrastructure with the aim of making it more competitive with road and air. A recent funding package for Banverket approved by the Swedish Parliament allocated around $A6 billion to improving rail infrastructure alone over the next decade.

The idea of introducing competition to the Swedish rail network is a more recent one, and the Swedes are now searching for a way to work out how competition can be introduced to their existing split structure. According to Swedish State Railways (SJ), the debate over introducing competition has been driven by a number of parties that feel they have insufficient choice.

This includes the government and a number of major industry groups, which puts SJ and State Rail in similar positions. In NSW, State Rail's major customers are the coal companies operating in the Hunter Valley, and a consortium of mine owners has been pushing for lower rail costs for some time.

In Sweden, SJ is faced with pressure from LKAB, a large mining group, for lower transport costs, and LKAB is also proposing to take over the ore line between its mine and the port of Narvik in Norway. This is the same initial proposal that the Hunter Valley Rail Consortium made some years ago to the NSW Government.

SJ states that it is not opposed to competition, so long as competition is not introduced at the expense of the railways becoming uncompetitive with other modes. I might add however that SJ has not been altogether happy with the infrastructure - operations split, and has been seeking to claw back some infrastructure functions.

SJ argue that by creating an infrastructure monopoly, the monopoly has little incentive to increase efficiency or to keep in touch with the needs of its customers. This would place it at odds with the operators, who are under continuous pressure to show a profit.

SJ is now arguing that following the opening of operations to competition, the largest rail operator should assume responsibility for train control and timetabling from Banverket. However, it appears that SJ is not being given much choice by the Swedish government.

Inevitably, the Swedish approach will either produce more bureaucracy, or an unwieldy body like Railtrack in the UK. We believe that it will also eventually suffer from a classic railway problem, which is allowing the infrastructure to be driven by engineers.

Engineering driven infrastructure generally ends up being gold plated, which is something we are trying strenuously to avoid. In fact one of our prime aims is to provide the same level of infrastructure as we have at the moment at lower cost, and we will be putting a lot of effort into this in the near future.

I have included in Appendix 3 some comments from SJ that outline position on the current arrangements.

### *EC Directive 91/440*

During 1991, the European Economic Community issued Directive 91/440 which granted access for certain international rail services from 1 January 1993. Railway operators now have the right to operate freight and passenger rail services throughout the community, although few formal arrangements have been put in place as yet to facilitate these operations.

Directive 91/440 also provides that infrastructure and the provision of transport services should have separate accounts. EC countries are obliged under Directive 91/440 to lay down rules for the use of infrastructure by railway operators, and for paying for that access.

### *UK Model*

Perhaps the best known model is that of Railtrack in the UK.

In setting up Railtrack and the rest of the rail industry structure, the British Government felt that,

> *"regular users know that the performance of the railways is not good enough. Too frequently, and on too many lines, the quality of service fails to meet the travelling public's expectations. BR's staff and management work hard to improve services. But they are limited by the structure of the industry in the public sector. The industry is more insulated from the demands of the market than its private sector airline, coach and road haulage competitors. It therefore has fewer incentives to improve its performance and less freedom to respond to what the customer wants. Radical changes are needed.*
>
> *"The Government therefore wishes to involve the private sector in the operation of the railways. Introducing competition, innovation and the flexibility of private sector management will enable the railways to exploit fully all the opportunities open to them."*[2]

The monolithic structure of British Rail has been split into what the British Government hopes will be easily digestible operating franchises, and even the providers and maintainers of both the rollingstock and the infrastructure have been divided to provide a competitive market for support services. Only Railtrack has remained as a single entity in order to provide a single point of entry to the network.

