

# **Review of access pricing on the NSW grain line network**

**Discussion paper for 5 August stakeholder  
roundtable**

**Transport — Discussion Paper**  
July 2011

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## 1 Introduction

The purpose of this discussion paper is to:

- ▼ summarise some of the key issues arising in stakeholder submissions
- ▼ facilitate roundtable discussion on these key issues
- ▼ request follow up information and evidence from stakeholders.

The public roundtable discussion will focus on asking stakeholders for further advice, information and evidence on the key issues outlined in this Discussion Paper. Stakeholders may provide information at the roundtable or directly to IPART at any time before or after the roundtable. Members of the Secretariat will also be available to meet with stakeholders individually over the coming weeks.

The output from the roundtable, stakeholder submissions and follow up information (subject to being received in time) and our research will inform our draft recommendations and report to be released in October 2011.

## 2 Efficient rail costs

In our Issues Paper, we defined the NSW grain line network as the 19 lines that were assessed as part of the in the NSW Grain Freight Review (2009). Our understanding is that on 1 July 2011, 2 of the lines were transferred to the ARTC and will no longer be included in our review. These are Moree to Camurra and Camurra to North Star.

We also noted in our Issues Paper that the Cowra lines were no longer operational, subject to a Ministerial Taskforce review. These lines are still part of our review.

### 2.1 Efficient below-rail costs

The efficient cost of providing rail infrastructure on the Country Regional Network (CRN) is a matter of some debate. Recently, Country Rail Infrastructure Authority (CRIA) negotiated a contract with John Holland to provide rail infrastructure maintenance and operations on the CRN. The contract was awarded following a competitive tender process and as such, the contract prices are likely to provide a good proxy for efficient costs. Unfortunately, we did not receive information about the contract costs in enough time to include them for the roundtable discussion.

The joint submission from the Blayney, Cowra, Harden, Weddin and Young shire councils attached a 2009 study from SAMROM that implies some of the costs of the current maintenance regime on the NSW grain line network are considerably higher than best practice.<sup>1</sup> SAMROM claims that, following initial rehabilitation work, combined routine maintenance, MPM and capital costs should average about \$12,000/km/pa.<sup>2</sup> SAMROM presented the results of a discounted cash flow analysis that indicated there was a project internal rate of return of 22.5% for reopening the Cowra lines.<sup>3</sup> This analysis was based on the \$12,000/km/pa infrastructure cost, along with other operating cost parameters and assumptions about marketing and government funding that are unsubstantiated at this time.

Currently available indications of the below-rail costs on the CRN can be derived from three sources: CRIA annual reports, the GIAC Review (2004) and the NSW Grain Freight Review (2009). The CRIA Annual Report (2010) states that \$94.88 million was spent on external maintenance in the 2009/10 financial year.<sup>4</sup> This was to maintain a network of approximately 2,735km.<sup>5</sup> The implied average cost of \$34,700/km tends to overstate the cost of maintenance for the grain lines as the network includes around 578km of Class 1 and 416km of Class 3 lines, which would be more expensive to maintain per kilometre than the Class 5 grain lines.

Taking these differences into account, the NSW Farmers' Association submissions states that the cost of maintaining a line at a Class 5 level is in the order of \$31,000/km.<sup>6</sup> This figure includes long-term renewals but assumes that the underlying formation and track structure is sound.

The GIAC report presents annualised costs for a set of 15 lines that include some of the same lines subject to this review.<sup>7</sup> The annualised costs represent 4-year averages to 2001/02 including routine maintenance, MPM, flood and derailment costs, but excluding capital costs. Dividing each line's annualised cost by its length; a range of per-kilometre costs is obtained. The average for these lines was \$14,700/km, while the maximum was \$40,000/km and the minimum was \$5,300/km. The standard deviation was substantial at around \$8,000/km.

The NSW Grain Freight Review notes that its indicative rail infrastructure costs were determined in conjunction with the ARTC.<sup>8</sup> Information about these rates supplied to IPART in confidence show the rates to be lower than the estimation of rates derived from the CRIA annual report (2010).

