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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON PROGRESS IN RAIL REFORM

MRS H. OWENS, Presiding Commissioner
PROF D. SCRAFTON, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON WEDNESDAY, 12 MAY 1999, AT 2.33 PM

Continued from 12/11/98 in Melbourne

MRS OWENS: Good afternoon and welcome to the public hearing of the Productivity Commission's inquiry on progress in rail reform. This public hearing in Sydney is the first of four sets of hearings. The others are scheduled for the next two weeks in Perth, Adelaide and Melbourne. The hearings are designed for people to raise issues in relation to our draft report entitled Progress in Rail Reform issued in March. They give people the opportunity to provide an input into the final report which is due to be released in early August.

While people who provide information are protected in the inquiry as if they were giving evidence to a court, this is not a court of law. We shall try to make the hearings as relaxed as possible, despite the microphones. However, there are some formalities which we try to follow each time we conduct public hearings. First, for the benefit of the transcript, we will ask participants to introduce themselves and to indicate in which capacity they appear - and I will come back to that in a minute. Secondly, information provided at these hearings is often used in our reports. We therefore ask participants to be as accurate as they possibly can with their comments and their answers to any questions. If there is any doubt about the accuracy of anything that is said then you could tell us later - if you are not absolutely certain - and we will try to come back and get it verified one way or the other later.

Finally, the transcripts from today's hearing will be provided to all participants at the hearings and if anybody else here wishes to obtain a copy they can contact the staff who, I think, are identifiable. Let me introduce Derek. I think everybody knows Derek Scrafton, who is the associate commissioner on this inquiry. I think we will get started at this stage, so if you could each identify yourself for the transcript?

MS STACK: I am Judi Stack, chief executive officer of Rail Access Corporation.

MR BONES: Terry Bones, general manager, marketing, Rail Access Corporation.

MR HICKS: Peter Hicks, general manager, operations, Rail Access Corporation.

MRS OWENS: Thanks for coming and welcome. You are the first cab off the rank, so to speak, or the first train out of the station or whatever you want to say. We have read your submission, apart from the appendices, so I think we can say that we are aware of what is in the submission and I would like to thank you very much for giving us such a comprehensive submission. We really do appreciate it because we do like to get feedback on our reports so we can make sure that the final report is as accurate as possible. I understand that you now have a presentation that you would like to make, so we will go straight into that. Thank you.

MS STACK: Thank you, commissioner and associate commissioner. Obviously, Rail Access Corporation welcomes the opportunity to participate in this inquiry being run by the Productivity Commission into the progress of rail reform. I should say at the outset that we regret the fact that we didn't make an initial submission to the Productivity Commission prior to you publishing your draft report and we are appreciative of the fact that you have now received our full report. I will be speaking to a presentation which has been provided to you and which we would also appreciate being entered into the record of the commission's inquiry.

What I would like to just run through for you - and I will do this as quickly as possible - is the progress of rail reform in New South Wales. Rail Access Corporation itself has been at the centre of that progress of rail reform. The private sector in New South Wales has responded by taking the opportunity to involve itself in the provision of rail transport services and I want to just outline the achievement in rail reform in New South Wales in the last two and a half years.

We were established to manage and establish safe and reliable rail infrastructure. We are established in a similar model to that in the UK. We were established as a state-owned corporation to be a successful business and to exhibit a sense of responsibility to the community. We have customer revenues of $550 million per annum and a maintenance schedule of around $450 million per annum and capital works programs averaging around $300 million per annum, and we manage over eight and a half thousand kilometres of track, and support two and a half thousand interstate and intrastate passenger and freight movements, and the argument that I will be putting to you today is that the New South Wales network, while it is not the largest network in Australia is, in fact, particularly in and around the environments of the greater Sydney metropolitan area, the most complex rail network in Australia.

Our heavy rail infrastructure network is four to five times in Sydney as complex as that in Brisbane. Adelaide is less complex than the Sydney metropolitan network by a factor between 6 and 12, depending on the measure used, and some 80 million tons of freight are carried on New South Wales track each year, making us second only in size to Queensland. By comparison, Victoria carries less than half that amount of freight while Western Australia moves one-tenth of the amount on 5000 kilometres of track.

Our core capabilities are our infrastructure management and access and we have demonstrated our performance capabilities since corporatisation and I note the commission's draft comments on corporatisation, and I will be addressing those. During the past 30 months we have been able to reach negotiated settlements on over nine access contracts, extending from single-train access paths to multiple year contracts, and that excludes obviously the very many contracts that we enter into with heritage operators and non-profit type organisations, so in total we have successfully negotiated over 900,000 train path movements and we believe there is still strong growth.

Our success as an infrastructure manager is reflected in, among other things, the condition of the New South Wales track - and I will be talking a little bit more about that later, and it is covered in our submission - and the consequential service improvements to our customers. For example, the number of speed restrictions has dropped by 25 per cent since 1994 and these restrictions currently affect less than 1.4 per cent of the passenger and major freight network. Furthermore, we have driven down State rail access charges by around 30 per cent since our establishment, so that the social dividend from that drawing down of access charges to the State Rail Authority of about $100 million dollars a year over 10 years would be in excess of $1 billion.

In this financial year operators have expanded their services in New South Wales and new business has been won to rail. Both FreightCorp and Austrac expanded their operations to provide Sydney-Melbourne services. Austrac commences operations of log trains between southern New South Wales and Port Kembla. National Rail has commenced moving cars between Melbourne and Brisbane and established a Trailerail and intermodal Western Sprinter services between Sydney and Perth. FreightCorp has won the contract to freight 800,000 tons of waste sandstone between Rozelle and St Marys and National Rail won the Macquarie general account, again another new account to rail.

We also estimate that since our establishment in June of 1996 approximately two-thirds of freight in New South Wales on a gross ton kilometre basis has been subject to competition between operators and, whilst in many instances the incumbent operator has won that freight, it has resulted in lower access charges. We have passed on the benefits flowing from efficiency improvements and cost savings to our customers through reduced access charges and, for example, between 1997 and 1998, 98-99, our access charges for SRA as a whole have decreased by 9.8 per cent and coal freight has decreased by 14 and a half per cent in real terms. FreightCorp in its 97-98 annual report reported that access arrangements for 1997-98, taken together with those for 1998-99 represent a 30 per cent reduction in access charges against all commodities.

Competition is also delivering the promised quality customer responses and cost efficiencies and this area of competition is something that we will be addressing because it is something that we believe - the Productivity Commission's draft report has moved away from a pro-competition stance, and this competition has delivered real benefits to end users. Freight haulage rates have been falling steadily and, as I said, access rates have reduced by 30 per cent, freight rates in the central Hunter Valley have reduced by 25 per cent since 1995-96 and the average reduction in freight rates has been 9 per cent during the 1997 and 98 year.

Our first two years of operation have been notable for the significant success in bringing down costs and I think the Productivity Commission has recognised that rail is essentially a mature, if not declining, business, and that revenue growth is going to be difficult to achieve in the rail environment in the current political and - and the lack of neutrality that exists, but certainly I think it is reasonable that the cost structure of rail has been inflated over many years and there is a lot of success we can bring to rail by improving efficiency and cost. Rail Access Corporation has been successful in bringing down costs and these costs have been achieved at the same time as asset condition has improved, as has the availability of train paths and the system safety record.

If current projections are met, the 1998-99 maintenance costs will be

23 per cent less than the equivalent 1996-97 figure in real terms, and the reason we have used 96-97, which was our first year and during which there were significant cost cuts to maintenance, is because prior to 96-97 the records of the old State Rail Authority really didn't permit us to be able to do a proper like-for-like comparison with maintenance costs.

The primary strategy for moving towards efficient cost has been competition, or the threat of competition, for maintenance services, and although there is currently a government-imposed moratorium on competitive tendering, that moratorium will cease on 1 July 1999, and our assessment is that there are further unrealised cost savings in maintenance spending of in excess of $100 million per annum in the New South Wales system. Obviously our ability to reduce cost is critical to our ability to pass on savings to operators via reduced access charges, invest further in the rail infrastructure network, pay dividends and allow reduced CSO payments. You will see on that slide there the sources of the benefits in terms of maintenance cost savings, electricity cost savings due to competition in the electricity market, engineering cost savings and new revenue from volume growth, and the application of those benefits have gone largely to reduce access charges to operators and, obviously, to reduce CSOs and to improve government dividends.

I think the next one is slide 11. So whilst we obviously sell access we believe that our asset management skills have translated into a better management of the infrastructure for our customers and delivered cost savings; for example, over 14 million just from last year's capital program and, as I said before, well in excess of 150 million in our two and a half years of operation.

We have also successfully managed project delivery. The New South Wales network - as I said before, we have over $300 million per annum being spent on capital projects, particularly in the Sydney network. Those investments are from government grants principally, and we're involved in a lot of remodelling and upgrading of the network, particularly for the Olympics. We completed the Olympics loop, the Olympics works, on time. We're now involved in managing the new Southern Railway project for the government, which will be completed in May 2000.

Rail Access Corporation's own investments from its commercial investments off its balance sheet have been principally focused in the Hunter Valley, and you'll see that in the Hunter Valley we've been involved in concrete resleepering. We have a proposal to build a spur line to Jerrys Plains and we're doing a number of works in the Wittingham-Branxton junction and Hexham areas to improve the capacity of the network to meet the forecasts of the coal industry and ourselves, which would be in excess of 100 million tons per annum running across that network. So we have key experience in the delivery of capital projects and we're delivering those at a cheaper rate than has been done in the past.

The issue of safety is obviously of critical importance, particularly on a complex network, particularly on a network which carries passengers in the densities that we do in Sydney. We obviously treat safety as our top priority and the number - safety has a commercial value to us, but it also is very important that as we move to restructure and reform the rail industry and reduce costs, safety levels are improved, and the number of major incidents occurring across the network has dropped from a high of 578 in 1994-95 to a low of 365 in 97-98, an improvement of 37 per cent or the equivalent of just 0.0004 major incidents per train movement, given approximately 912,000 train movements per annum.

The state's network is in the best condition it's been in for a decade, and all major safety categories are reporting improvements of up to 67 per cent. So I think it's important for the Productivity Commission to understand that whilst we're driving down costs and improving service improvements, safety records are not suffering. We have record high levels of infrastructure performance. The results of the 1997-98 financial year show that the reduction in incidents that are attributable to infrastructure overall are 16 per cent and a reduction in delays by 21 per cent over the previous year and, as that slide shows, the track condition index is at its best level in a decade, and we had the pleasure of showing the Productivity Commission members that in person some months ago, and obviously the number of serious incidents on the network has also dropped. Train delays due to infrastructure problems in the metropolitan network under our responsibility have declined by 25 per cent.

Now, what I've tried to put forward very briefly, commissioners, is that the network costs are reducing but network performance is increasing. Now, that's not to say that we've come to the end of our path. Obviously RAC has only been corporatised for just over two and a half years, nearly three years, and the corporatisation process, as occurred in New Zealand where New Zealand Rail was corporatised for approximately 10 years to get itself into a position from a complete dog of a business, I might say, to a business that could be sold and making a small profit, to a business today which is very successful, although they have very different competitive - they have a different framework there for road and rail competition.

But certainly I think I would argue that the commission's view that seems to be coming through the draft report that corporatisation is some sort of fairly ineffective form of privatisation, we would be against. Essentially, in a very short period of time there have been major improvements in the New South Wales network through corporatisation and certainly there are more improvements to be had by following the path of introducing both competition above rail and competition below rail.

As I said at the outset, we did not provide a submission to you before your draft report, and I regret that. But we therefore didn't illustrate any link between industry structure and performance benefits, particularly pertaining to the vertically separated model, and I'm aware some of the other organisations that have different views, such as Queensland Rail, did provide quite extensive submissions and naturally the commission relied upon that evidence.

The New South Wales experience of rail reform we believe clearly demonstrates that the vertically segregated model of rail reform has facilitated competition in New South Wales and facilitated improved performance. Key issues in considering the

structural model for access arrangements in New South Wales are the simplicity of negotiating access agreements for rail operators within an already complex market and equity of access for new entrants.

We've looked at the Productivity Commission's views on vertical separation and our analysis of the draft report says that essentially there was no clear view on whether high-volume regional railways, such as the Hunter Valley, should be vertically separated or integrated. You've said that low-volume regional railways should be integrated. You've said that urban passenger networks should be integrated, and you've said that the interstate network should be a vertically separated, independent network.

We believe that some of the bases on which the commission came to that view don't - they didn't have the opportunity to have an appreciation of the understanding of how those various markets work in New South Wales. Let me first start with the high-volume regional railways; for example, in New South Wales we have the Hunter Valley. In the Hunter Valley we would argue - and I think we would be supported by those people that have benefited from the reforms - that there has been a significant efficiency and price improvement following from vertical separation of the Hunter Valley infrastructure from the Hunter Valley operations.

As I said, FreightCorp reports that in the Hunter Valley customers pay 25 per cent less in average rail freight rates in 1997-98 compared to two years previously. On low volume also in the Hunter Valley our estimate is that 50 to 60 per cent of the Hunter Valley has been contested, mines contesting the carriage of their coal to the market, and most recently in terms of the regulatory framework in New South Wales, where in New South Wales obviously the government took a decision to reduce monopoly rents in the Hunter Valley over a four-year period, there has been yet another very important move to lower freight rates in the Hunter Valley where Rail Access Corporation's ceiling rate of return has been reduced from 14 per cent nominal post-tax to the equivalent rate being 6.2 per cent nominal post-tax by an IMPART inquiry into what would be a reasonable rate of return for our corporation in the Hunter Valley.

So already not only is competition working for coal owners in the Hunter Valley but also regulation of the vertically separated model in New South Wales is also working in their favour, and all these price declines - that will be another $22 million in this coming financial year - have happened within a three-year period of the restructuring of the New South Wales rail system.

