Submission No 12

INQUIRY INTO RAIL INFRASTRUCTURE PROJECT COSTING IN NSW

Organisation: Australasian Railway Association

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AUSTRALASIAN RAILWAY ASSOCIATION INC

The Director
General Purpose Standing Committee No. 3
Parliament House
Macquarie St
Sydney NSW 2000

Dear Director,

Please find attached the submission from The Australasian Railway Association Inc (ARA) on behalf of it's members and the Australian Rail Industry. The ARA would welcome an opportunity to discuss in further detail any or all of the aspects of this submission.

Yours Sincerely,

Bryan Nye
Chief Executive Officer
Australasian Railway Association

26 September 2011

AUSTRALASIAN
RAILWAY
ASSOCIATION INC

Submission to New South Wales Legislative Council General Purpose Standing Committee No. 3

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September 2011

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1. Introduction

The Australasian Railway Association (ARA) has considered the terms of reference for the Inquiry into rail infrastructure project costing in NSW and consulted with ARA members in order to lodge this submission on behalf of the Australian Rail Industry.

The ARA is a member based organization that represents the rail sector in Australia and New Zealand. The rail sector comprises all rail operators, government and private, track owners and managers, track contractors, manufacturers of rolling stock and rail components (eg track and systems), and other aspects of the rail industry in Australia.

The ARA National Council is the supreme governing body of the Association. It has 22 senior company representatives as members and is currently Chaired by Mr Lance Hockridge, CEO of QRNational. Company members of ARA are diverse and include Australian Rail Track Corporation, Pacific National, Queensland Rail, Bluescope Steel, Metro Trains Melbourne, BP Australia, WestNett Rail, Department of Defence, John Holland Rail, Port of Melbourne Corporation, Railcorp, Siemens, Transfield Services, V/Line Passenger Pty Ltd, United Group Limited, and many more.

Over 100,000 men and women are either directly employed in rail or in supportive industries providing goods and services throughout urban and regional Australia in diverse operational and professional occupations.

The most significant issue about employment numbers for the Australian Rail Supplier industry is the geographical locations. Major plants and therefore often 2nd and 3rd tier suppliers sit in regional locations. The concentration of operations in regional locations makes this industry a vital employer to many communities, and therefore an essential part of the local economies.

The rail industry contributes $7.7 billion to annual Gross Domestic Product. Non-bulk freight is projected to increase by 82% in tonne-kilometre terms between 2003 and

2020. Rail is expected to remain the largest mode in shipping bulk freight (46% share in 2003 and growing) throughout the resources boom.

In 2010, 770 million passengers travelled on urban rail and tram services and another 13.4 million passengers used long distance services. We now know that the true value of every passenger rail journey can reduce the cost to society by between $3.00 and $8.50 depending on the capital city. This means that in the year 2010 alone between 2.3 billion and 6.6 billion dollars was saved by society through the use of urban and regional passenger rail services. The pressure to increase the use of efficient rail is expected to increase, particularly in view of:

- Concerns over green-house gas emissions;
- Congestions on roads in capital cities and environs
- Accidents and noise pollution and
- Costs of fuel.

Driving these trends is the continuing development of Australian cities and according to the Major Cities Unit data released in 2010; Melbourne, Sydney and Brisbane will grow by around 30% in population between 2006 and 2026. Also the combined projected population of these three cities by 2026 will be in excess of 13 billion people, with Sydney leading the way with a population of 5,426,300. Governments have been increasing investment in Passenger Services due to the community demands for improved rail services and reliability.

The ARA organisation represents 200 member companies of varying size with an interest in the rail industry and construction supply sector, a full member listing is available at www.ara.net.au.

2. Company Feedback

The ARA has consulted with our members in respect to the terms of reference for this inquiry. The following submission is an aggregated response obtained from a range of these feedback sessions.

The cost of bidding rail projects in NSW is very high when compared to alternate domestic options and industry needs to recoup this cost somehow. There are many opportunities elsewhere, with better predictability, opportunity for efficiency and improved financial outcome, therefore NSW is not currently as attractive as other jurisdictions when pursuing projects.