The Railtrack model has been chosen as,

> *"Flexible solutions will be needed to encourage private sector participation in the railways. A structure is required which will promote the introduction of new operators while taking account of the continuing need for subsidy. BR currently operates as a vertically integrated railway, with track and train operations under its control.*
>
> *"The Government believes that track and train operations should be separated at an early stage and that a new track authority - Railtrack -*

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2 "New opportunities for the railways - the privatisation of British Rail", The Department of Transport, p1

*should be established initially within BR with responsibility only for track and associated infrastructure. When BR's train operations are in the private sector, Railtrack will continue on its own as a separate organisation. This structure offers the greatest prospect for private sector involvement in operations and will enable BR to provide fair treatment between operators wanting access to the track and other infrastructure."*[3]

Railtrack is responsible not only for setting access charges, but for building and maintaining the infrastructure, operating the signalling system and managing the timetable.

A large problem with the Railtrack model is that access prices are set according to a formula that is required to generate a rigid rate of return on the assets. Railtrack has initially been set a target of producing an 5.6% return pa on its assets for 1994-95, with this rising to 8% within 4 years. Railtrack will receive no subsidies from the British Government, although it may receive some capital grants for new infrastructure works.

It is already quite clear that the government is going to have to provide subsidies of several billion pounds each year to the operators to allow them to pay the sort of access fees that will allow Railtrack to generate any return at all. For instance, one train operating unit has seen its access charges bill jump from £5.9m to £22m in one year.

In NSW, we have a rail network that, with the exception of the Hunter Valley and the Sydney region, carries a very low density of traffic. In the US, most of the low density branch lines formerly operated by the Class 1 railroads have been handed over to shortline operators who are able to make a living by operating a very low cost operation. However, most of the network has an even lower traffic density than what the US shortline operators have to deal with.

For RailNet, the idea of aiming for a set rate of return on our assets is therefor a questionable proposition. Depending on the valuation method used, our infrastructure assets are worth anything up to around $12-15 billion. An 8% return on such a large asset base would generate a profit of around $1 billion, which is clearly unattainable given the current levels of traffic and the fares charged on the passenger network.

Instead, we are aiming to make the most efficient use of the infrastructure that we have in place, and to generate the greatest amount of economic benefit to the state from the rail network.

### Track Australia

When the first railway tracks were laid in Australia 140 years ago, each state decided to go its own way when it came to gauge, so we now have a mix of narrow, standard and broad gauge across the continent. Although standard gauge links between the capital cities were completed in the 1960's, the final standard gauge link between Melbourne and Adelaide has only just been completed.

The Prime Minister and the Federal Minister for Transport used the occasion of the opening of this link last month to call for a single track authority, known as Track Australia, to manage access to the main national rail corridors. The aim is to provide a single point of

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[3] "New opportunities for the railways - the privatisation of British Rail", The Department of Transport, p3

access for operators wishing to compete on the interstate freight routes, and to make the system more competitive.

Track Australia would be able to offer a common pricing formula to all comers, and under a proposed pricing system, private operators would only pay for the capacity they required, rather than bearing all the costs of the track. Although Track Australia would not necessarily own the track, it would take over management control from the existing state authorities such as RailNet. This approach would be similar to that followed with road transport and aviation where the Commonwealth Government funds the major interstate links, but does not own them. However, the interstate highways are seamless across the state borders.

Regardless of whether Track Australia is up and running quickly, the Financial Review reported on the 5th of June that there is a real possibility that private transport companies could soon be launching their own rail challenge to the National Rail Corporation. TNT is reported to be developing a partnership with FCL Interstate Transport Services to run a container service on the Melbourne to Perth route. Another company called Specialised Container Transport is also reported to be looking closely at running its own services.

The public sector is also looking at getting into the act, with both Westrail and the Public Transport Corporation looking at starting up interstate services.[4]

[4] "Rail reform needs more momentum", Financial Review, 5 June 1995

## Appendix 1 - Other European Experience

### *Denmark*

Danish State Railways (DSB) are being reorganised to establish the infrastructure groups as an independent business unit within DSB, but with its accounts separated out from the other business units. However, infrastructure will remain within the DSB group so as to preserve the synergy between operations and infrastructure. To ensure that all operators can gain clear access to the network, operational control of the network will remain with the infrastructure unit.