On the low-volume regional railways, where the commission has formed the view, really from the position of I think looking at the Tasmanian example in particular, that they should be integrated, our experience is quite different to that. We've found that in fact our low-volume regional customers do want rail competition, and in New South Wales on those low-volume lines we've seen the establishment of Rail Track, we've seen the establishment of Northern Rivers Railroad, and we've also seen the establishment of GrainCorp as a contractor to

FreightCorp, and in the New

South Wales experience - and Terry I'm sure will talk about this a little bit later - in fact regional railways for grain are really not subject to a lot of road competition. Those railroads are very heavily subsidised in New South Wales by CSOs. Those CSOs to us are transparent. The CSOs at the moment to FreightCorp are not contestable, but there is a lot of interest and in fact activity on low-volume regional railways and competitive activity that is being welcomed both by customers and by local communities.

In respect to urban passenger networks, again the commission suggested that urban passenger networks should be horizontally separated I think and vertically integrated, and again it seem that you looked at the yet untested Melbourne Kennett model for your solution in this particular segment of business, and I'm a bit disappointed that you didn't look at other models such as Rail Track and the horizontal and vertical segregation that exists in the United Kingdom. But certainly in New South Wales we've been operating on a vertically separated model in the metropolitan region for the past two and a half years. As I indicated to you, our access rates have gone down substantially during that period to our principal customer and our liability and safety has gone up. So we'd just suggest to the commission that you rethink that conclusion. I don't think that the evidence necessarily points to the conclusion that you've arrived at and we've provided more information in respect to that in our submission.

In terms of the interstate network, we'll be addressing the issues that you've raised in terms of vertical separation and, whilst we support that, the reasons that the commission has put forward - that in markets where there are road, if you like - if there is competition from road, that there is more of a case for vertical integration, in fact this interstate market is the market where there is the most competition from road. We would support vertical separation. However, we would like to also address some of the issues in respect to the one-stop shop.

So just moving into a little bit more detail in respect to RAC's various business segments, you'll see from that graph that, in terms of GTK, coal is the largest part of our business, and in terms of revenues urban passengers contribute the largest amount. The intrastate freight is a very large part of our business, long-distance passenger is quite small. Interstate freight in GTKs is 24 per cent of our business, but you'll see there interstate freight and passenger, in terms of revenues, represents 11 per cent, and of that the interstate freight represents less than 5 per cent of our revenues. You can see from that graph that we have a market based pricing in New South Wales. In other words, we price in accordance to the market's ability to pay, so interstate freight, which has a very large percentage of GTK, can only afford to pay a very small percentage of our revenues.

The urban passenger network carries around 900,000 people every day and makes up 21 per cent of the gross kilometres, providing a revenue of $324 million, and more than 66 per cent of all metropolitan train trips occur during the morning and evening peak periods. Long-distance passenger services equate to 4 per cent of the GTK and revenues of about $12 million.

Obviously in New South Wales the north-south interstate rail corridor is the busiest in Australia, carrying almost 4 million tons of freight through the Sydney metropolitan area per annum. However, this is still only 19 per cent of the north-south freight market share, with some 71 per cent on the north-south corridor currently carried by road. Rail fares much better on the east-west corridor and I'm sure the commission has heard evidence that rail carries 60 per cent of the land freight each year on that corridor. As I said before, interstate freight accounts for around 24 per cent of our GTK and generates a revenue of $33 million per annum. I invite you to think about that because $33 million for nearly 25 per cent of our business in GTK is a pretty sorry indication of what the market's ability to pay is in terms of both access fees and in terms of freight rates.

Coal freight services: the Hunter Valley network obviously also intersects with the north-south main line and also contains some of the most intensively used freight lines in New South Wales. Revenue from this network this year is projected to be around $118 million per annum, not including the monopoly rent of around $26 million. Later on I'll just talk about the utilisation of that network. Grain and other interstate freight services: the intrastate freight market comprises grain, minerals and general freight and accounts for 20 per cent of our GTK. In 1998-99 this market is projected to generate a revenue to Rail Access Corporation of approximately $24 million.

So we have around a 15 to 20 per cent share of the major commodities transported within New South Wales and we're experiencing increases of around 6 to 7 per cent increase in the intrastate transport task as the benefits of rail reform continue. 6 to 7 per cent in intrastate growth is much more significant than the sort of growths we're experiencing in the interstate market.

If you look at this next slide, and we're being as frank as we can with the commission here about the economics of our business - - -

MRS OWENS: Can I just interrupt, Judi. This particular slide on the material you've given us has got "commercial-in-confidence" at the top of the page and I was just wondering if you still want to go ahead with that slide, given that this is going to be on the public record.

MS STACK: I don't have any problem with it. I think it was put "commercial-in-confidence" for another presentation but I've decided that we should share with you this information. If you like at this slide, you'll see the revenues, approximately, of the various parts of our business and the next slide shows those revenues in terms of their profitability. The pink on the right-hand side is the CSO component of those different market segments. As you know, and I think we've said in our submission, Rail Access Corporation has a seven-year agreement with the New South Wales government which is fully transparent on a line sector basis which provides the subsidy to enable us to effectively break even on the network between the market's ability to pay and the cost of running that network.

The agreement shows that CSO going down over a period of time and as we make further inroads into efficiency and lower cost, we would expect the profitability to go up. But just quickly looking at that slide, you will see that effectively the only profitable part of our business, without CSOs, is the coal business. All the rest of the business in terms of line sector is supported by government CSOs and with those government CSOs, because of the cost efficiency measures we've taken, we're now making some small profit on some parts of the business.

These slides are just indicating to you the complexity of the network, particularly in and around Sydney, and the difficulties perhaps of the New South Wales network in any event fitting into the Productivity Commission's draft structural model, which sort of suggests that there are different networks for different types of traffics. In other words, you can almost geographically isolate different networks. "Metropolitan networks should be vertically integrated," said the draft report. "Interstate networks should be vertically segregated," said the draft report. "High-volume coal networks should be maybe integrated, maybe not integrated," said the draft report, "and low-volume lines should be integrated," said the draft report.

The New South Wales network quite frankly does not work like that. In Sydney itself, priority is currently given under legislation to passenger services, and that is likely to continue for the foreseeable future. Public interest demands that the commuter requirements of the Sydney network will enable people to get to and from work on time, and with the current investments in the rail system you will see that ultimately, where freight and passengers are sharing the network. All of that black section there is shared between freight and passenger services. Those red ones there are the only lines that are actually exclusively used by passenger services. So a vertically integrated operator, as was the case before we had the reform of rail in New South Wales - the SRA, as it was then - was most unlikely to give any priority to freight services.

In fact I think the first year after we did reform the rail system, Rail Access Corporation had a very difficult task getting its freight customers through the metropolitan region in the first Easter Show, which was the first trial event for the New South Wales Olympics. Since that time, because we're in control of the allocation of the train paths in the metropolitan network, freight operators are getting a fair run, although there are still significant peak curfews for freight in Sydney, and that's an infrastructure issue, but certainly you can't expect, in a vertically integrated structure where the metropolitan operator also controls the access to the track, that there would be any real incentive to enable freight operators to improve their businesses by having a fair go in the Sydney area.

Under your draft model of a franchised vertically integrated urban rail system we believe that new entrants would have to deal with a multiple of owner-operators across the system. In other words, getting into Sydney, if it was to be horizontally segregated and vertically integrated, if you wanted to run a freight train through Sydney and there is no other way of getting through Sydney, you would need to deal with several vertically integrated owners who would have no incentive, because the levels of revenue are so small in comparison to their primary task, to really facilitate that access. That would create major complexity and coordination cost problems and there's also a concern that competitiveness would not be enhanced by the incumbent owner-operators.

I think that new entrants would really find that very difficult indeed and we're very aware that whilst the access arrangements and the access regimes and safety and all of the other things place pretty large constraints - not as large as the barriers to entry of having to get your own train set and operate them, but certainly there are some barriers to entry posed by the administrative arrangements for access. We would argue to you, and we'd encourage the commission to ask those operators that are currently operating in the New South Wales environment - and I understand FreightCorp is coming in next, but certainly National Rail, I think, and others would certainly attest that operating in the New South Wales environment post-reform - and National Rail is probably a better example because they never were integrated - is much better than operating in the pre-vertically integrated reform environment. I'd also invite you to compare their experiences of negotiating access in New South Wales compared to other jurisdictions such as Queensland.

If you look at the wider network outside of Sydney, again we have common use on the system by a number of different operators. There you'll see that Austrac and Northern Rivers Railroad, which I told you are new entrants into New South Wales, GrainCorp, new entrants on low-volume regional railways, are operating in those railways. Great Southern Pacific Express is a Queensland train that is coming to New South Wales. As yet, as far as I'm aware, there are no New South Wales operators operating in the vertically integrated Queensland marketplace. If you look at New South Wales, obviously even - - -

MRS OWENS: Can I just clarify something on that slide? Where it's got, say, the blue Austrac, is that just Austrac running on - - -

MS STACK: No, they're the lines that they operate on.

MRS OWENS: Underneath that is green as well.

MS STACK: Sorry?

MRS OWENS: It's not just - - -

MS STACK: These are where our new operators are operating on the network.

MRS OWENS: Yes, okay, so with Griffith to Narrandera it's Austrac and FreightCorp?

MR BONES: It would be Austrac, FreightCorp and Countrylink.

MRS OWENS: So there are three of them?

MR BONES: Yes.

MRS OWENS: It's just that you've got a key which just says Austrac and I'm just trying clarify - - -

MS STACK: We're just trying to show you at this stage where the new operators are operating in New South Wales, and I think the next slide overlays on that where the SRA is operating in terms of Countrylink. The next slide looks at the coal network and you'll see - I mean, we could build this up with FreightCorp and National Rail and others, but essentially the argument that we're putting to the commission is that there is multi-operator utilisation and multi-product segment, and particularly the interesting thing about the coal network is the coal network runs right across the main line on the same lines that the CityRail services are running on, on the same lines that Countrylink, National Rail and FreightCorp are running on, so we have multiple users, multiple product sectors, all running on the same network. There are some small parts of the network where there is only one user but they are very much in the minority of the network and that's essentially what you see there, which is FreightCorp grain movements.

Just looking at the network again - and as I explained before, interstate movements represent about 24 per cent of our GTK, intrastate movements represent 20 per cent of our GTK, and we currently are developing a one-stop shop with the ARTC, but if the commission's draft - if you look at this graph, there are current jurisdictional interfaces at the Queensland border - those yellows are a bit unclear but at the Queensland border, out at Broken Hill and down at Albury. If you want to operate a train interstate, those three places are where you will need to have a separate access agreement with us or alternatively, when we come to a commercial arrangement with ARTC, have no separate access agreement but where there would be underpinning commercial arrangements between us and the ARTC to transfer revenues.

If you look at all of those other yellow dots on that graph, essentially they are the yellow dots that would be created if that turquoise line, which is the main line, was transferred to the ARTC as a one-stop shop. What that would basically mean would be that FreightCorp and our other operators within New South Wales would in fact need two access agreements - one to travel on the blue line and one to travel on the rest - and you would see that in some movements they may in fact have to have an agreement with us, an agreement with ARTC and then travel back onto our own line. In any event, you can see that the Sydney metropolitan region, in our assessment, is unlikely to ever be transferred in its entirety, or even in part, to an interstate operator to enable interstate traffic because of the passenger movements required.

So, essentially what we're arguing is that in the case of the ARTC - and I think I gave this example off the record to the commission before, but if I ring New York City I don't pay a bill to Telstra, to AT and T, to the Chicago Telephone Co and to Ninex. I pay one bill to Telstra or OneTel or whoever it might be, and Telstra have commercial arrangements, wholesale arrangements with other telephone suppliers to provide that access for me. Let me say this to you: the rail system is much less complex commercially than the international telephone environment, and if we can't get commercial agreements that can provide a one-stop shop to access users, then I would be fundamentally amazed, and we're quite close to getting to that with the ARTC. We would argue that ownership of the track is completely unnecessary to achieve the sort of customer benefits and the customer simplicity that we're all seeking to achieve.

So, essentially, in looking at slide 31, generating above-rail competition, who would you rather seek access from? Somebody whose interest it is to in fact generate more business on the railroad, who has no interest as a competitor to your business, or from a vertically integrated railway where there is no incentive for them to provide access to a competitor?

There are a couple of other issues in relation to the Productivity Commission's report which I'll go through very briefly. Obviously the private sector investment models - we won't comment on that, but we do welcome the privatisation of freight operators in Australia and we do believe that will re-energise and reinvigorate the business, and also provide a better platform for a voice for rail in the federal environment when it comes to investment and pricing. But we disagree that the corporatisation model is a factor in weak commercial investment; in fact, we believe that we can play a valuable role as a corporate commercial organisation.

The real difficulty with investing in rail is not that there isn't money. Rail Access Corporation has a very sound balance sheet and free cash flows, significant free cash flows to invest in the system. As a state-owned corporation we can invest where we're going to get a reasonable commercial return. There are very few opportunities in the New South Wales rail network, outside of the Hunter Valley - because of what I showed you before - because they're unprofitable and they will be unprofitable until we can really drive down the costs. There aren't very many profitable opportunities for investment, and so that's at the core of the problem.

You just don't wave a magic wand and say, "Let the private sector in to invest." The private sector is only going to invest if there's a return, and the sort of concepts that are floating about - that, you know, we can set up a toll or something through Sydney and establish a priority route through Sydney and we can spend $450 million or $650 million on it, and half of it or two-thirds of it can come from the private sector - when you're looking at revenues of $35 million a year, it's nonsense. It's nonsense. Unless the pricing is changed so that rail prices and road prices are in a neutral framework, or unless the investment framework is changed, then there is no magic wand for the rail industry coming from private sector involvement. Certainly we are completely unfettered as a commercial business in terms of investing in the rail business in New South Wales.