Client Capability

Design consultant costs in NSW (as a % of project size) seem to be much greater than in other states. An industry view is that a lot of the expertise has been lost by clients and is now outsourced to consultants, therefore clients have a greater reliance on consultant advice and have lost some ability to control outcomes and therefore cost and efficiency. In response to this inquiry the ARA understands that all of the consultants were invited to meet and discuss the inquiry terms of reference ie asking why design costs are so high in NSW rail projects. This action was considered by industry to be somewhat symptomatic, ie the consultants will not promote change as they are the major beneficiaries of the cost waste and in-efficiencies perceived to exist for example, why do consultants need to sit at the top table on alliance contracts. This actually makes it harder for contractors to manage the consultant and client expectations, especially when the advising consultants are working to performance targets that do not benefit cost and time-line reduction. The Railcorp interface in NSW is a complex and difficult one that often adds to project cost. NSW clients have limited track record of letting new entrants into the market, and this may have had an impact on value for money.

Risk Allocation

The risk allocation in NSW is not clear and often inappropriate therefore difficult to predict with certainty and prices reflect this situation. The stories circulating the industry on the changes requested through the Warratah rolling stock supply project are a recent example of what experienced suppliers expect to face when bidding for jobs in NSW, most rail infrastructure project tenders attempt to price in some of this lack of certainty.

There has been an increasing trend where contract conditions in NSW try to push Parent Company Guarantees and Uncapped 3rd party consequential losses, when these style of conditions are imposed into contracts they need to be priced from a risk perspective.

Oder Pipeline Clarity and Predictability

Sydney Metro was a major infrastructure disaster for NSW rail industry which used a procurement model that acted to separate the delivery of the "Tunnel" from the delivery of Station Boxes, Rail Infrastructure, The "Tunneling Contract" or Public Route Infrastructure Contract ("PRI") was to be undertaken on a Design & Construct basis on Sydney Metro whereas the residual set of Contracts were packaged under a single Contract noted as the Integrated Metro Operations ("IMO") Contract.

There was a lack of clear guidelines to determine right of access to contractors and conditions for hand-over on completion for contractors managing major consortiums for this project. The lack of certainty and ultimate cancellation are the issues which caused major problems for suppliers and concerns about future pricing. The failure to proceed with this major project and other rail infrastructure projects causes a lack of confidence in announced plans and ultimately make it very difficult to keep specialist expertise available to service key rail projects.

3. Competition to NSW for rail infrastructure capability

The ARA has currently assessed that there is $36 billion dollars being invested into rail infrastructure and rolling stock projects across Australia now and within the next five year period. This level of investment has been consistent in volume over the last 10 years and is projected to continue for many years to come as rail investment has started to close the gap on a 30 year period of under investment.

This investment has a high proportion of private sector funding mostly through the resource related projects in regions such as the Pilbara in WA, Central Queensland / NSW coals fields and many port related upgrades. In addition all state and federal governments have significant investment in passenger rail and rail networks.

All this investment generates competition for the capability required to execute NSW rail infrastructure projects and most suppliers have at least a national if not an international focus and against this level of demand suppliers are forced to price risk and complexity into the NSW rail infrastructure projects as they come to the market.

4. Road and Rail Pricing

The ARA has long argued that road and rail funding create a problem in generating sufficient investment necessary for rail infrastructure which in turn creates in-efficiency in the investment of public infrastructure dollars. This argument this has been picked up within work by the NTC and COAG and we include key elements in this submission for this NSW standing committee to be aware of and consider.

4.1. **Key differences**

There are two important areas of difference between the current road and rail pricing models. Firstly the rail model is based on negotiate / arbitrate regulatory arrangement. With a limited number of operators this is a viable model. Road is reliant on a regulated set price model, the only viable option given the very large number of operators. Secondly the pricing principles are very different. The road pricing principles do not focus on investment efficiency.

In terms of the application of the pricing principles the key area of difference is the treatment of capital costs. Some recovery of capital costs is necessary to provide incentives for new infrastructure investments. This therefore creates an environment where an infrastructure investor will seek to recover their investment plus a rate of return commensurate with the risks involved; if this can be achieved. Currently for road there is no recovery of historical capital infrastructure investments, and for new investment only actual costs incurred are recovered under a limited short term approach. This excludes both financing costs associated with the investment and a commercial profit margin for provision of the asset.