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1 SAMROM Pty Ltd, *Cowra rail line network revival study*, December 2009.

2 *Ibid*, p 49.

3 *Ibid*, p 52.

4 Rail Infrastructure Corporation, *Annual Report 2010*, p 34.

5 NSW Farmers' Association submission, p 4.

6 *Ibid*.

7 GIAC, *Report on Rail/Road Options for Grain Logistics*, January 2004, p 10.

8 Department of Infrastructure, Transport, Regional Development and Local Government, *NSW Grain Freight Review*, 2009, p 73.

## 2.2 Upgrading below-rail infrastructure

Separate to the question of maintaining the existing network in its current state is the cost to upgrade the grain lines to a standard that would permit higher axle loads, higher operating speeds and potentially lower ongoing maintenance costs.

Several submissions including Asciano, GrainCorp and the NSW Farmers' Association argued that there may be a business case for upgrading the lines. While submitters were broadly in favour of upgrading, they were of the view that Government should bear the full cost of the upgrade, with some degree of benefit sharing from users. Most submissions acknowledged that the benefits flowing from line upgrades would accrue mostly to private parties. Asciano and GrainCorp suggest that higher axle load limits would permit the train operators to run mainline locomotives or fully utilise wagon capacity, resulting in a reduction in the above-rail operating cost per net tonne kilometre. The NSW Farmers' Association claims that more reliable rail service on the grain lines would assist growers to avoid a large price penalty of up to \$8 per tonne from consigning their grain to a grain line silo.<sup>9</sup>

The GIAC and NSW Grain Freight Reviews both conducted a social cost-benefit analysis to determine the value of upgrading the lines. The NSW Grain Freight Review concluded that upgrading to Class 2 was not justified for any of the lines. It determined that upgrading to Class 3 standard was justified on selected lines.<sup>10</sup> However, these conclusions were predicated on estimates of above and below-rail costs that were substantially lower than comparable costs proposed by some submitters to this review. If the higher figures are to be accepted, then the level of social benefits may not justify upgrading at all.

### 2.2.1 Issues to clarify further with stakeholders

#### 1 How willing are stakeholders to contribute to the costs of upgrading the below-rail infrastructure?

If there are real benefits to be achieved by upgrading certain lines, then we consider that there should be some willingness on the part of the beneficiaries to co-fund the upgrade. This co-funding could take many forms, ranging from direct capital investments, take-or-pay commitments, increased access charges on particular lines, or some form of annual rail availability charge for grain handling facilities that are situated on the grain lines.

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<sup>9</sup> NSW Farmers' Association submission, p 3.

<sup>10</sup> Department of Infrastructure, Transport, Regional Development and Local Government, *NSW Grain Freight Review*, 2009, p 38.

## 2 Is the NSW Farmers' Association right that grain line silos penalise growers' \$8/tonne?

The NSW Farmers' Association submission claims that growers face a penalty of \$8/tonne in the price they receive for their grain by virtue of the lack of competition amongst buyers wary of the logistical burden imposed by 'dilapidated branch lines'. The implication is that improvements to the quality of branch lines would intensify competition among buyers, and therefore grower returns.

We request more evidence to support this claim.

### 2.3 Efficient above-rail costs

A significant difference in the average cost of train operations on the grain network has emerged between values presented in submissions and the evidence from previous reviews. The submission from GrainCorp suggests that rail freight rates range from approximately 6 to 13c/ntk across all lines.<sup>11</sup> By comparison, the NSW Grain Freight Review indicates that its recommendations were based on above-rail costs that range from 3 to 6c/ntk.<sup>12</sup> The NSW Grain Freight Review notes that its operating cost estimates included capital costs for the rolling stock.<sup>13</sup> This would include a reasonable rate of return on investment. Before these figures can be compared, rail access charges must be added to the NSW Grain Freight Review figures. According to GrainCorp, rail access charges on NSW grain lines amount to 0.53c/ntk.<sup>14</sup> Thus, the comparison of estimates of the rail freight rate is as follows:

**Table 2.1 Estimates of rail freight rates on the NSW grain line network**

Estimated rail freight rates (c/ntk)	Minimum	Maximum
GrainCorp submission	6	13
NSW Grain Freight Review <sup>a</sup>	3.5	6.5

<sup>a</sup> Including estimate of access prices from GrainCorp submission.