Just quickly, the New South Wales rail access regime: we talk about this in detail in the report and I won't go into it in any detail, but I will say that with the rail access regime, we were the first to try and lodge a rail access regime with the

National Competition Council. We had all of our friends from the Minerals Council and elsewhere, but we've been the pioneers. We're quite close now to getting that regime finally ticked off by the National Competition Council. It hasn't been an easy process, but certainly it's not been for want of trying. Certainly the commonatorial pricing and the way in which our pricing policy is determined in respect to the end market's ability to pay has had a tick from the National Competition Council and they asked IPART to check on the basis of the ceiling and the ceiling, as I reported before, has been reduced from 14 per cent to an equivalent 6.2 per cent.

Now, as an organisation I'm not that happy about that, obviously, but certainly what that says is that the model is working, because what that means is that price reductions will be passed on to our customers and to the coal industry and to the economy in general. So the vertically segregated regulatory environment in New South Wales is working well.

The commission has talked about safety and harmonisation of safety, and I won't talk very much about this, only to say that we support the COAG regulatory model. RAC is a very active participant in national harmonisation of safety. I have some of my best people working on it and leading those teams, so we are very committed to that and we believe it will happen. It will take some time, but certainly we're committed as an organisation. There are no structural impediments to that occurring.

Competitive neutrality you also talked about, and I think suggested that there were some biases against rail, and we'd agree with that. Obviously road receives at least four times the amount of subsidy as rail, and we would support a land transport commission. We obviously see privatisation being important in raising the lobby. We don't think that we're going to be just able to sort of - it's going to happen. There aren't any magic wands. It's going to take a sustained effort by the rail industry over many many years, and probably the way to go will be in terms of improved investment in infrastructure rather than pricing, although having worked in New Zealand I believe pricing models can work very well and I'd hope that the Productivity Commission will look at the New Zealand experience to perhaps point some direction as to how we might be able to approach the issue in Australia. This particular road virtuous circle, rail vicious circle is essentially pretty self-explanatory, but we're going down, down, down, and road has continued advantages within the environment that we're playing in.

The social dimension: we believe that New South Wales has come a long way in terms of making the CSO arrangements transparent, certainly insofar as Rail Access Corporation is concerned. Certainly the purchaser-provider model we believe should be adopted more widely, both in New South Wales and elsewhere, and that model should be based on outcomes and service targets. In terms of the reintroduction of contestability, we'll certainly be mindful of the sorts of issues that the National Competition Council and Graham Samuels and others have been very aware of following the Pauline Hanson debate: that competition and reform can proceed without major social dislocation and disadvantage.

In conclusion - and I'm sorry, I've taken a few minutes longer than I said I would - we believe that the Productivity Commission should take a presumption that competition, and competition that's created through vertical separation, is in fact the right model, and then you should ask those that don't want competition and want monopolies through vertical integration to justify that on the basis of performance, not on the basis of perhaps commercial self-interest, or on the basis of untried models and untested models that exist in some parts of Australia, because where vertical integration has been tested - and vertical integration has been tested for a very long time in New South Wales - it was very difficult for people to compete.

In Queensland, not one single operator, new operator, has been able to commence a service in Queensland, and I'd be interested for you to ask the FreightCorp what has happened to their attempts to enter the very lucrative Queensland market, particularly in the coal market. We would refute the concept that there is some sort of ambivalence about whether vertical integration in high-density bulk haulage markets is a good thing. In the Hunter Valley it is quite clear that Hunter Valley coal producers - they'll always want more - have benefited substantially, both from the competition model, the vertical segregation and from the regulatory model in New South Wales, and that has been good for the economy as a whole.

We believe that vertical separation in the metropolitan markets is working well. It has focused the passenger operator SRA on improving service levels, and has certainly in terms of cost to the taxpayer reduced costs overall. In the low-volume regional markets we would contest the concept that these markets are subject to road competition in all cases and that there is no desire or economic capability for competition, because even if only one operator ends up operating on some of our tracks, the threat of competition to that operator will continue to drive prices down and efficiencies into the business.

We can guarantee that Rail Access Corporation is committed to significant annual reductions in cost to government, to continued improvement in infrastructure safety, to continued increases in shareholder value, continued increases in network productivity and to continue to convert the opportunity of the rail industry into a reality of future success. We're very grateful for the commission's time in listening to our submission. Thank you.

MRS OWENS: Thank you, Judi. Thank you for the presentation. I think it reinforced quite a number of the points you made in your submission, and in my case in some instances actually clarified a few things for me. We do have quite a few questions we want to ask, so I hope you'll bear with us because we may have to go over time. Have you got sufficient time?

MS STACK: We're fine.

MRS OWENS: One of the areas I'd like to start off with is, I think, a general misunderstanding that the RAC has about what we were trying to do in our report, and I think the misunderstanding was reflected both indirectly in your submission and I think more directly in your chairman's speech to CEDA, where he said that the Productivity Commission seems to have changed its mind on one of the cornerstones of national competition policy, and that was separation. He also said later in his closing remarks at that time that he was disappointed there had been criticism from some who, he thought, would be supporters, and I presumed that we would come in as one of those that he would be disappointed in.

I don't think - and I think Derek would agree with me - that what we were trying to do was to criticise the New South Wales model. What we were trying to do was to tease out some basic principles about what is sensible in terms of a structural arrangement, ownership arrangements, access arrangements, and so forth, and we haven't tried to say anywhere in our report that this is a formula approach. In fact I think what we're trying to do is the opposite. We are saying that you cannot have necessarily a recipe approach to this issue, particularly structural issues, and when you're reforming anything you need to have a very clear idea of what you're doing, why you're doing it, and be able to evaluate what it means for the industry that you're talking about.

What we want to see are changes which will give us the greatest improvements. We're not only just interested in the implications for the rail sector but for the transportation system in Australia more generally, so I think we're trying to stand back from it and say there are different models in different states. I don't think - and I think I can speak for Derek - that there is a wrong and a right way of doing this, and I don't think we actually have any recommendations that say this is what should happen. I think in New South Wales' case there is already a system in place, but I'm very interested to see how that system is working, and I think you've given us some valuable information about that, but I think we are interested in the whole issue of why one would want to vertically separate, and the main reason, as I can gauge it from what you're saying, and from the literature, is that there's a natural monopoly characteristic and so there's a potential to take some aspects of the business out and introduce some competition.

What we believe is that there may be instances - maybe not in New South Wales, I don't know - I'm yet to be convinced, but we can talk about this - but there may be instances where there is not going to be a lot of rail-on-rail competition, regardless of what you do. You could separate, but it's really not going to happen, or it might happen for a little while but it mightn't last for very long. There will be a bit of a shake-out. And that may be because there is already competition in that particular market, hauling grain or whatever, from road. It may be because the volumes are so low you've never going to get many more than one participant in that market, and you want to maximise the economies of scale that you have.

So there are instances where you may argue that, regardless of what you do in terms of vertically separating, you may not actually achieve competition, rail-on-rail competition in a way that we would argue would be desirable. The Productivity

Commission likes competition.

MS STACK: That's what we thought.

MRS OWENS: Yes, we do like competition, but we're saying that sometimes you can do it and sometimes you cannot, depending on what you're talking about, and in some cases, rather than have competition in this way, we could think about - as they're going to do in Victoria - competition for the market, or you can have competition for contracts and so on. We're trying to stand back from it and take a fairly balanced view, but I think it's very good for you to then bring us back down to earth and say, "But this is the way it works in our state," and I think that's exactly why we've got a draft report and exactly why I'm very pleased you're here today. I'd like to ask you, would you separate, regardless of whether there was potential to have more competition in a particular market? Would you still vertically separate or would you then say, "If there's no potential, no, I wouldn't"? I just want to clarify that.

MS STACK: Let me just address a couple of your earlier comments and perhaps I can't speak on behalf of my chairman, but certainly it would be our presumption, given the antecedents of the Productivity Commission and its purpose in life as we saw it, that the Productivity Commission would presume in favour of competition in the absence of evidence that competition was not good. We don't believe that in the draft report that there has been evidence put forward, other than evidence of parties where they may be a self-interest at stake, that says that competition doesn't work in any rail market in Australia.

Now, I take your point that there are a number of markets where ultimately there will be one operator, and that's because the thinness of the traffic is such that there will be one operator, and many of those markets throughout New South Wales already are supported by a CSO which is non-contestable, so there's the non-transparency of a government subsidy to a single operator in a market, and that's the historical situation that's existed, and it exists in Queensland, outside of the core coal markets of Queensland. That's the only place they make money as well. So elsewhere there's been lack of transparency and particularly a lack of transparency in respect to government subsidy across the rail system.

Our view is that the subsidies, if they're operator subsidies, need to be transparent or they need to be open to everybody to get access to, and in the case of vertical separation we get a subsidy for the below-line, but that subsidy is effectively available to everybody who could use that line or may use that line, and the threat of competition in a particular area always will keep the operator in that area more honest in terms of pricing and more honest in terms of access to CSOs. So we've seen in New South Wales the threat of competition work in the Hunter Valley and we've seen on thin-line traffic routes where the incumbent operator, like FreightCorp, has essentially abandoned traffics, them being picked up by ma and pa type operators - you know, the people who drive the loco also do the books type operators - going in and actually rekindling traffic where everyone said it was hopeless. The single operator had not pursued that traffic. Their overheads, their business, couldn't do that traffic at a profit.

Now, I would hope that the Productivity Commission starts from the point of view of saying, "Okay, competition should be the norm," and it's only where there is tremendous evidence to say that competition is never going to occur - and we can't say that there's any single place in New South Wales where that will happen, even in the natural monopoly type area of the metropolitan type network. We have utilisation of that network by other operators, freight operators, and we also have utilisation by other passenger operators, and we have interest from other passenger operators talking to us about establishing passenger services within the greater metropolitan area.

So I guess our concern with the report was that you tended to sort of create these boxes and say, "Well, this is where competition is going to happen, this is where it's not going to happen." Our view is competition should be the presumption, and that if you then took the view and said, "Well, why is a non-competitive, an integrated environment going to be better?" - and there was evidence for that - we don't believe there is.

MR BONES: I could perhaps add there as well - as general manager marketing I'm sort of in the front line and I'm the first one that operators come to see about access charges, etcetera, so I've got a fairly good insight into what's happening in the market out there, and we're the ones who have put together these estimates of how much competition there's been out there, and really the only significant market - or the most significant market where there has not been a great deal of evidence of competition to date has been in the grain market, but that is now changing.

There are particular circumstances in the grain market. We're currently in a situation with a single export marketer through the AWB. That will change over the next few years. We are already seeing other players entering the grain market. We have people now knocking on the door to build new grain loading facilities in various locations in New South Wales. They've indicated that they will be going through contestable processes for their grain transport needs, and although you might look at an individual grain branch line and say it's a very thin market, in an overall sense we're talking about a substantial volume of grain movement - - -

MRS OWENS: Terry, does that mean that the rail is actually winning back business from road for grain, or what's happening, or is it because there is a CSO in those lines?

MR BONES: What's happening in the market now is that players are shaping themselves up for deregulation in export marketing essentially, and that will fundamentally change the nature of the grain market in Australia.

PROF SCRAFTON: Are any of these players assuming that they can carry that traffic without subsidy against an operator who is ready receiving a CSO?

MR BONES: We receive below-rail CSOs, so essentially the access charges are subsidised, but there is a significant policy issue there in terms of any CSOs that above-rail operators, as FreightCorp, might receive for grain. But certainly some players have indicated to us that they believe they can do it without above-rail subsidy.

MRS OWENS: I'd like to come back to the below-rail subsidy too.

MR BONES: The other issue too that Judi mentioned in passing was this issue of road competition. I think the draft report worked on the presumption that there was intensive road competition in these low-volume regional freight markets. That's certainly not the case in New South Wales grain, where by virtue of the CSOs and the distances to the port, the volumes involved, rail has essentially had a natural monopoly in grain. That's evidenced by the fact that there weren't even road receival facilities put in at the ports.

That's not the situation necessarily in all other states. In South Australia, for example, the distances are far shorter and it's quite easy to run a truck direct to port, but the situation is fundamentally different in New South Wales, and I'd have to say that I can't, sitting here, see any freight market in New South Wales that isn't potentially subject to competition.

MRS OWENS: You actually do say in your submission very early on that you see that competition has boomed - I think were the words that you used - and having listened to the presentation and received your full report at lunchtime, I look at appendix 2 where it does cite on page 11 of the appendix some of the areas, and I think you put up a slide which had similar information about where there have been new private operators, and Austrac has come in. We've got the Northern Rivers Railroad, and that's subcontracting to FreightCorp. Subcontracting also applies to GrainCorp. Are they functions of having a vertically separated market or is that just a function of FreightCorp entering into contractual arrangements with other players? Where do we attribute the cause for that?

MR BONES: Those two examples - I agree, they are a contractual arrangement that FreightCorp has entered into, but I think the comment that competition has boomed is focused more on what is the norm now in the rail freight markets, and in New South Wales it is that coal companies, minerals companies, etcetera, will go through competitive processes, tender processes, call informal bids or whatever. Now, I'd have to be honest with you and say the two principal players in those tender processes tend to be FreightCorp and NRC.

We've had a situation in New South Wales, unlike other states, where as of day one we had two very substantial standard gauge rail operators kitted out with rolling stock, and they're the ones that are most effectively placed to compete. There has also been competition from Austrac and certainly a lot of the new entrants are also bidding in those processes.

MRS OWENS: Have you got any idea of how much business - and maybe we'll ask FreightCorp this, but how much business FreightCorp would have lost as a result of other entrants coming into their markets and winning the business?

MS STACK: But I don't think that's the point, you see.

MRS OWENS: Well, I think it is the point.

MS STACK: No, it's not the point, because the point is that in fact FreightCorp has won most of the income business.

MRS OWENS: But you're saying that - - -

MS STACK: No, but what's happened is prices have gone down by 30 per cent.

MRS OWENS: Excuse me, I just want to say something. You're saying that the main thing is to have contestability in the market, rather than actually getting the competition into the market, the contestability is what's counting. I mean, you can't say competition has boomed. The contestability, I suppose, has boomed is really what we're saying.

