

**Submission
No 2**

INQUIRY INTO TRANSPORT ASSET HOLDING ENTITY

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Secretariat
Public Accountability Committee
NSW Legislative Council
Parliament House
SYDNEY NSW 2000

TRANSPORT ASSET HOLDING ENTITY INQUIRY – SUBMISSION

Dear Secretariat

Please find attached a submission to the above Inquiry.

If the Committee wishes, I am happy to expand on any point.

Of course, corrections on any matters would be welcomed.

Yours sincerely

J Austen
8 September 2021

NSW LEGISLATIVE COUNCIL PUBLIC ACCOUNTABILITY COMMITTEE INQUIRY INTO THE TRANSPORT ASSET HOLDING ENTITY

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0. Summary

Public commentary about the Transport Asset Holding Entity is dominated by speculation about it being a gimmick to hide Government spending, with the public deceived about NSW's fiscal position.

This submission puts the view such arguments overlook important matters. Both sides of the debate are assuming such devices do not have real-world effects. That assumption is wrong.

Industry structure changes of the type involving the Entity have profound consequences irrespective of motives, purposes or whether they are gimmicks. The submission draws attention to almost identical changes in NSW rail in 1996 – for competition policy purposes - to illustrate.

That experience involved creation of an organisation similar to the Transport Asset Holding Entity. The organisation was Rail Access Corporation. A small state-owned corporation, it was given the NSW rail tracks to manage, separately from other rail organisations, on a 'commercial' basis. It did not run trains but provided other organisations such as State Rail – a predecessor of Sydney Trains - access to tracks. It was not given the track maintenance workforce – that remained with another Government organisation, Rail Services – but it was to make maintenance contestable by contracts.

That part of the 1996 changes failed. Among the consequences were neglected assets, enormous restoration costs, service unreliability and a series of rail accidents. The changes were progressively reversed from the year 2000 starting with appointment of an industry overseer, suspension and then cancellation of maintenance contestability. Rail Access was merged with Rail Services and, in 2004, further merged with State Rail, putting all commuter rail assets and operations in a single point of accountability – RailCorp – virtually returning to the pre 1996 industry structure.

The submission briefly explores some reasons for the failure. The most significant:

- mistaken splitting of State Rail into separate organisations;
- misapplication of corporatisation ideas to some of these organisations;
- pursuit of conflicting agendas hidden by a nebulous slogan of the 'commercial approach'.

After 1996, these factors gave rise to increasing conflict among Government organisations. The 'commercial approach' embroiled the industry, Departments and politicians in brawls.

The main differences between 1996 and now are: the Entity has not operated for long; the system is under much less pressure due to the pandemic. Those differences are fortunate but transient.

Rail industry arrangements involving the Entity do not match the supposed accounting motive. Other motives are likely in play. Among them: a dislike of Sydney's commuter railway and a wish to franchise/privatise it. Issues in that extend far beyond those mentioned in promotional material such as some Infrastructure Australia/Infrastructure Partnerships reports.

Recent statements about rail 'responsibility' are unsatisfactory. They do not indicate to whom responsibility is owed, nor how it arises.

The 1996 debacle is a warning about Governments endorsing coterie agendas under misleading guises. Policy decisions on matters like rail industry structure and governance need to be informed by facts, analysis and discussion in open forums.

1. Introduction

This is a submission to the above inquiry.

Between 1993 and 2007, I was a principal adviser on rail policy in Transport for NSW's predecessors.

I retired in 2014 yet maintain an interest in several Commonwealth and NSW public policy areas, including transport and infrastructure.

That interest includes commentary on issues where public information is deficient and public policy appears seriously mistaken. That is the case with present Sydney commuter rail arrangements in which the Transport Asset Holding Entity is to play a crucial role.

Those arrangements appear to envisage Sydney Trains 'accessing' track managed by the Entity. In material respects that is near identical with the Sydney commuter rail structure introduced in 1996 which involved Rail Access Corporation.

The 'access' aims of the 1996 commuter rail structure were unclear. Among its assumptions: changes to organisational structures might not have real-world consequences.

The access part of the 1996 structure resulted in substantial problems for the railway, Government and the public. It caused enduring operational and planning deficiencies, led to substantial financial losses and significantly increased risks to public safety. It was progressively reversed from early 2000, after the Glenbrook accident and in the lead-up to the Olympic Games.

Available public information suggests present arrangements ignore the lessons of that experience.

This submission seeks to start to rectify that deficiency. To do so:

- Section 2 outlines salient aspects of the scheme involving the Entity;
- Section 3 outlines similar aspects of the 1996 rail structure;
- Section 4 gives reasons for the failure of the 1996 rail structure;
- Section 5 identifies some likely problems arising from the Entity;
- Section 6 draws some conclusions.

Adverse consequences of the 1996 structure took several years to publicly manifest. The lag made necessary policy reversals more difficult. Some consequences remain visible today.

The principal differences between the situation then and now are:

- the Entity has not operated for long; and
- there is far less pressure on the Sydney commuter rail system, due to the pandemic.

In the context of this submission those are fortunate but transient circumstances.

Of course, corrections to matters raised in this submission would be welcome.

2. Transport Asset Holding Entity

2.1 Introduction

The Transport Asset Holding Entity is a type of public non-financial corporation - a statutory State-owned corporation.

It is a result of two organisational changes to RailCorp - the former urban commuter railway:

- organisational separation of assets from train operations and maintenance activities; and
- corporatisation of those assets, in the Treasury portfolio.¹

The underlying characteristics of the railway remain unchanged. These include its service provision and a great reliance on subsidies.

The primary motivation for the changes is said to relate to having certain Government expenditures accounted 'off' Budget. Such accounting is said to require a 'commercial focus' on assets - to place them outside direct control of Budget sector agencies, and under the control of a for-profit organisation not directly controllable by Government.

2.2 a. Organisational separation

Organisational separation involved removing at least some control of assets from RailCorp (Sydney Trains) from 2012. First to Transport for NSW, now apparently to the Transport Asset Holding Entity.

Important aspects of asset control include determining:

- how assets are used;
- how assets are maintained including the level of maintenance and who does it.

Relevant assets are:

- fleet;
- track and related infrastructure;
- stations, maintenance facilities.

From the public perspective, Sydney Trains continues to provide train services and (therefore) uses assets as before. To the public the separation has not made a difference, yet.