Presumably, GrainCorp's rail freight rate estimates represent the prices it pays for haulage. These may differ from the costs estimated in the NSW Grain Freight Review to the extent that prices include a profit component for the rail operator.

<sup>11</sup> GrainCorp submission, p 9, Graph 3.

<sup>12</sup> Department of Infrastructure, Transport, Regional Development and Local Government, *NSW Grain Freight Review*, 2009, p 40.

<sup>13</sup> *Ibid*, p 75.

<sup>14</sup> GrainCorp submission, p 8.



### 2.3.1 Issues to clarify further with stakeholders

#### 3 What evidence do stakeholders have to provide clarification on the real level of above-rail operating costs?

If the NSW Grain Freight Review significantly underestimated the true costs of above-rail operations, then its conclusions about the viability or upgrade potential of certain branch lines may be overstated.

Alternatively, if actual grain freight rates exceed the full economic cost to the above-rail operator, there may be scope for greater cost recovery of rail infrastructure costs.

## 3 Share of efficient costs to be allocated to users

It was clear from submissions that a key concern of stakeholders is the impact that grain line closures or a modal shift would have on the road network and greater community.

An ongoing problem for the NSW grain line network is that current levels of cost recovery are not sustainable in the long-term. Following the NSW Grain Freight Review, the former NSW Government agreed to fund the stabilisation of the network to provide a minimum 'fit for purpose' level of infrastructure service provision. However, as noted in the Department of Transport's submission, the current asset replacement and maintenance regime is driven by stakeholder requirements relative to the available long-term funding. It is assumed that funding will be available in the later years for the maintenance and renewal of assets required to maintain the existing level of service.<sup>15</sup>

While the network continues to rely heavily on the continued availability of government funds for 95% of its costs, it is likely that the current uncertainties concerning deteriorating track condition and threatened line closures will persist.

### 3.1 The road-rail price differential and tipping point

In an ideal scenario, there would be full cost recovery of efficient below-rail and below-road costs from users (which also took into account any external costs and benefits). However, most submissions recognised that competition between road and rail along the grain lines is the limiting factor on rail freight rates, including the recovery of access prices. Submissions tended to assume that all aspects of the rail logistics price are closely reflective of costs so that any increase in rail access prices will lead to an equal increase in rail freight rates. It was therefore claimed that any significant increase in rail access prices could potentially drive grain traffic off rail and onto road.

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<sup>15</sup> Department of Transport submission, pp 17-19.

The underlying logic is that the optimal user share of efficient rail costs would be determined by the location of any 'tipping point' beyond which higher access prices would worsen the situation of rail—and society overall. From a theoretical point of view, it seems likely that such a tipping point exists. Obviously it is important to this review to understand where it might be on the spectrum of possible access prices and if the access price, being such a small proportion of the overall freight cost, is really that important in influencing the tipping point.

In its submission, Asciano states that “...in the NSW grain transport market rail and road transport costs are at a level where rail users may become indifferent as to which transport option they use”.<sup>16</sup> This claim suggests that the tipping point has nearly been reached.

If pricing on rail is currently at a level where users are truly indifferent, it would be expected that road and rail modal shares for grain originating on grain line and main line silos would be approximately equal. According to GrainCorp 68% of grain transported on a selection of grain lines and 72% of grain on all lines is transported by rail for export or domestic (human) end use.<sup>17</sup> On these figures, rail is the dominant transport mode.

GrainCorp's submission presents a comparison of road and rail freight rates that demonstrates that the difference is small.<sup>18</sup> The basis of the comparison appears to be a rail movement from silo to port that requires on-farm pick up by road, and a direct road movement from farm to port, avoiding the initial farm-to-silo handling costs.