MR BONES: Well, it's the competition between operators. It's happening in practice. It's the reality in the New South Wales rail freight market today, it's the way the rail freight market in New South Wales now operates. It's fundamentally different to what it was two and three years ago. Pose the question to FreightCorp and see what they say.

MRS OWENS: I will.

MS STACK: Prices have gone down. Prices have gone down because people have been competing for the business.

MRS OWENS: I'd like to come back to prices. It might be useful to put that slide up that you had, the one with the low volume, the urban - you had the two, there were a couple of slides. Anyway, in the meantime, we have an issue in terms of the extent of potential competition for the low-volume markets, which we have discussed, and I think a factor there is going to be the size of the CSO that is in place and that is a government or political decision as to whether the government is putting a CSO into those markets to keep trucks off the road, or whatever their objectives are, and I presume if the CSO is transparent, then everybody can see what it is and they can say, "Well, that's fair enough in that instance." In some instances, the volumes aren't that great. Why aren't we just saying, "Let road do the business"? You know, out in the middle - Hay or wherever. Why not just let it go on the road?

MS STACK: I think you're right, commissioner, that as far as we're concerned, Rail Access Corporation, that is a decision for the government. When we took over the network in 1996 and we assessed the actual cost of maintaining the network on a line sector basis, which had not been ever done before, it was quite clear that on market ability to pay, not for a very long foreseeable time would there be the ability of revenues to cover costs and, as a commercial organisation, our decision in that circumstance would have been to close those lines, and we're talking about very significant disparities in costs. I mean where the revenues are covering less than 5 per cent of the costs. I mean not even close. Even if we get the costs down by 50 per cent or 60 per cent, we're still never going to get the revenues up and there are no further markets there to generate further traffic and so the government of New South Wales has given us that CSO contract on a line sector basis so that we can keep those lines open and give some certainty to our customers over the longer period, that if they invest in businesses and terminals and other activities on those lines, that those lines will continue to be supported and be open, even though the revenues don't sustain them.

It's really as simple as that. The government has decided to keep those lines open, just as the government decides to keep roads open that have very little traffic on them, because it's considered that there are economic benefits and social benefits in doing that.

MRS OWENS: Couldn't there be situations where a private operator could come along and say, "Well, I'm happy to run that little line there. I want to actually run it as a vertically integrated. I'm more likely to get the capital to invest in this if I had a vertically integrated business here," and we've actually had people from the capital market tell us that they are more likely to invest in some of these companies if there is infrastructure involved as well, than if there's not. Couldn't these owners potentially be relieving government of some of this responsibility for putting CSOs in?

MS STACK: I think it's quite a plausible hypothetical scenario that you're describing and certainly there are people who came in to buy V/Line freight in Victoria who said exactly that same thing and paid a significant amount of money for V/Line freight, thereby relieving government - at least in the short term - of its requirement to subsidise the losses of the previous V/Line and I agree with you that that is a plausible proposition. However, what I would say is that there's no evidence in this Australian rail market yet that says that that will be successful and that these organisations will be able to succeed and that these organisation will no longer require government subsidy, so all I'm suggesting to you is that, yes, it's plausible. Yes, if I was a banker, I would probably say something like that, but I don't think the economics of rail are very well understood in the New South Wales or the Australian environment and my own personal view is that there may well be some consolidation and failures of some of these smaller privatised types of entities and, ultimately, we'll probably end up with two, or maybe at the most three, larger rail operators in Australia.

MR BONES: But I think the scenario that we'll end up with in New South Wales is potentially two large standard gauge operators, plus niche operators, but they'll all be operating over common trackage. There's this myth of horizontal separation and geographic separation of markets. The markets aren't geographically separable, they're overlapping - certainly in New South Wales, I wouldn't speak for other states - so I can see us having NRC and FreightCorp or their privatised successors as two competing standard gauge operators and the Austracs, Silvan and Tramway of the world servicing the niche markets, not on separate networks, but on the same network, targeting different markets.

PROF SCRAFTON: I think the interesting thing that has come out of this discussion for me - two things, really, one that Helen has already mentioned: it was never intended that these characterisations of systems were to be taken as rigid. In fact, the words we use is that they are not a taxonomy. We actually say that in there, but the other thing that's important that comes out of this discussion for me is the fact that we in the commission need to acknowledge very clearly in our final report where some of these models have worked and where different models have worked in different circumstances. I think that a very important aspect of our report is to say that there is no perfect model. I know that you have argued fairly strongly that you think there is and you certainly would argue that for New South Wales and, equally, the Queenslanders will argue that for their system.

But if we have left the impression in our report that these "networks" - as we call them - that were characterised were meant to be taken as a dogmatic view about how things should be done in certain circumstances, that's not the case. But equally, I think we would argue that we still remain to be convinced that the delivery of benefits are any greater or lesser from different models and that's one of the things that I think is useful, certainly in your presentation today, that you have attempted to link the delivery of benefits to the model that you're using and that is very useful to us and we will look for other people so that in the end we can give a balanced view. I wonder if I could ask just one question in relation to that. Has anybody ever come along to the RAC and said, "You've got these lightly used branch lines" - or you've got disused lines, in fact, as you show on your maps - "We would like to buy those from you." You've actually heard that?

MS STACK: Yes.

PROF SCRAFTON: What is the corporation's reaction to that?

MS STACK: We have a proposition in front of us at the moment - or an outline of a proposition in front of us at the moment, which is for the Tumut line, which is disused, that a company would like to buy it, take a lease on it, whatever, and operate on it, and we're in discussions with them at the moment. We would be extremely happy for them to be in a position to do that. There are legislative requirements in New South Wales which would require them to make that available on reasonable terms to other operators and, obviously, our concern is just a commercial concern that there are no costs to us for which there won't be commercial returns in that procedure, but certainly, as far as I'm aware, there has only been that one.

MR BONES: That's the only substantive proposal, but I might say, too, that it's not that difficult to accommodate those sorts of scenarios within a vertically separated framework, in that it becomes a matter of the contractual structure and essentially what those sort of proponents are after is some certainty that they're going to get their capital returned at the end of the day and so they're after a monopoly. Now, potentially, in an open-access framework, you can address those sorts of concerns through clawback arrangements, so that if another operator does utilise the line and in fact actually steals the end market from the proponent, the proponent can get a return back through the ultimate track owner, which is Rail Access Corporation.

PROF SCRAFTON: I appreciate that. What I was trying to get at there is that, just in the same way that we were not trying to imply any rigidity, which obviously hasn't been read in our report - in a way that's a bit of a worry - equally that is true of your organisation, that although this is your preferred model, it is not rigid to the point that somebody could not come in and negotiate in some way to take a share of ownership.

MS STACK: From our point of view, we've argued very strongly about the vertically separated model because we felt that you hadn't had evidence. I believe it's been the right model in New South Wales at this time. Now, we wouldn't argue that no other models work around the world either. We would argue that it is a perfectly legitimate model that has worked right now for our customers and for the people of New South Wales. Certainly in terms of looking at propositions like Speedrail, for example, where there is potential different ownership of the Greenfields track and contractual and commercial arrangements in respect to our infrastructure, we'll have to come up with quite clever commercial arrangements with these sorts of parties and we're quite capable of doing that, and just as I described the arrangements that we can come to with the ARTC, essentially commercial arrangements, what's important in New South Wales from our perspective and what we're legislatively required to do is not to discriminate against a particular traffic or a particular operator where two traffics are the same and that's really done some very good things in terms of pricing and in terms of contestability of the market.

We might have come over a little bit more Messianic than we really believe, but we would try to counter, I guess, a view that we thought may have been formed in the absence of other evidence and I think, as we have more experience - and let's face it, three years is not a lot of experience - it may well be that we'll find that other models might work.

MRS OWENS: I'd like to tease out a whole lot of other issues and we're going to have to call this to a halt fairly soon and there are a lot of other things we want to talk about, but one of those things is urban, the urban network. We've been concentrating on low-volume regional freight and the urban network. As I understand it, in Sydney, you're talking about, say, 2300 passenger trains going through the urban network per day.

You've got 100 freight trains and something like 22 non-urban passenger trains. Now, as I see it, and I think as my colleagues see it, we've got a bit of a trade-off here between running an efficient urban network which happens to have other trains passing through it, against the problems at the boundary between the other parts of the system, ie the freight trains, the non-urban passengers and the urban network. You're saying that that overlap is an important issue and it dominates over getting an efficient urban network in place which may involve integration.

Other participants have told us that there are so many things in the urban network one has to be able to coordinate, and it's timetables and it's a link between above-track operations and ensuring appropriate infrastructures in place and so on. So there are arguments to have an integrated urban network as I see it. I think with this argument that you've got, there's very few bits of the urban network where you don't have other trains. That's not the issue. It's how important those other functions are. You've got a government in your state, as I understand it, which has given an instruction that passenger trains take priority over freight trains, or is that no longer the case?

MR BONES: Well, passenger services have reasonable priority under the Transport Administration Act. In the access regime, passenger services are guaranteed the paths they had on 1 July 96, and changes beyond that are subject to negotiation, having regard to the reasonable requirements of freight services. So it's not quite as one-sided as sometimes people would have people believe. I'd have to say too that there's this concept that somehow an integrated railway is more efficient by some means. Now, I think that's not a proven argument by any means. Certainly in the Sydney context the degree of interaction between freight services and passenger services is very intense and Sydney itself, or the traverse of Sydney, is very critical for a few particular freight markets.

I mean the main interstate corridor between Melbourne and Brisbane goes through Sydney. Now, that's sort of a linchpin in that service and it's very important to the marketability of those services that that traverse is handled in an equitable and efficient manner. We also have a major coal flow from the western coalfields to Port Kembla. It goes directly across the metropolitan area. Again that traverse of the metropolitan area is very critical to that flow and undue favouritism towards passenger services has the potential to have a major escalation in freight operators' above-rail costs.

MRS OWENS: How do you judge which service is going to have the highest priority at any one time?

MR HICKS: Perhaps I can answer that. The Easter Show example, that we talked about earlier, was one which we did by negotiation between the various operators and we've got a protocol in place with the network controllers for the metropolitan area that allows us to sort services on different corridors by different priorities. That's something which is changed and altered from time to time as we go along. Obviously during the Easter Show there's a different set of priorities. But at those sort of peak times we negotiate a timetable that allows those priorities to proceed, so that all the operators have a fair access to the track.

MS STACK: I think what you've got to do is say, "Well, where are the incentives in different structures for different sorts of outcomes?" If the metropolitan network in Sydney was owned and managed by CityRail, I am pretty confident in saying that the incentive for CityRail would be 99.99 per cent to make sure passenger services were running on time, on time, on time, and that their incentive would be to ensure that those passenger services had absolute priority. Now, under the structure that we have in New South Wales, the incentive actually on us because our customers, representing 50 per cent of our revenue - and in the potential growth market of our business, because the SRA's business - in fact, there's been extreme downward pressure on revenues on us from the SRA - has been to give them better customer service. So the incentive for us is to make sure everybody gets a fair go and to make sure that the freight operators can get through the Sydney metropolitan area.

I don't think that in a vertically integrated model, in a place like Sydney, you're going to have those sorts of incentives by the operator of the passenger services because that access through Sydney itself, just the access through Sydney, will be an infinitesimal part of their overall business.

MRS OWENS: But you don't think any access regime will be able to deal with that situation?

MS STACK: Look, I think in theory anything can be dealt with by regulation. But I mean you've only got to look at the telecommunications industry to see where the incentives and the difficulties have been in getting access, for example, to the retail domestic marketplace by Optus and others to understand how difficult and incumbent it can make it to stop access to competitors and to frustrate access where there is no financial incentive for them.

PROF SCRAFTON: I think this is another case though where it's very important that you present this Sydney evidence to us. Again we would ask you just to bear in mind that in preparing our draft - if you look at the situation in the much smaller markets, which Judi herself alluded to in drawing those comparisons very early on in the presentation, in Perth and in Adelaide and to a lesser extent in Melbourne those urban systems are largely separate.

MR BONES: That's right, yes.

PROF SCRAFTON: So it is important for us to take on board what you tell us today, but equally for you to understand that we were not picking on New South Wales in making generalisations which obviously were not in accord with the facts in the Sydney metropolitan area.

MR HICKS: We reinforce the point about efficiency. I mean in the last three years we've delivered, on all those graphs that we showed, good results for the metropolitan operator, more so than they delivered in the previous period as the vertically integrated owner.

MR BONES: I think it's fair to say that - - -

MR HICKS: The facts are there that under our management, as segregated, it has been a better performance.

PROF SCRAFTON: I think also that comment relates very much to what Judi said about incentives. There is no incentive for that metropolitan operator particularly, given the high level of subsidy that underpins the operation.

MR HICKS: That's right.

PROF SCRAFTON: Given the separation - and in support of your arguments, you begin to separate out some of these financial implications, and organisations that can make progress are able to do so. So I acknowledge what you've said.

MR BONES: I think it's fair to say SRA are a very satisfied customer, very happy with the level of infrastructure performance provided by RAC. There's another question too that the commission has raised: couldn't this be addressed through having an effective access regime in place? Now, I guess possibly singularly in the Australian rail industry I've had the experience of, back in 1993, having the dubious privilege of being the one-man band as the SRA's network access unit. So I've seen both sides of the fence and I might say too that I guess back then I was an integrationist rather than a separationist, if I can use those terms. Having seen both sides of the fence I remain extremely sceptical that you'll ever see effective competition on a vertically integrated railway, no matter how effective the access regime may appear.

It's extremely easy for an integrated railway, through subtle means, to prevent competition, whether it be through the negotiation process itself or through the day-to-day running of the railway. Even if there might be proposals for access, proponents seeking access, the integrated railway only has to kill one or two of those to begin with and effectively the threat of competition is gone.

