10 Rail

The NCP agreements specifically cover electricity, gas, road and water infrastructure services, but contain no specific obligations for rail. Rail services are, however, subject to general provisions in the Competition Principles Agreement (CPA).

Rail services are delivered in both competitive and uncompetitive markets. Rail line infrastructure has natural monopoly characteristics. These arise from the high fixed costs of establishing a network of rail lines from which economies of scale and scope can be maximised. Rail line services are usually delivered by only one provider in a market. Rail transport businesses operate in markets with varying levels of competitive pressure. Where there are substitute services, as in passenger transport markets, rail businesses are generally subject to strong competitive pressure. Where substitute services are few, as in bulk coal transport markets, rail businesses face fewer competitive pressures.

The Australian rail industry is changing. Historically, there was a high level of government ownership. This is still the case in several States, but private-sector involvement in the industry is increasing as governments move to fully or partly privatise their rail businesses. In both Western Australia and Victoria, rail line and rail transport businesses were privatised. New South Wales maintains government ownership over its rail line infrastructure but intends to privatise its rail freight business by the end of 2001.

Such changes trigger NCP obligations for governments to apply competitive neutrality principles and structural reform. Competitive neutrality obligations are relevant where there is competition, or the potential for competition, with government rail businesses. Structural reform obligations arise where governments privatise rail businesses and/or introduce competition through third-party access regimes.

Several States introduced access regimes to address a range of issues, including the establishment of frameworks within which access can be negotiated and disputes can be resolved. Where the rail line and transport businesses are conducted by separate organisations, access regimes focus on removing the monopoly elements from terms and conditions. Where a single organisation conducts rail line and rail transport businesses, access regimes commonly address competitive neutrality issues such as ensuring access seekers affiliated to the access provider are not advantaged over other access seekers.

Legislation review and reform commitments are relevant, because railway legislation has traditionally included restrictions on competition. Table 10.1

summarises governments' progress in reviewing and reforming legislation that regulates rail services.

Commonwealth

The Commonwealth (majority shareholder), New South Wales and Victoria established the National Rail Corporation Limited as a rail freight business. National Rail operates some 250 train services across Australia each week and carries over 600 000 containers each year.[1]

In September 1999 Capricorn Capital (Capricorn) lodged a competitive neutrality complaint against National Rail. Capricorn claimed that it was in breach of the Commonwealth's competitive neutrality policy because it had not earned a commercial rate of return on its assets for the financial years 1995-96, 1996-97 and 1997-98. Capricorn further claimed that National Rail would not earn a commercial rate of return in the foreseeable future.

The Commonwealth's competitive neutrality policy states that:

> *All Commonwealth organisations identified as engaging in significant business activities will be required to earn commercial returns at least sufficient to justify the long-term retention of assets in the business, and pay commercial dividends (ie, equivalent to the average for their industry) to the Budget from those returns …* (Commonwealth of Australia 1996, p. 16)

The Commonwealth Competitive Neutrality Complaints Office (CCNCO) reported on this matter on 18 January 2000, noting that:

> *The Shareholders Agreement establishing [National Rail] provided for a transfer of responsibilities and assets to the corporation over a 3-year Transition Period. The Agreement also specified a 5-year Establishment Period, after which the company was expected to be fully established and to operate profitably. Both periods commenced on 1 February 1993.* (CCNCO 2000b, p. 2)

The CCNCO also noted that the transfer of assets and agreed responsibilities was occurring more slowly than envisaged in National Rail's Shareholders Agreement. It reached the following conclusions.

- National Rail had not earned a commercial rate of return on assets for the years 1995-96 to 1998-99 inclusive.
- Its level of return projected for 2000-02 would not represent a commercial rate of return.

[1] Information supplied by National Rail.

- Given delays in the restructuring of National Rail, the inability of the corporation to achieve a commercial return was not sufficient to find it in breach of the competitive neutrality guideline that requires a government business to achieve a commercial rate of return over a reasonable period. Arguably, restructuring could improve National Rail's viability over a reasonable period.

- However, if a government business proves it cannot trade commercially over the longer term (and thereby comply with competitive neutrality), then the government can sell the business. The CCNCO noted that the Commonwealth, New South Wales and Victorian governments had announced their intention to sell National Rail.

The shareholding governments indicated that the restructure and privatisation of National Rail would address competitive neutrality issues. The most recent advice from the shareholding governments is that privatisation is to occur before the end of 2001. Capricorn made a further complaint to the CCNCO on 16 February 2000. The CCNCO has suspended any investigation of this complaint in view of the proposed privatisation.