If GIAC and the NSW Grain Freight Reviews are correct, then it would be incorrect to count the road to silo price as a cost to rail but not road. It should factor equally in both. That would make a difference to the rail freight costs presented by GrainCorp.

It is also relevant to this comparison to know whether the principal modus operandi for road movements is farm to port (as assumed by the Australian Trucking Association's (ATA) and GrainCorp submissions) or silo to grain consolidation facility (as assumed in the GIAC and NSW Grain Freight Reviews) and implied by the statistics cited by GrainCorp concerning the low prevalence of farm to port road movements. This is discussed further in Section 3.2.

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<sup>16</sup> Asciano submission, pp 5-6.

<sup>17</sup> GrainCorp submission, p 5.

<sup>18</sup> Ibid, p 9, Table 3.

### 3.1.1 Issues to clarify further with stakeholders

#### 4 Is rail's dominant modal share really under threat if access prices increase?

If the tipping point is close to current access price, then there would be almost no tolerance for greater cost recovery. On the other hand, if the tipping point is much higher than current access price, then there may be scope for modest price increases which could assist in the sustainability of the grain network in the longer term—an objective on which all parties seem to agree.

Subject to any contrary evidence that stakeholders may present, it appears the assertion that users are indifferent between modes at current prices is incorrect. The preference for rail appears to be strong and that is a clear message from almost all of the submissions.

We seek quantitative evidence to support a view that a substantial increase in current grain access prices would cause a significant modal shift away from rail.

#### 5 Is the road-rail price differential small?

There appear to be widely varying views on the degree of road-rail price differential. We seek further quantitative evidence to support statements that the actual differential is small.

## 3.2 How road competes with rail

The ATA's submission claims that IPART was incorrect not to include a transport option of using a large combination road vehicle to transport grain from farm to port.<sup>19</sup> Figure 2.1 in IPART's Issues Paper did include an option for transport by farm truck direct to port, but this was not a large combination vehicle.

This claim is potentially important to the question of how road competes with rail. If it were true that most road-hauled grain travelled direct from farm to port then there would be a cost saving compared to rail, because there would be no need for the shorter farm-to-silo road trip and the associated double-handling in a road movement. The GIAC Review and NSW Grain Freight Review both assumed that grain is delivered ultimately to port by a train and that the competing road movement is from silo to main line grain consolidation facility.

GrainCorp's submission notes that only 5% of grain from CRN storage sites and 15% of grain from mainline storage sites is transported to port by road.<sup>20</sup> In combination, these figures represent approximately 200Kt of grain from GrainCorp sites to port by road. A similarly small amount of grain (between 100 and 200Kt) is moved by road from on-farm storage to export elevators in NSW.

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<sup>19</sup> Australian Trucking Association submission, p 7.

<sup>20</sup> GrainCorp submission, p 17.

GrainCorp's submission also notes that "...closing grain storage sites on the CRN in favour of 'super' sites on the main line, and requiring growers to haul grain up to 100 km or more from farm, will increase the total rail and road supply chain cost" appear inconsistent with the view that road and rail rates are nearly equal.<sup>21</sup> If it is true that farmers would balk at a road haul of 100km, what would make a potential 600km haul to port cost-effective?

### 3.2.1 Issues to clarify further with stakeholders

#### 6 Is farm-to-port road transport the chief competitive threat to rail's modal share?

We seek quantitative evidence on the extent of farm to port road movement, with the aim of clarifying whether this, or the more often analysed silo-to-port road movement, constitutes the chief competitive threat to rail.

We are interested in understanding the constraints that may be posed by the need for quality control and flexible storage arrangements that are provided by up-country silos, limitations to the market penetration of on-farm storage and limitations on road access to ports.

In particular, we are interested in receiving empirical evidence on what has happened to grain movements in the Cowra region since the closure of the grain lines following the NSW Grain Freight Review.

### 3.3 Below-road infrastructure costs

Comparable road haulage costs that contribute to the rail-road tipping point are made up of 2 parts – the contribution that operators make towards below-road infrastructure and the costs of operating the vehicle.