MRS OWENS: I suppose we've got to be clear about what sort of competition we're talking about in urban markets. I mean there's the competition for time-slots in the timetable. But there is this question of can we expect to see competition for the same types of services? Can we expect to see competition from others? And you've said that you've been approached from others who would like to do this. I don't quite know what it actually means to have, say, competition between Sydney and Chatswood, because you can't have two trains going along the line at the same time. The only thing they can compete on is one will go at 12.15 and one will go at 12.30, which I don't see as very valuable competition.

MS STACK: I agree with that, and I think they are natural franchises really. In a market where the metropolitan network is not being traversed by any other traffic and there's a natural franchise, I would agree that your horizontal model is a good one with or without vertical integration. But certainly in the Sydney market we have a growing requirement, particularly for inter-urban services, where you're looking at the central coast growing very rapidly, the Illawarra region with a large commuter group into the Sydney market and even the Blue Mountains and beyond, where some private operators believe they may be able to do a better job and be a more attractive alternative to the commuters in those particular marketplaces.

Now, we haven't seen that yet. Again, it's one of these plausible hypothetical-type scenarios, but certainly we have had direct approaches in respect to those sorts of propositions and I suppose it comes back to the fact that whilst there are some natural franchise opportunities in metropolitan railways, there are also some competition opportunities in metropolitan railways that may not sort of appear obvious unless you open the door to enable them to have them.

MRS OWENS: I'd say all those examples you've just used, Judi, are all franchising opportunities rather than competition opportunities. I mean the track is a natural monopoly and urban areas are - I think it would be quite difficult. I don't think you ever write off any idea and the commission is not ever going to write off any prospect of competition anywhere. We would always say, "Well, if it's there, fine." I think it's a matter of the balance of probabilities. I think we should probably move on because we've got our other participants.

MR BONES: Yes, how will - - -

MRS OWENS: Well, I'd like to come to the issue that you raised about the benefits that we've seen from vertical separation and you raised, in your talk, a number of benefits including the fact that maintenance costs have come down. There was a whole range of other things, safety and quality of services and so on. But can we attribute what is happening, say, on maintenance costs and the fact that there has been vertical separation, or is it more to do with the fact that we have now a separate maintenance organisation, Rail Services Australia, that's undertaking the maintenance responsibility?

MS STACK: I think our proposition would be that the improvements in efficiency are not necessarily a result of vertical separation, but they have occurred in an environment of vertical separation. There can be obviously benefits in efficiency in a vertically integrated organisation too, depending on the management within those structures. I mean certainly we believe that the contestability that happens in the below-rail maintenance is very important, and that the separation of the maintainer from the owner is a major driving force in driving down cost. But that's not the separation we're looking at between operator and owner.

I guess our point is really that efficiency can happen under a vertically separated model. In New South Wales we believe that it was necessary for that vertical separation to take place, for those efficiencies to occur, because they weren't occurring under the old vertically integrated government-owned monopoly. But we're not suggesting that they couldn't take place under a vertically integrated model. I think probably a more important contribution to the efficient driving of efficiencies, apart from the contestability of maintenance itself, is the corporatisation of the Rail Access Corporation and the corporatisation and general commercialisation of our customer base and of the understanding of the customer interface in a much better way and in a way that drives the business imperatives. I don't mean to be understood to say vertical separation is the only way to drive efficiency, because I don't believe that, but certainly in New South Wales it has been a very effective tool to do that.

MRS OWENS: With most of the indicators you used I could put another scenario: maintenance costs we have already discussed; the other one was input costs and an element of that was electricity costs, for example, which have gone down say 33 per cent. Is that because of greater energy efficiency or is it because of the fact that the price of electricity has been coming down because there is a national market in electricity now?

MS STACK: No, it is obviously the latter. It is because of competition in the energy area but it is also because we have been able to manage that in a better way. There is no question that we have purchased electricity at the cheapest price that it has ever been sold in New South Wales and our supplier is currently losing money on that, which is unfortunate for them, but it is a management issue; it is certainly not a result of the vertical separation of the industry. But there had been an inference in your report that vertically integrated businesses were more efficient that vertically separated businesses, and we are looking to address that issue. We would say that the structure is not necessarily irrelevant but doesn't drive the efficiency.

MRS OWENS: I think we are going to run out of time and I just wanted to ask about the Hunter Valley. You also argued in your presentation that the Hunter Valley access fees and freight charges have come down largely because of the access arrangements and the contestability in that market now. But a very significant thing that has happened over the last couple of years has been this attack on monopoly rents and getting rid of the royalties and so on. Surely that is where the gains have come from, or am I wrong, or is it a bit of both?

MS STACK: I think I did say that the gains have come through monopoly rents essentially being phased out by the New South Wales government over four years and those monopoly rents are being phased out and that is a pass-through benefit. The access charges have come down, both in terms of reduced cost and also in terms of the regulatory decisions, and then freight rates have gone down because FreightCorp, who are here and I am sure will answer this much more eloquently than I, have had to contest for their business and they have had to lower their rates in order to continue to win that business. So there have been three factors but there has been quite a dramatic result from all those factors and all those factors come from competition policy.

MR BONES: I realise we are way over time but there is one, I think, significant point to make and it picks up on Judi's point about efficiency of vertical integration versus vertical separation. There often seems to be a presumption that somehow the command structure that goes with an integrated organisation is somehow more efficient than the contract structures in a separated organisation - on the access side I am talking - particularly when it comes to things like capital investment and then trade-offs between a below-rail investment generating above-rail efficiency savings.

Again, having seen both sides of the fence, I would have to say I think that is a myth. I firmly believe that the rigour that goes with contract structures drives the most efficient outcomes and I can give you a very concrete example of this: we are currently in a position where we're looking to roll out a particular project statewide that was initiated in the days of the integrated railway and justified financially within the integrated framework; the developmental work has been done; the pilot has been done; we're looking to roll it out. I am now in negotiation with FreightCorp, saying it generates an above-rail benefit; we can't justify the project solely on the below-rail benefits; this is what we need to make the thing fly. We had based that on work done previously on the integrated railway, and they're going, "Well, we're not really certain they're real benefits. After all; you know, that was sort of invented by the engineers back in the integrated railway to justify the project."

They are the sorts of things that happen in an integrated structure, in my opinion. That is just one example and I am sure if we went back and had a look at the sorts of investment decisions made in the integrated railway there were those sorts of things happening all over the place. I am firm believer that the rigour of the contract structure drives the most efficient outcomes.

PROF SCRAFTON: I think that comment would apply again in a separate environment such as you have got, or in an integrated environment that was being properly run. I think some of the examples that we gave and which you endorsed in your comments to us, is that you see it mainly in small organisations. Whether or not you can achieve those efficiencies or that mechanism more effectively in a small organisation than a big one is another issue which we could debate at length, but certainly the examples we have used were from small organisations where that command structure, the decision-making structure, particularly insofar as it relates to pricing and investment, is much clearer. But I agree with you, certainly I think one of the things we have tried to demonstrate is a lot of progress has been made in the 90s and that issue of much clearer contractual relations, whether within an organisation or between organisations, has contributed greatly to that. I think we would endorse that.

MRS OWENS: I hope our other participants don't mind being help up a little while but I was just wanting to ask you about auctioning. You seem to have rejected the idea of auctioning or having price signals. You have argued on page 22 that you prefer to provide adequate capacity to meet demand. I am a bit puzzled as to how you think that is in any way going to be efficient in terms of meeting - are you saying that you are going to be setting up a system which is going to be there to meet every peak that occurs? That is not what normally happens in other markets, such as the electricity market, or now, in the case of aviation, where there are quite significant steps being taken to introduce pricing through auctioning and so on in those markets, and slot trading.

MR BONES: But you normally associate auctioning where there is a single or a very finite supply of a particular resource. The reality in the railway is that that is not the case. There are very seldom situations where you can't expand capacity. We're not saying we won't peak price but if your pricing is correct then there is the investment incentive for the track owner to invest to provide additional capacity, rather than just saying, "We're not going to provide additional capacity. We're going to auction and it goes to the highest bidder." I just don't think it is the model that actually suits the realities of the railway industry. There are a finite number of slots you can get out of an airport; it is a finite resource, unless you go and replicate the airport. But a railway is something where there is virtually a continuum that can be provided in capacity. Certainly there are some quantum steps but it is not like an airport where you eventually reach a point of saturation and the decision is, do we put in another 50 per cent through an extra runway or build a whole new airport?

MS STACK: But the reality is, as Terry says, that most of the railway in New South Wales is under-utilised and our objective is to price so that we encourage more utilisation. We also recognise the notion of grandfathering of people that have had particular rail slots and the inequity of necessarily just saying, "Sorry, you've lost your slot. You've made all this investment in a very large capital-intensive business and we're going to auction that slot off to somebody else." I don't think it would be a very equitable and it has not been an issue in respect to there being - as Terry says, the amount of investment to increase capacity is quite incremental - things like crossing loops, and those sorts of things - it's not large amounts of investment.

MRS OWENS: I am afraid I am still puzzled. You say it is not a large amount of investment and I think, in your opening comments, Judi, you used the words "unfettered investment" investing in the rail business. It sounded as if there were no real budget constraints that you were operating under and that you could do really what you liked.

MS STACK: That's right.

MRS OWENS: I can't really understand that in an environment such as we're working in. You're a corporatised entity so it can't be open-ended.

MS STACK: It is. We are unfettered in terms of our investment. I suppose if you take the legal term - if we are going to invest in something that is, I think, more than 10 per cent of our total asset base we need shareholder approval, but ultimately the issue for us is that providing we can find opportunities to make a commercial return, we can invest in our network. What I think I was trying to say before is that the opportunities to invest where there is a commercial return - in other words, where we're going to get a growth of volume or a premium price paid by our customers - are not very many, and that is because of the economics of the railway. It is not because - we have got lots of money in the bank, we have got a very strong balance sheet, we have got the ability to borrow if we have got projects, but the number of projects that are available to us where there are commercial returns are very few. It is not the government saying, "Do this" or, "Don't do that," it is up to our board to decide those things.

MRS OWENS: But you have money in the bank because you have got these CSOs. Isn't that right? You get money from the government.

MS STACK: We get money from the government to maintain the under-utilised part of the network but those CSOs don't cover the full cost of that. We also have to return revenues from those parts of the network.

MRS OWENS: Your access charges then don't reflect the costs of the network?

MS STACK: No. We have developed our access charges essentially to reflect what the market's ability to pay is. Our assessment is - and it is borne out by the market paying it - that in the Hunter the market has a much greater capacity to pay, so in the Hunter they have been paying a rate which, up until the end of this year, reflected our full costs, plus a return on our investment of 14 per cent after tax, and that will be reduced to 6.2 per cent after tax. Most of the rest of the network does not return - we don't get a return.

MRS OWENS: So it has got a zero value?

MS STACK: It has got zero value, yes, in recoverable amounts - - -

MRS OWENS: But in other states, such as Victoria, with the sale of V/Line Freight - it didn't have zero value to the extent that somebody else was prepared to pay $169 million or whatever they paid for it.

MS STACK: Yes, and I think that if you were to sell Rail Access Corporation today it might realise a billion dollars, but unfortunately the accountancy standards don't allow me to record in my books the sort of speculative value that might be there in terms of future efficiencies and savings of costs or future revenues. I am required to record my values in respect to accounting standards and so they're on the books at $300 million - 385 million, I think.

MR BONES: Just on the CSO contract, I might add, too, it is not as though we have got some blank cheque from the government. We have negotiated a commercial contract with the government - a seven-year commercial contract. We deliver CSO reductions each year and then we take both cost and revenue risk on those lines in return for that guaranteed revenue stream. So it's quite groundbreaking in a way. It's a true commercial contract with government and the service we deliver to them is to keep these lines open.

MRS OWENS: Do you think there's a time when you might get privatised?

MS STACK: We are not aware of any plans by the New South Wales government to privatise the Rail Access Corporation.

MRS OWENS: I just wanted to ask you about - can you bear with us another couple of minutes - interstate issues? We jumped over interstate when we were talking about the different networks but I think there may have been a misunderstanding. It would seem to be more in the speech of your chairman than in the submission that we were advocating a single owner and that would be ARTC. We were actually talking about a single manager, network manager, which I don't think was quite the same thing. Your submission actually says that you support integration of management but I think, if I read it correctly, only for the interstate traffic, the interstate trains, or is that not right?

MS STACK: No, we support the concept that somebody should be able to come and buy access to the rail system with the simplest and easiest transactions and generally that means going to one party. If you want to do a journey and you're going to cross several jurisdictions you would go to one party to purchase that access and that party would become accountable to you for delivering that train pass and that level of reliability, or whatever it is you decide to purchase. Certainly within New South Wales we are the one party that a whole range of different organisations can come to and purchase that access. We believe we will have an agreement with the ARTC where people can go to the ARTC and won't have to deal with us at all, they can purchase that access from the ARTC. The ARTC will have an arrangement with us whereby we will supply that essentially as a wholesaler to them and that, to us, seems like a very workable outcome.

What we wouldn't support would be that the management of the track, or the ownership of the track, would mean that those parties who are working to have intrastate or inter-urban or other traffics that are having to cross both our track and that track that may be managed by another party, are going to have a whole series of jurisdictions to cross so that they are in fact going to have to have a number of different access agreements. As I think I said before, 76 per cent of the traffic in New South Wales in GTK terms actually has an origin and termination in New South Wales. From our point of view, from a revenue point of view, that's 95 per cent of our revenue. So it doesn't make sense to us for a minority of the traffic and a minority of the revenues to hand the track over to someone that is going to inconvenience the rest of that traffic.

MRS OWENS: We suggested in our report that there would be single management of the track, the interstate system.

MS STACK: What does that mean?