However, to legally use these assets, Sydney Trains must have formal arrangements – leases, access rights etc. - with the asset (title) owner. Initially, such arrangements would be with Transport for NSW. Now they are to be with the Transport Asset Holding Entity.

The intention appears to be for Sydney Trains to (effectively) operate fleet under leases. If so, Sydney Trains will have exclusive use and control of those assets.

The intention appears to be Sydney Trains will 'access' track etc. Access is not like a lease. It is a non-exclusive right of use.²

¹ While the Entity also holds rail assets used outside the metropolitan area – e.g., by NSW Trains – for ease of exposition this submission only refers to assets used by Sydney Trains.

² *NSW Rail Access Undertaking*, clause 4. The intended arrangements for stations and maintenance facilities are unclear.

If so, Sydney Trains will not control those assets. Rather, at least some aspects of control of track etc. – use and maintenance – will rest with the Entity by statute.³

Recently, the Secretary of Transport for NSW expressed a view *‘responsibility for maintenance’* sits with his organisation. The assertion appears odd if control of assets lies with Sydney Trains (fleet) and the Entity (track). It also appears odd if Sydney Trains pays access charges to the Entity. If it is correct, Transport for NSW is playing a central role in commuter rail operations and would likely need to be duly accredited to avoid breaching national rail safety law.⁴

The assertion may be related to ‘contracts’, ‘agreements’ among Sydney Trains, Transport for NSW and the Entity, said to have come into force in July 2012. To my knowledge relevant documents – or schematics - are not publicly available.

It is conceptually possible for the asserted result to occur, via a convoluted scheme of quasi-contracts. First, on the maintenance side: the Entity to give control over (condition of) assets to Transport for NSW; Transport for NSW to sub-contract specific track maintenance tasks to Sydney Trains. If so, several points about those arrangements should be borne in mind:

- they reflect policy, not necessarily agreement. They are not ‘commercial contracts’ as is commonly understood. For example, financial ‘consideration’ may be abnormally high or low; arrangements with Sydney Trains can be rescinded by Transport for NSW at any time;
- each of the three organisations needs independent capability to assess track condition, rates and causes of degradation, maintenance requirements etc. – for reasons explained in section 3. This is in addition to the usual duty of a principal to satisfy themselves of the capability and performance of their contactors.⁵

Several other ‘agreements’ or components are implied by the assertion: Transport for NSW to pay Sydney Trains; Sydney Trains to pay access charges to the Entity; the Entity to pay Transport for NSW for maintenance; Transport for NSW to pay Sydney Trains for maintenance. The monies shifted may not reflect direct costs of, or value added by, the service provider.⁶

The (recently claimed) inclusion of Transport for NSW at the centre of commuter rail operations complicates matters. For ease of explanation, the following limits itself to arrangements between Sydney Trains and the Entity.

³ *Transcript Budget Estimates, Portfolio Committee no. 1 Premier and Finance, 3 September 2021.*

⁴ From the transcript (note 3): *‘I have been intimately involved in the discussions around safety and the development of the commercial agreements over the past five or six months. The reason for that is that it is important that Transport maintains responsibility, accountability and the ability to underpin safety, and a key element of that is maintenance. The budget for maintenance, the strategy for maintenance and the responsibility for maintenance sits with me as secretary’*
National rail safety law requires a party involved in railway activities to be accredited for those activities, otherwise it will commit an offence. Restoration and repair work – maintenance - is such an activity, as is ‘management’ – *Rail Safety National Law (South Australia) Act 2012.*

⁵ Transport for NSW recently stated it had reviewed proposed (access?) charges and was *‘comfortable’* they represented value for money. This implies each of three organisations (should have independently) estimated relevant charges. See note 3.

⁶ For example, if Transport for NSW controls track maintenance, it rather than the Entity would effectively determine a (physical) cost-based access charge – and, directly, the condition of assets.

An organisation controlling assets needs funds. It can acquire funds from customers or the Government. Around 70% of funds for Sydney's commuter railway come from the Government. The remainder come from customers such as passengers and station tenants e.g., shopkeepers.

Arrangements allowing another organisation to use assets involve payments from the user to the asset controller. The organisational separation means the intention is for Sydney Trains to pay the Entity to use assets needed for train services.

It appears the intention is the Entity will not undertake on-the-ground maintenance tasks. There have been suggestions Sydney Trains will undertake these tasks. This may underlie opinions parties other than the Entity will have 'responsibility' for safety operations and maintenance.⁷

The Entity's lease of fleet to Sydney Trains would likely see the latter controlling the amount and type of train maintenance. It would also determine who undertakes that maintenance.

However, arrangements for the Entity to own – and Sydney Trains to access - track etc. would see the Entity liable to Sydney Trains for track condition and therefore controlling at least the amount of maintenance undertaken for those assets. To Sydney Trains, the Entity would determine the track etc. maintenance budget. Unless there was a Ministerial Direction to the contrary, it would determine who performs maintenance and what tasks are to be undertaken.⁸

2.3. b. Corporatisation in another portfolio

The assets needed for Sydney's commuter rail services were (intended to be) transferred from Transport for NSW to the Transport Asset Holding Entity. The Entity is a statutory state-owned corporation. Such corporations are:

- not directly controlled by the Government;
- profit seeking;
- for NSW, within - 'owned' by/reporting to – Treasurer/Treasury rather than a portfolio Minister.⁹

The Government stated an expectation the Entity will operate 'commercially'. This appears to mean it operates independently of the Government and receives the bulk of its funds from customers.

Its principal customer - Sydney Trains – is not such a corporation and is within the Transport portfolio.

The apparent expectation is: funds will flow from Sydney Trains to the Entity. Sydney Trains, in turn, receives most of its funds from the Government and some from its customers. Such a scheme expects Treasury to determine the financial performance of an organisation it owns.

⁷ E.g., Ascribed to a Transport for NSW Spokesman in: *Battle over \$40b rail entity left Sydney network on knife edge* Sydney Morning Herald, September 6, 2021 <https://www.smh.com.au/national/nsw/battle-over-40b-rail-entity-left-sydney-network-on-knife-edge-20210905-p58ow5.html>

⁸ An instruction by the Treasurer/Minister to the Entity regarding how much/what maintenance is to be performed, or who is to perform it, would make them responsible for maintenance.

⁹ In other jurisdictions State owned corporations have a portfolio Minister as shareholder. For example, VicTrack (Victoria) and Queensland Rail (Queensland) have as shareholders their State's respective Transport Ministers.