For rail the ceiling price represents both historical costs based generally on a depreciated optimised replacement cost methodology and full recovery of new investment including a rate of return (excluding government funded investments). While the ceiling rate is an appropriate charging level on high density bulk lines it would not support cross modal competition on the intermodal and grain lines where

intermodal competition does not meet full costs on the same basis. Therefore a price is set below the ceiling.

There is also significant expenditure not paid by road users that are paid for by rail users. For example, rail is required to meet at least partial cost and in many cases the full cost of items including, boundary fencing, pedestrian crossings and footbridges, rail crossings and noise walls. Under a competitively neutral framework, road users would also pay for these items in a proportional manner.

4.2. A new pricing framework

The primary objective in a new road rail pricing regime has to be the promotion of efficiency. In developing a new approach the need to deliver an efficient freight transport service has to be clear, as does the need to ensure competitive neutrality between charging regimes where there could be modal competition.

The absence of competitive neutrality has long term detrimental implications for users of freight services. To ensure efficient competition between road and rail freight operators there are a number of issues that need to be addressed in a new pricing regime. They include:

- Developing a common approach to the recovery of capital costs for both historical and new, road and rail infrastructure investments, including accounting for the financing costs associated with road infrastructure investment;
- Calculating a historical road asset value, preferably using the Depreciated Optimised Replacement Cost methodology, identical to that used for most rail assets, with an equivalent treatment of land and easements; and
- Addressing the equivalence of government contributions between road and rail infrastructure, to ensure there are no distortions in the mix of road and rail infrastructure use, and to provide appropriate incentives for ongoing efficient infrastructure investment.

A new pricing regime should therefore consider the total cost on a common basis of providing both road and rail infrastructure in the calculation of charges. It is proposed that this be done through a two part tariff with variable charges covering the marginal costs (usage charge) and fixed charges covering capital costs (access charge). In practice this may need to be adjusted to not pose a barrier to entry to the transport industry.

Achieving commonality of approach requires standardisation of the approach to recovering capital costs and the treatment of government capital contributions. In addition, it will also require the same methodology for including costs in the variable and fixed charges for road and rail infrastructure, and the same government proportion of the total cost of providing road or rail infrastructure services.

4.3. Individual pricing

The rail industry applies individual pricing through mass distance charging. This should be extended to the road industry, if only in the first instance where it directly competes against rail. Mass distance charging, using a variety of increasingly sophisticated technologies, is currently used in other countries. In fact some companies within Australia use mass and location technology for internal management processes. The long held arguments that it can't be done are no longer true. New Zealand has used a form of individual distance charging with averaged mass for over thirty years with a high level of compliance using simple technology; this would be an improvement on what currently occurs within Australia.

Individual pricing is essential to establish equity within the road sector and between modes if competition within the trucking industry and between road and rail is to be achieved.

The drive for individual road charging will also assist in addressing the longer term inequities associated with using energy taxation as part of an access pricing arrangements. It is recognised that there will need to be an established timeframe for

the introduction of mass distance charging, in the short term diesel pricing could act as a substitute for a distance charge and an averaging system used for mass. Acknowledging that this is a sub-optimal approach but an interim alternative until mass distance charging is implemented.

4.4. Pricing and investment

The current link between charges and infrastructure investment costs is not sufficiently clear to provide appropriate incentives to infrastructure investors to invest optimally in road and rail infrastructure.

In order to provide appropriate incentives for efficient infrastructure investment not only are changes to the existing pricing framework required, but also there is a need to align institutional arrangements for road and rail particularly in respect of pricing and investment policies.

4.5. Pricing and government transport policies

While revision of the pricing framework would address current distorted competition policy, it would not of itself necessarily deliver an optimised transport chain. Pricing reform will need to be followed by transport planning and investment policy reform.

The application of valuation of historical costs will need to take into account desired policy objectives, for example, depreciated optimised replacement costs values to be adjusted for projected volumes rather than current actual volumes assuming a change in volume is the policy objective. Such a reason may be to ensure sufficient asset utilisation to warrant future investment, or to meet modal share targets.