New South Wales

Prior to 1996 New South Wales provided all rail track, passenger and freight transport services via the vertically integrated State Rail Authority. The *Transport Administration Amendment* (*Rail Corporatisation and Restructuring) Act 1996* separated the transport ('above rail') services from the ownership, access and maintenance components ('below rail'). The Act established four transport entities:

- the State Rail Authority, to provide passenger services;

- the Rail Services Authority, to maintain the track;

- the Rail Access Corporation, to manage the rail network and administer access by public and private operators; and

- FreightCorp, to provide non-passenger freight services.

The restructuring of the public monopoly State Rail Authority raised structural reform responsibilities under clause 4 of the CPA. The Council addressed these in the first tranche NCP assessment in 1997, noting the restructuring that had taken place in New South Wales. In September 2000 the New South Wales Government announced that it would sell FreightCorp, anticipating a sale during 2001.

Following the Glenbrook accident in 2000, New South Wales further reviewed the structure of its rail businesses. New South Wales advised in its 2001 NCP annual report that the Glenbrook Inquiry found that rail safety had not been

given sufficient weight following the 1996 reforms. In response to this finding, New South Wales passed legislation in late 2000 that:

- merged the Rail Access Corporation and the Rail Services Authority into a new Rail Infrastructure Corporation that owns and operates track infrastructure;
- established the Office of Rail Regulator to control and monitor service standards;
- allowed network control functions to be transferred to other operators, including the State Rail Authority (for CityRail network); and
- formalised the Office of Co-ordinator General, giving it sufficient powers to implement structural changes as necessary.

New South Wales reported that it would make decisions on the responsibility for safety regulatory functions following the release of the Glenbrook Inquiry's final report in 2001. For compliance with NCP principles, New South Wales will need to ensure that responsibility for safety regulation is not vested in the Rail Infrastructure Corporation, given that the corporation is an entity with commercial operating responsibilities.

While New South Wales has decided to privatise FreightCorp, the corporation is still a publicly owned business. It is therefore subject to competitive neutrality principles. Capricorn lodged a competitive neutrality complaint against FreightCorp in September 1999, stating concerns that:

- FreightCorp had preferential access to strategic assets including port and metropolitan rail terminals;
- only FreightCorp received payments for community service obligations (CSOs) and these were unconnected to costs incurred and services delivered;
- the Department of Transport tended to act as an agent of FreightCorp rather than as a neutral regulator; and
- the prices being charged by FreightCorp meant that the FreightCorp was not earning a commercial rate of return;

New South Wales initially deferred consideration of whether to request the Independent Pricing and Regulatory Tribunal (IPART) to investigate Capricorn's complaint until the Department of Transport had completed a review of FreightCorp's CSOs. Moreover, because the privatisation of FreightCorp would remove NCP competitive neutrality obligations, New South Wales indicated that it would consider a referral to IPART only if the timetable for privatisation was delayed.

To address the focus of the Capricorn complaint, the Department of Transport reviewed FreightCorp's CSOs. The department engaged Booz Allen and

Hamilton to assess FreightCorp's arrangements for delivering CSOs to assist its review. While the consultancy concluded that the exclusive contract between the Department of Transport and FreightCorp for the delivery of freight services did not itself contravene competitive neutrality principles, it recommended changes aimed at improving the focus and transparency of the arrangements.

New South Wales advised that it had responded to the Booz Allen and Hamilton review by:

- drafting separate contracts for each product grouping (grain, containerised traffic, fuel and the North Coast service);
- ensuring that each contract incorporates more specific service specifications so that the services New South Wales is purchasing are more transparent;
- providing discrete amounts of funding for each product grouping so that the Government can better consider where efficiency gains can be made; and
- incorporating a mechanism to allow examination of any complaint by a third party regarding use of CSO funding.

Victoria

Victoria privatised its intra-state rail freight network, V/Line Freight, in 1999 as part of a wide-ranging series of transport reforms. It sold V/Line Freight to a private-sector operator, together with a long-term lease over the intra-state rail lines. The Council considered Victoria's compliance with structural reform obligations as part of the second tranche NCP assessment in June 1999. Victoria had reviewed its reform options before privatising V/Line Freight and concluded that the costs of inefficiencies introduced by separating the infrastructure from the freight business would outweigh the gains from increased competition. Despite financial losses, Victoria considered that the freight business provided significant community benefits. As a condition of its sale, Victoria included a defined CSO payment for light general freight services of $6.5 million per annum in 1997-8, declining to $4.7 million in 1999-2000. This payment has been independently reviewed and the level of service negotiated to be $7.1m in 2000-2001, declining to $5.1m in 2003-04.