MRS OWENS: That meant somehow you need to be able to determine what trains are going on the track at what time, and there's going to be interstate trains crossing borders and there's going to be trains that are going within borders, intrastate trains. Somehow somebody has got to manage that process. I don't know how on earth they do it now. I have no idea how you all organise it; you can tell me in a minute. We were putting the proposal that the operators getting onto the track at particular times should be paying and what they pay should be determined by how much they value that access. And you need some coordinated way of ensuring that whoever is on the track at that time is the operator that values that particular time slot most. So how do you actually determine that? If you're there in New South Wales still ensuring that your intrastate network is operating efficiently, and you've got the ARTC there ensuring that the interstate system is working efficiently, we've got a problem.

MS STACK: Can I just say I think we've got to analyse what the problem is first because there has been a lot of discussion about single ownership of the interstate track. In fact, it has been trotted out by every single committee.

MRS OWENS: No, we're not talking about ownership, we're talking about management.

MS STACK: No, ownership or management - whatever.

MRS OWENS: No, they're different. They are totally different.

MS STACK: I don't think you actually describe what management of the track actually is.

MRS OWENS: Well, we will.

MS STACK: Because I think you need to understand that management of the track and ownership of the track aren't necessarily the same. Certainly in terms of the management of traffics and the sort of incentives - this concept is a sort of solution looking for a problem, to my mind. I have not heard any of our customers say to us that they have problem with getting access between Melbourne and Sydney, or Sydney and Brisbane, or Sydney and Perth, on our track. There are sometimes capacity issues; there are sometimes people that would like one slot instead of another slot or slots that somebody else already has. There are people that don't necessarily like the price, although there's no real differentiation of price between ourselves and ARTC.

What we're hearing in this sort of management of the track or ownership of the track is a response to a problem that's about six or seven years old and which has already been solved, and I don't believe there is a problem with interstate access in terms of access. There are some problems still in terms of safety, harmonisation, communications and those sorts of issues, but in terms of access I haven't seen any indication of any real problem. We have got a sort of solution in search of a problem, it seems to me.

MRS OWENS: I think we will ask other participants about that. We probably ought to keep moving. I think we've probably held you long enough. It is now 20 to 5 so I will break now. Thank you for coming and for all the work you put into this. We will have a break for five minutes and then we will resume.

MRS OWENS: The next participant today is FreightCorp, and I would like to welcome you both very much. Thank you for coming and sorry for the delay, and hopefully we can make up a bit of lost time. We haven't got a submission from you but I understand that you do have a short presentation to give us. Before we get started could you both give your names and positions with the organisation for the transcript.

MR DI BARTOLOMEO: Thank you. Lucio Di Bartolomeo, I'm managing director of FreightCorp.

MR PEDERSEN: Gary Pedersen, general manager, strategy and corporate affairs with FreightCorp.

MRS OWENS: Thank you. I think we'll just go straight into the presentation and we'll try not to interrupt you. We'll ask you questions at the end.

MR DI BARTOLOMEO: That's fine. What I have here is only a very short presentation. It focuses on just some thoughts, preliminary ones at that, in terms of our views of the draft report that we thought we might feed back, and I'd very much appreciate just following this being able to take questions and maybe address issues that you have interest in.

I guess as a quick overview on the draft report as we see it today is that we welcome the thrust of the commission's recommendations. The recommendations address a number of key issues that FreightCorp believe are necessary in terms of further reform in this industry. We have no doubt that the rail industry is in the midst of its most significant reform maybe ever. That reform isn't complete and I think reviews like this can in fact continue to provide appropriate feedback from the various players to ensure we get the optimum model.

Two key issues that we see are critical are the access arrangements, particularly outside New South Wales, and the competitive neutrality issue with road; and I guess the latter one in particular we see as ultimately maybe the most challenging one for the rail industry in terms of identifying its long term role in Australia's land transport requirements.

FreightCorp supports the Productivity Commission's work on comparisons that it has developed, both comparative analysis vis-a-vis the US operations and the comparisons within the Australian environment. However, we do consider the conclusion on systems performance comparisons to still be premature, and I think you make more than sufficient notation during the course of the report, but we'd love the opportunity to be able to discuss many of the issues that we see with you, if you would be so interested.

If I could just go back to some of the key issues: access, again, as I say, we support the general thrust of the recommendations. We do see some issues in terms of the practicality of some of the mechanisms that need and can be put in place to achieve truly efficient path allocation and I think this is an area that a lot more work needs to be done in terms of being to translate kind of a theory of a competitive analysis to a practical environment that actually works in the real operating world.

The issue, however, that I believe is, long term at least, more critical to the future of this rail industry, is the competitive neutrality or what we see as the lack of competitive neutrality that exists between road and rail. Significant dimensions of this competitive neutrality are to do with the fuel excise situation. I mean, the reality is we don't know. There's great debate about whether the 18 cents currently extracted out of the diesel fuel excise is in fact a road hypothecation, sort of semi access charge, or in fact whether it's just a straight tax. I think the official line, it's a straight tax. It doesn't matter which it is because if it is the case, then that's fine, we're all paying our taxes quite separate to our use of various infrastructure, but what we do have is then the case for road as to what road pays to get access to its infrastructure as opposed to what rail pays to - there's an even greater gap that develops.

The other issue, of course, quite separate to what we pay to get access to our various infrastructure, the various land modes of transport, is the notion of what's being invested in this infrastructure and how are those investment decisions being made or have they been made historically and are being made and will be made in the future. It's very difficult. There was discussion earlier about Sydney-Melbourne corridors, etcetera, but at the end of the day you can focus a lot about who should have a particular path between Sydney and Melbourne and what will they be willing to pay, but it's all about vis-a-vis another rail operator, when the real question is how can any rail operator afford to pay for any path when their true competition is with road and what are they paying, what are the relative merits of their various access payments. So they're really quite significant issues.

Then if that was overcome, somehow that was overcome, and there could be some link made between what operators pay to get access to infrastructure, some equality between road and rail, and then have investment decisions that are made on similar criteria, clearly rail today lags considerably behind road. We have entered the Sydney-Melbourne market in very market niche market only. Our opportunities for growing that business today is very limited, because the reality is - and mind you, the only reason we've entered it is that we've been able to take some business off one rail operator and shifted it to us. It may have done FreightCorp's cause some good; it hasn't really done the rail industry cause much good at all, to be honest.

The issue is that while ever we have an access to a path that gets us between Sydney and Melbourne in something like 14 or 15 hours at best, or 17 and 18 hours more realistically on a general freight train, and we are attempting to compete with the road operator who's doing it in 10 hours, and if he's cheating, maybe 9 hours - and they're paying less for that, for the privilege of being able to get that better transit - then clearly the rail industry is going to have an issue. It really will never move much beyond where it is now if in fact it can retain what it has now.

Just some other issues - accreditation, I guess we feel a little for what NRC has been going through over the last three years in attempting to get accreditation - well, maybe more than three years - across a myriad of different systems. We've only just entered the market and getting accreditation in four states, never mind the access charging arrangements across four different states, is time consuming, it's costly, slow, and ultimately is a restriction on true effective competitive and effective operation, efficient operation.

So we see the opportunity to implement a single annual fee for accreditation and at least an acceptance by the other entities that if you are accredited in one system that should apply automatically to the others. I see that as no different to a road operator registering a truck in one state and being free to run across all states. As we say, the accreditation shouldn't be state based at all; it really should be nationally based.

On the productivity analysis we find the work that the commission has been doing on the new performance evaluation system interesting, albeit in its detail, and I guess we're only just starting to understand it. In its detail we do see shortcomings and improvements that can be made, and I guess to the extent that some conclusions have been drawn, albeit I think there's been qualifications on them, we certainly see them as not necessarily supporting, for instance, the analysis to date that says Australian Rail is substantially less effective than its US counterpart. I think it's a little simplistic to draw those analyses and I think more work could be done. Scale of economy obviously is a significant proportion of those differentiations that we see when looking at raw numbers. But, as I say, we accept that the commission has noted these limitations and is working on improving them. We'd be happy to participate in that if you so desire.

The modelling of rail operators I guess in Australia, as opposed to the US or overseas comparisons, does provide, from my perspective at least, probably the greatest concern with this report. It looks at what's been happening in rail since 91 and it goes all the way to 96, and as worthwhile as that is unfortunately we're in 99 and people will read this report - some in great detail, others very superficially - and whatever conclusions the report makes, whether it be the draft ones or any subsequent or updated ones, will read these conclusions and put them within the context of today's environment, and the reality is - as I say, as far as New South Wales is concerned, and the reality is this applies to every other state - the changes have been dramatic since the mid - effectively the end of your time-scale for reviewing this, or near enough to it, and I think it's going to be a problem with the report and I'm not sure how you overcome it. I'm not trying to be critical, I think I'm just giving a view as to its potential limitations or the skewing of how people will read this about what's happening today as opposed to what in fact happened between 91 and 96 relative to those performance indicators.

We actually think by the definition of the time-scale you looked at, you're looking very much at stated-based systems and they are forever - you know, they're declining in their role in the Australian rail industry, so the notion of an NRC/AN or an SRA has very little relevance to the industry we see today. I guess one opportunity to improve this would in fact be to include 97-98 data; it's been available for some time - now, I don't know how within your own time-frame, what this would mean to do that - and furthermore to look at whether in fact instead of looking at them as state-based systems, whether the above-rail operations and the new operations can be brought into account far more than it is to date.

As I say, I think there are opportunities for improvement. Whether this particular Productivity Commission report is going to be the one or it's going to be the next one - I recall having a similar discussion with your predecessors back in - I'm trying to think of the - - -

MR PEDERSEN: 91.

MR DI BARTOLOMEO: Yes. Anyway, there was a certain frustration. You always like to think that your performance is evaluated against your latest performance or the one you've had the greatest impact - when in actual fact it's always two or three years back. Any report of this nature will always suffer if in fact it's looking at an industry that's in the midst of significant change, because almost by definition it's going to be out of date before it's able to come out.

The next one - I think I've got one more - the other one was on competitive neutrality, and I think I've actually covered that. Look, I think that covers just the highlights of just some issues that we raise. It's not a comprehensive review of your draft report but maybe gives some clues as to where we think some critical issues need to be addressed.

MRS OWENS: Thanks very much, Mr Di Bartolomeo. I think you've actually made some pretty valid comments and I think we both totally agree with you about our performance measurements. We are going to try as much as we can to update and expand the analysis for the final report. I wasn't aware there was 97-98 data. The team probably is, but I'll just make sure that they're chasing that up. I think that is a major weakness. What we're doing has been sort of a historical sort of - running over where things were a few years ago, which provides useful baseline data.

MR DI BARTOLOMEO: It does.

MRS OWENS: It was a problem when we got started. People said we really shouldn't be doing an inquiry at this stage anyway because reform is still going on; it would be better to do it when things had settled down. There's no right time, because you really don't want anything to ever settle down, you want it to keep moving.

MR DI BARTOLOMEO: That's correct.

MRS OWENS: So I think the best we can say is that hopefully in another few years' time somebody - it might be us or it might be somebody else - will again get the measurements that are available at that time, which will again be two years out of date, no doubt, and upgrade the work. Eventually you do start to get a picture. You're still often not in a position then to say, "This is what we think is happening with performance and it is because this and this and this happened." I mean, there is always this problem of attribution which I was raising with Judi when we were talking to her.

MR DI BARTOLOMEO: Yes.

MRS OWENS: You can make all these claims and say, "This has improved and that has improved and isn't this great?" But then to bring it back and say, "That is because we've had vertical separation, we set up an RAC and so on," that is very difficult.

MR DI BARTOLOMEO: Yes.

MRS OWENS: That's not to say it's impossible - you can use some judgment - but we are aware of some of the problems you have raised. We are going to expand the international comparisons to include a number of other countries but we couldn't do that for the draft because we didn't have the data. Some of it came in late and we got the New Zealand data, I think, just before the draft report was finalised, and we got some European data.

MR DI BARTOLOMEO: I think the American data is fine. I think, however, we should focus less on the class 1s and more on the class 3s or the regionals and short lines, which are more comparative in scale and size and operation to Australia.

MRS OWENS: I think we are going to be looking at some of the individual railways in the States as well, aren't we?

PROF SCRAFTON: That's right. My understanding is that the researchers doing that work are going to try to access some particular companies at class 2s and the regionals. The problem was that whereas the class 1 data, because it's such a small number of carriers, is easier to get. The organisation responsible for the class 2s covers a large number - hundreds of railroads - and to get some of that disaggregated was proving difficult, but they're going to try to do that. Your comments will be well received.

MR DI BARTOLOMEO: On that score, we'd be happy to share whatever information we've got. We do have a considerable sum of - - -

PROF SCRAFTON: There are people you would compare yourself - - -

MR DI BARTOLOMEO: Performance on class 3s and class 2s, yes.

PROF SCRAFTON: Thanks for that.

MR DI BARTOLOMEO: As well as class 1.

PROF SCRAFTON: That's great.

MR DI BARTOLOMEO: If that's of value we'd be happy to do that.

MRS OWENS: We would be very grateful if you could do that. You raised another couple of issues: one was the importance of - you said you supported the approach we had on access but you were concerned about the practicalities and introducing such things as auctioning systems. I suppose we're floating the idea. We're saying, "Here is an interesting idea."

MR DI BARTOLOMEO: Yes, and I couldn't presume to say that it wouldn't work, because I don't think we know enough about it. It's early days for all of us and I could easily see difficulties with it, but that's not to say that we shouldn't keep those sorts of things on the agenda. I think there are more fundamental issues, though, I must admit about access, simple issues as to the notion of - let's take the interstate corridors, with some of the discussion that was taking place earlier. Certainly we'd like to be able to negotiate access arrangements for interstate movements with one body only. That would be a good start.

Having made that statement, though, likewise I wouldn't like to, as an intrastate and predominantly an intrastate operator today, have to deal with let's say RAC for an intrastate movement and then maybe go to ARTC because part of that intrastate movement goes over the interstate lines.

MRS OWENS: It's a dilemma, isn't it?