Such a scheme is likely predicated on Sydney Trains accessing track.¹⁰

For the Entity to turn a profit, funds – largely from Sydney Trains, possibly for track access - need to exceed its costs. If the above is correct, costs likely include track etc. maintenance.¹¹

For profit reporting, costs should include estimates of asset deterioration - depreciation. Otherwise, it will not be possible to determine whether profits arise, or dividends are paid, from asset stripping.¹²

Prior to the Entity, the assets did not generate a profit. To now generate profits:

- Sydney Trains would need to pay the Entity more than (former) relevant costs, a necessary condition of which is: Sydney Trains receives increased funds;¹³ and/or
- the Entity would need to reduce outlays on maintenance.¹⁴

The monitoring framework for the Entity, like that of other state-owned corporations, relies on Treasury assessment of reported financial indicators. Monitoring of railway asset condition is:

- to be undertaken by Treasury; and
- reliant on positive values for all assets, such that shortfalls in maintenance are immediately and fully reflected in increased depreciation costs – reduced asset values.¹⁵

Recent remarks about the arrangements may reflect uncertainty about the situation of State Owned Corporations. These included:

*'Treasury said that finding a leader for this \$40 billion corporation was the responsibility of the Transport cluster, especially TAHE's board. If there had been a failure to secure a permanent leader, it really was Transport's job to call TAHE's board to account.'*¹⁶

It may be that some officials feel the Entity should be in the 'Transport cluster' and have a view there should be administrative practice to effect this purpose. However, such feelings and arrangements cannot override legislation which apparently has the Entity accounting to the Treasury portfolio.

¹⁰ A similar approach in the UK - 'the money-go-round' - had a regulator setting payments other than subsidies. The significant differences with the NSW scheme: UK train operators were *obliged* to make specified payments to the track owner; those amounts were set independently of Treasury.

¹¹ The Entity may or may not incur fleet costs, depending on terms of the lease to Sydney Trains.

¹² This relates to a profit seeking organisation. One mechanism of asset stripping is to restrict maintenance – to reduce maintenance expenditures and therefore increase (pre-depreciation) profits. However, lower than necessary maintenance increases the rate of asset deterioration. Inclusion of depreciation in the profit accounts – *if estimated from observed asset condition* rather than just other accounting rules e.g., straight line, reducing balance – reduces risks of asset stripping.

¹³ Arithmetic condition. A necessary, not a sufficient condition – Sydney Trains decides about making such payments. Assertions the Independent Pricing and Regulatory Tribunal/Government decides how much Sydney Trains pays for access seem wrong. Cf: *Transcript Budget Estimates, Portfolio Committee no. 1 Premier and Finance 20 August 2021* with footnote 20.

¹⁴ To the extent this does not result in an increase in disclosed depreciation.

¹⁵ Necessary to avoid asset stripping which is a particular risk for long life multi-component assets such as track etc. infrastructure being controlled by a for-profit organisation in an industry making losses or reliant on subsidies.

¹⁶ See note 3.

3. 1996 rail structure

3.1 Introduction

The 1996 NSW rail structure involved the break-up of the State Rail Authority – which had run all trains, owned all tracks etc - into several new organisations. For the purposes of this submission, the relevant new organisations were State Rail, Rail Access Corporation and the Rail Services Authority.¹⁷

State Rail owned fleet and stations and provided train services to the public. Rail Services provided fleet and track maintenance services - mainly to other NSW Government rail organisations.

Rail Access was a statutory State-owned corporation. It was to be a small but expert organisation. It involved the simultaneous:

- a. organisational separation of track etc. assets from train operations and maintenance; and
- b. corporatisation of those assets in the Treasury portfolio.

The break-up had bi-partisan support. The primary motivation was said to be competition policy. It was assumed this required a new ‘commercial focus’ to all rail activities. Various parties had further agendas. It was assumed such focus and agendas would not affect commuter train services.¹⁸

The new commercial focus involved abandonment of some administrative controls of the integrated State Rail Authority and reliance on ‘commercial contracts’ between new organisations.

The new organisations were vitally reliant on each other. It was assumed the new commercial contract approach would see them co-operate.

There was a prohibition on Government organisations litigating to resolve disputes among themselves. The Government rejected the idea of an independent regulator to resolve disputes.

3.2 a. Organisational separation

Rail Access’ ownership of track etc. infrastructure enabled it to determine:

- use of those assets;
- levels of track etc. maintenance and who would conduct maintenance.

Rail Access did not conduct on-the-ground maintenance tasks. However, it did control maintenance through setting budgets and the contractual timing, grouping and scope of works. It could determine who conducted maintenance tasks.¹⁹

Rail Services was to initially maintain the tracks etc. However, Government and Rail Access wanted such work to be ‘contestable’. Rail Access would determine how much and what types of maintenance would be undertaken in seeking bids for potential contractors.

¹⁷ Another NSW organisation was FreightCorp, a state-owned corporation. It provided intra-state freight services and owned relevant assets – except track etc. which was with Rail Access. A further rail organisation was the Commonwealth /NSW/Victoria National Rail Corporation. It provided inter-state freight services, owned relevant assets, except track etc.

¹⁸ The purpose of the passenger priority provisions of the relevant legislation.

¹⁹ The Minister could, under certain conditions, direct Rail Access regarding maintenance. The Minister did so in relation to the contestability program suspension.

Rail Access did not operate trains. Rather it permitted rail operators, such as State Rail, to use its tracks etc. It did so via access contracts in which operators paid for usage rights. The contracts needed to conform with a regulatory Rail Access Regime. Rail Access was to gain its funds from access contract revenue rather than direct subsidies.²⁰

3.3 b. Corporatisation in another portfolio

Rail Access Corporation was:

- not directly controlled by the Government;
- 'owned' by, 'reporting' to Treasury rather than the portfolio Minister;
- profit seeking.

Its main customer – State Rail – was a statutory authority in the Transport portfolio. State Rail relied on Government funding. The scheme had Treasury indirectly funding an organisation it owned.

Prior to Rail Access, the metropolitan track etc. assets did not generate a profit. For those assets to contribute to the corporation's profits:

- State Rail would need to pay Rail Access more than (formerly) relevant costs, a necessary condition of which would be State Rail receiving increased funds; and/or
- Rail Access would need to reduce outlays on maintenance.