### *Norway*

The Norwegian State Railways (NSB) introduced separate accounts for their operations and infrastructure arms in 1990 with the aim of placing road and rail infrastructure costings on a level playing field. Although the issue of a full split between operations and infrastructure has been raised, it is being resisted by the NSB.

The Director General of NSB was quoted in early 1994 as saying that,

> *"any managerial segregation will inevitably mean that infrastructure problems will hit the quality of service that operators can offer to their customers".*

### *Finland*

The Finnish State Railways (VR) also restructured in 1990 into infrastructure and operations groups, although the responsibility for infrastructure maintenance has remained within VR. Responsibility for new or improved infrastructure has however been removed from VR, and now resides within the Ministry of Transport and Communications.

VR is moving towards becoming an independent limited liability company, at arms length from the government. Given that the government wishes to retain state control of the infrastructure, the Finnish Transport Minister is already looking at some further separation of infrastructure management from VR through the creation of a track authority.

VR favours a small body similar to RailNet that would be responsible for deciding who could use the tracks, setting access charges and overseeing safety management. This combines the roles of RailNet as access provider and the NSW Department of Transport as safety regulator.

## Appendix 2 - How the UK sees privatisation being a benefit

Improved services for passengers and freight customers will come from:

1. More concern for the customers' needs. Management and employees in the private sector have greater incentives to provide the services which the consumer wants. The profitability of their company - and at the end of the day their jobs - depend on providing a service which attracts custom. Nationalised industries do not face such acute pressures.

2. Competition and Ending the Monopoly. New operators will be allowed to provide services, giving customers a choice and stimulating improved services and value. Already a number of companies have indicated an interest in introducing new freight or passenger services.

3. Management Freedom. Railway management should be free to get on with its main task of running services to the satisfaction of passengers and customers. The Government's proposals will provide for greater participation by the private sector in railway operation, with less scope and justification for Government involvement in managerial issues.

4. Clear and Enforceable Quality Standards. The Franchising Authority will specify and monitor the level of services which passenger operators will be required to meet. For the first time standards such as punctuality, reliability and overcrowding will be written into contracts. A franchisee failing to perform to the required standards will be in breach of contract and subject to penalties including, in extremis, the loss of the franchise.

5. Motivation. Franchising passenger services to reflect regional or local identities will help to boost the pride that all employees take in providing a high quality service to the travelling public.

6. Efficiency. Smaller operating companies will bring more localised management closer to the public and greater opportunities to cut out waste and otherwise reduce costs, without sacrificing quality.

## Appendix 3 - Comments by SJ on the operation of the infrastructure authority

In opposing the continuation of Banverket as it stands, SJ argues that,

> *"There are major disadvantages in the present situation, with totally separate organisations for the infrastructure and railway operations....the Rail Administration has a monopoly over the services it provides for SJ and any other rail operators, and is not run along business lines.*
>
> *"...It is critical to efficiency that the management of joint functions...is closely linked both to the market and to the operation of rail services. Failure to achieve this incurs the risk that the organisation will become a large, unwieldy bureaucracy, reinforcing the drawbacks existing today, with the operational activities being divorced from the management of the infrastructure. Such a development would be directly counter to the policy pursued in recent years, which involves developing rail services by way of a businesslike approach and enhancing efficiency.*
>
> *"Because there is pressure today on SJ to run all its activities profitably, which includes property assets and workshops, SJ is becoming more efficient. If some of these functions are taken away from SJ and new monopolies created, there will not be the same incentive to run efficient and profitable services. Such a situation would render it almost impossible to provide viable rail services.*
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> *"As the main operator in the future as well, SJ proposes that it should be made responsible for all joint activities such as traffic control and timetabling, pricing, ticket and information systems, stations, development and training....SJ will also be obliged...to make station facilities available for other operators."*[5]

[5] "The consequences of free competition on the railway track", Swedish State Railways, p38

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