MR DI BARTOLOMEO: Yes. My view is yes, I would like to deal with one track - not owner - manager, let's say, for interstate trains without having to deal with someone in Victoria and someone in New South Wales and someone in Queensland because I've got to go over three. I'm sure NRC would totally agree with that. But conversely, I wouldn't like it to the point that ARTC has such management control over the interstate track that when I want to run a train from Temora in the south-west to Port Kembla and I cross and do a considerable part of my journey on that Sydney-Melbourne corridor that I have to somehow negotiate with RAC and ARTC, as an example if ARTC were given the interstate.

MRS OWENS: What happens now in that situation?

MR DI BARTOLOMEO: Right now we only deal with RAC in New South Wales full stop.

MRS OWENS: Yes.

MR DI BARTOLOMEO: ARTC has not been given the notional one-stop shop. It was meant to go down that path and in fact at one stage we actually negotiated a Sydney-Melbourne path in total with ARTC and we started running a train and we were about to - - -

MR PEDERSEN: We were about to pay for it.

MR DI BARTOLOMEO: Pay an invoice.

MR PEDERSEN: And we found we couldn't.

MRS OWENS: Yes.

MR DI BARTOLOMEO: Then we got word, "Hold on", they haven't got anything formally with RAC. I said, "All right, stop payments. I'm not going to be in a position where I might be chased by two different bodies for the same charge." Yes, it hasn't moved very far there.

MR PEDERSEN: I guess the challenge of all of that is to make ease of access on the interstate easy, while not denigrating the service we currently get. You know, always remember that the great bulk of rail in Australia is intrastate, not interstate.

MR DI BARTOLOMEO: In terms of tonnage and trains, yes.

MRS OWENS: I am sure you've heard David Marchant arguing the case for stronger pricing signals and he has talked about auctioning and so on. I mean, this is not a totally unique idea that we're running with. It has been around and I suppose - he is sitting over there and he has got one set of - - -

MR DI BARTOLOMEO: There is no doubt that there are some parts on the interstate corridor that have intrinsically more value than other parts. They relate to the ones that, for instance, get you into the Sydney metropolitan area just prior to the peak. So if you can get that one just before the peak you can run that train in I think about 13 hours or so. If you, however, miss the peak, then you add two or three hours to that transit time, even though you might only be 20 minutes behind. You might have left Melbourne only 20 minutes, half an hour later, but you get in three hours later. There is a clear example where the earlier path, which gets you before the peak and therefore gets you considerable advantage over the train that might have left only half an hour later but gets you in three or four hours later, must have a greater value than the latter one. At this stage, that sort of value isn't really assigned.

MRS OWENS: I suppose there is the issue of assigning values to getting access into the urban network as well, say within Sydney.

MR DI BARTOLOMEO: There are lots of different attributes that you could assign to a path. It's the time of the day, the transit time that it's able to give you in that instance. In other words, if you can get in at a particular time of the day then it gives you a different transit time than if you've got a path at a different time of the day when the curfews by definition make the transit times longer. Then there are other attributes: the speed that you want to run the train at, the axle loads that you would like to run the train at, right down to the quality of the rolling stock you want to run over your track.

I've used the example in the Hunter Valley when a potential competitor was seeking to acquire rolling stock - in fact, it was one of our customers seeking to acquire rolling stock - to make it easier for a competitor to enter the market. That's fine. In fact they did, they acquired the rolling stock, and we then became aware that they actually were paying less for their rolling stock than we were. It was basically the same design, same contractor and we wondered why. Under investigation we found that they were buying a cheaper bogie. By cheaper bogie I mean a bogie that is not as - let's use the simple term - track friendly as the bogies that we had acquired and made a decision on, by the way, only one or two years before the vertical separations.

We were acquiring these same wagons at the same time with a different bogie underneath. We made that decision as Freight Rail, a vertically integrated operation, taking account of all costs. Higher capital cost in the case of buying the rolling stock, but a lower track - or both track maintenance and wheel maintenance, wheel life improvement. This new operator came along and basically asked the question, "Is there any difference in track access costs? No. Well, I'll buy the simplest and cheapest," and they did. We raised this with RAC and they said they acknowledged, "Yes, it should be," and it's three years later and we are negotiating still on what their differentials should be.

I raised the question earlier, we don't know the difficulty of managing this, and I'm saying, well, it becomes a lot more difficult. Right now acquisitions are still being made on effectively cheaper bogies that give us, on the surface, a lower operating cost and so therefore rightly being pursued, but we don't believe a lower net cost to the system.

MR PEDERSEN: The difficulty is then how you implement that within a regime which is based on a capacity to pay argument, not a cost causation. So there is a sort of fundamental difference.

MRS OWENS: Yes, there is a dilemma there.

MR PEDERSEN: Yes. It's not easy to come up with the right answer but it sends some different signals to different operators.

MRS OWENS: Yes. That's a very interesting example for us. The other issue you raised was in relation to competitive neutrality and I think you've just summarised the fuel excise debate in pretty well the same way as we have. I mean, it's horses for courses so long as it's consistent.

MR DI BARTOLOMEO: As long as it's consistent. This whole debate of comparative neutrality can be very complex. For instance, you obviously were able to identify with RAC that in fact the cost of the rail infrastructure is not paid for in total by users. In the Hunter Valley it is paid by users but outside the Hunter Valley it's not. So there is a CSO. We're not pretending that the access charges fully cover the

cost of the infrastructure that's provided. But what we're saying is, that notwithstanding, we don't see our competitor doing the same either, and in fact, we'd suggest they're far from recovering their costs or even their contribution to that infrastructure. At the same time they are being provided with far superior infrastructure that allows them operating advantages which further makes it - so not only do we pay our access charger higher, our above-rail operating costs are higher by the very nature of the fact that transit times are slower, gradients are steeper, curves are greater, so that we're not competing on a similar corridor between Sydney and Melbourne. They're almost chalk and cheese.

MRS OWENS: I suppose there's another competitive neutrality issue which Derek might want to get into, and that is the issue that was raised with us and I think with everybody else in Australia by ASR about the Leigh Creek contract.

MR DI BARTOLOMEO: Good question.

MRS OWENS: I think they went quite public on that and felt that there was, for whatever reasons, some unfair competition. You might not want to go into the details.

MR DI BARTOLOMEO: I would love to go into the detail and, in fact, I'd take the opportunity to be able to answer that question before you here. Yes, there was a clear implication - which, mind you, Chuck Chabot denied when confronted face to face - that somehow our price was able to be manipulated through the fact that we received a CSO in New South Wales. I have to say categorically, without limitations, that our CSO in no way influenced the price we were able to put on the table in South Australia for the Leigh Creek business.

The reality is we were able to put together a lower operating cost operation through the use of better equipment and issues such as driver only, and basically operating changes that when we spoke to them - why they hadn't done it - they said they'd had problems making some of the changes with the customer. Maybe they did, I don't know and I don't really care. The reality is we did negotiate with the customer changes to operations. We negotiated with the unions changes to things like driver only, and we were able to put in place a lower cost structure and was reflected in our price which was better than the cost and price structure that ASR could reflect. CSOs in New South Wales had absolutely no bearing on the costs and prices we were able to put in in South Australia, and we are extracting a full return on the assets that we have deployed over there.

MRS OWENS: You say you had better equipment. Did that mean you had excess capacity in terms of equipment?

MR DI BARTOLOMEO: We've had capacity in New South Wales that has kind of stepped up with the growth. New South Wales has been asked for many years to ensure that it kept up wagon acquisition and loco acquisition capital in line with the growth in the Hunter Valley. What we have been able to do, particularly in the last three years, is improve the utilisation of our resources so that, in fact, we obtained a significant capacity gain through the improved utilisation of both locos and wagons. That's what gave us the opportunity to, in fact, be able to extract wagons out of our business here in New South Wales and move it across to South Australia. So in short, yes, it was capacity that we had.

MRS OWENS: But that was because of efficiency gains particularly in the New South Wales market.

MR DI BARTOLOMEO: Yes, capacity we created by better utilisation of the resources we had.

MR PEDERSEN: As Lucio said, if you look at every aspect of that operation, what we have put in place now is a step change improvement over what ASR had. We have got more powerful locomotives, we have got bigger capacity wagons. We are running a longer train than they ran, we're doing it with single man crewing when they had two men on the ground. It's a significantly lower cost operation that we've put in place.

MR DI BARTOLOMEO: And we were able to negotiate their input into both the loading and unloading of the train, both at the mine at the Port Augusta end - that wasn't the norm prior - and that extracted further savings.

MRS OWENS: So have you got plans to get into more of these markets in other states?

MR DI BARTOLOMEO: We have plans to be a national operator in Australia. We will look at opportunities wherever we believe they exist. Our criteria, however, is that we will not deploy assets into any business that we can't get an appropriate return. The commercial imperatives do apply. There was another article, only I think last week, from the same gentleman, who somehow reflected that there wasn't a commercial imperative by state-owned corporations. I'm not quite sure - he obviously hasn't come to any of our board meetings or sat down with our shareholder meetings on setting a statement of corporate intent and signing off plans.

Clearly, if we are going to pursue growth - and we are - it will be on a full commercial basis. So our operation into Melbourne and our operation into Brisbane - we have entered those again with capacity - what we have at the moment is surplus capacity. I've got to say in terms of those interstate operations, the long-term replacement of capital is not only a problem for us but for every single operator in Australia today, particularly in the general freight market. It's no use saying, "Well, you've gone in on the Sydney-Melbourne on something of a marginal pricing and costing arrangements", because the reality is that is exactly what TNT and now Tolls do. It's exactly what SCT has done, it's exactly what any operator that has emerged into the market has made use of - generally older and previously available assets and utilising them, and utilising them efficiently.

PROF SCRAFTON: We appreciate those comments because that is the context in which the issue is always raised. It is by newly-privatised or new private operators entering Australia, arguing that government-owned entities are capable of somehow underwriting their operations, or that when the chips are down there's always the government you can fall back on. I appreciate the reply that you have given, it is very useful to us.

MR DI BARTOLOMEO: In our three years - we do receive a CSO for some intrastate services - suffice to say, though, that there's a net cash flow to government than to us. What the government has attempted to do - and I think they should be applauded for it - is in fact to try and make the operation as transparent as possible; ie let's identify those services that are non-commercial, let's identify the true cost of providing those services and the assets used in providing those services, and let the operator - ie us - operate with those CSOs on a full commercial basis. If we then make profits and dividends, let's return them, but separate the non-commercial activities the government wishes to pursue, quite separate from the fact that it also happens to be a shareholder in a business that is providing these services.

So I think for the first time it's attempting to put transparency in place where historically railways have not had that transparency. Railways have, for many years, received much criticism for their non-performance and general inefficiencies, and the reality is there was a lot of truth in all that, but there was also a lot of hiding of numbers between carrying out non-commercial activities as well as being non-commercial in the way it behaved and conducted its business, and the inefficiency of how it operated its business.

MR PEDERSEN: If I can just add there, similar to the rail access answer: like RAC we also have a CSO contract with the Department of Transport which clearly sets out the remuneration, it's negotiated annually, and also sets out the specific traffics to which it applies within intrastate New South Wales. So it's not hidden in any way, it's spelt out in a contract with the government.

MRS OWENS: When we put out our draft report, one of the newspaper articles that came out not long after was an article by Alan Mitchell in the Financial Review. His response to our report was to say, "Well, the obvious outcome of this would be to privatise FreightCorp." We've already seen Westrail will be privatised, National Rail will be privatised. It has already happened to V/Line Freight, it has happened in Tasmania, so that leaves you and Queensland Rail in a slightly different position in these markets. Have you got a response to that particular challenge?

MR DI BARTOLOMEO: I think there are two dimensions to this issue. The first is whether, in fact, a current shareholder of us, and a similar shareholder for Queensland should in fact hold on to these assets or not, and that is clearly a decision for government - you know, the shareholder to make, whoever they may be. I think what is more critical is the opportunity of FreightCorp here in New South Wales - and QR for that matter in Queensland - to be able to conduct their business on a full commercial basis without artificial restraints in being able to carry out its activities.

The history over the last three years in New South Wales is that I can't recall a significant action of the New South Wales government that has prevented us from carrying out our task as a corporatised entity - the same as being privately owned. In fact the biggest negative impact of being New South Wales government owned has been the differential treatment applied to FreightCorp by the federal government in the case of AN, the Victorian government in the case of the sale of V/Line, the Western Australian government, at least in terms of its statements to date in the case of its sale of its Westrail business, and potentially - and I'm not quite sure what the latest status is in terms of their National Rail Corporation sale - as to comments being made both by the Victorian government and the federal government about the capacity or the willingness of the sellers to sell to someone who has parentage of dubious character.

That has really been our most severe impact on otherwise behaving commercially. We were interested both in AN and V/Line and, in both instances, simply were ruled out for that and no other reason.

MRS OWENS: And it could happen again, do you think with NR?

MR DI BARTOLOMEO: Certainly in terms of Western Australia the government press release that was put out is saying just that, even in the form of a joint venture with a private sector company. I don't think there is an official position in terms of the Victorian and federal government in respect of NRC, although certainly what we hear and see in the press would seem to indicate that they have concerns about that sale. I know we have full support from the New South Wales government. As I said to you, we have developed a national strategy for FreightCorp. We have certain views about what we believe the long-term rail industry in Australia will look like, particularly in terms of above-rail operations.

We are seeing a proliferation of new operators entering the market. Realistically that will not remain so longer term, there will be consolidation. We can all speculate whether that means we'll only see one or two three large operators, but whatever the case is it won't be many and we need to protect our franchise, and we believe we've got to be one of those few large national rail operators. That's what we have been positioning FreightCorp to be and are being supported by our shareholders on that strategy.

MRS OWENS: Good. One of the other things I was going to ask you about was this issue of vertical separation and vertical integration. I understand as part of your contract to carry the Leigh Creek coal that you are acting in a vertically integrated manner. Is that right?

MR DI BARTOLOMEO: No.

MRS OWENS: Do you have control of the track?

MR DI BARTOLOMEO: No.

MRS OWENS: So that's wrong.