The apparent expectation was a 'commercial focus' would reduce funding requirements. An increase in funding for State Rail would be inconsistent with that expectation. Hence, State Rail funding was not increased. And State Rail did not pay Rail Access more than formerly relevant costs.

Rail Access reported profits. Its Hunter Valley assets and (claimed) reductions in maintenance spending contributed. As the income of Rail Services - an organisation in the Transport portfolio – depended on Rail Access' maintenance spending, profits were associated with a significant cut to Rail Service's revenue. One Government business was threatened by another's desire to make profits.

The monitoring framework for Rail Access was as for other state-owned corporations. It relied on Treasury assessment of reported financial indicators.

As State Rail was not to pay Rail Access more than (formerly) relevant costs, Rail Access re-valued metropolitan track etc. assets to zero. From then, depreciation of those assets was unable to be reported in Rail Access' accounts. The financial monitoring framework was incapable of informing the Government about metropolitan track etc. asset condition.

²⁰ The *Rail Access Regime*, later retitled *Rail Access Undertaking*, remains in force. It requires a NSW track etc. owner to allow (operators') trains to use its tracks under contracts – 'access agreements'. Contract terms are negotiated and include access charges. Charges must be greater than (or equal to) direct costs, and less than full economic costs, of track use. There is a substantial difference between direct and full economic costs - only the latter includes depreciation, a return on assets etc. The Independent Pricing and Regulatory Tribunal arbitrates disputes. The arbitral role was not activated for NSW rail operators due to the prohibition on internal litigation (see section 3.2). National Rail Corporation (note 17 above), was not subject to the prohibition and sought arbitration over access charges. Before the Tribunal determined the matter, the parties agreed to charges nearer direct costs than full economic costs. National Rail, therefore, did not contribute to Rail Access' profits and Rail Access used the result to (successfully) lobby for subsidies direct from the Government and not merely via train operators.

4. Failure of the 1996 structure

4.1 Introduction

From the outside, for a short time, the 1996 structure appeared to be effective. It was lauded. The two state owned corporations – FreightCorp and Rail Access – reported profits and provided dividends to Treasury.

However, from the outset, problems in Sydney’s commuter railway were evident to those involved. The contestability program was suspended and later cancelled.

The structure contributed to poor performance of all organisations, worse train services and a series of accidents. The inquiry into the Glenbrook accident criticised the scheme as ideological.²¹

The inquiry identified many instances of misunderstandings – wrong identification, wrong allocation, wrong assertion, wrong denial and disputes – of responsibility. This was despite apparently clear legislation, and clear governance in terms of organisational functions.²²

An associated issue was bad relations between the organisations. These became so fraught, in late 1999 they led to public concerns the situation could jeopardise the Olympic Games. In a last-ditch effort to avoid that, the Government appointed an overseer – a Co-ordinator General of Rail – with powers to direct all the organisations.

Major and costly ‘restoration’ programs were then commenced. On the Coordinator General’s advice, Rail Access and Rail Services were merged to form Rail Infrastructure Corporation.²³

Such problems in the commuter railway can be traced to aspects of the structure, notably:

- organisational separation of track etc. assets from train operations and maintainers; and
- corporatisation of those assets in the Treasury portfolio.

Some other factors were also significant. These included: hidden agendas; ‘commercial’ behaviour.

4.2 a. Organisational separations

The organisational separations involving track etc. assets were:

- assets from operations – ‘vertical separation’; and
- assets from maintainers.

Vertical separation

Separation of track assets from operations relates to access. The aim is to offer train operators a ‘level playing field’ for use of track. However, that aim is irrelevant where subsidies are needed or

²¹ Of the new organisations, only FreightCorp performed as well as expected.

²² *Special Commission of Inquiry Into the Glenbrook Rail Accident Final Report*, April 2001.

²³ The Co-ordinator General advised the Government and the Glenbrook accident Inquiry that Rail Access and Rail Services should be merged. The Inquiry agreed and made this a central feature of its second interim report.

one operator dominates track use with high traffic density. As is the case for Sydney commuter rail.²⁴

The downsides of such separation are ‘interface’ issues – reduced communication, sub-optimal use of resources and conflicting objectives and ‘cultures’ of track owner and train operators. These issues are vastly more important in rail than other transport modes due to its guided-use infrastructure and the necessity of trains being separated by signals rather than line-of-sight.

Such issues can manifest in deficiencies in planning, budgeting, operational performance, occupational health and safety, and public safety. The problems can become very serious.²⁵

A main cause of interface issues is misstatement/misunderstanding of responsibilities.

The problems can prove intractable, not least because causes – even problems themselves - are difficult to perceive by those not at the interface. Issues are not amenable to case-by-case resolution by outside parties. Indeed, vertical separation with a dominant rail operator creates an environment and incentives for parties throughout the organisations to contribute to such problems.

Risks increase as – and when – infrastructure capacity is more heavily used. Resolution requires the organisations to be merged.

All of these problems occurred in Sydney’s commuter railway post 1996. After the merger of State Rail and (the successor to) Rail Access, the issues greatly diminished.

Assets from maintainers

The issue with separating asset ownership from maintainers is: the asset owner may not properly understand the assets. If so, it cannot effectively contract out maintenance. The more complex and the longer the life of the assets, the more likely this will occur.

The risk is maintenance will be inadequate as the asset owner seeks to minimise outlays. This occurred in the United Kingdom rail privatisation where track owner, RailTrack, contracted-out maintenance. After several major accidents, nation-wide service unreliability and financial collapse of RailTrack, track maintenance was brought back in-house.

The risk of inadequate maintenance also eventuated in NSW. However, there the risk was magnified by the contestability policy and its existential threat to Rail Services.

In the 1996 break-up of the State Rail Authority, Rail Services sought its highly knowledgeable asset-managers and assets to give itself the best chance of successfully competing for work once Rail Access made maintenance contestable.

²⁴ The leading examples, United Kingdom and NSW are outlined in: Policy SPAD, July 2021 at <https://www.thejadebeagle.com/policy-spada.html>. Victoria considered adopting a similar model but was dissuaded in the lead up to franchising.

²⁵ An example of consequences of a hidden (train operator – track owner) interface problem was the Ladbrooke Grove disaster in the UK. Interface problems were also evident in some NSW accidents including at Glenbrook and Robertson. For the latter (asset owner-maintainer) interface problems contributed to the absence of risk assessments, and there being no clear responsibilities or accountabilities for maintenance works: David Edwards, *Why is Rail Safety Important to Me? - Lessons Learned During Accident Investigation*, International Rail Safety Conference, Vancouver 2013.