Many submissions expressed the view that additional road costs caused by trucks were not adequately paid for by truck operators. While heavy vehicle road users pay a contribution towards the cost of their use of the road network, that contribution is not linked directly to the actual mass of the vehicle, the distance travelled and cost of damage to the particular road type that is traversed. Further, the contribution paid by road users is not wholly hypothecated to the road agency that bears the cost of asset replacement and maintenance. This is a particular problem for the regional roads that compete with the grain lines because the damage caused by heavy vehicles is much greater than that for highways, which are built to withstand heavier and more frequent vehicle traffic.

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<sup>21</sup> Ibid, p 10.

In the absence of heavy vehicle road pricing reform, the key concern for this review is to determine the appropriate access price and level of government subsidy that should be applied, while maintaining the price competitiveness of rail with road. We will also need to determine how access prices should change should some form of heavy vehicle road pricing reform be implemented while still providing a degree of industry certainty and sustainability for prices.

### **3.4 Above-road operating costs**

The importance of accurately estimating the above-road cost lies in the relativity between that and the comparable above-rail cost, since the modal substitution effect is what determines the limit to rail access prices. There was some degree of convergence on the estimates of above-road operating costs cited in submissions compared with those in the NSW Grain Freight Review.

The NSW Grain Freight Review cites an indicative range of 8 to 10c/ntk<sup>22</sup>, while the GrainCorp submission presents an average of 11c/ntk.<sup>23</sup> The differences between these estimates could potentially be explained by changes to input costs (particularly diesel prices) between 2009 and the present. The NSW Farmers' Association submission states that all input costs to road haulage have increased since 2009.<sup>24</sup>

## **4 Access price structure and levels**

### **4.1 Access price structure**

A majority of stakeholders, including the Department of Transport, supported the publication of reference access prices. However, stakeholders had widely varied opinions about how the access price should be structured - whether a single price or a differentiated pricing structure, such as Ramsay pricing, should be employed.

Some stakeholders considered that access revenue would be increased by increasing volumes transported on the grain lines rather than access prices.

Without knowing the quantum of efficient rail costs to be recovered from users, it is too early to seek specific feedback on proposed pricing schemes. However, we are interested in stakeholders' views on the broader objectives of the access price and how equivalent measures of cost recovery could achieve the same objectives.

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<sup>22</sup> Department of Infrastructure, Transport, Regional Development and Local Government, *NSW Grain Freight Review*, 2009, p 40.

<sup>23</sup> GrainCorp submission, p 9.

<sup>24</sup> NSW Farmers' Association submission, p 6.

#### 4.1.1 Issues to clarify further with stakeholders

- 7 Is the objective of the access price to be reflective of the fixed and variable costs involved or to ration track use?

GrainCorp claims that a flagfall is not required to ration track use and makes it more complex to price train movements that require trains to be shunted into two or more sidings on a rail line.<sup>25</sup>

The Department of Transport states that the costs associated with the grain lines maintenance regime are almost entirely fixed. The low traffic volumes on the grain lines generally lead to maintenance activities and renewals based on time intervals rather than traffic intervals.<sup>26</sup>

- 8 In the instance that the majority of below-rail costs are fixed would a 'rail availability charge' be a more appropriate way of recovering these costs?

As noted in Section 2.2.1, some form of annual rail availability charge for grain handling facilities that are situated on the grain lines could be levied to assist in recovering fixed costs, rather than through access prices. We seek stakeholders' views on the merits of such a pricing mechanism or other ideas.

- 9 Would a variable access price – such as a two-part tariff with flagfall that is varied depending on the line, region or season – provide improved price signals and utilisation of the network?

Asciano considers that amending the current single tariff structure in some instances could provide improved price signals and encourage increased utilisation and investment in some lines.<sup>27</sup> The Grain Growers Association suggests that peak pricing could be applied to any period where a bumper harvest resulted in increased use of the rail network with few transitional issues.<sup>28</sup>

Alternatively, GrainCorp claims that use of peak or variable pricing would not have any economic benefit, would create confusion and add administrative complexity.<sup>29</sup>

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<sup>25</sup> GrainCorp submission, p 17.