MR DI BARTOLOMEO: We are an above-rail operator. Flinders Power, our customer, not only mine the coal and use it at the other end to generate electricity as a power utility, but they also own the line in between. They have contracted us to provide an above-rail operation and train control functions. They have contracted separately with ABB for the maintenance of the track. In an interesting scenario we found that us putting in place train control functions in New South Wales for that line was going to be more expensive than subcontracting ARTC, and we have subcontracted ARTC to provide train control function on that line on our behalf. But that is part of an overall service we provide to our customer Flinders Power. But in essence we operate on that line as an above-rail operator only.

MRS OWENS: And that is the way you prefer to stay?

MR DI BARTOLOMEO: No, I never said that.

MR PEDERSEN: The point to make about that line is that it is a single-purpose line. We are the only operator, we are the only trains on there.

MR DI BARTOLOMEO: Fairly simple.

MRS OWENS: It's a bit like Hamersley, it's just na part of the production process.

MR PEDERSEN: Yes.

MR DI BARTOLOMEO: Correct. The whole question of vertical integration as opposed to vertical separation - let me, if I may, give you my views on the benefits that we've seen flowing out of what has occurred in New South Wales. The vertical separation in New South Wales has allowed competition above rail. It has two things actually: it has allowed competition above rail and, quite separate to the separation, but the fact that RSA - there was a position taken by the New South Wales government that maintenance services would be provided albeit progressively on a contestable basis, and that's really the issue. That contestability and that competition no doubt is the catalyst for the reform that we've seen, whether it be the reform in FreightCorp in reducing cost, and the reform in RSA in reducing their cost as they've faced up to contestability.

You can't argue against the notion of competition doing exactly what it is meant to do. It does provide the catalyst for reform which in turn reduces cost, which in turn reduces prices - it sometimes reduces prices even if costs don't reduce - where competition occurs. They're all the positives that are coming out. Certainly things like monopoly rents are something of a separate issue in the Hunter Valley, but again the government stepped in and basically said monopoly rents will be phased out and there is a regime in place that will limit returns for Rail Access Corporation.

We certainly don't have a monopoly anywhere. There are some sectors that rail has more of a natural monopoly than road over some parts of the market, but where rail has a natural monopoly, clearly those are the areas where we have seen the greatest competition from other rail operators, or the potential, the threat of competition there. That is what has driven prices and the reform we see. However, there have been other things that have driven reform, and our corporatisation and the transparency that has been put in place in how we are to operate and what our objectives are be made clear, has also been a means of bringing about change and reform and efficiencies.

The question that I think, however, no-one can be totally definitive on - let me go to another part. Is the contractual arrangement with RAC providing access via a contract more efficient than an operator having control of those services? The Americans quite clearly will say that there is no way that you can contract to the same level of flexibility, timeliness and responsiveness that you can manage internally. What we have to differentiate in terms of what RAC was saying is they were comparing improvements today, improvements that have been brought about through other dimensions, with a scenario in the past which was clouded by all sorts of other government interventions of a non-commercial nature. The Americans quite clearly state that there are - and I believe it to be the case, although I would have trouble putting some number to it - benefits in being able to manage the rail wheel interface in a more responsive manner than through contracts.

Now, do those disbenefits outweigh the benefits of competition that it might be argued could be attained, is more the moot point. In an ideal world what you'd like to do is get the benefits of competition on the one hand and get the benefits of vertical integration and better management of that rail wheel interface. Is there a system that does it? In America it, by and large, occurs. It's not perfect either, but the fact that in America franchises are limited by geography, the need for mutual access between rail operators says that - there's a system whereby you can't behave totally irrationally against another operator who might be looking at tracking rights over your track because there's a reciprocal arrangement and it will be in no-one's interest in the long term to behave that way. Whether you could replicate that in Australia, I'm not sure, because we are talking about very different size and scale of markets, and that I think influences that possibility.

MRS OWENS: You said that you wonder whether you can get a better rail wheel interface than the New South Wales system, and I was wondering whether you have encountered any problems in that regard, if you're an above-track operator.

MR DI BARTOLOMEO: The example I gave you before, I think, is a perfect one. The issue of the train radio project: that's very complex and I don't want to go into the details and I don't think I could explain it adequately here. But, again, attempting to come to conclusions on investments that have benefits to both the track owner and the operator is a difficult one, and we've had this instance where basically the Rail Access Corporation looks at investment on the track and if there's a benefit of that investment to the rail operator they seek only to proceed with that investment where in fact they can get the operator to contribute their portion, which would offset.

There's no doubt that that's a legitimate way - I'm not disputing it - but there are other ways, and one of them could be that that could be reflected in the access charge. In other words, "If we go ahead with this, will you pay more?" and that's all about this differential pricing that we don't see a lot of at the moment - "Will this path be of greater value if we in fact undertake this investment and allow you benefits on the operating side?" I know NRC have in fact been willing to go down a path where they've contributed to capital investments, and then if other people use that infrastructure then there's some payback mechanism to NRC. I think there's a complexity that we're building there that really limits potential investments, rather than enhances potential investments for improvement.

MRS OWENS: With that NRC example, are you talking about those crossing loops that they're going - - -

MR DI BARTOLOMEO: The crossing loops. There's a triangle out at Parkes which they've paid for, and clearly, if the triangle is there, we see some benefit and we'll have to look and see what benefit it is to us and what we might like to pay further. All I'm saying is, there's a complexity; not impossible, it all can be overcome. But there's a complexity, I believe, that nevertheless hinders progress towards the most efficient system and, while you can make comparisons against the SRA-evolved and whether they make good or bad decisions, I think it's a poor comparison because you're not comparing just that dimension. You're comparing all sorts of other dimensions of SRA and how it behaved that are inappropriate.

MRS OWENS: I tend to agree with you, and I think that was one of our concerns about the way the RAC had presented some of the benefits of what's been happening. I felt that it was painting a particular picture without recognising all the other things that were happening.

MR DI BARTOLOMEO: Just on that, if we can take the Hunter Valley and the so-called benefits - and clearly our above-rail charges have reduced and that's clearly one benefit that the customers have seen, and the below-rail charges has various components, but the monopoly rent has been legislated to be removed and that's occurring, so obviously they're paying less, and we are seeing that the access charge exclusive of the monopoly rent also has reduced in the Hunter Valley. But our argument would be, it's only reduced because of the volume increases that have occurred, and in fact in the first year the starting point for negotiation - sorry, after the first year; for the second year, the starting point for access charges for the Hunter Valley after you remove the access was last year's access charge plus CPI.

Through some very difficult negotiations (a) we were able to take off the CPI and (b) able to say, "Look, not just us, but the whole industry is looking at growth of some 10 per cent. We know your costs aren't going to increase. They're only going to increase at the margin, and the access charges should reflect that extra volume and the benefit," and eventually we got that. I don't believe we've seen any reduction in access charges through improved maintenance costs. Admittedly they haven't gone to contestability in the Hunter Valley either, but we certainly haven't seen that.

PROF SCRAFTON: Potential won't be there.

MRS OWENS: You just raised the issue of the increased volume of business and it's predominantly coal. Is that because rail is winning business from road - I didn't think much was carried on road - or is it because coal markets are improving?

MR DI BARTOLOMEO: Generally speaking it is that coal exports out of Newcastle are growing.

MRS OWENS: Yes.

MR DI BARTOLOMEO: But not only. In 96-97 and to a lesser extent 97-98 virtually the sole remaining road haulage coal tonnes in the Hunter Valley were transferred to rail. So we did win - and I'm talking about 5 to 6 million tonnes. So probably half of our growth in that first year was transfer from road to rail, but we've basically got it all now. For instance the tonnage growth this year in the Hunter Valley is all market growth. Conversely, our tonnage in the south-west going to Port Kembla, which peaked about two years ago at about 8 million tonnes - or close to it - is now down to about 4 million tonnes, and the opposite - it's fallen, and it's just market. Mines have closed or production is reduced because the market is not there. The south-west coalmines are competitively disadvantaged versus the Hunter Valley and they've not fared as well in the lower pricing regime that coal has been in of late.

MRS OWENS: I think the RAC is going to have to be very careful in future when they are talking about increased volumes of coal in the Hunter, not attributing that to the state of the system, if in future it is because the export coal markets are continuing to expand.

MR PEDERSEN: You can track that back 15 years. The trend has been there through the good and bad days, or whatever. The market is just growing.

MRS OWENS: That's right.

MR DI BARTOLOMEO: I think, nevertheless, there's some truth in the fact that if in fact the Hunter Valley coal region is in a competitive environment out there and our transport costs have fallen - and they've fallen significantly - and they are significantly relative to the transport cost; relative total cost - it does assist in their overall competitiveness. It may be argued that there would be marginal tonnes that may not have been moved if the extra $1, $1.50 - whatever was in there in transport costs - was still there. So I think there's some dimension of the growth being able to be afforded by the fact that the costs in the Hunter Valley - to export a tonne of coal in the Hunter Valley is cheaper, for instance, than to export it out of the southern and western coalfields, and for that reason - amongst many - is the fact that their volume has gone down while the Hunter Valley has gone up. But we shouldn't overplay that card.

PROF SCRAFTON: Helen, there was one other question that came out of our discussions with the RAC. In fact the expression that the RAC used was that, "Above-rail competition is booming in New South Wales," and they put up a list of new operations. But some of those were subcontracted - FreightCorp, Northern Rivers and - - -

MR DI BARTOLOMEO: I'm not sure whether I should support RAC here and allow this view that this proliferation occurring is good.

MRS OWENS: You're all independent though.

PROF SCRAFTON: My question was really quite simple. My observation on the list was that it was hardly really core FreightCorp business that was going to these other - GrainCorp was the other subcontracted arrangement - and I wondered whether that was a fair assumption on my part; that they seemed to be fairly small. But, nevertheless, I guess if they're all added together, they begin to eat away with this - - -

MR DI BARTOLOMEO: Derek, can I go back to my earlier statement that I believe long term in Australia the volumes just don't justify a dozen operators all aggressively attacking each other on every corridor.

PROF SCRAFTON: Right.

MR DI BARTOLOMEO: It just won't occur. There will be, I believe, probably two major national operators, largely standard gauge base, and there will be a number of smaller short-line operators, and I think Northern Rivers Railroad is a good example of one where they exist to support a bigger operator like us. We use them neither to artificially create the environment or the impression that there are operators - it isn't that - nor is it for any other benefit of theirs. It's for our benefit. We believe they can undertake a particular activity in a particular region more cost-effectively than we can, and I can give you an example - and I don't think it's giving any commercial secrets away.

When NRR first approached us they said, "Look, we could do this run for you," and we asked them for a price, and we did our costings on it and it was about the same price as ours and we said, "Sorry, but what's the value? I'm going to go through all sorts of union hassles because I've got to dismiss people, you've got to rehire them, and I'm no better off." They came back, they sharpened their pencil, and they were below, substantially enough for us to proceed with the deal. GrainCorp is a similar arrangement. There are very good reasons why they can undertake that part of the train crewing for us - and that's all it is; it's train crewing - at a lower unit cost on those areas than we can.

PROF SCRAFTON: I think Gary described to us informal discussions that that was a more effective use of GrainCorp's labour.

MR DI BARTOLOMEO: Correct, both in terms of what they could use them - and where they happened to be located, as opposed to where our train crew depots are located, and the dead running of moving crews from our depot to these sites in a road truck when in fact they could already be there if they were part of the GrainCorp.

MR PEDERSEN: And the multiskilling they're able to achieve with the other balance of GrainCorp operations which are in the country areas and the flexibility of their hiring arrangements.

MR DI BARTOLOMEO: It was a - - -

MR PEDERSEN: Natural fit.

MR DI BARTOLOMEO: - - - good contract that we entered into. GrainCorp are obviously pleased because it helps their own cost structure, we're pleased because it reduces ours. It's good for everyone, good for the industry. Our customers at the end of the day will retain lower prices than otherwise might be the case.

PROF SCRAFTON: Thanks for that. That's all I had.

MRS OWENS: I'll just check and see if I've got anything else I was going to ask you.

MR DI BARTOLOMEO: Sure.

MRS OWENS: If you had the choice between competing within a market or competing for a market, as for the Leigh Creek business, which way would you rather go?

MR DI BARTOLOMEO: As opposed to?

MRS OWENS: Competing for the market. In the Leigh Creek situation - or most situations, I suppose - you were actually competing in the market, but occasionally you can be competing on a line to become the monopoly provider. Does it make much difference to you either way?

MR DI BARTOLOMEO: I'm not sure if I totally understand the question. But it's fair to say that at the end of the day, to be able to compete effectively you need to have a scale of operation that allows you to put the most efficient operation on the table. So at Leigh Creek - if we can use that as an example - it was a given volume and a given operation that fully utilised the resources we were deploying. The notion of, however, potentially splitting a market amongst many, such that (a) the volumes are reduced and then you've also got the complexities of operating simultaneously over the same, would certainly make it far more difficult and ultimately I think less cost-effective.

Now, whether those costs then get passed back on to your customers may be more of a moot point, but there's no doubt there's a complexity raised by it. We've always assumed that there'll eventually be another operator in the Hunter Valley, but I have no doubt - and that's not to say we're giving up - that another operator in the Hunter Valley will increase the complexity of the operation and effectively lower, to some degree - and I can't put a figure on it - the overall efficiency of the way it operates today with one operator.

MRS OWENS: That actually does answer my question, thank you very much.

PROF SCRAFTON: I haven't got any more questions.

MRS OWENS: It's been a very interesting discussion. Is there anything else you'd like to say before I close today?

MR DI BARTOLOMEO: No. I think we've covered the territory, thank you very much.

MRS OWENS: It's been a very useful discussion. I'm now going to conclude the hearings today, and we're adjourning until 9.30 tomorrow, Thursday, 13 May. Thanks very much.

AT 5.49 PM THE INQUIRY WAS ADJOURNED UNTIL
THURSDAY, 13 MAY 1999

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