In the second tranche NCP assessment, the Council considered that Victoria would meet its CPA clause 4 obligations if it introduced an appropriate access regime. Victoria established an access regime to cover track services used to transport freight to operate from 1 July 2001 (through orders gazetted on 15 May 2001 under part 2A of the *Rail Corporations Act 1996*) over the intra-state freight network leased to Freight Australia. The regime also covers the Dynon terminals and the Bayside Network for the purpose of transporting

freight. As a result of these reforms, the Council considers that Victoria has met all CPA clause 4 requirements with regard to V/Line Freight.

Queensland

Queensland Rail (QR) is a vertically integrated corporatised entity that provides rail track and passenger and freight transport services across rural and urban Queensland. Queensland declared QR's rail transport infrastructure under the Queensland Competition Authority Regulation 1997 with regard to the provision of intra-state rail transport services. Following declaration, QR submitted an undertaking to cover access terms and conditions. The undertaking requires the Queensland Competition Authority to regulate prices and quality of service for QR's rail line service business. The Queensland Competition Authority released a draft recommendation for public comment in December 2000 but is yet to approve the final undertaking.

The undertaking introduced competition into Queensland's rail transport markets and triggered the CPA clause 4 obligation to conduct a review of QR. In its 1997 review, Queensland concluded that QR's corporatisation charter and the *Government Owned Corporation Act 1993* specified appropriate relationships between QR and Ministers. The review also noted that the Statement of Corporate Intent set out financial and non-financial performance targets, including a target rate of return and dividend.

The review recommended that QR's businesses remain vertically integrated, concluding that the benefits from separation were ambiguous but that the costs of establishing and operating separate legal entities were significant. The Council notes that the Queensland Competition Authority proposed that QR's undertaking contain ring-fencing arrangements to ensure access seekers are not disadvantaged by QR's operation of integrated businesses.

QR has no regulatory responsibilities in relation to the rail industry. The Rail Safety Accreditation Unit within Queensland Transport is responsible for safety regulation and accreditation of all rail operators and railway managers. This arrangement addresses the obligation under CPA clause 4(2) that the former monopolist obtains no regulatory advantage over competitors.

QR's CSOs are contained in the Statement of Corporate Intent and formalised in contracts with Queensland Transport. The Statement of Corporate Intent is not a public document. However, QR's annual report for 1999-2000 provided a listing of the service outputs for which QR receives payments from the Government. The annual report stated that revenue in 2000 from sales of Government community services was $670 million. This figure is broken down into metropolitan and regional services ($346 million), Traveltrain ($59 million), Network Access Group ($263 million) and other ($2 million). Queensland Transport's 1998-99 annual report stated that the contracts are performance based.

In the second tranche NCP assessment in June 1999 the Council questioned QR's application of competitive neutrality principles. This question arose from the finding by the Queensland Competition Authority in July 1998 that QR was not applying appropriate competitive neutrality principles to fares on the Brisbane – Gold Coast route, and from subsequent actions by the Queensland Government (NCC 1999c).

In August 1998 the Queensland Treasurer and Premier rejected the Queensland Competition Authority's decision that QR had breached competitive neutrality principles in relation to the fares. However, they requested that the Minister for Transport develop, as a matter of priority, a comprehensive CSO framework for passenger transport in south-east Queensland, taking account of competitive neutrality.

The Council did not consider this matter substantively as part of the second tranche NCP assessment. At the time of that assessment, an application for judicial review of Premier and Treasurer's decision was before the Supreme Court of Queensland.[2] Given this application, along with the Government's undertaking to develop the passenger transport CSO framework, the Council deferred assessment of Queensland's competitive neutrality compliance to a supplementary process.

In the supplementary second tranche assessment of June 2000 (NCC 1999d), the Council noted advice from the Queensland Treasurer that the Government was proceeding with the implementation of a CSO framework for passenger transport in south-east Queensland and was also improving the transparency of arrangements between itself and QR by entering into formal contracts for the delivery of rail services. Nevertheless, the Council considered that the failure to finalise the framework meant that Queensland had not satisfactorily addressed its second tranche competitive neutrality obligations. However, because there had been some progress, the Council recommended a suspension rather than a reduction in Queensland's NCP payments. The Council advised the Federal Treasurer to suspend an amount equivalent to 10 per cent of Queensland's NCP payments for 2000-01 (approximately $8.6 million). The Council also recommended a further supplementary second tranche assessment of Queensland's progress in this matter. On 2 November 2000 the Federal Treasurer suspended an amount equivalent to 10 per cent of Queensland's NCP payments for 2000-01, as advised, pending a further assessment of the State's progress in finalising a passenger transport framework for south-east Queensland, which would include defining and costing QR's CSO obligations.