A result was these staff and assets did not go to Rail Access, and did not assist its maintenance oversight and contracting activities.

By 1999, a decline in the condition of track etc. was evident. This was later attributed to Rail Access reducing major periodic maintenance - discussed below. The Coordinator General's review considered reasons. He thought the situation of Rail Access being unable to effectively oversee maintenance a 'grave' concern. That concern reflected Rail Access not having sufficient knowledge about *its* assets and its 'commercial' imperative outside the Transport portfolio.

The Glenbrook accident inquiry recommended the merger of Rail Access and Rail Service. Legislation created a new organisation – Rail Infrastructure Corporation.

4.3 b. Corporatisation in another portfolio

There are two issues:

- corporatisation;
- 'ownership' outside the Transport portfolio.

Corporatisation

In theory, corporatisation is applicable to government businesses operating in competitive markets or selling services to the public. It is not applicable to organisations with a monopoly over providing intermediate inputs or operating in markets reliant on subsidies. It was not appropriate for an organisation like Rail Access.²⁶

A corporatised business is supposed to operate like a company privately owned by two shareholders. It is supposed to maximise profits and look after only itself.²⁷

Profit maximisation involves maximising revenues and minimising costs. As a monopoly maximises profit by restricting output, a corporatised monopoly should be subject to economic regulation. Such regulation needs to keep prices down *and* ensure service quality is not compromised.²⁸

Rail Access was subject to such regulation for its Hunter Valley operations but (effectively) not for elsewhere in NSW. The (then) given reason: outside the Hunter, the rail industry lacks market power. In the metropolitan area it is subsidised.²⁹

²⁶ Rail Access might be compared with FreightCorp. FreightCorp operated in competitive end markets, with little subsidy. It met all the criteria for candidates for corporatisation. Its corporatisation was regarded as a success.

²⁷ Shorthand for maximising the net financial worth of the corporation.

²⁸ Service quality of rail infrastructure is indicated by asset condition. Condition is accounted as depreciated replacement value – which is used in an asset base. The regulator sets an allowable rate of return, which is applied to this base to determine maximum profits. Deterioration in asset condition will lower maximum profits.

²⁹ For this reason, Rail Access valued metropolitan assets at zero. The accounts could not reflect their depreciation – and therefore changes in their condition. This removed the (regulatory) control over service quality (note 28) and allowed reporting of (apparent) profits without reporting of asset condition.

Rail Access simultaneously provided inputs to highly profitable and to highly unprofitable train operators. This made it difficult for external parties to assess Rail Access' performance through financial reporting e.g., true results may be obscured by cross-subsidies. Lack of effective oversight in the metropolitan area left open the risk of lower service quality arising from cost reductions.³⁰

Ownership outside the Transport portfolio

Rail Access and Rail Services having different 'owners' within the NSW Government had adverse effects. The *State Owned Corporations Act (1989)*, under which Rail Access was constituted, curtailed the ability of the industry to function as a whole.³¹

One visible effect of different owners was disputes – and dubious decisions – about track maintenance.

Rail Access perceived its tasks were to make profits and provide dividends to Treasury. Mechanisms included reducing maintenance spending.

As noted above, Rail Services foresaw this threat and acquired key staff and assets. It was in a better position to discuss maintenance matters – to assess track condition and identify maintenance requirements. However, it may have been reluctant to pass information to Rail Access.

Further, Rail Access would likely listen more to its owner - Treasury – than Rail Services. Dividend requirements apparently trumped maintenance advice from Rail Services.

Maintenance aggregates were affected, as was the balance between preventative works and reactive tasks. Another effect was Rail Access moving from a 'standards' to 'fit for purpose' basis for maintenance, but without having the information needed for that new basis.³²

A result: track maintenance was not adequate to sustain train service levels in Sydney. Rail Access' profits and dividends were seen by many to come from deferring major maintenance. It was seen as working in, but not for, the rail industry.

Departments sought to justify the new approach to maintenance via comments such as 'engineers gold plate everything', or 'Rail Services workforce is too big'. These were seen as cliches. In conjunction with maintenance funds only being available short term, this gave an impression of some outside the rail industry having their own track maintenance strategy and wanting it imposed on the industry, while representing it to be the product of others.³³

³⁰ A profit maximising business will seek to close down unprofitable assets.

³¹ The *Act* requires state owned corporations to only consider their own interests - not the interests of other organisations, a wider industry or community. The *Act* prevents a public interest direction to a Corporation from the portfolio Minister unless the Treasurer – the owner of the organisation – agrees!

³² 'Fit for purpose' in the sense used here requires a superior understanding of asset condition *and* its rate of degradation *and* identification and constant monitoring of the factors that lead to degradation.

³³ Some private contractors withdrew track machines from regional NSW from 1998 onwards. Central agencies referred parties who raised concerns about maintenance to the Department of Transport, notwithstanding the Department having no influence over – or visibility of – the problems created by views about gold plating, staffing levels etc.

In his review, the Coordinator General condemned such practices and use of subsidies to support Government organisation profits. He recommended maintenance be subject to 7-year plans.

Another effect of organisations having different owners was higher-level tensions. Instead of relations between rail organisations being governed simply by contracts, each of the organisations regularly sought interventions of (their) different Ministers and other political supporters.³⁴ Rail Access, Rail Services and State Rail were in almost constant dispute. One side of the arguments felt Treasury was using Rail Access to further an agenda of reducing the rail workforce – but lacked the courage to do so overtly. On the other side, Rail Services was seen as uncooperative and shielded by the Transport portfolio. Tensions and disputes extended beyond rail organisations.

In that light, the design of pitting Government organisations - and portfolios - against each other was idiotic. As was failure to create an appropriately empowered independent party to decide disputes between organisations.

The excuse to not have a UK style regulator was fear of hindering commercial spirits, and of constraining organisations and prerogatives. Instead, an administrative ‘Steering Committee’ was formed to oversee the changes and, implicitly, deal with disputes. Despite great efforts and best intentions, it failed. There were two reasons.

First, it comprised representatives of the disputing organisations and their ‘owner’ Departments. It lacked knowledge and expertise. Its ‘decisions’ were perceived – fairly or not – as political rather than efficient or equitable. Unfavourable decisions were ‘appealed’ behind closed doors.