While governments may choose to subsidise freight operations to adjust outcomes this should be done in a transparent and competitive way.

4.6. Remote and regional options

It is recognised that there are specific issues relating to the movement of goods in remote and regional areas. Direct government intervention may be justified for public good reasons. This should be done transparently so that it does not distort or impede competition. A range of options are available including targeted industry rebates, capital infusion, accelerated tax depreciation, and/or investment tax credits. Recent US experience has shown tax credits for rail movements have assisted in maintaining the viability of grain networks.

4.7. Externalities

It is recognised that freight transport has a range of impacts on the community, including:

- Its land take, in some areas transport operations are now located on potentially high value residential land;
- Impact on the environment ranging from reduced air quality, waste management, disruption to natural water flows;
- Contribution to congestion and the costs this imposes on business and the community;
- Disruption to social amenity, eg noise;
- Social and health costs through for example, accident costs, air quality impacts on health; and
- Property damage caused by accident or misuse, not already internalised.

Currently these impacts are treated differently between road and rail, rail is directly charged for many of these impacts through the current pricing regime, for example weed management, fire protection barriers, and noise reduction measures. Some impacts are regulated, for example truck emissions.

Further consideration is needed on quantifying the extent of impacts and determining the best options for management. This may include a range of infrastructure manager responses and regulatory options.

It is important that differences in the treatment of external issues between modes removes any distorting impact on pricing.

5. Project Tendering Processes

As mentioned previously in this document (company feedback) there has been an increasing number of examples of tendering and contract terms that are considered not appropriate in generating the most efficient approach to tendering.

The ARA would suggest that NSW Government in collaboration with ARA, other jurisdictions and industry participants would benefit from developing a specific guide to tendering rail projects. This work has been undertaken in other industry sectors and global regions, the main benefit of the process is to have the parties engage in dialogue on principles of tendering and benefits and pitfalls for all involved.

The most current and rail appropriate guide we find available is referred to below, however a simple piece of work to undertake the development of a rail focused version of this document would be of high value.

Australian Constructors Association Guidelines for Tendering – 10/8/2006 is available from
http://www.constructors.com.au/publications/tendering_guide/ACA%20Guidelines%20for%20Tendering%2011%20August%202006%20Final%20.pdf)

We refer the commission to the Australian Contractors Association Guidelines for Tendering (August 2006) written by Evans & Peck. The purpose of these Guidelines for Tendering is to provide a framework for the effective, consistent and efficient management of tendering practices throughout the Australian construction industry and associated industries (such as the information technology and telecommunications industries). Inherent in these Guidelines is the adoption of ethical principles that underpin best practice tendering procedures. Successful projects have generally started with the use of best practice tendering processes.

6. Recommended Actions

The ARA proposes the following strategic programs that will assist NSW to improve the environment within which it releases new rail infrastructure projects into the market place.

1. Risk Allocation
    a. Undertake work to establish guidelines for effective risk allocation and procurement models that support the management of risk where it is most effectively managed.
    b. Undertake work through the ARA with industry and other jurisdictions to establish guidelines for appropriate principles for tendering a rail infrastructure project.
2. Client Capability
    a. Establish the Performance Indicators and rewards to ensure those responsible are rewarded and accountable for delivering the transparency and certainty required for suppliers to improve efficiency.
    b. Recruitment is required of experienced commercial project management experience at the most senior level.
    c. For this recruitment to be able to impart capability and engender confidence within the supply chain it is going to require an environment permitting structural reform to ensure change does stick.
3. Renew Supply Chain Engagement
    a. As the client side of the process becomes more capable and stable then it would be timely to re-engage with the supply chain by reviewing and creating transparent preferred supplier agreements with transparent and open selection of suppliers and ongoing performance monitoring.

7. Concluding Comments

To add specific commentary relevant to the Australian Rail Industry the ARA has consulted with it's members to be able to present additional information to the commission. This information is based on the Terms of Reference. In summary, we strongly support the Government's rationale for inquiry into this issue and getting the basics right.

The ARA is very keen to be involved in further consultations. Please advise if you require clarification or elaboration of any of the issues raised above.

Yours Sincerely

Bryan Nye
Chief Executive Officer

26 September 2011