Queensland subsequently set out its CSO objectives for passenger transport in south-east Queensland in a publicly available document (Queensland Transport 2001). As required by the Council of Australian Government's (CoAG) November 2000 amendments to the NCP, the framework transparently defines the Government's CSO objectives for the south-east

[2] The Supreme Court denied the application in September 1999.

corridor. QR's CSOs are established through contracts between QR and Queensland Transport and meet the CoAG obligations relating to costing and funding. The Council provided a supplementary second tranche assessment report to the Federal Treasurer, recommending lifting the suspension of NCP payments and reimbursing Queensland for the money withheld to date.

Western Australia

Western Australia's rail business, Westrail, was a vertically integrated entity providing rail line, freight and passenger services. In December 2000 Westrail's freight business, consisting of rolling stock and freight contracts, was sold to a private consortium, the Australian Railroad Group. Western Australia retained ownership of the rail track but leased it to the consortium for a 49-year term. The consortium manages and controls access to the track. Western Australia also legislated to introduce an access regime that applies to both interstate and intrastate rail services. Western Australia expects to finalise access arrangements so the regime commences operations by mid-2001.

These developments triggered obligations under CPA clause 4 to review the structure of Westrail. Western Australia's Rail Freight Sale Task Force completed a review in September 1999. The review was assisted by a scoping study (conducted by consultants, including Mercer Consulting Group, Deutsche Bank and Booz Allen and Hamilton) on ownership and structural options.

A key question for the review was whether the natural monopoly rail track infrastructure should be sold separately from the more competitive rolling stock and freight contracts. The review found no evidence of clear benefits from vertically separating the rail businesses and concluded that the rail track, the rolling stock and the freight contracts should be sold as an integrated business. Further, the review concluded that privatisation would limit the need for competitive neutrality measures. However, Western Australia noted that the proposed access regime contained ring-fencing arrangements to ensure access seekers would not be disadvantaged by Westrail's operation of integrated businesses.

The review found that Western Australia had satisfied regulatory separation obligations by transferring responsibility for safety regulation to the Department of Transport under the *Rail Safety Act 1998.*

Western Australia reviewed the *Government Railways Act 1904* and bylaws in 1998. This review found that restrictions in the Act related to mostly matters of competitive neutrality. The review recommended amendments to remove the competitive advantages available to Westrail, including:

- reducing its powers to determine who may seek access to rail;

- ensuring its assets are valued on a commercial basis;
- neutralising its advantages gained from Government guaranteed borrowings;
- imposing rates and taxes equivalent to those imposed on other transport operators;
- removing its powers to: set conditions for the carriage of goods by other railway operators; control persons employed by other parties; fix charges for all persons providing railway related services; and license taxis and other transport operators; and
- applying safety rules and standards on an equal basis.

Western Australia advised that the *Government Railways (Access) Act 1998*, the Rail Safety Act and the freight sale-enabling legislation addressed the majority of the review recommendations. Western Australia's rail access regime is likely to address residual issues.

Assessment

The Council is satisfied that relevant governments have addressed CPA clause 4 structural reform requirements relating to rail. While some legislation still stands pending repeal, the Council is also satisfied that governments are appropriately progressing legislation review questions relating to rail.

There have been complaints lodged concerning the implementation of the CPA clause 3 competitive neutrality obligation by National Rail and FreightCorp. In both cases, the Council acknowledges that privatisation will remove the NCP competitive neutrality obligations because the businesses will no longer be in public ownership. However, the Council considers there is an entitlement under CPA clause 3 for competitors of significant government businesses to have complaints addressed expeditiously. For NCP compliance, the Council considers that the government owners of National Rail and FreightCorp will need to address the competitive neutrality matters raised by Capricorn if the planned privatisations do not occur in 2001 (the current timetable).