Second, it did not have relevant power. The rail organisations were established by legislation, yet the Committee – not envisaged by the legislation – had only an informal administrative basis. It could not make binding decisions. At most, it might provide advice to Ministers. However, even then, the Government’s ability to settle disputes involving Rail Access was severely limited.

Disputes remained unresolved, and the attitude was ‘possession is the law’. Examples included:

- non-compliance with - withholding payments contrary to - the ‘operating and financial model’;³⁵
- the need for a direct subsidy to Rail Access to ensure its solvency and prevent it closing lines;
- staff and assets remaining with Rail Services rather than where they were most needed; and
- the metropolitan access function effectively being conducted by State Rail not Rail Access.

³⁴ An echo of well-known phenomena of big-business jurisdiction shopping and rent seeking via political lobbying.

³⁵ To assess the feasibility of the 1996 scheme, a financial model was developed for each organisation and for the industry as a whole. It had expected balance sheets, profit and loss accounts and cash flows. The industry model included ‘inter-entity’ financial flows – payments among organisations. The industry model was necessary for the State Budget to determine the quantum and placement of subsidies. The main inter-entity flows were access charges and Rail Access payments to Rail Services. Note 20 (above) indicated the law required access charges to be negotiated rather than, say, set by the Government or Treasury. While the industry model indicated expectations (prior to the changes) of funding needs there was no process to ensure it was implemented. The model, even if agreed, could not override the law. Various parties could validly point to their primary legislation directing them to be a successful business – without reference to other organisations or the industry - to excuse non-conformance with the model. Indeed, such provisions arguably required them to make their own judgement and not rely on the model.

4.4 Other factors

Other factors behind the failure of the 1996 rail structure were hidden agendas and a misunderstanding of 'commercial' behaviour.

Hidden agendas

Competition policy was the supposed basis of the 1996 structure. However, properly conceived, competition policy related only to Hunter Valley coal.

Competition policy was not relevant to commuter rail.³⁶

The significant competition matters were: allowing parties other than (the former) State Rail to operate coal trains in the Hunter Valley under regulated track access rights; ensuring State Rail's freight division was not advantaged against potential rivals by reason of Government ownership.³⁷

That the 1996 structure went beyond these issues means some parties had other aims. Its conflict with Labor's 1995 election platform for transport suggests political overtones, less than unanimous support within the Government and it was generated outside the transport portfolio.

Among likely motives: dislike of the State Rail Authority and the rail workforce.

Among other aims: reduce subsidies; greater cost transparency.

Yet the structure arithmetically increased and dispersed costs. Together with inter-organisational transactions, this made costs more difficult to understand. The Government pursued 'savings' by reducing aggregate net subsidies, rather than seeking internal efficiency.³⁸

Treasury doctrine on public sector governance emphasises avoidance of 'conflicts of interest'. This was offered as an argument for placing competing and buying/selling organisations in separate portfolios. Yet perceptions were the real motives for placement of new organisations outside the Transport portfolio was to weaken that portfolio's power and increase central agencies' influence.

Another motivation was career advancement. The creation of new organisations meant there would be more senior management. Senior staff in several organisations could newly claim they controlled funds related to a single activity – a criteria for salary. Staff of the new organisations would not be under the 'dead hand' of State Rail Authority management.

³⁶ This does *not* equate with absence of market-failure type issues for commuter rail. Competition policy relates to correction of adverse effects of monopoly behaviour, largely high prices and low service quality compared with optimums. Comparatively high prices might be unlikely, but *low service quality – including long term surety of service - is highly likely*, from a subsidised industry, like commuter rail. Contracts/regulation of community services therefore need to specify service quality levels etc. *and* surety that asset condition etc. will not deteriorate such as to jeopardise service quality in the future – irrespective of whether 'traditional economic regulation' is warranted. Simply, in relation to rail - especially its infrastructure - service quality the idea of a dichotomy between 'unregulated' and 'regulated' is false.

³⁷ NSW had agreed, in 1993, to implement the national *Competition Principles Agreement*.

³⁸ Including direct and cross subsidies. Prior to the 1996 structure, coal haulage profits cross-subsidised commuter tasks. The cross-subsidy was removed by coal haulage profits being kept in FreightCorp and Rail Access.

Truly commercial behaviour

Section 4.3 noted 'commercial' behaviour of maximising profits went beyond providing better services and reducing costs – and into political lobbying like big business does.

Other examples of political-type behaviour seen in real-world commerce were by Departments seeking to look good and placing risks – like explanations of their decisions - elsewhere.

Treasury owned the organisations with the least risk of public dissatisfaction, and via Hunter coal returns, the best chance of reporting profits – Rail Access and FreightCorp.

However, the Transport Department was required to provide them subsidies – on a non-contestable basis - the effect of which increased reported profits.

Transport retained the unprofitable and more problematic State Rail, and was 'given' the organisation targeted for reduction – Rail Services.

This aspect of the scheme increased antagonism particularly between Rail Access and Rail Services. In the eyes of the latter, Rail Access appeared to be privileged and Rail Services persecuted.

5. The Entity

5.1 Introduction

There are reports of bureaucratic disputes about the Entity and the structure of NSW Government railways. There are conflicting comments about responsibilities of organisations within the structure. There are different interpretations of the Entity's purpose and motives behind it. It has taken inordinate time to commence operations.

5.2 Grouping of transport assets?

Organisationally, the Entity is almost identical to the former Rail Access Corporation. It appears to differ in only one respect: it holds fleet. The reason given for it holding fleet is: the Entity is to be a central asset manager for the transport 'cluster'. That is based on an assumption that grouping assets enables better asset management plans.³⁹

As noted above – section 4.2 - such an assumption is wrong in transport because of the different nature of rail and other transport assets. Moreover, it is inconsistent with lease of fleet to, and the undertaking of related maintenance by, Sydney Trains.

Stated NSW policy assumes an asset managing organisation has other functions. That implies NSW organisations must do more than merely hold or manage assets. Further, policy states commercial public non-financial corporations receive most of their income from customers.⁴⁰

It is not obvious the Transport Asset Holding Entity meets such policies, and some comments – such as about Transport for NSW having maintenance responsibility - suggest it does not. Further, there was a pre-existing organisation holding railway assets and providing them to an operator - Sydney Metro. Unlike the Entity, Sydney Metro is a statutory authority, within the Transport portfolio and does not have a profit seeking charter.