<sup>26</sup> Department of Transport submission, p 26.

<sup>27</sup> Asciano submission, p 7.

<sup>28</sup> Grain Growers Association submission, p 3.

<sup>29</sup> GrainCorp submission, p 17.

## 4.2 The level of access prices and access revenue

In its submission, Asciano proposes that “*some of the issues facing the grain lines may be addressed by encouraging increased volumes to rail, which will increase revenue while not significantly impacting on prices*’.<sup>30</sup> This option assumes that sufficient scope exists to increase volumes by a large enough factor to fund a higher level of cost recovery on existing assets and potential upgrades to the network without increasing prices.

According to the GrainCorp submission (discussed previously) and other sources, rail already enjoys a high modal share of grain from grain line regions. The figures quoted by GrainCorp imply that the largest possible increase in grain line share of all grain for export and domestic end use is around 47% - an increase of almost half the current volume. However, such an increase would still not improve the cost recovery position for rail infrastructure substantially – cost recovery is estimated at between 0.5% and 6.3% of unavoidable maintenance costs.<sup>31</sup>

In its submission, GrainCorp estimates that the rail access price constitutes around 8% to 11% of the total cost of rail transport. However, this appears to represent the access charge for the total rail journey.<sup>32</sup> In its Issues Paper, IPART estimated that the access charge for the grain line comprises only around 1% of the total freight cost.<sup>33</sup>

Both the submissions from GrainCorp and Asciano note that CRN access prices increased significantly over the past two years.<sup>34</sup> Asciano appears to accept the estimate in our Issues Paper that CRN access prices increased by 14% and grain network access prices increased by 30% in 2011.<sup>35</sup>

### 4.2.1 Issues to clarify further with stakeholders

#### 10 Can access revenue be increased significantly without increasing prices?

We seek evidence from stakeholders on the potential for the grain lines to capture additional market share from grain destined for stock feed or other sources of traffic that would substantially increase the cost recovery of the lines.

#### 11 What can we learn about price elasticity from recent access price increases?

The recent access price increases provide a useful natural experiment from which claims about price sensitivity of grain shippers can be evaluated quantitatively. We seek quantitative information from parties concerning any impact these access price increases may have had on the volume of grain hauled by rail, and how much tonnage was diverted to road as a result.

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<sup>30</sup> Asciano submission, p 6.

<sup>31</sup> IPART, *Review of Access Pricing on the NSW Grain Line Network Issues Paper*, May 2011, p 42.

<sup>32</sup> GrainCorp submission, p 16.

<sup>33</sup> IPART, op cit, p 54.

<sup>34</sup> GrainCorp submission, p 8; Asciano submission, p 5.

<sup>35</sup> IPART, op cit, p 42.

## 5 Governance

There was broad support in submissions for greater industry planning and consultation. The ARTC considered that there should be a single regulatory and policy objective for road and rail infrastructure, planning and investment in infrastructure by network or corridor.<sup>36</sup>

GrainCorp considered that, in line with the recommendations of the NSW Grain Freight Review, a coordination group could be established to advise on maintenance and upgrading priorities and how access fees could contribute to track upgrades.<sup>37</sup>

The Department of Transport put forward a model of vertical integration, where the track operator also controls the below-rail infrastructure.<sup>38</sup>

### 5.1.1 Issues to further clarify with stakeholders

#### 12 What would be a good model for industry engagement and coordination?

We seek ideas from stakeholders' on an appropriate model of industry engagement.

#### 13 Under what conditions would a model of vertical integration be sustainable?

We seek feedback from stakeholders' on the merits of a vertically integrated model of above and below rail maintenance and operations.

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<sup>36</sup> ARTC submission, p 2.

<sup>37</sup> GrainCorp submission, p 18.

<sup>38</sup> Department of Transport submission, p 10.