Having said that, the Council accepts that New South Wales has addressed the substance of the Capricorn concerns relating to the delivery of CSOs by FreightCorp. Following the Booz Allen Hamilton review, New South Wales now separately contracts FreightCorp for each CSO service, with each contract detailing the relevant service requirements. The Government now allocates funding for each CSO service, and there is a mechanism to allow examination of any complaint by a third party regarding FreightCorp's use of CSO funding. These arrangements accord with the obligation set by CoAG for

the delivery of CSOs by publicly-owned businesses; that CSOs are transparent and appropriately costed, and that they are directly funded by government.

Table 10.1: Review and reform of legislation regulating rail services

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
New South Wales	*National Rail Corporation (Agreement) Act 1991*	Approves and gives effect to an agreement between the Commonwealth, New South Wales and other States relating to the National Rail Corporation Limited.	During the pre-sale process, shareholders agreed to remove the restriction in Section 7 that prevented the corporation from carrying intra-state freight.	Section 7 repealed through the *Statute Law (Miscellaneous Provisions) Act 2000* in August 2000. Act will need to be repealed with the privatisation of National Rail.	Council to assess progress in 2002.
	Rail Safety Act 1993	Allows potential for restraint on competition in pursuit of the safe construction, operation and maintenance of railways.	Review deferred pending consideration of the final report of the Inquiry into the Glenbrook Rail Accident. Final report presented to the Governor in April 2001.		Council to assess progress in 2002.
Victoria	*Border Railways Act 1922*		Review concluded that legislation does not restrict competition.		Meets CPA obligations (June 2001).
	National Rail Corporation (Victoria) Act 1991		Review concluded that legislation does not restrict competition.	National Rail to be privatised by end 2001.	Meets CPA obligations (June 2001).
Western Australia	*Government Railways Act 1904* and By-law Nos. 1 – 53, 55, 59, 60, 62, 63, 64, 68, 74, 75 and 76.	Raises market power and competitive neutrality issues.		*Government Railways (Access) Act 1998* and the *Rail Safety Act 1998* have removed various advantages and disadvantages conferred on the Government business.	Meets CPA obligations (June 2001).

(*continued*)

Table 10.1 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Tasmania	*Burnie to Waratah Railway Act 1939*	Provides a particular company with a competitive advantage by conferring the authority to operate and maintain a railway.	Review deferred pending proclamation of the *Rail Safety Act 1997*, because the safety and access provisions will negate the need for this Act.	Scheduled for repeal.	Council to assess progress in 2002.
	Don River Tramway Act 1974	Provides a particular company with a competitive advantage by conferring authority to construct and operate a railway.	Review deferred pending proclamation of the *Rail Safety Act 1997,* because the safety and access provisions will negate the need for this Act.	Scheduled for repeal.	Council to assess progress in 2002.
	Ida Bay Railway Act 1977	Confers on Ida Bay Railway an exemption from the provisions of the *National Parks and Wildlife Act 1950* and the *Railway Management Act 1935.*		To be repealed following proclamation of the *Rail Management Act (Repeal) Act 1997*.	Council to assess progress in 2002.
	Railway Management Act 1935	Gives the Transport Commission the power to issue licences to re-open abandoned railways. Exempts railway buildings from planning laws.	Government no longer owns railways.	Scheduled for repeal.	Meets CPA obligations (June 2001).
	Railways Clauses Consolidation Act 1901	Authorises the construction of railways or tramways and sets fares, construction standards, rates and charges.		Repealed by the *Legislation Repeal Act 2000*.	Meets CPA obligations (June 2001).

(*continued*)

Table 10.1 continued

Jurisdiction	*Legislation*	*Key restrictions*	*Review activity*	*Reform activity*	*Assessment*
Tasmania (continued)	*Van Dieman's Land Company's Waratah and Zeehan Railway Act 1895* *Van Dieman's Land Company's Waratah and Zeehan Railway Act 1896* *Van Dieman's Land Company's Waratah and Zeehan Railway Act 1948*	Provides a particular company with a competitive advantage by conferring the authority to construct and operate a railway, and prescribes the construction standards that must be met.	Review deferred pending proclamation of the *Rail Safety Act 1997*, because the safety and access provisions will negate the need for these Acts.	Expected to be repealed following the proclamation of the *Rail Safety Act 1997.* Act now proclaimed.	Council to assess progress in 2002.
	Wee Georgie Wood Steam Railway Act 1977	Provides a particular company with a competitive advantage by conferring the authority to construct and operate a railway and prescribes the construction standards that must be met.	Review deferred pending proclamation of the *Rail Safety Act 1997*, because the safety and access provisions will negate the need for this Act.	Expected to be repealed following the proclamation of the *Rail Safety Act 1997.* Act now proclaimed.	Council to assess progress in 2002.