Of all the transport assets, the ones most easily provided by an owner to the control of other organisations are buses, not trains. Buses are the assets most likely to meet bona-fide commerciality criteria – the ability to support positive asset values.⁴¹

In my view, the 'central asset manager' rationale is either a falsehood or reflects a mistake.

Various parts of the Government would have different motives behind their support for the Entity. They likely see the Entity advancing different, possibly conflicting purposes – as was the case for Rail Access in the 1996 changes. Those purposes extend beyond a 'budget accounting trick'.

Information in the public domain suggest undisclosed purposes and motives include:

- animosity towards the former RailCorp – now Sydney Trains;
- a wish to reduce the size of the rail workforce; and
- a desire to franchise – privatise – commuter rail in Sydney.

³⁹ Transcript Budget estimates, 18 August 2021.

⁴⁰ *Asset management policy for the NSW public sector*, Treasury, 2019.

⁴¹ Being the higher of scrap/resale or future earning potential values. Buses are generally higher than rail pro-rata because fleet is more easily redeployed to another business or location.

5.3 Hidden agenda – franchising etc?

Relevant to understanding agendas is the removal of assets from Sydney Trains. Also of interest is the removal of some rail functions and their placement within Transport for NSW. Among these is the central determinant of the railways, the Standard Working Timetable.⁴²

When assets were first removed from Sydney Trains they were placed in Transport for NSW. At that time, the Standard Working Timetable was also moved to the Department. These are the things necessary for Transport for NSW to seek bids for a commuter rail franchise.

Such moves do not have a credible efficiency purpose. Sydney Trains is in a significantly better position than Transport for NSW to deal with these assets and functions from an operational and safety perspective. It is subject to virtually identical Government-control arrangements as Transport for NSW. Because it relies on the assets and timetable, removal (to the Department) created risks to operations and costs. This is despite recent assertions of Transport for NSW participating in the centre of the commuter railway by being '*responsible*' for maintenance.⁴³

The move to Transport for NSW was initiated at the same time it started promoting the Sydney Metro concept – in 2012. The most obvious effect of the move is to inhibit Sydney Trains, which is a purpose of Sydney Metro. It prepares the ground for franchising, privatisation – as has been done for Sydney Metro.⁴⁴

At another Parliamentary Committee I noted the implausibility of Government explanations for Sydney Metro and the likelihood of other motives and purposes. Among the few unchallenged ones was animosity against Sydney Trains.⁴⁵

That the Government is interested in minimising the size of the rail workforce is indicated by its promotion of Sydney Metro running driverless trains. As the Rail Access discussion shows, this is not a new interest. Some people believed franchising would 'achieve' this.

In mid-2017, Infrastructure Australia / Infrastructure Partnerships Australia published a paper promoting public transport franchising. While panned by eminent experts, its outlandish estimates of financial gains - from franchising Sydney Trains - attracted attention.⁴⁶

⁴² The standard working timetable is the timetable of infrastructure use, which determines the Sydney Trains passenger timetable, freight train running, and closures for maintenance etc.

⁴³ See section 2.2.

⁴⁴ Compare with section 4.4.

⁴⁵ Submissions to Legislative Council Committee Bankstown line Metro conversion: <https://www.thejadebeagle.com/submission-to-nsw-legislative-council---bankstown-line-metro-conversion---sep-23-2019.html>

⁴⁶ Policy SPAD, July 2021 at <https://www.thejadebeagle.com/policy-spad.html> Section 6.3.2. The Infrastructure Australia/Infrastructure Partnerships paper ignored considerable academic research on the topic – led for many years by Sydney University's Institute of transport and logistics – ironically located a block away from Infrastructure Australia's headquarters.

Shortly before, legislation for the Transport Asset Holding Entity was passed. It envisaged transfer of commuter rail assets from Transport for NSW to a Treasury portfolio organisation. A similar treatment was not envisaged for metro rail assets. Actual transfer appears to have taken place in July 2020.

While some may feel Treasury, or a 'commercial' organisation, would do a better job of franchising/privatisation than Transport for NSW, the arrangements present several difficulties. First, a franchisee would want control of track, stations etc. and would not be satisfied with just access to assets essential for its business.

Yet if only access was granted, a franchisee would not pay the Entity 'commercial' rates for asset use. The assets would need to be given to a franchisor's then franchisee's use for nominal fees.⁴⁷

Second, public transport franchising is likely seen as a core function of Transport for NSW. If so, what might be the role of the Entity in franchising?

In Victoria, even though VicTrack is within the transport portfolio via the Minister being a shareholder, it has little real role – it provides assets to the Department who provides them to the franchisee. At a nominal charge. VicTrack reportedly receives minimal infrastructure management revenue from all operators.⁴⁸

A similar arrangement in NSW would be embarrassing – as assets just moved from the Transport to Treasury portfolio would need to be returned. However, that may be the lesser evil if Treasury doesn't properly understand transport matters relevant to privatisations – for which the Newcastle port case provides evidence.⁴⁹

5.4 Likely problems

Organisational separation of commuter train operations from assets is a strategic mistake. As is seeking to make profits out of those assets. In my view, such arrangements cannot work effectively or efficiently – no matter how clever or how diligent the policy makers, architects or participants.

If the recent assertions - of Transport for NSW being inserted into the rail industry - are correct, the situation may be worse than in 1996. This is because a series of additional organisational interfaces has been created. It is not apparent all parties understand responsibilities – evidenced by reported claims that Treasury thinks Transport for NSW is somehow responsible for appointment of a Chief Executive of a State Owned Corporation.⁵⁰

⁴⁷ Because the franchise would be determined by a minimum subsidy bid – rather than a payment to NSW.

⁴⁸ *VicTrack Annual Report 2019-20*. For 2019-20: Capital asset charge \$2384m (cashflow income, and cashflow payment to and from the Government); rollingstock lease revenue \$26m; infrastructure management revenue \$50m.

⁴⁹ In that case, Treasury advised the Government to impose restrictions on Newcastle port via a secret arrangement in the sale of Port Botany. These restrictions apparently went beyond bidders' requests, were ignorant of transport matters and were characterised as bidders 'purchasing' NSW transport policy – yet there remains a question of whether Transport for NSW was aware of the purchase or of Treasury's interpretation of transport policy. The restrictions are currently being litigated: Newcastle Port case, August 2021 at <https://www.thejadebeagle.com/newcastle-port-case.html>

⁵⁰ See section 2.3.

If implemented, consequences of the structure involving the Entity will be difficult to unwind. On-the-ground problems would be unpredictable. Unpredictability renders risk mitigation difficult – other than through adopting more appropriate governance.

Risk mitigation would be even more difficult if Treasury continues the stance of referring questions about its Entity to Transport for NSW – reinforcing the appearance of it seeking to avoid its legislative responsibility.⁵¹

Reviewing the experience of the 1996 changes, major areas of difficulty likely include:

- overconfidence in the ability of officials to deal with issues and influence outcomes;
- Government being poorly advised due to inappropriate reliance on financial indicators;
- failure of the ‘operating model’ by organisations withholding funds from each other;
- conflict between the Entity and rail organisations, and politicisation of their relations;
- inability to properly understand rail infrastructure assets, leading to inadvertent asset stripping;
- interface issues including in planning and in operations/safety;
- opacity and deterioration in costs and rail operational performance;
- need for new capital funding injections to deal with deteriorating assets and performance.

⁵¹ Reinforcing: see note 50. Also: *Leadership turmoil deepens crisis enveloping \$40b rail corporation*, Sydney Morning Herald August 20, 2021 at: <https://www.smh.com.au/national/nsw/leadership-turmoil-deepens-crisis-enveloping-40b-rail-corporation-20210819-p58k44.html>.

6. Conclusion

6.1 Introduction

Aspects of Transport Asset Holding Entity governance – a for-profit, state owned corporation in Treasury portfolio holding rail assets - seem much like those for the centrepiece of NSW's 1996 rail structure - Rail Access Corporation. An apparent expectation Sydney Trains will (merely) access the tracks makes the analogy even closer. If correct, recent claims of another party - Transport for NSW - being responsible for maintenance exacerbate rather than mitigate the issues arising.

If so, lessons from the failure of the 1996 structure apparently have not been learned. This submission draws attention to some.

6.2 1996 structure

The main lessons of the experience of the 1996 structure are:

1. rail governance is not a Heath-Robinson machine. Instead, it has consequences;
2. for a commuter railway, like in Sydney, there must be a single point of accountability.

Some hoped the 1996 arrangements would be bring about 'commercial' behaviour and results without real-world effects. Those hopes were in vain.

Problematic aspects of the 1996 arrangements were:

- a convoluted structure;
- inconsistent - and hidden - agendas about purposes;
- track etc. owned by an organisation that neither operated trains nor undertook maintenance;
- the track owner being corporatised yet was heavily reliant on (indirect) subsidies;
- the track owner being in the Treasury portfolio;
- absence of a mechanism to resolve disputes among rail organisations;
- subsidy levels below that required by the structure.

The separation and corporatisation of freight via FreightCorp was appropriate and successful.

The separation and corporatisation of track etc. assets from passenger train operations in the Sydney area – based on track access - was not appropriate and failed.

Also inappropriate, and a failure, was separation of track ownership from maintenance.

These separations of track and maintenance from operations fragmented responsibility, undermined accountability and reduced the ability of management to control Sydney's commuter railway.

Results were notorious:

- weak performance and a series of accidents;
- the need for an overseer (Coordinator General) to supervise the organisations; and
- run-down infrastructure, and a major call on Government to fund restoration.

Less obvious to outsiders was non-stop conflict among the organisations. The separations meant differences in opinion could no longer be resolved within one organisation, yet there wasn't an effective process to deal with disagreements among several. Disputes became intractable. Instead of being handled in a business-like fashion, they were escalated and entrenched via organisations seeking to create blocs of supporting officials and politicians.

That so-called commercial approach of the *State Owned Corporations Act* caused far greater bureaucratisation of, and political intrusion into, the NSW rail sector.

While the most frequent criticisms of the 1996 structure relate to vertical separation of commuter trains from the tracks they run on, the harshest criticism should be reserved for the scheme making:

- the track owner incapable of managing those assets;
- antagonism and conflict widespread and certain.

Features of the scheme leading to these problems reflect dogma about state owned corporations:

- reporting to Treasury, but not portfolios like Transport;
- operating 'commercially' in and being required to make profits from a subsidised industry;
- making 'profits' by adversely affecting other Government organisations.

6.3 Transport Asset Holding Entity

Information in the public domain suggest intentions surrounding the Transport Asset Holding Entity echo some of those problems. Already there have been conflicts among Departments.

Prior experience is not the only thing ignored in the scheme centring on the Entity. Factual context, including in other jurisdictions, has apparently been overlooked.

Some comments - intended to defend the scheme – seem to misrepresent basic factual matters. These include a claim the Independent Pricing and Regulatory Tribunal does – even has – determined/ provided advice to the Government on access charge amounts. There is no public evidence of that. The issue of the Tribunal advising on access charges was raised prior to the 1996 changes. It is understood the Tribunal did not wish to do so lest it pre-empted its arbitral role. In any event a determination was not necessary to complete the 1996 operating model.⁵²

Another claim was that the Entity's role in NSW commuter rail is analogous to arrangements in Victoria and Queensland. That looks wrong.

In Victoria, the asset owner - VicTrack - is corporatised and does not operate trains. Otherwise, it is different to the Entity. Unlike in NSW, the Minister for Transport is a shareholder in VicTrack. VicTrack reports it provides assets to the Department of Transport to enable the Melbourne franchise. The franchise involves leases and is not dominated by track access. Assets are to be provided for a '*nominal consideration*'. The Victorian asset owner actively holds and manages only that land and infrastructure *not* needed for commuter rail operations. The vast bulk of VicTrack's income and outlays comes from a capital asset charge – paid by and to the Government.⁵³

Queensland's commuter railway integrates - does not separate - assets and operations. The Minister for Transport is a shareholder in the commuter railway owned and operated by Queensland Rail. It is not required to act commercially to the extent it provides community services.⁵⁴

⁵² See notes 20, 28 and 35. *NSW Rail Access Undertaking*, clause 6.2.

⁵³ Victoria, *Transport Integration Act (2010)* s.120. *VicTrack Annual Report 2019-20*. For 2019-20: Capital asset charge \$2384m (cashflow income, and cashflow payment); rollingstock lease revenue \$26m; infrastructure management revenue \$50m.

⁵⁴ *Queensland Rail Annual Report 2019-20*.

